Chapter

II Regional Trends

Developed countries attracted $636 billion in FDI inflows in 1999, $156 billion more than in 1998, accounting for nearly three-quarters of the world's total. The United States and the United Kingdom continued to lead in both inward and outward FDI. The United Kingdom became the largest outward investor in 1999, replacing the United States for the first time since 1988. These two countries also were the principal host countries. Total flows between the European Union (EU) and the United States increased significantly in 1999, after doubling in 1998. Inflows of FDI to the EU as a region were an estimated $305 billion, a 23 per cent increase over the previous year. Inflows of FDI to Japan quadrupled: from $3 billion in 1998 to $13 billion in 1999. Japanese outflows showed a slight decline, from $24 to an estimated $23 billion. The countries of *Central and Eastern Europe*, still in transition to a market economy, managed to retain a stable inflow of about $23 billion in 1999.[1]

Flows of FDI to *developing countries* increased by 16 per cent in 1999 after stagnating in 1998. However, given the rise in flows to developed countries in 1999, their share in world FDI inflows continued to decline, falling in 1999 to 24 per cent from 38 per cent in 1997. Total flows to developing countries amounted to $208 billion, some $106 billion went to developing Asia (including Central Asia and West Asia), $40 billion of it to China alone. Latin America and the Caribbean pulled in 23 per cent more than in 1998; of the region's estimated total flows of $90 billion, some $31 billion went to Brazil, which was the regional leader for the fourth consecutive year. In Africa, large increases in FDI were recorded in Morocco and South Africa; the continent (including South Africa) is estimated to have attracted $10 billion in inward investment.

Flows of FDI to the 48 least developed countries (LDCs) increased slightly from $3.7 billion in 1998 to $4.5 billion in 1999. Despite this positive development, the LDCs as a group remain marginalized as they account for only 0.5 per cent of global FDI inflows and 2.2 per cent of FDI inflows to developing countries. Angola, Mozambique, the Sudan and Myanmar were the most important recipients, with FDI inflows of $1.8 billion, $0.4 billion, $0.4 billion and $0.3 billion respectively. Within the LDC group the 33 African LDCs accounted for a share of 84 per cent in the total flows to LDCs in 1999, representing no change to the previous year.

A. Developed countries

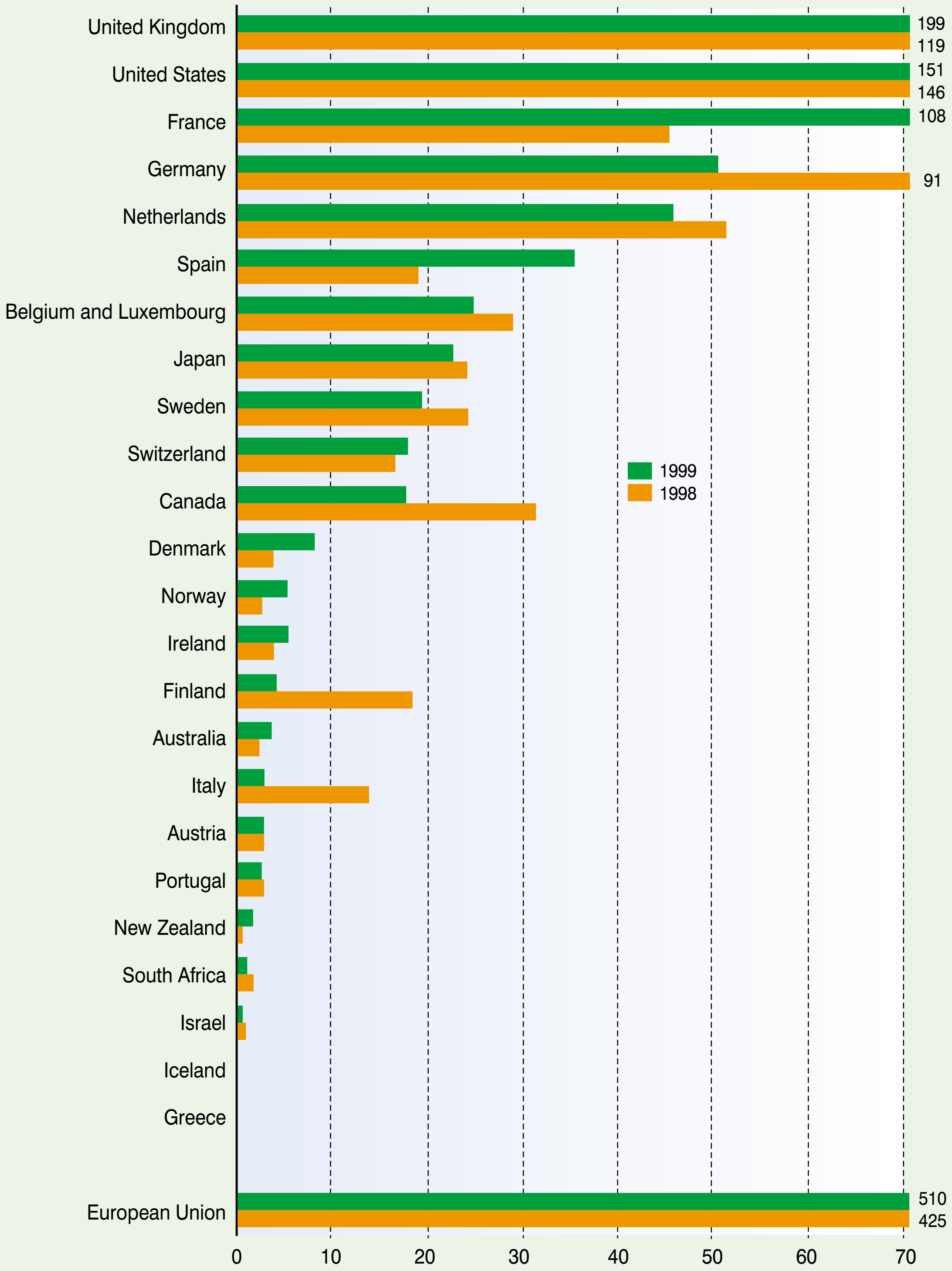
1. *United States*

For the third consecutive year, FDI *outflows* from the United States continued to increase, reaching a record $151 billion in 1999, though the pace of growth slowed down compared with the two previous years (a 3 per cent increase). With this performance, the United States fell to second place behind the United Kingdom (figure II.1). The stock of

FIGURE II.1

Developed countries: FDI *outflows*, 1998 and 1999[a]

(Billions of dollars)



Source: UNCTAD, FDI/TNC database and annex table B.2.

[a] Ranked on the basis of the magnitude of 1999 FDI outflows.

United States FDI abroad (at historical cost) as of 1999 stood at $1.1 trillion. During that year, the United Kingdom was the largest beneficiary of FDI outflows from the United States, receiving one-fifth of the total. Japan, where United States TNCs had registered net outflows (i.e. divestments) in both 1996 and 1997, received about $4 billion in FDI in both 1998 and 1999. Latin America and the Caribbean continues to be the biggest developing recipient region of United States FDI flows ($23 billion in 1999[2]). As in previous years, finance, insurance and real estate were the most important industries for outward investment, and accounted for almost one-third of total United States outflows. Altogether, the service sector accounted for 59 per cent of total outflows from the United States, against 31 per cent for the manufacturing sector.

Since 1996, FDI *inflows* into the United States have exceeded outflows. In 1999, they again registered a substantial increase of 48 per cent (which is, however, less than the 1998 increase of 77 per cent). With a record $276 billion, the United States was the largest host country in the world in 1999 (figure II.2), accounting by itself for one-third of global FDI inflows. The United Kingdom was the largest investor in the United States, accounting for 39 per cent of the total, followed by the Netherlands with 14 per cent.

After a decline in 1997 and 1998, Japanese FDI flows into the United States rose to $13 billion in 1999, a level comparable to that of 1996. In 1999, the services sector replaced the manufacturing sector (which was by far the largest recipient sector in 1998, accounting for about two-thirds of all inflows), primarily because of the acquisition of AirTouch Communications by the Vodafone Group (United Kingdom) with a transaction value of $60 billion, the largest completed cross-border M&A deal in 1999 (annex table A.IV.4).

These large FDI inflows into, and outflows from, the United States, unperturbed by the financial crisis, have placed that country at the centre of the current FDI boom. Cross-border M&As, especially between companies based in the European Union and the United States, lie in the heart of recent United States FDI in both directions (table II.1). But both the number and the value of cross-border M&A transactions by United States TNCs exceeding one billion dollars fell in 1999: from 26 to 21 in terms of number and from $74 billion to $55 billion in terms of value.[3] On the inward side, about 90 per cent of investment outlays by foreign investors in United States businesses in recent years were attributed to the acquisition of United States companies by foreign-based TNCs (annex table A.IV.8). Some of these inflows reflected capital contributions to existing affiliates in the United States, which were in turn used to acquire local companies. This raises the question of whether recent levels of FDI flows for 1999 can be sustained in the future. They may be sustained in the short-term if the present M&A boom persists with similar large M&A transactions: indeed, even if the pace of M&A activity subsides, a few large transactions can still lead to very high values of FDI activity, as in 1999.

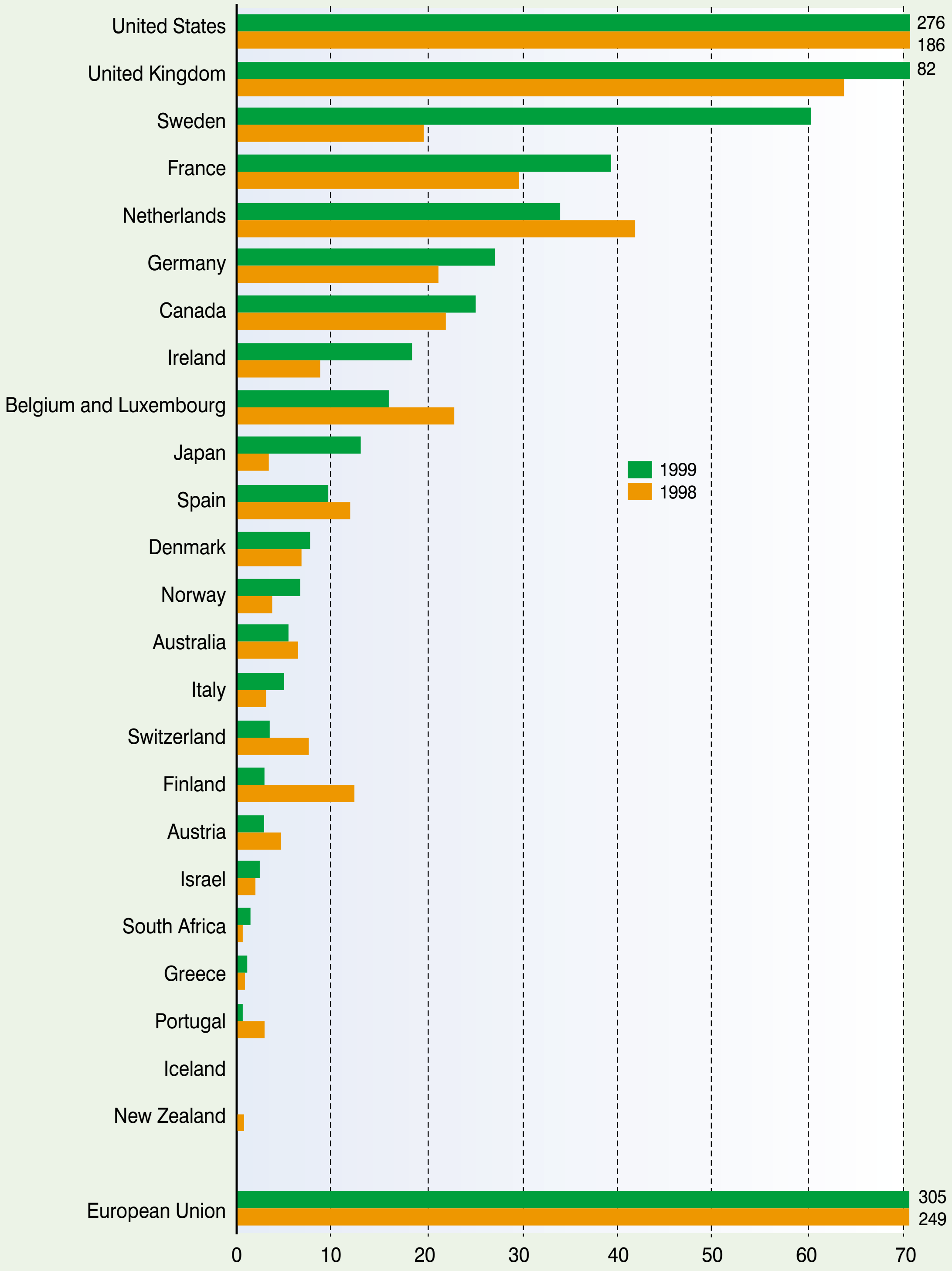
There are, however, signs that both sales and purchases of cross-border M&A activity are slowing down, reflecting the lower number of large-scale transactions that characterized the United States cross-border M&As until 1998. This could suggest that a decline in United States FDI flows, both inward and outward, could take place in the next 1 or 2 years. For example, while outflows dropped to $35 billion in the first quarter of 2000 compared with $38 billion of the quarterly average of 1999, the corresponding figures for inflows were $42 and $69 billion, respectively.

From a longer-term perspective, however, United States FDI outflows are likely to remain robust, as the country's TNCs continue to seek to improve their competitiveness by accessing new markets and resources and to generate strong ownership advantages at home. Given the size of its domestic economy, the United States still lags behind other developed countries with a long history of outward investment. The ratio of outward FDI flows to gross domestic fixed capital formation for the United States during the period 1996-1998, at 8 per cent, was considerably below that of Sweden and the Netherlands for instance, or even the United Kingdom; on the inward side, the picture is similar (figure II.3). As regards inward investment, with the value of the United States dollar virtually unchanged in 1999 (it appreciated by a mere 1 per cent on a trade-weighted basis against a group of seven major countries),[4] it is unlikely that the burst of FDI flows was dictated by low asset prices. The rates of return earned by non-financial foreign

FIGURE II.2

Developed countries: FDI *inflows*, 1998 and 1999[a]

(Billions of dollars)



Source: UNCTAD, FDI/TNC database and annex table B.1.

[a] Ranked on the basis of the magnitude of 1999 FDI inflows.

affiliates in the United States were also consistently lower than for non-financial local companies, although the gap appeared to be narrowing (Mataloni, 2000). The main motives for high FDI inflows were clearly access to the huge and rapidly growing market and the pull of dynamic technological activity there. These attractions are likely to persist in the future.

Table II.1. Sales and purchases of cross-border M&As in the United States, by home region/country, 1987-1999

(Billions of dollars)

(a) Sales

		Developed countries				Developing countries				
Year	World	Total	EU	Japan	United States[a]	Total	Africa	Latin America and the Caribbean	South, East and South-East Asia	Central and Eastern Europe[b]
1987	51.8	50.5	23.0	3.2	21.8	1.3	0.1	-	1.0	-
1988	63.9	63.1	19.0	10.8	17.7	0.7	-	-	0.7	-
1989	68.8	66.6	35.9	5.7	19.3	2.2	-	0.9	1.3	-
1990	54.7	50.9	26.8	7.7	10.8	3.8	-	0.4	1.8	-
1991	28.2	27.7	12.7	10.5	3.6	0.5	-	0.1	0.3	-
1992	15.8	14.6	6.7	3.4	3.5	1.2	-	1.0	0.1	-
1993	20.0	18.5	9.2	0.8	6.4	1.5	-	0.7	0.4	-
1994	44.7	42.6	19.0	0.4	9.2	2.1	-	1.0	0.8	-
1995	53.2	49.3	19.3	2.1	13.4	3.9	-	2.0	1.6	-
1996	68.1	66.0	42.1	4.4	8.8	2.0	-	1.0	1.1	-
1997	81.7	78.7	39.2	1.6	16.8	3.0	-	0.4	2.0	-
1998	209.5	206.1	148.4	0.7	22.7	3.4	-	2.5	0.7	-
1999	233.0	215.1	184.3	0.4	10.9	17.9	0.4	16.8	0.6	-

(b) Purchases

		Developed countries				Developing countries				
Year	World	Total	EU	Japan	United States[c]	Total	Africa	Latin America and the Caribbean	South, East and South-East Asia	Central and Eastern Europe[b]
1987	28.4	27.3	2.1	-	21.8	1.2	-	1.1	0.1	-
1988	24.2	23.9	4.4	-	17.7	0.3	-	0.1	0.2	-
1989	38.9	38.3	12.4	1.6	19.3	0.6	-	0.1	0.5	-
1990	27.6	24.5	6.5	-	10.8	2.9	0.4	2.2	0.3	0.2
1991	16.6	14.5	7.9	0.1	3.6	2.0	-	2.0	-	0.1
1992	15.0	12.5	5.9	0.1	3.5	2.1	-	1.3	0.8	0.4
1993	21.4	17.9	9.5	0.1	6.4	3.2	-	2.7	0.5	0.3
1994	28.5	25.6	12.3	0.3	9.2	2.6	-	2.3	0.3	0.2
1995	57.3	52.4	26.3	0.4	13.4	4.6	-	3.8	0.7	0.3
1996	60.7	50.3	28.2	0.3	8.8	8.9	0.2	7.1	0.4	1.5
1997	80.9	60.0	24.9	0.3	16.8	20.4	0.1	16.3	3.9	0.5
1998	137.4	115.6	62.8	4.0	22.7	20.8	-	15.6	5.2	0.3
1999	112.4	98.0	51.5	8.7	10.9	13.7	-	7.9	5.8	0.7

Source: UNCTAD, cross-border M&A database, based on data from Thomson Financial Securities Data Company.

[a] Sold by foreign affiliates operating in the United States to United States firms and/or sold by United States firms to foreign affiliates operating in the United States.

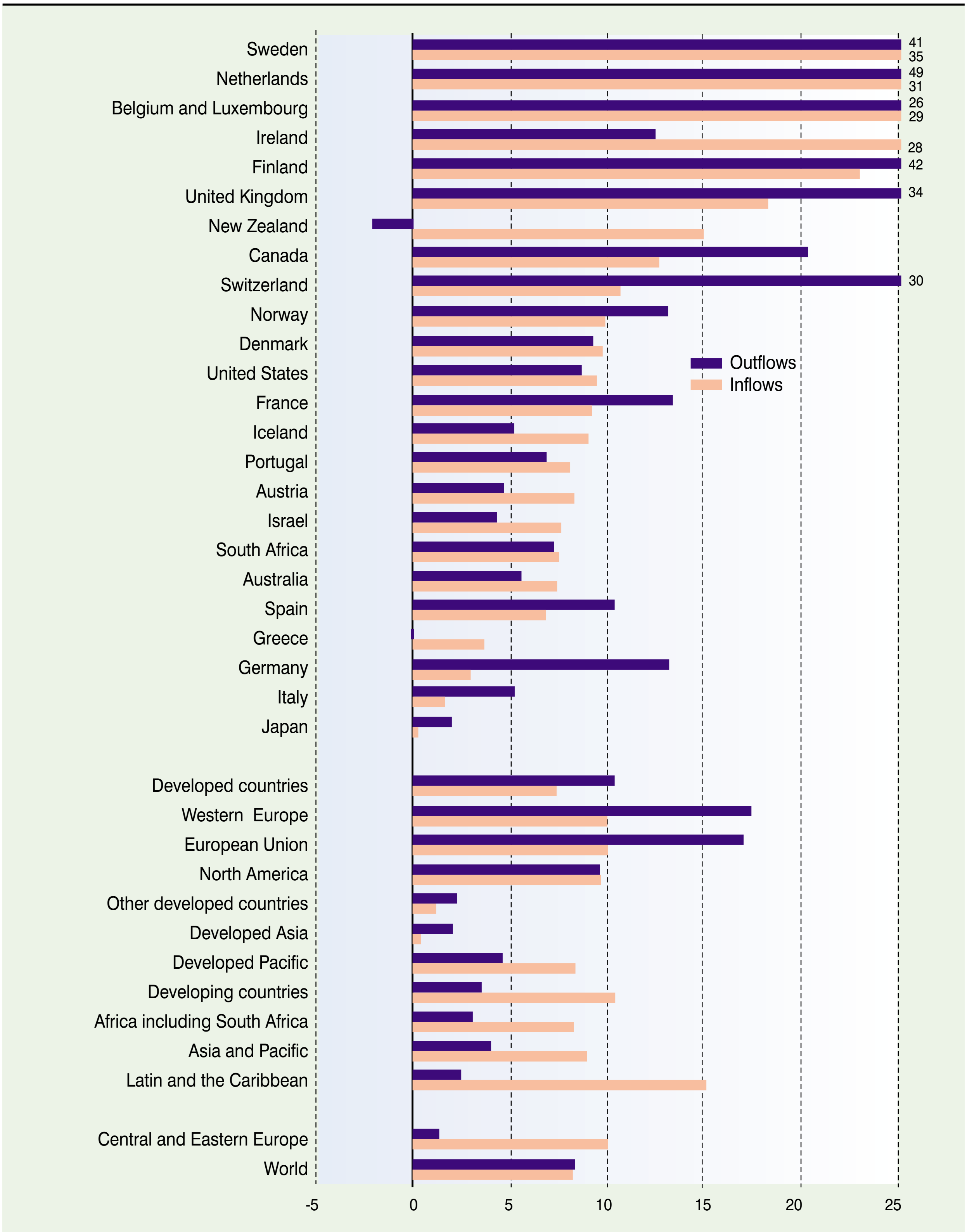
[b] Includes the countries of the former Yugoslavia.

[c] Acquisition of United States firms by foreign affiliates operating in the United States and/or acquisition of foreign affiliates operating in the United States by United States firms.

FIGURE II.3

Developed countries: FDI flows as percentage of gross fixed capital formation, 1996 and 1998[a]

(Percentage)



Source: UNCTAD, FDI/TNC database and annex table B.5.

[a] Ranked on the basis of the magnitude of 1996-1998 FDI inflows as a pecentage of gross fixed capital formation.

2. European Union

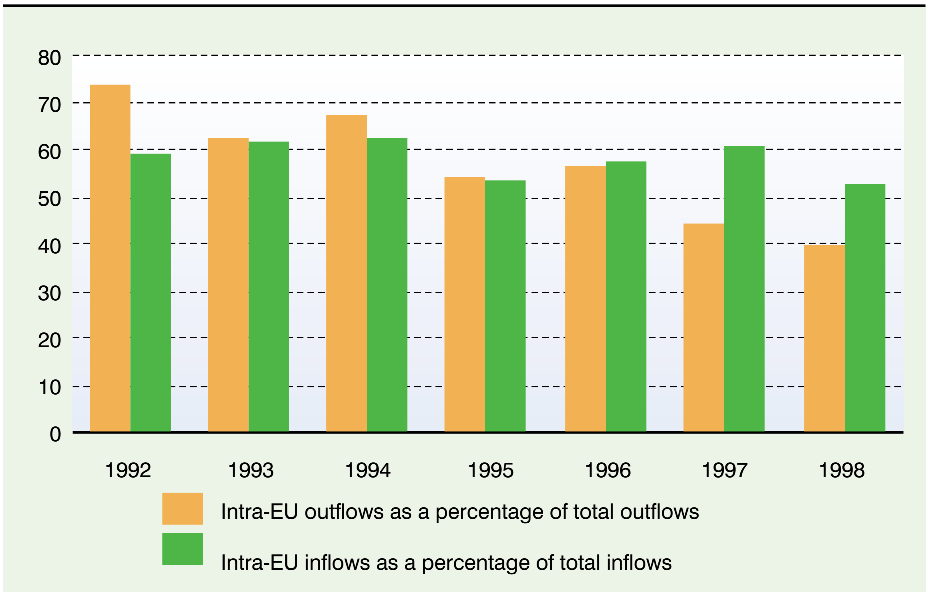
The position of the EU as the world's most important source of FDI was reconfirmed in 1999 as *outflows* of FDI rose for the sixth year in a row. Firms of the EU accounted for outward flows of $510 billion, an increase of 20 per cent over 1998. The United Kingdom maintained its status as the largest investor this year not only in Europe, but globally. The United Kingdom, which alone accounted for 39 per cent of total EU outflows, was followed by two other large economies, France and Germany, and by the Netherlands (figure II.1 and annex table B.2). In terms of growth, Denmark, France and Spain reported the largest increases, while FDI from Finland, Italy and Germany fell significantly in 1999. As in earlier years, FDI outflows from EU countries greatly surpassed the level of EU inflows. The discrepancy continued to expand from $95 billion in 1997 and $177 billion in 1998 to reach $205 billion in 1999.

Inflows of FDI to the EU countries increased by 23 per cent to a total of $305 billion, higher than inflows into the United States (annex table B.1). The United Kingdom remained the largest recipient in the EU, with the small economy of Sweden as the runner-up with a growth rate of more than 200 per cent compared with 1998. France and the Netherlands were in third and fourth places, respectively (figure II.2). The remarkable increase in inward investment to Sweden was mainly the result of the merger between the two pharmaceutical companies Astra (Sweden) and Zeneca (United Kingdom). Inflows to Ireland more than doubled, in which M&As (e.g. the acquisition of Telecom Eireann by Iranian investors with an acquisition value of $4.4 billion) played an important role. On the other hand, inflows to Portugal, Finland, Austria, Belgium and Spain declined markedly compared with the year before.

Distinguishing between intra-EU and extra-EU flows, it appears that FDI between the EU and other parts of the world is gaining in importance. In the case of both outward and inward flows, the intra-EU share of total FDI was at its lowest level in 1998 since 1992 (figure II.4). In 1998, extra-EU FDI was dominated by the United States, which accounted for 59 per cent of total outflows and 69 per cent of total inflows. About one-quarter of flows in both directions was related to Central and South America and the EFTA countries, while the share of the rest of the world was only some 10 per cent (Eurostat, 2000).

European FDI developments in 1999 were more than ever driven by M&As. The value of cross-border M&A sales and purchases within Europe increased by 83 per cent and 75 per cent, reaching $345 and $498 billion respectively.[5] The EU accounted for almost half of all global cross-border sales of M&As and as much as 70 per cent of global purchases (table IV.3). Companies of the EU were involved in all but one of the ten largest cross-border M&As in 1999 (table IV.4), with Vodafone's takeover of AirTouch Communications and the merger between Astra and Zeneca topping the list.

FIGURE II.4
Intra-EU FDI flows, 1992-1998
(Percentage of total EU FDI)



Source: Eurostat, 2000.

These cross-border FDI flows in Europe are partly a response to the ongoing integration and liberalization affecting much of European industry. The implementation of the various single market directives and subsequent deregulation efforts at both national and EU levels have made national borders increasingly obsolete. The industries that have been the most affected during the late 1990s are in the service sector, including financial intermediation, telecommunications, electricity, media and transportation. The sectoral breakdown of FDI flows reveals the growing importance of these industries in European FDI (table II.2). During the period 1997-1998, services accounted for more than 70 per cent of both intra- and extra-EU FDI inflows, with financial intermediation, real estate and other business activities the main recipient industries. In terms of outward FDI, there was a marked difference between intra-EU and extra-EU flows. While services accounted for 67 per cent of total intra-EU outflows, the share in total extra-EU outflows was only about 44 per cent. Financial intermediation was the primary generator of service-related FDI, accounting for 62 per cent of the EU outflow of all FDI in services in 1998. Throughout the 1990s, services have accounted for a greater proportion of inflows to the EU compared with EU firms' FDI outside of the Union. This discrepancy has widened in recent years (figure II.5).

Due to the merger between BP (United Kingdom) and Amoco (United States) in the petroleum business, primary industries grew in importance in extra-EU outflows of FDI in 1998. Within manufacturing, the share of the motor vehicles industry in extra-EU outflows rose considerably. The 1998 merger between Daimler (Germany) and Chrysler (United States) played an important role, making motor vehicles by far the most important industry in German FDI outflows that year. For the first time, motor vehicles also became the largest manufacturing sector in EU outflows, taking the lead from the chemical industry (Eurostat, 2000). The consolidation of the automotive industry continued at a high pace in 1999 and 2000, examples of which are the following:

Table II.2. Sectoral distribution of intra-EU and extra-EU flows, 1997-1998

	Outflows				Inflows			
	Intra-EU		Extra-EU[a]		Intra-EU		Extra-EU[a]	
Sector/industry	*ECU million*	*Per cent*	*ECU million*	*Per cent*	*ECU million*	*Per cent*	*ECU million*	*Per cent*
All industries[b]	**199 323**	**100.0**	**281 190**	**100.0**	**163 963**	**100.0**	**131 432**	**100.0**
Primary	**-2 919**	**-1.5**	**70 861**	**25.2**	**548**	**0.3**	**-594**	**-0.5**
Manufacturing	**65 545**	**32.9**	**87 186**	**31.0**	**38 450**	**23.5**	**38 498**	**29.3**
Food products	1 015	0.5	4 228	1.5	5 545	3.4	1 532	1.2
Textiles and wood	9 567	4.8	6 098	2.2	6 633	4.0	3 051	2.3
Petrol, chemicals and rubber	17 922	9.0	13 702	4.9	10 625	6.5	9 535	7.3
Metal and mechanical	12 635	6.3	6 902	2.5	5 504	3.4	4 111	3.1
Office machinery and radio	6 286	3.2	3 950	1.4	1 854	1.1	14 280	10.9
Motor vehicles, other transport equipment	3 091	1.6	44 344	15.8	4 567	2.8	2 878	2.2
Services	**134 259**	**67.4**	**122 819**	**43.7**	**121 730**	**74.2**	**93 148**	**70.9**
Electricty, gas and water	4 622	2.3	5 203	1.9	34	-	12 460	9.5
Construction	1 431	0.7	871	0.3	952	0.6	884	0.7
Trade and repairs	22 824	11.5	16 897	6.0	14 111	8.6	6 829	5.2
Hotels and restaurants	277	0.1	-2 651	-0.9	596	0.4	2 499	1.9
Transports, communication	4 124	2.1	13 385	4.8	8 363	5.1	9 051	6.9
Financial intermediation	51 012	25.6	66 068	23.5	43 811	26.7	29 988	22.8
Real estate and business activities	41 204	20.7	21 630	7.7	49 493	30.2	27 682	21.1
Other services	8 765	4.4	1 416	0.5	4 370	2.7	3 755	2.9

Source: UNCTAD, based on Eurostat, 2000.

[a] FDI flows which are not intra-EU, thus including flows which are not classified as either intra- or extra-EU.
[b] Includes FDI flows which are not allocated according to industry.

Ford's acquisitions of Volvo Cars and Land Rover (the latter from BMW); Volkswagen's acquisition of Scania, the Swedish heavy truck-maker; Renault's takeover of Samsung Motor Inc. (Republic of Korea); the acquisition of a 33 per cent stake of Mitsubishi Motors by DaimlerChrysler; Renault's 37 per cent equity acquisition of Nissan; and Volvo's acquisition of Renault's truck division (chapter IV).

Although it is difficult to assess the full impact of the Euro on FDI, the current reshaping of European industry is likely to be affected by the single currency. It has created a liquid market in European corporate bonds, which companies are increasingly using to refinance bank debt and to raise money for M&A activity.[6] The single currency will also contribute to greater price transparency and increased competition in Europe, putting more pressure on firms to restructure and consolidate their operations.

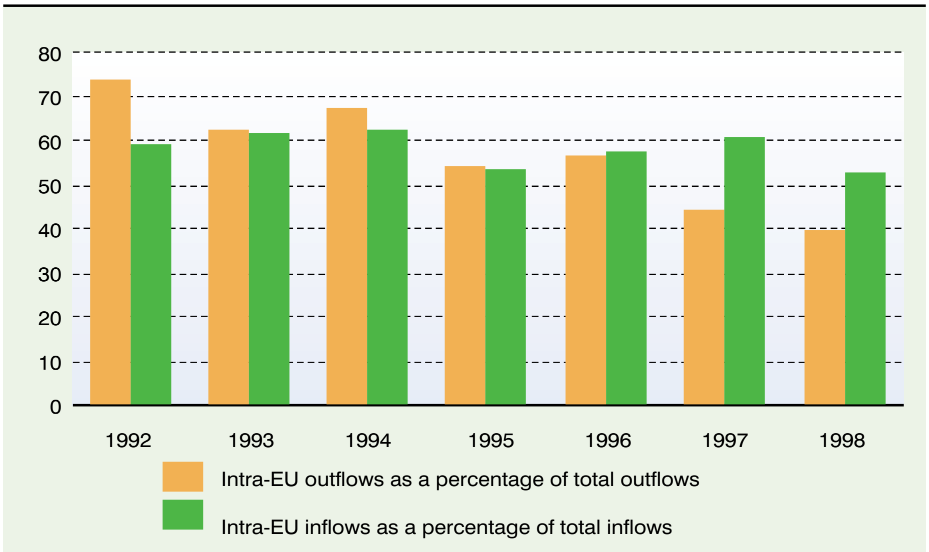
Contrary to expectations, however, it does not appear that the launch of the Euro has had a major negative impact on the inflow of FDI to EU members that have not participated in the European Monetary Union (EMU). Inward FDI to the EMU countries decreased somewhat (-2 per cent) between 1998 and 1999, though the level of flows remained high (figure II.6). On the other hand, FDI inflows to the non-EMU members increased by 66 per cent. Inflows to the United Kingdom, Sweden and Denmark have increased every year since 1996 (figure II.6). However, this does not mean that the Euro will not affect FDI flows in the longer term. First, as the dominance of M&As in FDI makes the data highly sensitive to individual business transactions, FDI statistics should be interpreted with caution. Second, it is still too soon to assess the longer-term impact of the single currency on FDI (UNCTAD, 1999a). There are several studies suggesting that the non-EMU countries may suffer from staying outside. For example, in a survey of leading British economists, two-thirds of 164 respondents stated that joining the European single currency would be beneficial for the economy of the United Kingdom.[7] The major advantage provided by the Euro, they said, would be a more stable exchange rate. This, in turn, would enable United Kingdom companies, whose major source of revenue are exports to other EMU countries, to reduce risk and related foreign exchange transaction costs. TNCs whose United Kingdom affiliates export to other EMU countries would probably be in favour of the United Kingdom joining the EMU. The same message was given by foreign affiliates in Sweden. Whereas none expected a Swedish membership in the EMU to lead to a reduction of FDI into Sweden, more than one quarter of foreign affiliates stated that joining the EMU membership would result in more investment into Sweden (Invest in Sweden Agency, 2000).

To conclude, FDI is a central element in the current European restructuring process. Cross-border M&As play an important role as a way for firms to respond to deregulation and increased competition. Major M&A transactions announced or completed in the beginning of 2000 (e.g. Vodafone AirTouch-Mannesmann) suggest that FDI flows will remain at historically high levels. Nevertheless,

FIGURE II.5

Share of services in intra-EU and extra-EU FDI flows, 1992-1998

(Percentage)



Source: UNCTAD, based on Eurostat, 2000.

the EU continues to attract considerably less FDI than what it undertakes abroad, with the United States receiving most of the outward FDI of the EU.

3. Japan

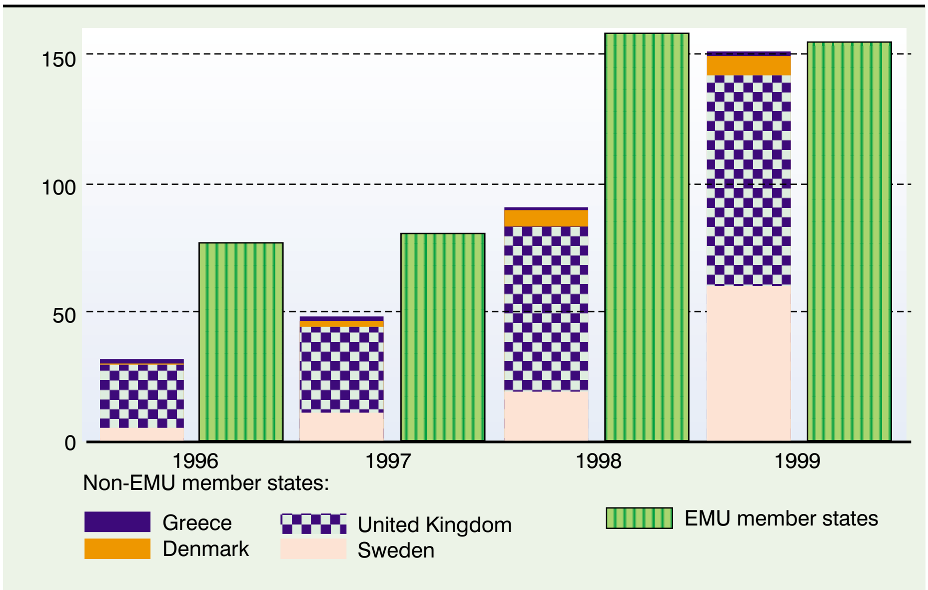
Cross-border M&As dominated Japanese FDI inflows and outflows in 1999. Outflows of FDI from Japan declined by 6 per cent, to $23 billion in 1999, while inflows quadrupled, to reach a record level of $13 billion. The imbalance between inflows and outflows fell to the lowest level since Japanese authorities started to collect FDI statistics (figure II.7) comparable to other major developed countries (e.g. France, Germany, and the United Kingdom). This is a remarkable and sudden shift: only a few years ago, foreign investors regarded Japan as extremely difficult to enter. More surprisingly, in spite of the traditional Japanese view that M&As are not suited to the country's business culture, most of the new FDI inflows came through a spate of large M&As. For example, the purchase of Japan Leasing Corporation by General Electric Capital, with a transaction value of $6.6 billion, was alone equivalent to about twice the value of the inflows registered in 1998. The purchase of a 37 per cent stake of Nissan by Renault was valued at $5.4 billion. Cable and Wireless invested $700 million in IDC.

Both the number and the value of inward FDI projects increased significantly in 1999. This mirrors strategic changes in Japanese companies, which are increasingly viewing M&As as a means to revitalize and restructure their companies. This stance is encouraged by a series of recent incentives and deregulation measures related to M&A FDI (box IV.7).

Inflows of FDI in the financial industry grew dramatically beginning in 1997, when Japan started to liberalize financial services. Inflows of FDI were relatively small in manufacturing as compared to services, but inflows into specific manufacturing industries, e.g. automobiles, have been rising lately. These have been mainly on account of some large-scale M&As – Ford-Mazda in 1998, Renault-Nissan in 1999 and DaimlerChrysler-Mitsubishi Motors in 2000. As a result, the shares of financial industries and transport equipment in FDI inflows increased from 4 per cent in 1996 to 21 per cent in 1999 in the former, and from 20 per cent in 1996 to 36 per cent in 1999 in the latter.[8]

With regard to FDI *outflows*, two features should be noted. On the one hand, FDI outflows were seriously affected by restructuring in the financial services industry.[9] On the other hand, the relative importance of M&As as a mode of entry by Japanese TNCs declined over the past few years. Since the late 1980s, Japanese companies have increasingly used M&As as a mode of entry into developed countries, notably the United States. However, the number of foreign affiliates established through M&As as a share of total new Japanese foreign affiliates declined from 17 per cent in 1983 to 12 per cent in 1995

FIGURE II.6
FDI inflows to EMU and non-EMU member states, 1996-1999
(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

(UNCTAD, 1999a, p. 99). The decline was the result of the increasing number of greenfield affiliates in developing countries. The number of affiliates created through M&A as a share of the number of new Japanese affiliates in developing countries was halved from 17 per cent in 1983 to 8 per cent in 1995. Even though M&As by Japanese TNCs increased in Asia after the financial crisis (as noted elsewhere — UNCTAD, 1999a), this was mainly in the form of additional equity or intra-company loans to existing affiliates affected by the crisis. Few new affiliates were established through M&As in 1998 and 1999.[10]

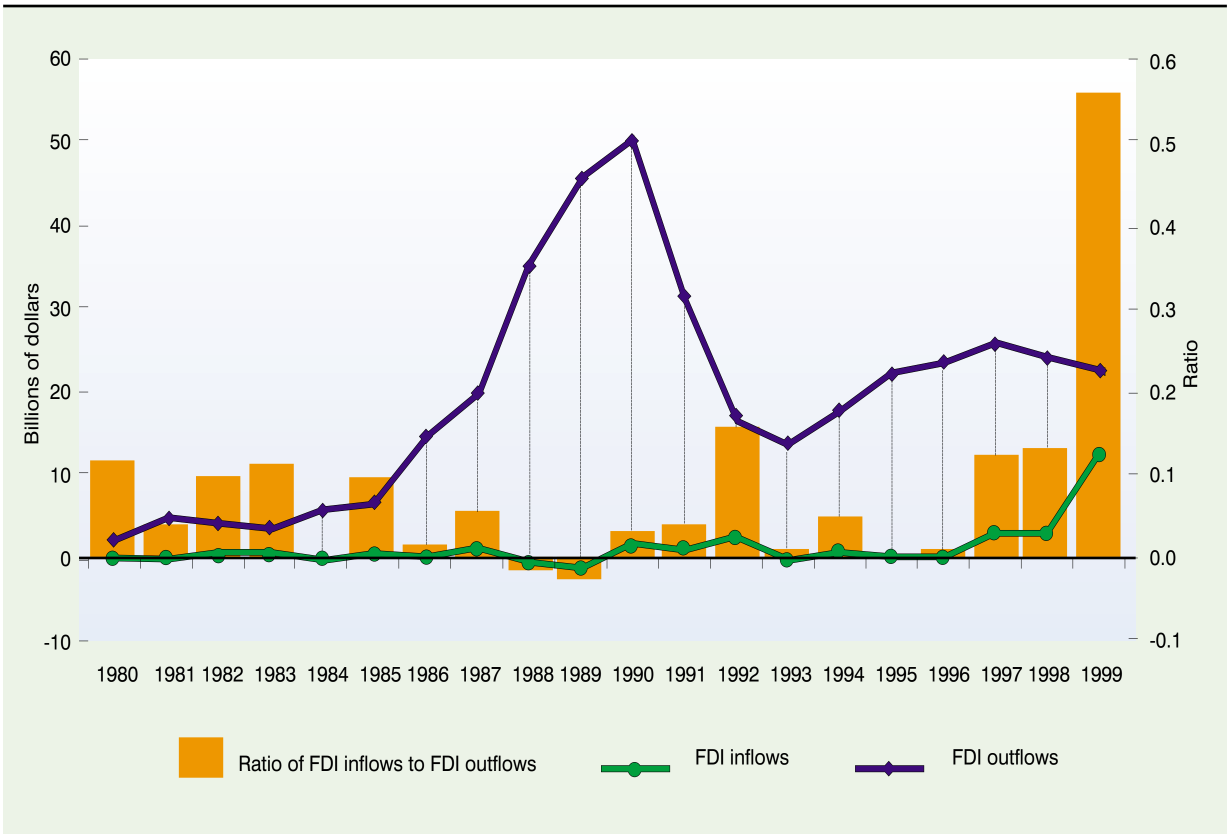
It should be noted, however, that on a value basis outward FDI through M&As increased in importance recently, mainly due to a few large deals. For example, the value of the ($7.8 billion) purchase of the international tobacco business of RJR Nabisco by Japan Tobacco — the largest cross-border M&A involving a Japanese firm — alone was equivalent to about a third of Japanese outward FDI in 1999.[11]

Some broader implications of these changes are worth noting. An indication of the possible decline of Japanese international competitiveness is its serious slippage in the rankings of the International Institute for Management Development's *World Competitiveness Yearbook*: from number 1 in 1989-1993 to 16 in 1999 (IMD, 1999). This reflects weaknesses in the performance of the domestic economy, especially in financial and corporate management. With declining (new) domestic capital expenditures since 1997, what Japanese industry seems to need to regain global competitiveness is not new investment as much as management know-how and practices in a globalizing world. Cross-border M&As may assist this process.

In 1999, Japanese TNCs started to increase production and hire or rehire employees in the Asian countries most seriously affected by the financial crisis.[12] The slow-down of the domestic economy and the rise of the yen have encouraged them to further expand and deepen their international

FIGURE II.7

Japanese FDI flows and ratio of FDI inflows to FDI outflows, 1980-1999



Source: UNCTAD, FDI/TNC database.

production networks. The allocation of specific functions to foreign affiliates has accelerated. The number of foreign affiliates designated as regional headquarters doubled in 1995 and rose by 59 per cent in 1996. This number was stable in 1997. As a result, one quarter of all Japanese foreign affiliates functioned as regional headquarters in 1997 (Japan, MITI, 2000).

While international production by Japanese TNCs is continuing to grow, its share in total production still lags behind other major home countries such as Germany or the United States (figure II.8). Prospects for further increases in international production in the near future are limited. Only about one-fifth of Japanese TNCs surveyed in 1999 plan to increase their investments in the next three years, compared to 38 per cent in 1998.[13] For inward FDI, about one-third of foreign affiliates operating in Japan planned to expand their business (JETRO, 2000); this compares to two-fifths of those surveyed in the previous year.[14] For the moment, foreign firms in Japan are trying simply to maintain their operations.

B. Developing countries

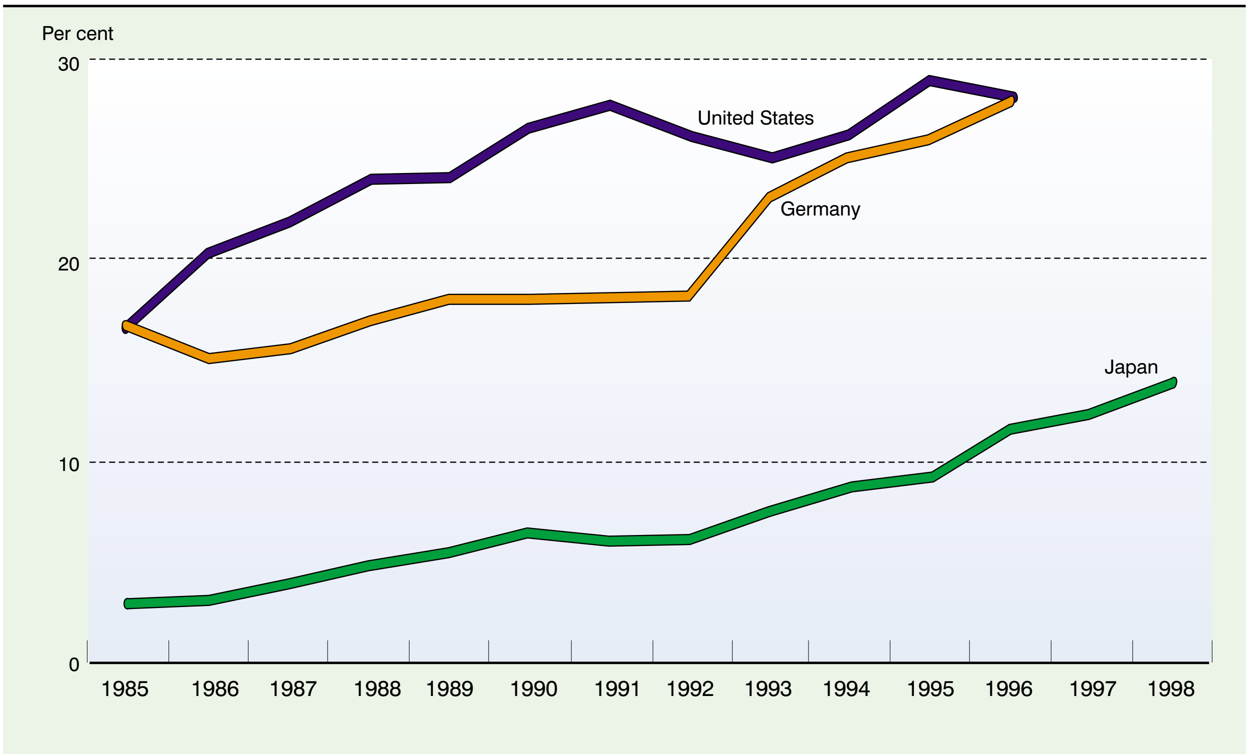
1. Africa

Inflows of FDI into Africa (including South Africa)[15] rose by 28 per cent, from $8 billion in 1998 to $10 billion in 1999 (figure II.9). This growth rate is higher than that of other developing countries. However, this was not enough for Africa to increase its share in global FDI inflows. It remained at the low level of 1.2 per cent in 1999, compared to 2.3 per cent in 1997 and 1.2 per cent in 1998. This performance should, however, be seen against the backdrop of dramatic increases in FDI inflows to developed countries in 1998-1999.

Recent FDI inflows to Africa have been growing faster than at the beginning of the 1990s, a result, among other things, of the efforts of many African Governments to create a more business-friendly environment after the turbulent 1970s and 1980s. But the real challenge for the continent lies ahead: integration into the global economy, including

FIGURE II.8

International production as a percentage of total production in Japan, Germany and the United States[a], 1985-1998



Source: Japan, MITI, 2000.

[a] The share of sales by affiliates abroad in total sales of the country.

integration into the regional or global production networks of TNCs. Only then will the continent become a more prominent player in the world market and benefit more from FDI.

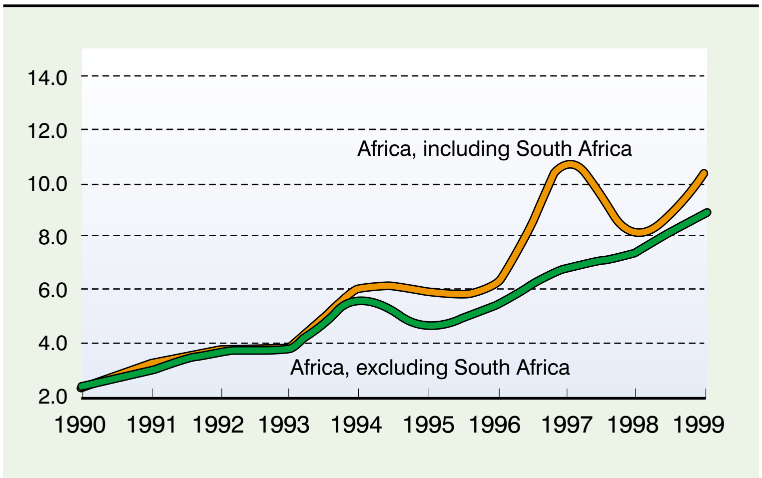
Given the limited amounts of FDI flows in absolute terms it is not surprising that most African countries receive small FDI flows. However, Angola, Egypt, Morocco, Nigeria, South Africa and Tunisia have attracted sizeable amounts of FDI in recent years (figure II.10). In 1999 the amounts received by Angola and Egypt were particularly impressive: for the former because of investment in petroleum, and for the latter, mainly on account of deregulation and privatization. As a result, these two countries became the largest recipients of FDI flows in 1999 in Africa, overtaking Nigeria, which had been traditionally the largest. Increases in FDI flows to Ghana and South Africa are also noteworthy.

The *distribution* of FDI inflows between the different regions in Africa has changed somewhat. North Africa (led by Egypt) attracted a slightly higher share of FDI flows during 1997-1998 than in the previous years. In 1999, this share rose to 29 per cent. The oscillations in recent FDI inflows into Morocco reflect its privatization programme, with large projects determining their lumpiness. The Libyan Arab Jamahiriya has matched the lifting of the external embargoes with a liberalization of internal policies, permitting FDI in some industries. If this continues, it might have rising FDI inflows in the future.

FIGURE II.9

FDI inflows to Africa, 1990-1999

(Billions of dollars)



Source: UNCTAD, FDI/TNC database.

Sub-Saharan Africa (including South Africa) had its share in total FDI inflows to Africa slightly reduced from 72 per cent in 1998 to 71 per cent in 1999. However, the development in the sub-region was not uniform; some countries managed to attract rapidly increasing FDI inflows in recent years. Angola and Mozambique have been particularly successful (annex table B.1).

Measured against other indicators, such as GDP or gross domestic capital formation, FDI in a number of small African countries appears much more sizeable than figures for absolute inflows might suggest. Angola, Equatorial Guinea, Lesotho and Zambia rank high if FDI inflows are related to gross domestic capital formation (figure II.11). A similar ranking emerges when FDI inflows are measured against GDP. The two rankings give different pictures of locational attractiveness, although neither has changed much in the past few years.

There is evidence of diversification in *sources* of FDI to Africa. In 1998, the United States maintained its position as the most important investor; it had lost this position to the United Kingdom and to France for a number of years up to 1995: in the period 1994-1998, its FDI outflows to Africa totalled $7.6 billion (figure II.12). France and the United Kingdom ranked second and third, with outflows to Africa of $2.5 billion each. However, the combined share of France, the United Kingdom and the United States decreased from 77 per cent of total FDI flows from OECD countries to Africa in 1984-1988 to 71 per cent in 1989-1993 and 65 per cent in 1994-1998. Other countries, notably such as Germany and the Netherlands, gained in importance. Thus, at least as far as Europe is concerned, the basis for FDI flows to Africa is widening over time, with an increasing number of countries becoming important sources for FDI into Africa.

Evidence on the *sectoral* distribution of FDI outflows to African countries remains patchy. United States FDI is mainly in natural resources, led by petroleum (UNCTAD, 1999b). French FDI also shows an increased share for natural resource extraction. On the other hand, FDI from Germany, the Netherlands and Switzerland has gone mainly into manufacturing, while outflows from the United Kingdom have gone mainly into service industries.

In addition, there is evidence that ongoing privatization programmes have triggered an increasing number of FDI projects. Approximately 14 per cent of FDI flows going into Africa during 1990-1998 have been linked to privatization (Pigato and Liberatori, 2000, p. 1). In 1998 alone, foreign investment through privatization triggered a total of $694 million in foreign exchange reserves in sub-Saharan Africa.[16] This figure was only exceeded in 1997, an exceptional year marked by large privatization projects in South Africa. In sub-Saharan Africa, South Africa ($1.4 billion), Ghana ($769 million), Nigeria ($500 million), Zambia ($420 million) and Côte d'Ivoire ($373 million) were the most important recipients of privatization-related FDI during the period 1990-1998. In terms of industries, the bulk of privatization (including projects with domestic as well as with foreign participation) took place in telecommunications (with a total volume of $2.5 billion during the period 1990-1998) and mining ($1.4 billion) (Pigato and Liberatori, 2000).

Although there has been a slowdown in privatization-related FDI in 1999 as compared to the mid-1990s mainly due to fewer privatization projects being offered, this trend is likely to be reversed in the near future. Some countries in sub-Saharan Africa, such as Kenya, Nigeria, Lesotho and South Africa, are preparing for major privatizations in the next few years, offering opportunities for FDI in the power, telecommunications and transport industries.

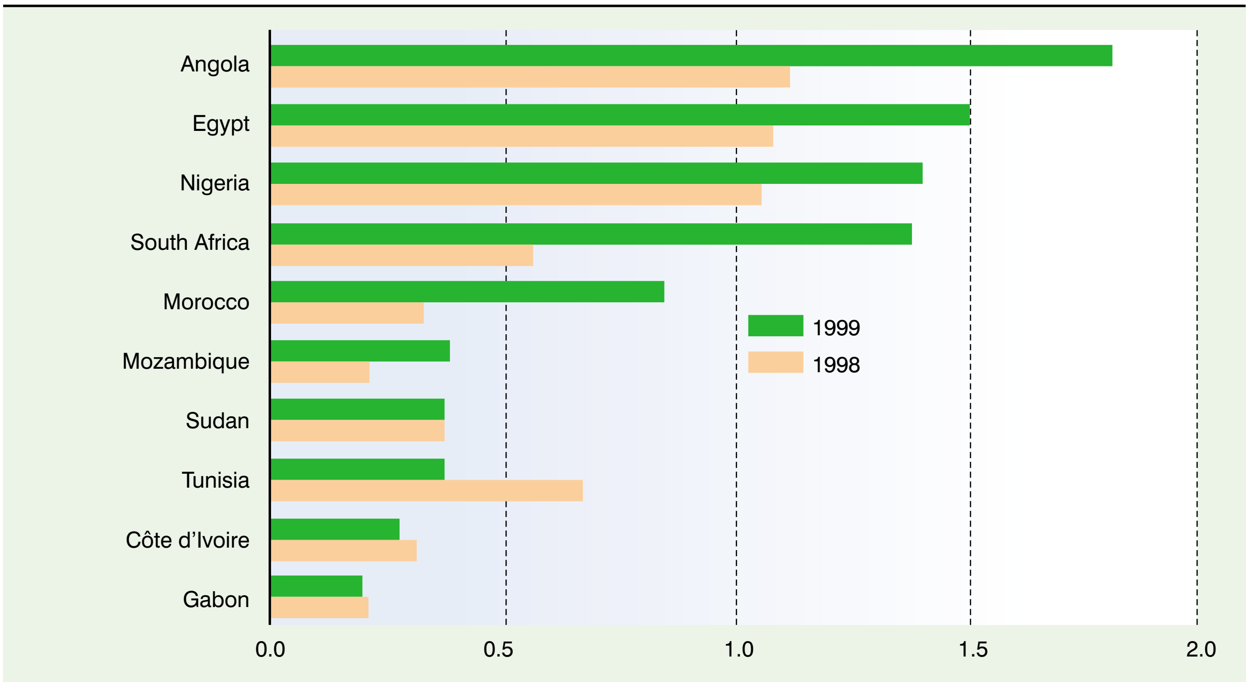
As to FDI *outflows* from Africa, they stood at $2 billion in 1999, $0.3 billion lower than in 1998 (annex table B.2). Major home countries for FDI outflows from Africa are – as in previous years – South Africa, the Libyan Arab Jamahiriya and Nigeria (figure II.13). In 1999, Uganda was also among the top countries in terms of FDI outflows, partly reflecting a large acquisition in the United States in 1999 (acquisition of Vistana by Starlight Communications with a transaction value of $406 million).

A joint survey by UNCTAD and the International Chamber of Commerce (ICC) of 296 of the world's largest TNCs at the beginning of 2000 provides insights into the prospects for

FIGURE II.10

Africa: FDI inflows, top 10 countries, 1998 and 1999[a]

(Billions of dollars)



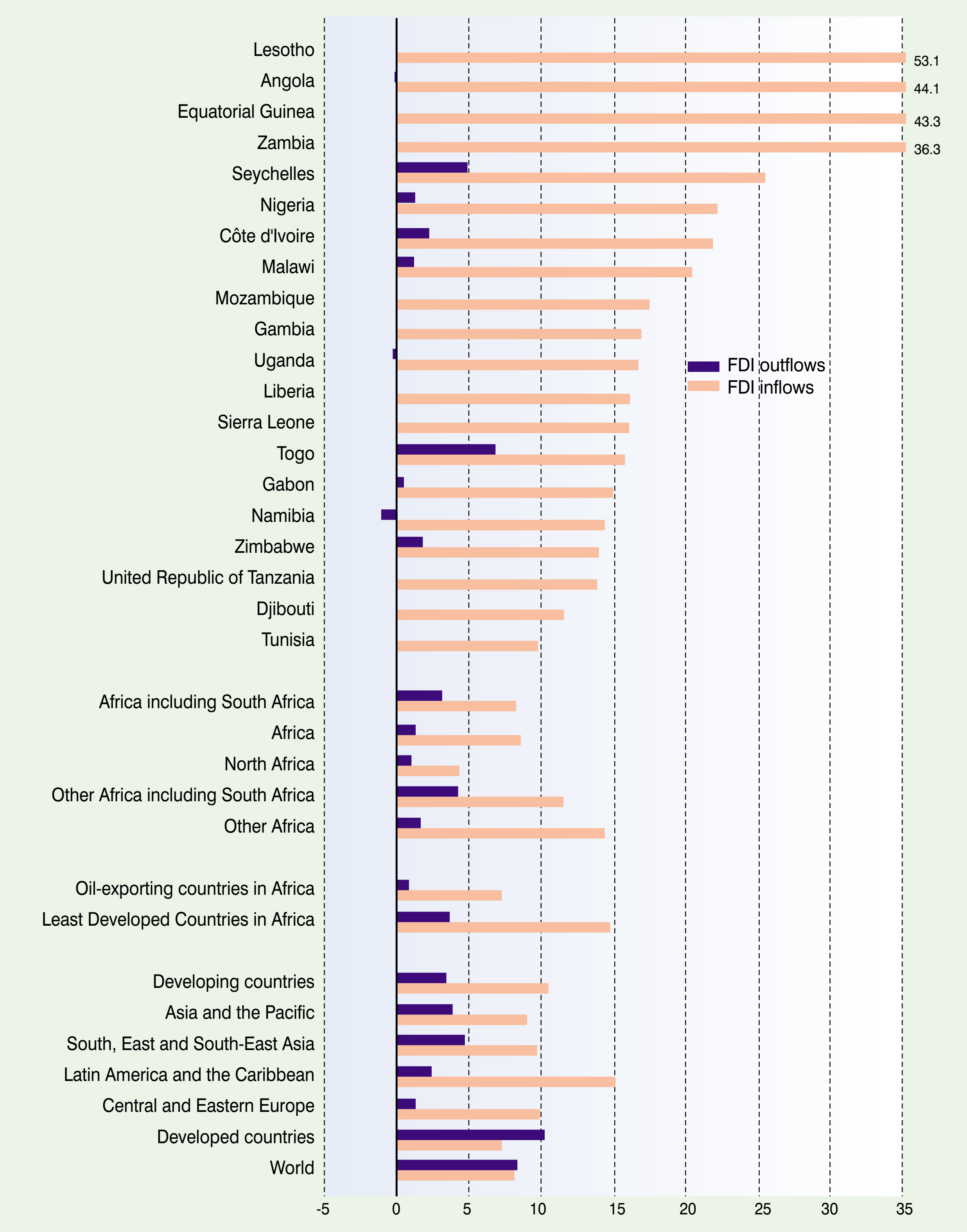
Source: UNCTAD, FDI/TNC database and annex table B.1.

[a] Ranked on the basis of the magnitude of 1999 FDI inflows.

FIGURE II.11

Africa: FDI flows as percentage of gross fixed capital formation, top 20 countries, 1996-1998[a]

(Percentage)



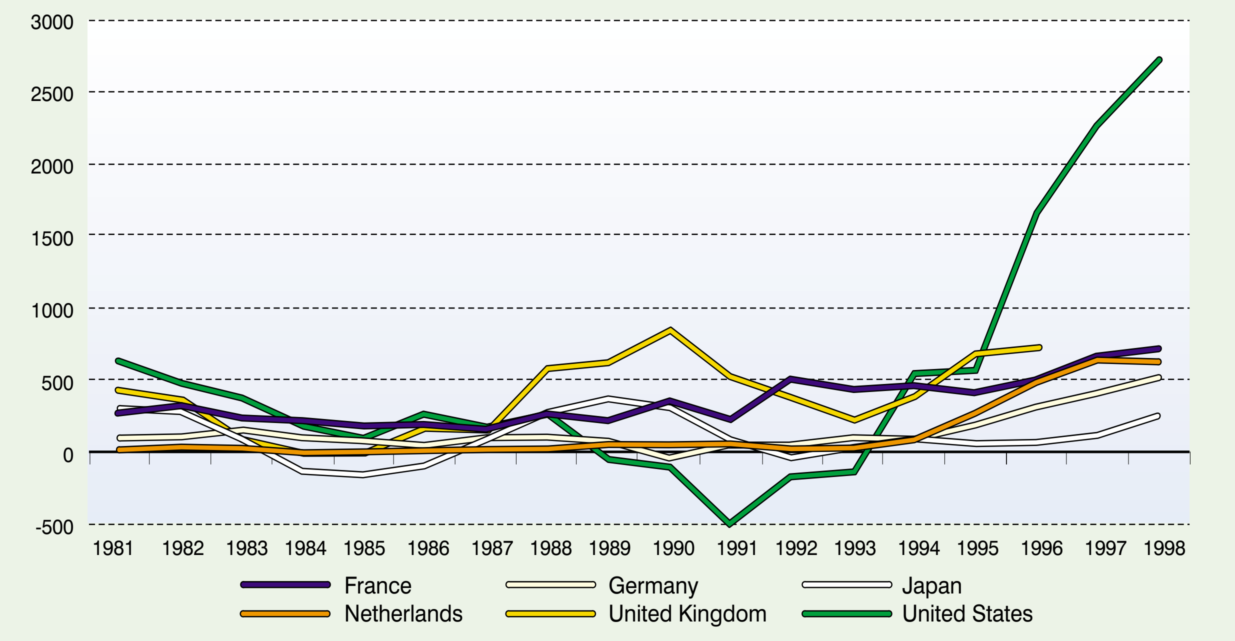
Source: UNCTAD, FDI/TNC database and annex table B.5.

[a] Ranked on the basis of the magnitude of 1996-1998 FDI inflows as a percentage of gross fixed capital formation.

FIGURE II.12

The most important countries for FDI outflows to Africa, 1981-1998

(Millions of dollars)



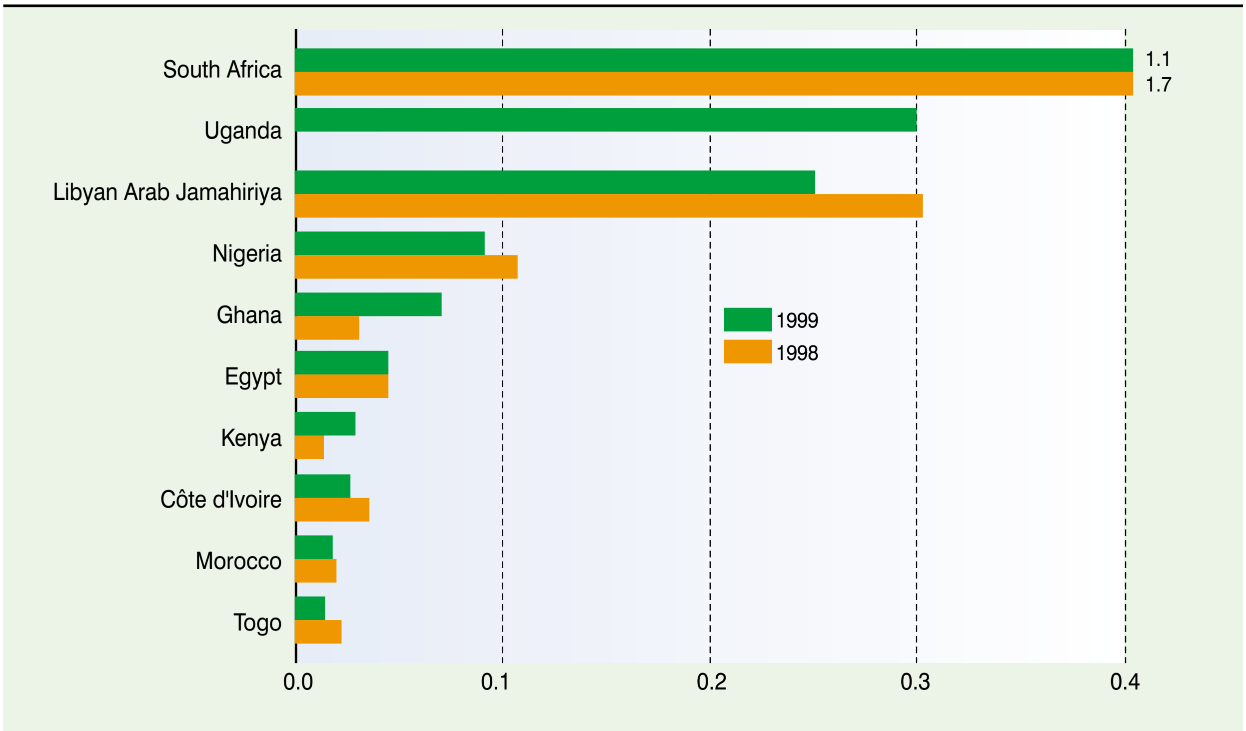
Source: OECD, unpublished data.

Note: FDI flows figures 1981-1997 are calculated as 3-year moving average. Data for the United Kingdom are not available for 1998.

FIGURE II.13

Africa: FDI *outflows*, top 10 countries, 1998 and 1999[a]

(Billions of dollars)



Source: UNCTAD, FDI/TNC database and annex table B.2.

[a] Ranked on the basis of the magnitude of 1999 FDI outflows.

FDI in the continent (box II.1). Overall, the assessment of the TNCs that responded to the survey suggests that the increase in FDI inflows into Africa in recent years might be sustained in the future. One-third of the TNCs that responded said that they intended to increase investment in the next three to five years (figure II.14), while more than half expect their investments to remain stable.

Box II.1. Who was surveyed?

All in all, a total of 296 companies were contacted between November 1999 and January 2000. The sample included 196 companies from the database of the top 100 TNCs of UNCTAD and the 50 largest TNCs from developing countries. The top 100 and top 50 databases do not include companies from the financial industry (including banks and insurance companies) for statistical reasons, but this industry accounts for a significant share in worldwide FDI flows – 50 financial companies were also included in the survey.

All in all, 63 useful responses were received, representing a 21 per cent response rate. The responding firms had a total of $658 billion in foreign assets in 1997, which corresponded to 5 per cent of total foreign assets worldwide that year. These companies had 1.6 million employees abroad (or 5 per cent of total foreign employment by all TNCs) and foreign affiliate sales of $625 billion (7 per cent of total foreign sales by the foreign affiliates of all TNCs). About 59 per cent of the companies that responded are based in Europe, 14 per cent in North America, 11 per cent in Japan and 13 per cent in developing countries. Some 3 per cent of the responding companies are headquartered in Africa. Compared to the overall sample, the share of European companies in the group of companies that responded was higher, while that of North American and Japanese firms was considerably lower. In terms of industrial sectors, 6 per cent of the industries included in the survey were companies from the primary sector, 56 per cent were manufacturing companies, and 37 per cent service companies.

Some 81 per cent of the responding TNCs produce mainly for the local market, while 24 per cent produce mainly for export to countries outside Africa.

Source: UNCTAD.

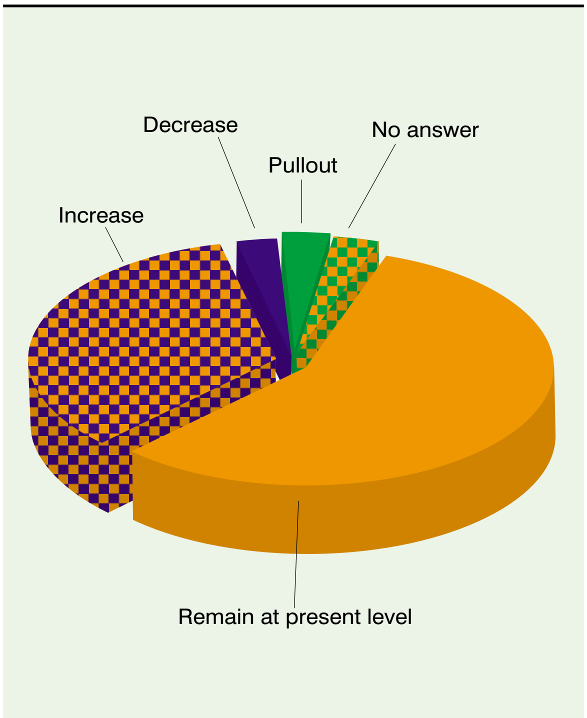
Though a number of companies did not respond to the survey, which should caution against undue generalization, it is encouraging that only 6 per cent of the responding companies were considering reducing their investment from current levels or pulling out completely. More than 43 per cent of the respondents expected that Africa's overall prospects for attracting FDI would improve in the next three to five years, compared with the past three years. Slightly more (46 per cent) did not expect prospects to change. A majority of the companies (73 per cent) assessed the overall potential for FDI in Africa as "limited" and only 12 per cent found it to be "very large" or "large", implying that there is potential in Africa, but that it is not obvious.

South Africa topped the list of the most attractive countries for FDI in Africa (figure II.15a), followed by Egypt and — at some distance — by Morocco and Nigeria. In general, countries with a relatively high level of development or relatively large domestic markets dominate the list of the most attractive countries. This preference is also reflected in

FIGURE II.14

Investment plans for Africa in 2000-2003

(Share in overall responses[a])



Source: UNCTAD/ICC survey conducted in November 1999-January 2000.

[a] Responding TNCs only.

the rating of countries expected to make the most progress in creating a business-friendly environment in the next three to four years. South Africa was the most frequently cited (figure II.15b), followed by Morocco and Egypt. Next on the list are Tunisia, Côte d'Ivoire and Ghana, in that order. However, Mozambique and the United Republic of Tanzania, two of the least developed countries, are also ranked relatively high. This might be an indication that some TNCs are beginning to take a differentiated view of the 53 countries that make up the African continent. Overall, the ranking is in line with the list of the main recipients of FDI in Africa, since South Africa and Nigeria, together with the two North African countries of Egypt and Morocco, account for most inflows into Africa (figure II.10 and annex table B.1). The survey suggests that this order will not change dramatically in the near future.

The growth and size of local markets and access to regional markets rank next to the profitability of FDI as the most enticing factors and were mentioned most frequently as influencing corporate investment decisions in a positive way (figure II.16a).

On the negative side, the incidence of extortion and bribery and the difficulty of access to global markets were the most discouraging factors cited (figure II.16b). This was followed by the overall political and economic outlook — poor access to capital, high administrative costs of doing business and deficiencies in the state of the physical infrastructure. Most of the responding TNCs were already located in Africa and most of them in countries with attractive markets, which might explain the fact that factors related to the characteristics of the market rank relatively low in their list of negative determinants, while other factors, such as access to global markets, access to capital and skilled labour, cost of doing business, and the state of the physical infrastructure ranked prominently.

The findings on the industries where TNCs see the greatest potential for FDI in 2000-2003 support this result (figure II.17). The most frequently mentioned industries for Africa are either natural-resource-seeking or market-seeking, with the exception of tourism, which is difficult to classify according to the motives of FDI decisions. Industries such as textiles and clothing, where FDI is efficiency-seeking, are low on this list. The results confirm that Africa's investment opportunities are perceived to be broader than those suggested by the traditional image of the continent as a mere provider of natural resources.

The assessment of investment potential by industry varied according to region. The poll gave the following regional profiles:[17]

- North Africa: petroleum, gas and related products, telecommunications and tourism were the most frequently mentioned industries with investment potential, followed by agriculture and motor vehicles;

FIGURE II.15a

African countries ranked according to their attractiveness for FDI in 2000-2003

(Percentage of replies[a])

Source: UNCTAD/ICC survey conducted in November 1999-January 2000.

[a] Replies as a percentage of responding TNCs.

- West Africa: petroleum, gas and related products, as well as mining, quarrying, agriculture, forestry and telecommunications;
- East Africa: tourism, followed at a considerable distance by telecommunications;
- Central Africa: a few opportunities in mining and quarrying, and forestry;
- Southern Africa: tourism and transport and storage, followed by telecommunications, mining and quarrying, metals and metal products, motor vehicles, food and beverages, pharmaceutical and chemical products and agriculture.

The results of the survey also point to a severe "image" problem for Africa. More than half of the respondents (56 per cent) stated that the actual business environment is better than the continent's image would suggest, in at least some African countries, while a quarter made the same observation about "many" African countries. Only a small minority (6 per cent) thought that in *no* African country is the actual business climate better than the external image. These results call for more efforts on the part of the international community to change the image of Africa and to provide investors with a more differentiated picture of the continent.

When comparing the results of the TNC survey with those of the survey UNCTAD carried out in 1999 among African investment promotion agencies (IPAs), some interesting differences, as well as similarities, come to the fore:

- With respect to the most promising industries, the top ten industries named by TNCs are similar to those named by IPAs. While both mentioned a wide range of industries, TNCs give a little more weight to industries from natural-resource-based industries, such as petroleum and metal, as well as metal manufacturing industries;

- As for the most attractive countries for FDI, the bias towards North African countries and large as well as more developed countries in sub-Saharan Africa is accentuated on the TNC list, while the IPA list also features a number of smaller countries, such as Botswana, Namibia and Mauritius — as well as a least developed country, Mozambique;

- As regards the *positive* determinants influencing investment decisions, while TNCs ranked markets high and efficiency-seeking low, IPAs rated access to global markets, along with the regulatory framework and incentives, much higher;

- The findings concerning the factors that are expected to have a *negative* impact on FDI during the period 2000-2003, largely overlap and coincide: both TNCs and IPAs mention extortion and bribery most frequently as having a negative impact on

FIGURE II.15b

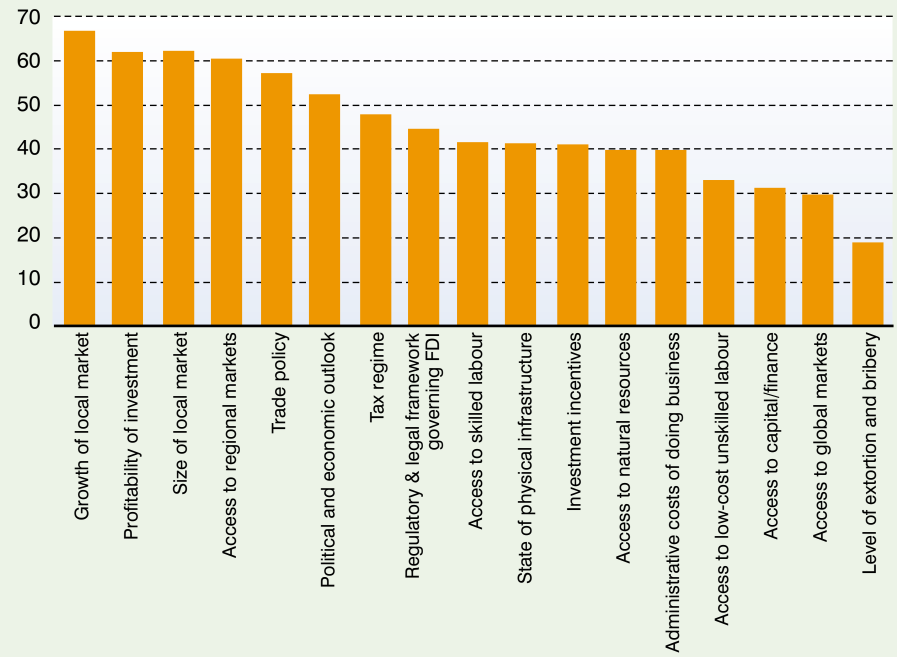
African countries ranked according to their progress in improving the business environment in 2000-2003

(Percentage of replies[a])

Source: UNCTAD/ICC survey conducted in November 1999-January 2000.

[a] Replies as a percentage of responding TNCs.

FIGURE II.16a
Positive determinants for FDI in Africa in 2000-2003
(Percentage of replies[a])



Source: UNCTAD/ICC survey conducted in November 1999-January 2000.

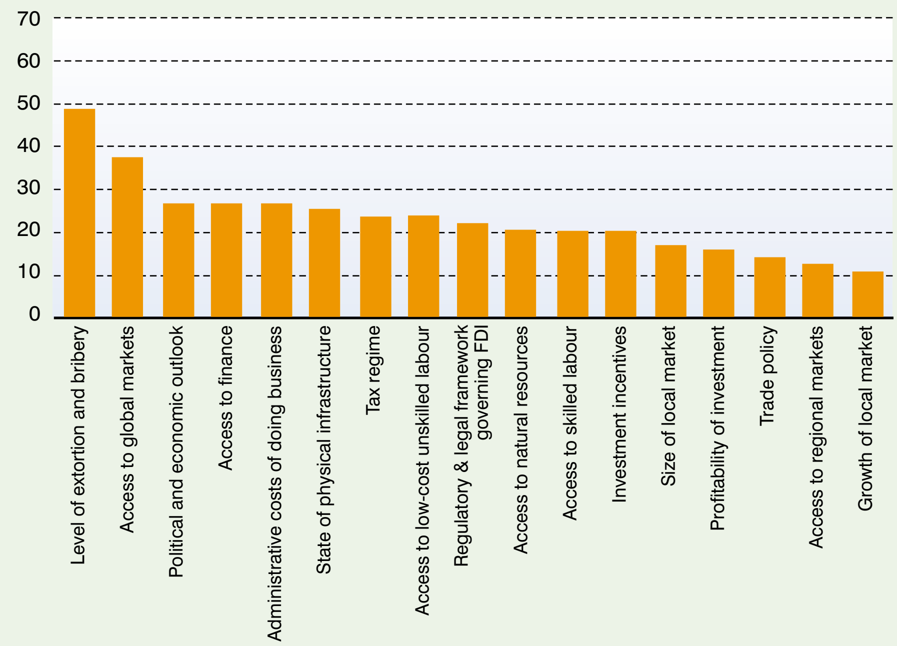
[a] Replies as a percentage of responding TNCs.

FDI in the coming years, and also agree that high costs of doing business, deficiencies in access to capital, and the relatively poor state of the physical infrastructure represent major obstacles.

While there is considerable overlap between the views of TNCs and IPAs, the different perceptions as to the most attractive countries and industries may hint at a certain degree of wishful thinking on the part of the IPAs. TNCs are less inclined to invest in smaller African countries and in globally integrated industries, such as textiles or mechanical and electric equipment, than most IPAs assume.

As for the policy conclusions to be drawn from the survey, many African countries that seek to attract FDI need to continue to improve investment conditions, in particular for efficiency-seeking investment. This includes (apart from general efforts to increase economic and political stability) the reduction of red tape and serious efforts to fight

FIGURE II.16b
Negative determinants for FDI in Africa in 2000-2003
(Percentage of replies[a])



Source: UNCTAD/ICC survey conducted in November 1999-January 2000.

[a] Replies as a percentage of responding TNCs.

corruption, improvement of physical infrastructure and a better-trained workforce. In addition, smaller African countries and LDCs need to accelerate regional integration to create sizeable and attractive markets. At the same time, given the fact that the majority of TNCs think Africa has an image problem, African countries have to make efforts, individually and jointly, to change their image and to persuade investors to differentiate among them. Assistance in projecting a better and more differentiated image of Africa is needed.

Recently UNCTAD has undertaken several initiatives to this effect. Together with the ICC, the Multilateral Investment Guarantee Agency (MIGA) of the World Bank and the United Nations Development Programme (UNDP), it has produced a fact sheet on FDI in Africa, based on the UNCTAD publication *FDI in Africa: Performance and Potential* (UNCTAD, 1999b). Also, jointly with the ICC, UNCTAD is working on a project on investment guides and capacity-building for LDCs, in which guides to Ethiopia and Mali have already been produced and others are to follow. These efforts need to be complemented by efforts on the part of developed countries to liberalize access to their markets for African products. The "African Growth and Opportunity Act", which would *inter alia* guarantee African textile exporters better access to the United States market, is a case in point.[18]

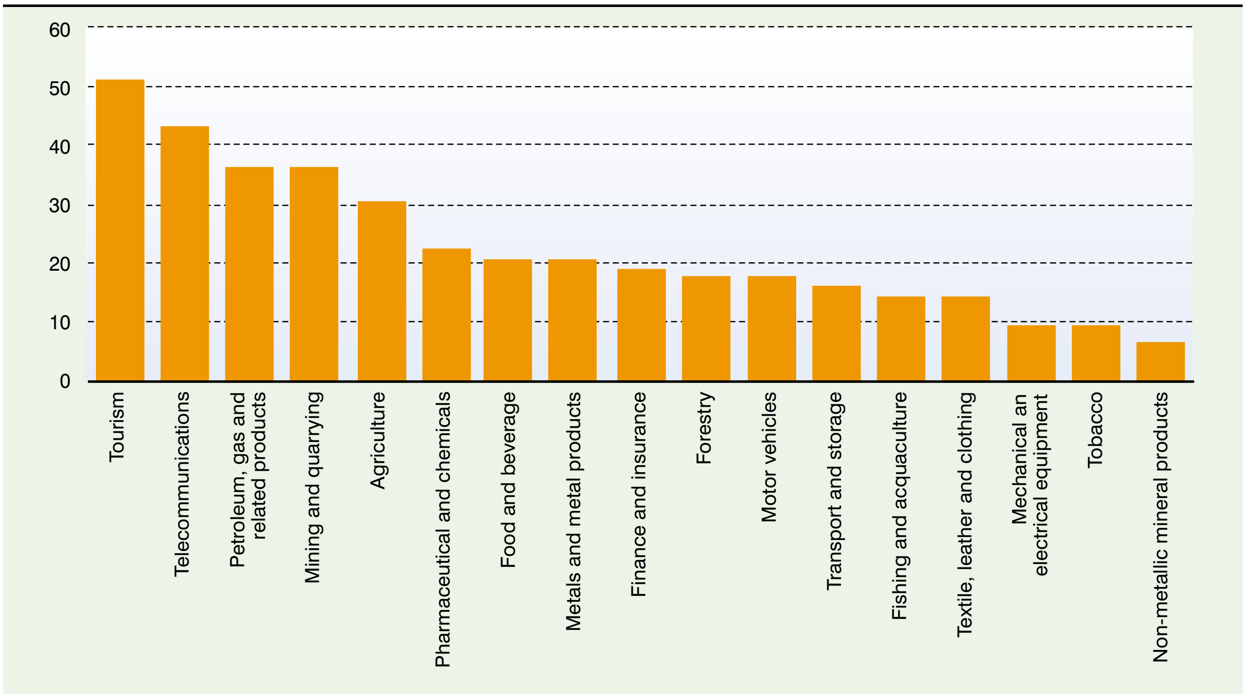
2. Asia and the Pacific

Inflows of FDI to developing Asia (South, East and South-East Asia, Central Asia and West Asia) increased by 9 per cent in 1999, to reach a record level, of $106 billion. This was contrary to the decline that was widely anticipated in the wake of the 1997-1998 financial crisis (figure II.18). This regional increase, however, masks considerable variations in flows to individual countries. China saw a drop of nearly 8 per cent in 1999. Compensating for this were the FDI boom in the Republic of Korea and the recovery of flows into Singapore and Taiwan Province of China (figure II.19). Among the five countries most affected by the crisis, flows declined in the Philippines and Thailand, while increasing

FIGURE II.17

Industries offering the best opportunities for FDI in Africa[a] in 2000-2003

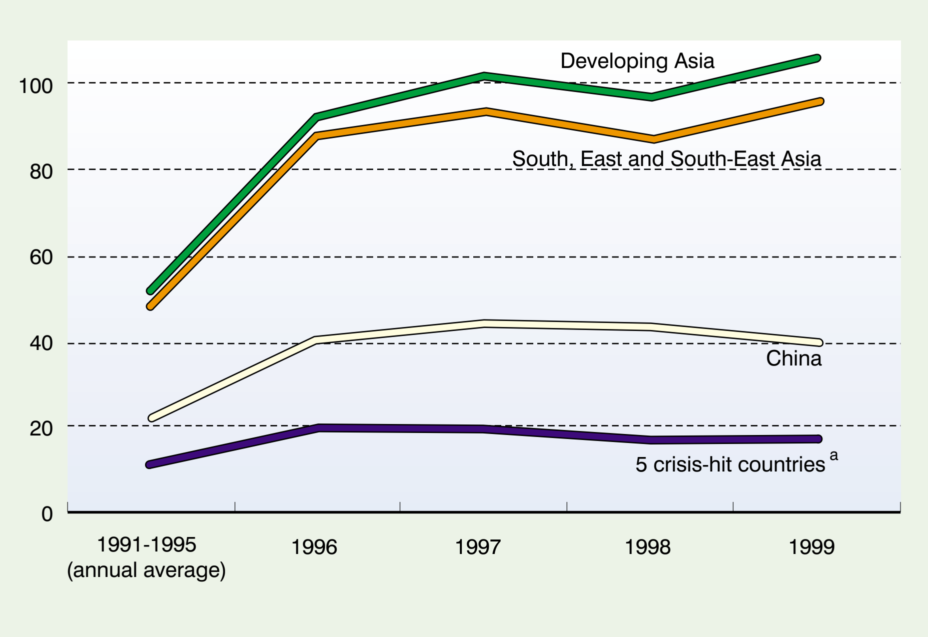
(Percentage of replies[a])



Source: UNCTAD/ICC survey conducted in November 1999-January 2000.

[a] This category is a cumulative expression of the data obtained from the responses of TNCs to the category 'Africa as a whole' and/or to one or more of the following sub-regions: North, Central, East, West and Southern Africa.

FIGURE II.18
FDI inflows to developing Asia, 1991-1999
(Billions of dollars)



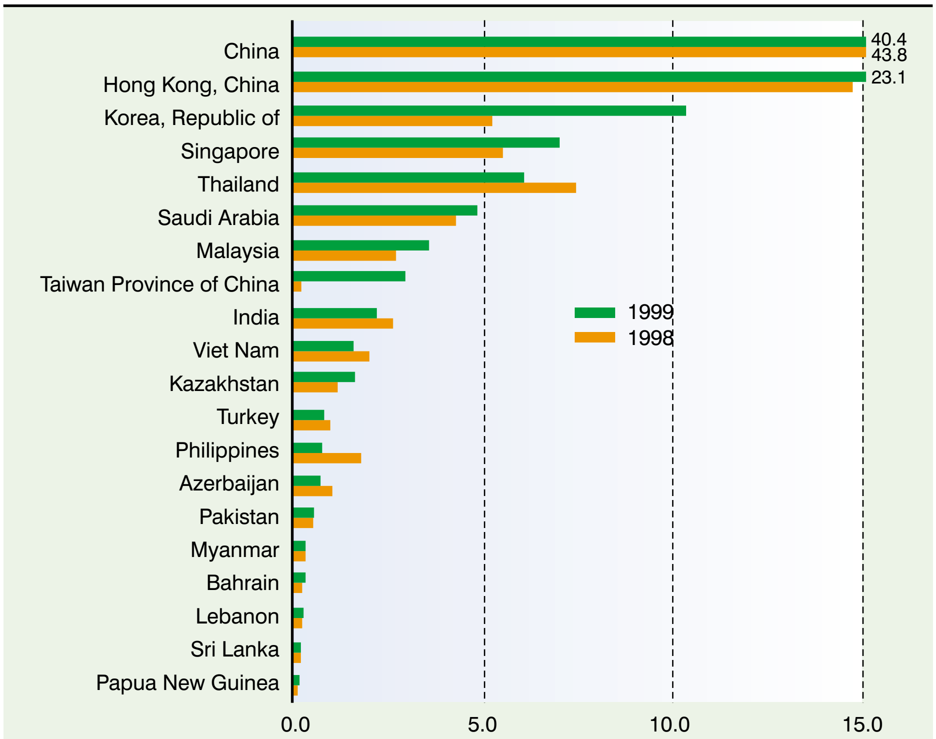
Source: UNCTAD, FDI/TNC database and annex table B.1.

[a] Indonesia, Malaysia, the Philippines, Republic of Korea and Thailand.

significantly in Malaysia and skyrocketing in the Republic of Korea. Indonesia registered a further decrease of FDI flows — negative flows in two consecutive years (annex table B.1). On balance, all five together gained 4 per cent, to reach $17 billion.

Efforts to attract FDI intensified further in most Asian economies. Sectoral liberalization was reinforced by more flexible modes of entry such as cross-border M&As. A number of countries also strengthened their competition policies and authorities with a view towards maximizing the benefits of liberalization. FDI retained its crucial role as a source of development finance for the region, dominating the composition of net private capital flows with over 80 per cent share in the total (World Bank, 2000a). The share of FDI in host countries' gross fixed capital formation continued to increase, particularly in crisis-hit countries (figure II.20).

FIGURE II.19
Asia and the Pacific: FDI *inflows*, top 20 economies, 1998 and 1999[a]
(Billions of dollars)



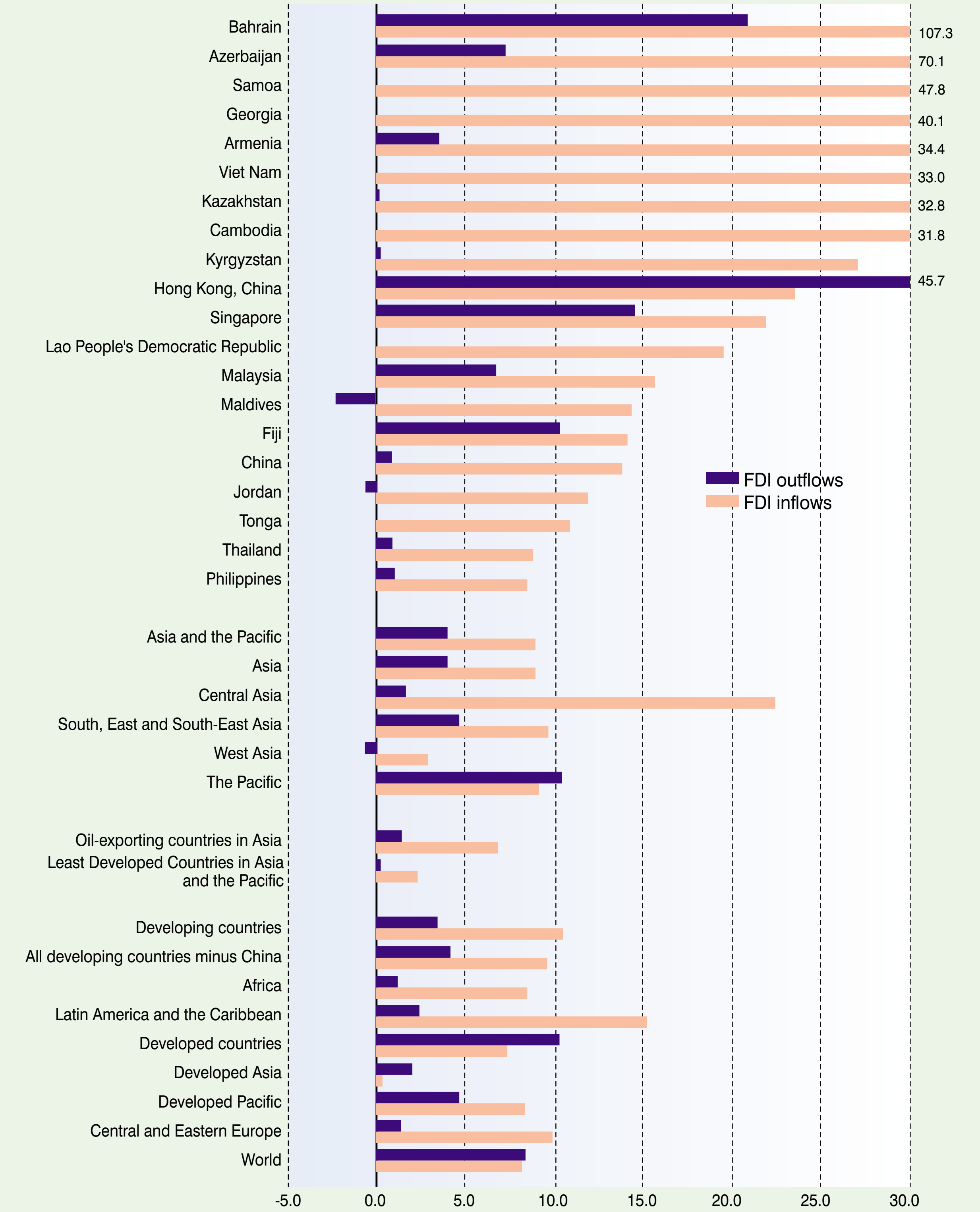
Source: UNCTAD, FDI/TNC database and annex table B.1.

[a] Ranked on the basis of the magnitude of 1999 FDI inflows.

FIGURE II.20

Asia and the Pacific: FDI flows as a percentage of gross capital formation, top 20 economies, 1996-1998[a]

(Percentage)



Source: UNCTAD, FDI/TNC database and annex table B.5.

[a] Ranked on the basis of the magnitude of 1999 FDI inflows as a percentage of gross fixed capital formation.

Cross-border M&As became an important mode of entry in developing Asia. Cross-border M&As in South, East and South-East Asia reached an annual average of $20 billion during 1997-1999, compared to an average of $7 billion during the pre-crisis years of 1994-1996 (figure II.21). The most significant increases occurred in the five crisis-hit countries. Their share of total cross-border M&As in developing Asia jumped to 68 per cent in 1998 compared to 19 per cent in 1996. Cross-border M&As in the five countries as a whole reached a record level of $15 billion in 1999 (figure II.22).

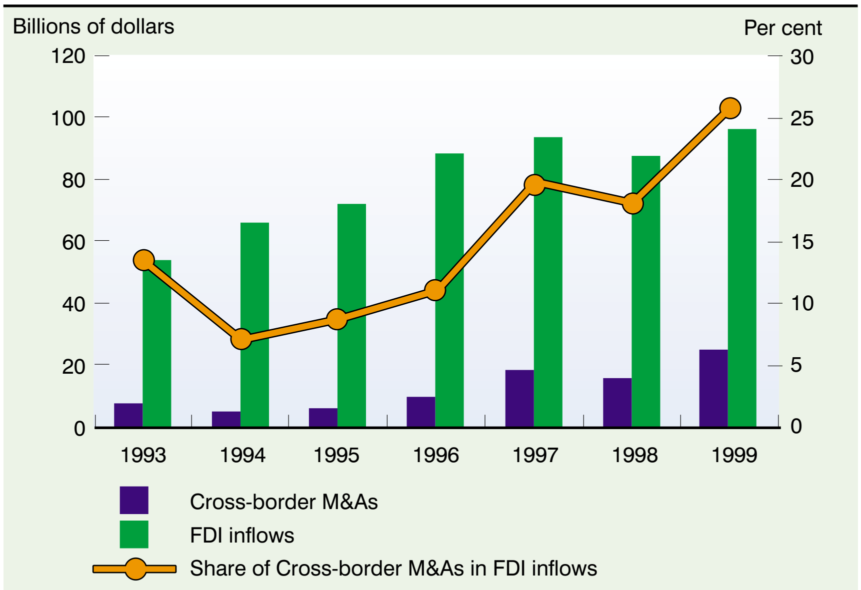
The distribution of cross-border M&As by country of origin saw a significant shift. The United States, the United Kingdom, Singapore and the Netherlands — in that order — were the largest purchaser countries during the financial crisis, and together accounted for nearly half of the total value of all cross-border M&A deals in the five crisis-hit countries during 1998-1999. They overtook Malaysia and Germany among the front-runners before the crisis during 1995-1996 (figure II.23). TNCs from France, the Republic of Korea and Switzerland also accelerated their pace of acquisition.

Two types of cross-border M&As can be distinguished: acquisitions of local firms by new foreign investors and acquisitions of shares in existing joint ventures by the foreign joint-venture partners (Zhan and Ozawa, 2000). The first was encouraged by the low prices of firms when translated into foreign currencies, the new openness to M&As and the favourable long-term prospects of the crisis-affected countries. The second took place either through acquiring more equity from a domestic partner or through buying new issues, motivated by changes in the law or to prevent a joint venture from collapse. Many domestic joint-venture partners were either in serious financial difficulties or had undertaken restructuring, spinning off their non-core businesses. The foreign joint-venture partners were willing to acquire equities held by their local partners, even if they were not immediately profitable. This category of acquisitions accounted for 39 per cent of all M&A deals in the Republic of Korea in 1998. Such acquisitions were also popular in Thailand, typically in component manufacturing in the automobile or electronic-and-electrical-appliances industries.

Within the overall regional trends, the performance of individual sub-regions and economies varied considerably.

China, the principal FDI recipient in developing countries throughout the 1990s, retained its lead, but saw a drop to just over $40 billion in 1999, compared with $44 billion in the previous year (figure II.19). A number of factors help explain this decline. There was a slowdown of economic growth leading to weaker demand. There was excess capacity in certain manufacturing industries due to over-investment during the past decade (e.g. garments and electrical appliances). There was also increasing competition from neighbouring countries. Outward FDI from Asian economies fell. The Government of China was cautious

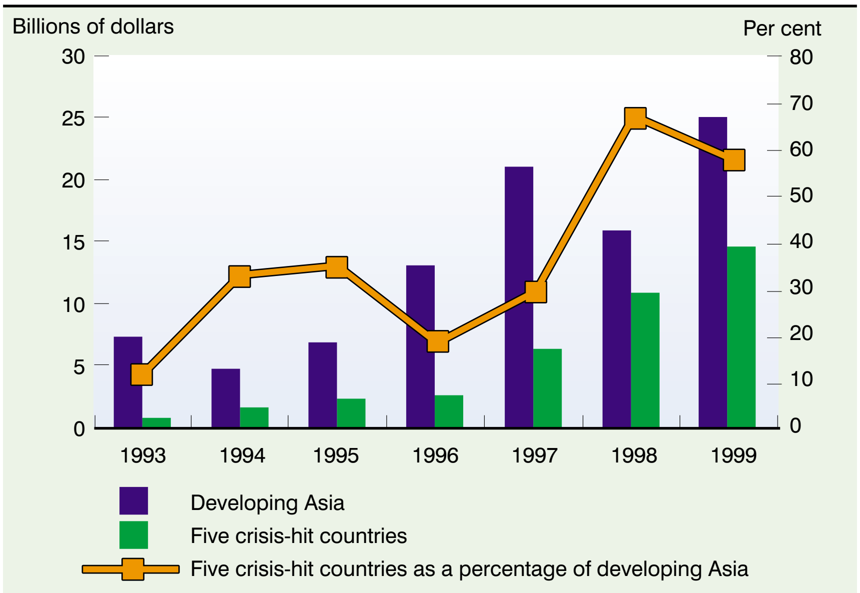
FIGURE II.21
South, East and South-East Asia: cross-border M&As and FDI inflows, 1993-1999
(Billions of dollars and per cent)



Source: UNCTAD, FDI/TNC database and cross-border M&A database, based on data provided by Thomson Financial Securities Data Company.

FIGURE II.22

Cross-border M&As in the five crisis-hit countries[a] and developing Asia, 1993-1999



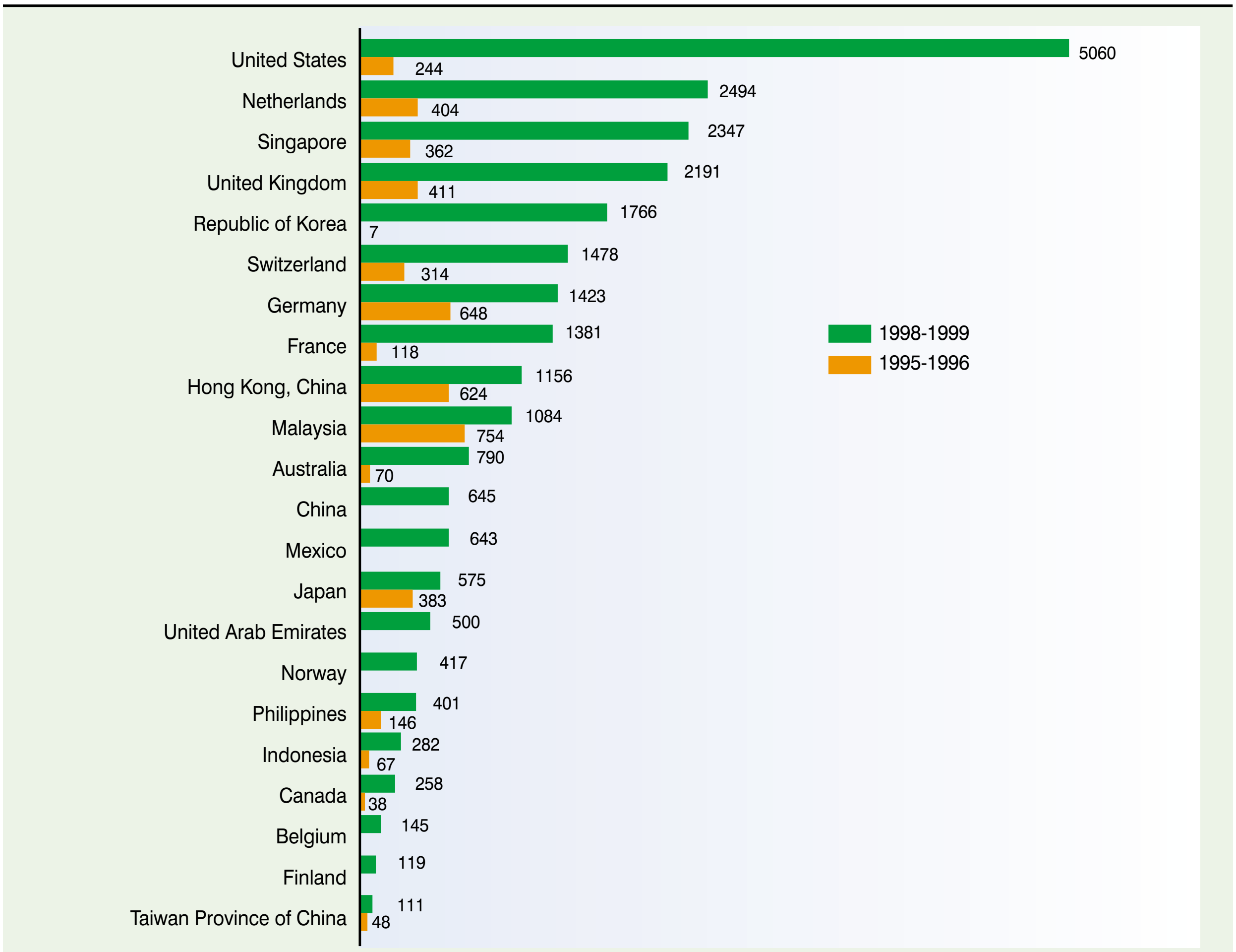
Source: UNCTAD, cross-border M&A database, based on data provided by Thomson Financial Data Company.

[a] Indonesia, the Philippines, Malaysia, Republic of Korea and Thailand.

FIGURE II.23

Cross-border M&A sales in the five crisis-hit countries[a] by selected home economy, 1995-1996 and 1998-1999[b]

(Millions of dollars)



Source: UNCTAD, cross-border M&A database, based on data provided by Thomson Financial Data Company.

[a] Indonesia, the Philippines, Malaysia, Republic of Korea and Thailand.

[b] Ranked on the basis of the magnitude of sales in 1998-1999.

Box II.2. China's accession to WTO: implications for inward FDI

The negotiation process for China's accession to WTO is in its final phase. The fulfilment of the WTO obligations by China will involve substantial trade and investment liberalization. This will have several impacts on FDI flows to China, which will be felt even more strongly once the transition period to the full compliance of WTO standards (2 to 5 years, depending on industries) has been completed.

Implications for FDI in the services sector

China's services sector accounts for one-third of GDP. At present, foreign investors' activities in this sector are largely restricted. Liberalization in the services sector will extend the type of activities permitted, and it will eliminate or reduce geographic and ownership restrictions. Liberalization will gradually allow foreign investors to operate in such service industries as distribution (wholesaling and retailing) and related services (e.g. warehousing, packaging, advertising, and express services); banking and securities; insurance (both life and non-life); information technology services and telecommunications; professional services (e.g. accountancy, management consultancy, legal services, engineering, business related services and computer maintenance); tourism; and motion pictures and audio-visual distribution. China will also participate in the WTO Basic Telecommunications and Financial Services Agreements. Liberalization in the services sector will set the stage for a large-scale participation of FDI in this fast growing sector.

Implications for FDI in manufacturing

China's manufacturing sector is already largely open to foreign investors. It has, indeed, attracted a significant amount of FDI. Therefore, liberalization in the aftermath of China's accession to WTO may not have immediate and substantial investment-creation effects overall. Some changes, however, might reduce the incentive for market-oriented FDI.

Over the past decades, tariff and non-tariff barriers have protected certain key industries in China, such as petrochemicals, automobiles and consumer electronics. Trade liberalization — and particularly a significant reduction in import licensing and quotas could seriously erode the incentive for the "barrier-jumping" type of FDI, as the principal motivation for such FDI comes from a desire to gain access to trade-protected markets by producing within the tariff or quota protected area. The automotive industry is a case in point: tariffs for automobile imports will be phased down from 100 per cent to 25 per cent, and for auto components from an average of 24 per cent to 10 per cent by year 2006. Quotas on automobile imports will be phased out by 2005.

China will also have to bring to an end trade and foreign exchange balancing requirements, as well as local content requirements (under the TRIMs Agreement). Those requirements are part of China's existing industrial policies. The elimination of local content requirements will, on the one hand, facilitate the import of foreign inputs, thereby reducing the incentive for some foreign investors to develop linkages with domestic subcontractors or for foreign suppliers of intermediary inputs to invest in China. On the other hand, it could help insure the quality and reduce the cost of the final products of foreign affiliates, therefore increasing their competitiveness in international markets, the abolition of trade and foreign exchange balancing requirements may reduce the pressure on some foreign affiliates to exports.

Imports / exports undertaken by foreign affiliates accounted for nearly half of the country's total trade in the past few years. With an improved external environment for exports and increased opportunities for the global sourcing of raw materials and intermediary goods, the share of foreign affiliates in China's trade is expected to increase even further in the light of the country's accession to WTO.

In addition, China has agreed to eliminate some other FDI entry requirements. In particular, it will no longer make the approval of projects contingent on specific requirements related to technology transfer and conducting R&D in China. This may generate additional FDI, but may not necessarily enhance the country's development.

Other implications for FDI

Through the process of its accession to WTO, China has further committed to integrate itself into the global economic system. This will boost foreign investors' confidence, as well as improve the overall investment environment.

/...

in opening service industries to FDI.[19] Most of these are short-term factors. In the longer run, China can be expected to remain an attractive location for FDI, particularly in the light of its expected accession to the WTO (box II.2) and a further liberalization of its services sector.

In *East Asia* (Hong Kong (China), the Republic of Korea; and Taiwan Province of China), FDI flows increased by nearly 80 per cent in 1999. In the Republic of Korea FDI reached another record level (it nearly doubled), over $10 billion, four times its pre-crisis level (1996). The recent liberalization of FDI policies led to higher M&A-driven FDI growth. The Government's public-sector reforms and its urgent need to supply financing at the time of the crisis led to large-scale privatization — another important attraction for foreign investors. The Republic of Korea is now being integrated more tightly into the regional and global production networks of TNCs. Inflows to Taiwan Province of China recovered to $2.9 billion from their exceptionally low level of $222 million in 1998. In Hong Kong (China), the second largest recipient in the region, FDI increased significantly over the period of 1998-1999. Its inflows reached a record level of $15 billion in 1998 and $23 billion in 1999.[20] In 1998, large inflows came from overseas tax-haven economies; some of the increase might be attributable to returning investment by foreign and Hong Kong domestic investors, which flew out before the return of Hong Kong to mainland China. As investors' confidence in Hong Kong's future gradually recovered, they

(Box II.2, concluded)

In turn it encourages longer-term investment commitments by foreign investors in the Chinese market. For instance, the relaxation of restrictions on foreign participation in terms of equity share in a number of industries (e.g. automobile, distribution, construction, hotel) will not only attract new investors, but also enable foreign joint venture partners to increase their equity shares in existing affiliates.

China will probably phase out preferential tax policies, following its accession to the WTO – in an effort towards levelling the playing field for foreign and local companies alike. Although this may not affect those foreign affiliates already operating in China, newcomers would be entitled to fewer fiscal incentives.[a] Foreign investors will be faced with fiercer competition in the Chinese market, as the market becomes more contestable due to the dramatic liberalization in investment and trade. Furthermore, the rise of domestic firms increases competitive pressures on foreign affiliates. This has been a widespread phenomenon in a number of manufacturing industries, such as garments, toys, travel goods and electronic and electrical appliances in recent years, where, following the "lost decade" between the mid-1980s and mid-1990s, domestic producers are gradually regaining market shares. In the services sector, Chinese firms have long-established business networks and infrastructure. As cross-border M&As are not yet encouraged in China, partnerships with domestic players would be the best way for a quick start-up and immediate access to the existing domestic business networks.

In conclusion, China's accession to WTO will make China more attractive for FDI. The services sector may well replace the manufacturing sector as the engine of FDI growth; within the manufacturing sector, foreign affiliates in China will most likely undergo a process of consolidation in response to the development of a more competitive landscape in the country. As foreign investors may adopt a wait-and-see approach until the new reforms are in place and liberalization is fully implemented, in the short-term, however, FDI may remain at a level close to the one achieved in recent years. In the medium-term, however, another FDI boom may well be forthcoming, with FDI flows perhaps reaching an annual level of over $60 billion. If cross-border M&As should be permitted, annual inflows could even reach $100 billion.

Source: Based on Zhan, forthcoming.

[a] Under the current law, all corporations in China are taxed at the flat rate of 33 per cent; but, after various deductions, most foreign affiliates pay only around 15 per cent. In special economic zones, foreign affiliates have been enjoying an even lower rate.

responded to the need for capital injections in the light of the financial crisis. In 1999, however, investments were mainly in the form of reinvested earnings, which accounted for over half of the total FDI.[21] This was mainly due to the distinct turnaround in local economic activity, with investment earnings of foreign affiliates doubling that year.

In *South-East Asia (ASEAN 10*), FDI decreased by 17 per cent in 1999. Flows of FDI to Thailand dropped 18 per cent, to $6.1 billion, due in part to the flattening of the wave of massive recapitalizations in the banking industry, which had reached exceptionally high levels in 1998. Manufacturing continued to attract considerable FDI to Thailand. Singapore was again the largest FDI recipient in this sub-region; inflows into the country increased by 27 per cent, to $7 billion. Flows to Malaysia ($3.5 billion) increased by 31 per cent in 1999. The Philippines experienced a decline and its overall level of inflows is still relatively low compared with some other economies in the region. Divestment continued in Indonesia, about $3 billion in 1999. Countries whose primary sources of FDI have been other countries in the region continued to suffer from the negative effects of the crisis – e.g. Viet Nam and Myanmar. Growth of inflows to Asian LDCs as a whole remained sluggish in 1999.

In *South Asia,* FDI in 1999 declined by 13 per cent to $3.2 billion, and $1.7 billion lower than the peak level of 1997 ($4.9 billion). Inflows to India, the single largest recipient in the sub-region, were $2.2 billion. The ongoing liberalization of FDI policies is expected to raise inflows in the years to come. FDI to Bangladesh declined after increases in the previous two years. Inflows to Pakistan and Sri Lanka remained at a very low level. In the longer term, the sub-region has considerable potential. Its realization will depend very much on the pace of liberalization and economic reform, as well as on domestic and regional stability.

Inflows of FDI to *West Asia* continued their upward trend in 1999, following their recovery in 1997 and 1998. Inflows to the sub-region reached $6.7 billion, an 8 per cent increase over 1998. The large increases in FDI since 1997 have gone mainly to Saudi Arabia, by far the single largest recipient in that region. Tourism, electrical and electronic plants, and various high-technology industries were particularly attractive. Recent improvements in the macroeconomic and political environment in the region, combined with the opening up of the oil industry to foreign investors, particularly in Kuwait and in Saudi Arabia (box II.3), are likely to mean larger flows to the region. Similarly, Kuwait is seeking to attract international oil companies to invest up to $7 billion to develop oil fields close to the border with Iraq. A large number of international oil companies have already expressed their strong interest to invest in the upstream part of the oil industry in both Kuwait and Saudi Arabia. Saudi Arabia has also been attracting foreign investors to invest in its rapidly growing power industry under build-operate-own and build-operate-transfer schemes. The Government of the Islamic Republic of Iran decided to allow foreign oil and gas companies to develop its natural resources for the first time since 1979. The development of further phases of South Pars valued at $1.5 billion is on the way with foreign companies.[22]

Central Asia lost the FDI momentum it had enjoyed at its initial stage of liberalization and reforms. Inflows to the sub-region in 1999 were slightly lower than in 1998 ($2.8 billion). The share of the two leading recipient countries (Kazakhstan and Azerbaijan) increased further, from about 70 per cent in 1998 to over 80 per cent in 1999. The share of oil and gas in FDI inflows in both Kazakhstan and Azerbaijan rose to 80 per cent. Other industries in these countries, and the other (non-oil) economies of the region, fared much worse, due to problems of transition (in Uzbekistan and Turkmenistan) and to bleak economic prospects.

After two to three years of subdued FDI flows to the *Pacific Island* economies, partly due to spillover effects of the financial crisis, a turn-around in business sentiment seemed to have emerged in 1999. Inflows are estimated at $248 million, a $17 million increase over the 1998 level. Papua New Guinea accounts for the bulk of FDI inflows to the sub-region (more than two-thirds in 1999), owing to its large-scale development in mining and petroleum. The opening of a stock exchange in April 1999 for the trading of large companies may attract some foreign investors.[23]

Looking ahead, the investment prospects for developing Asia remain bright, given the quality of the underlying economic determinants of FDI, the rapid recovery of the region from the financial crisis, and the ongoing liberalization and restructuring efforts that are now widespread in the region.

Box II.3. A new FDI law in Saudi Arabia

In recent years, a fundamental change of attitude towards the role of the private sector has emerged in a number of oil-exporting countries in the Middle East, including as regards the role of FDI in development. The countries of the Middle East are, however, at different stages of integrating FDI into their development, particularly when it comes to the petroleum industry. The Islamic Republic of Iran and Kuwait have either already signed contracts with foreign oil companies or are contemplating moves to allow foreign participation in this industry. Saudi Arabia, the world's biggest oil producer and exporter, has established a General Investment Authority and introduced in April 2000 a new foreign investment law aimed at improving the investment climate and attracting FDI. The newly created Authority is expected to establish a one-stop-shop for foreign investors to speed up the process of approving investment projects. The new law provides incentives to court long-term investment, including by reducing the top rate of corporate profits tax on foreign companies from 45 per cent to 30 per cent (the same as for national companies).

International oil companies have already been invited to submit proposals for investment in the Kingdom following negotiations with 12 of them. As a result, project proposals containing investments worth more than $100 billion over a period of 20 years have been received.[a] These projects are expected to be reviewed and finalized before the end of the year. Although details are not known, the main focus is on natural gas development, processing and distribution and other associated projects involving the use of gas as a feedstock for petrochemical plants and as a fuel for power generation and water desalination plants. Notwithstanding these reforms, the Government has made it clear that the upstream part of the oil industry, i.e. exploration and production, would remain off limits to foreign investment.

Source: UNCTAD.

[a] Middle East Economic Digest, 19 May 2000, p.19.

Outward FDI from developing Asia and the Pacific recovered from its recession since the onset of the financial crisis, but is still lower than the pre-crisis level. Outflows increased by nearly two-thirds in 1999, to an estimated $ 37 billion (annex table B.2). Hong Kong (China) remained the major outward investor, accounting for over half of the total outflows from the region. Nevertheless, its outflows to China, where it is still the largest investor, have been declining over the past few years (figure II.24). Divestment by Asian TNCs, particularly in the United States and Europe, also increased in 1999.[24] Two types of such divestment could be observed. One is that Asian TNCs sold their existing overseas businesses; the other is that parent firms were acquired by a foreign TNC and, subsequently, the overseas affiliates of the acquired firm were taken over by the acquirer. Such divestment does not necessarily imply that foreign affiliates are in an unhealthy state; they may be more a function of corporate restructuring and financial difficulties. Even within the region most Asian TNCs have been unable to take advantage of the cheap assets available. The exceptions are TNCs based in Hong Kong (China), Singapore and Taiwan Province of China, which managed to maintain their financing strength to engage in such activities, mostly in neighbouring countries.

As noted in *WIR99* (UNCTAD, 1999a), Asian TNCs are likely to continue their inward focus on restructuring and spinning off non-core activities. The revitalization of their outward investment may take some time.

3. Latin America and the Caribbean

Aggregate FDI *inflows* to Latin America and the Caribbean continued to expand in 1999 to reach a new record of $90 billion, nearly a quarter higher than in 1998. A significant part of FDI flows came through M&As. As in preceding years, FDI had an important stabilizing effect on the region's balance of payments, more than offsetting the $56 billion current account deficit posted in 1999.[25]

Changes in the distribution of FDI within the region point to an apparent paradox: inflows into the relatively stagnant South American sub-region increased by 40 per cent, while inflows into the faster-growing Mexican and Caribbean Basin economies declined somewhat. As a result, the share of South American countries in the region's FDI inflows increased from 70 per cent in 1998 to 80 per cent in 1999. This above-average growth in FDI inflows to South America in 1999 does not necessarily reflect a permanent change in the composition of inflows to the region. It can be explained by a few very large acquisitions in the southern cone by Spanish TNCs (box II.4). If these operations are excluded, FDI flows into South America would have been about the same as in 1998, consistent with overall regional trends.

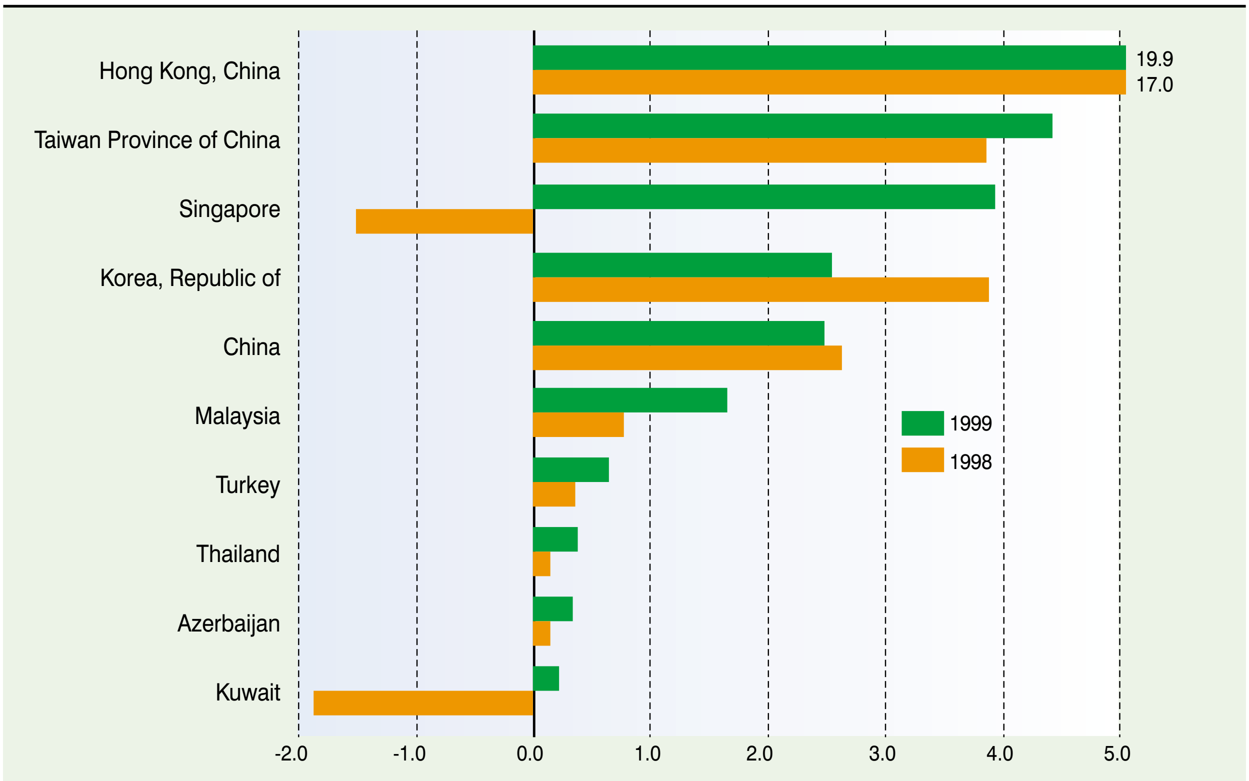
The MERCOSUR countries (Argentina, Brazil, Paraguay and Uruguay, with Bolivia and Chile as associates) increased their weight in total Latin American FDI inflows in 1999. Among them, despite economic stagnation and the instability surrounding the flotation of its currency in January 1999, Brazil continued for the fourth year to be the regional leader with around $31 billion of inflows in 1999 (figure II.25). This was close to the level registered in 1998 and equivalent to more than one-third of the regional total. In terms of FDI inflows as a percentage of gross fixed capital formation, however, Brazil is not ranked among the top 20 countries (figure II.26).

Most new inflows continued to go into non-tradable service and manufacturing industries producing mostly for domestic markets. As regards modes of investment, in contrast to 1998, a relatively low proportion of inflows went into the acquisition of state enterprises. Total privatization operations involving foreign M&As decreased from over $29 billion in 1998 to $21 billion in 1999 (annex table A.IV.22). Large amounts of new resources went instead into the restructuring of previously acquired service companies, mostly in telecommunications. The acquisition of private companies through M&As also gathered pace.

FIGURE II.24

Asia and the Pacific: FDI outfows, top 10 economies, 1998 and 1999[a]

(Billions of dollars)



Source: UNCTAD, FDI/TNC database and annex table B.2.

[a] Ranked on the basis of the magnitude of 1999 FDI outflows.

Box II.4. Consolidation strategies of Spanish firms

One of the most important developments in Latin America in the late 1990s has been the strong surge in the acquisitions of private companies by Spanish TNCs in the services sector, reflecting an effort by these companies to consolidate their competitive position in the region. Large Spanish companies clearly favoured Latin America for their international expansion throughout the 1990s, with a significant impact on the region's capital stock. Seven large Spanish companies — *Telefónica* (telecommunications), *Endesa España* (electricity), *Repsol* (oil and natural gas), *Iberdrola* (electricity), *Banco Bilbao Vizcaya Argentaria* and *Banco Santander Central Hispano* (banking) and *Iberia* (air transport) — accounted for over $50 billion of investment in Latin America between 1991 and 1999. As a result, investment in Latin America in 1999 accounted for around 40 per cent of *Endesa España's* total assets, and over 30 per cent of the assets of *Telefónica* and *Banco Bilbao Vizcaya Argentaria* and *Banco Santander Central Hispano*.

The largest M&A operation by a Spanish company in Latin America in 1999 was the acquisition by *Repsol* (Spain's largest company) of Argentina's oil giant *Yacimientos Petrolíferos Fiscales* (YPF). This operation started in January 1999 when *Repsol* acquired from the Government a 15 per cent share in YPF for $2 billion, followed in April 1999 by the purchase of the remaining 85 per cent of YPF for almost $13.2 billion (annex table A.IV.4). With this acquisition, *Repsol* became the largest operator in Argentina's oil industry and prepared itself for further expansion into the rest of the region. Soon after this, the company announced plans for an aggressive expansion into the oil industries of Brazil, Chile and Mexico, with investment plans of $7 billion before 2002.

The second largest operation by a Spanish TNC in the region during 1999 was the acquisition by *Endesa España* of majority control in the Chilean electricity holding *Enersis* for a total amount of about $3.5 billion. *Endesa España's* involvement in the region started in Argentina in 1992 and extended over the decade to Brazil, Colombia, Chile, the Dominican Republic, Peru and Venezuela (largely through its participation in privatization operations). In 1997 it entered into a strategic alliance with *Enersis* (which has a strong presence in the region), by buying a 29 per cent stake in it. Differences between the management of the two companies led *Endesa España* to obtain majority control in 1999. *Endesa España*, now the largest regional operator in the electricity industry with investments of over $8 billion and over 25 million customers, plans to restructure and consolidate its regional holdings under the umbrella of *Enersis* so as to improve its overall regional competitiveness.

Telefónica's strategy in the region is similar. It first became involved in the region in 1990 in Argentina and Chile, and continued its expansion through participation in privatization programmes in Brazil, El Salvador, Guatemala, Peru, Puerto Rico and Venezuela. By 1999, it had accumulated investments in the region of over $10 billion and a customer base of 49 million. In 1998, *Telefónica* had the largest consolidated sales of TNCs in Latin America. The company's strategy today is to consolidate operations and use its extensive regional base for expansion into new businesses. The simultaneous launch of its internet operation *Terra Networks* in most countries of the region in 1999 demonstrates the competitive edge it has obtained from its combined regional operations. *Terra Networks* is rapidly becoming a leading internet provider in Latin America, and the price of its stocks tripled during their first trading day on the Madrid and New York exchanges in November 1999. Plans for further expansion over the next two years include substantial investments in fixed and mobile telephones, as well as in cable television and the internet.

Spanish banks have also penetrated financial industry markets in Latin America. *Banco Bilbao Vizcaya Argentaria* and *Banco Santander Central Hispano* are the most aggressive banking acquirers. The strategy of Spanish banks is to deepen their core activity — commercial banking as well as investment banking and pension fund management — rather than to provide financial services for non-financial firms to expand their internationalization. Examples include the acquisitions of *Banco Excel Economico* (Brazil) and *Banco Santa Cruz* (Bolivia) with values of $0.9 billion and $0.2 billion, respectively, in 1998.

These examples point to some important common features. Large Spanish companies mostly started and expanded in the region through participation in privatization programmes. They are now also acquiring private companies and expanding into new areas. The strategy is marked by a regional rather than a national perspective.

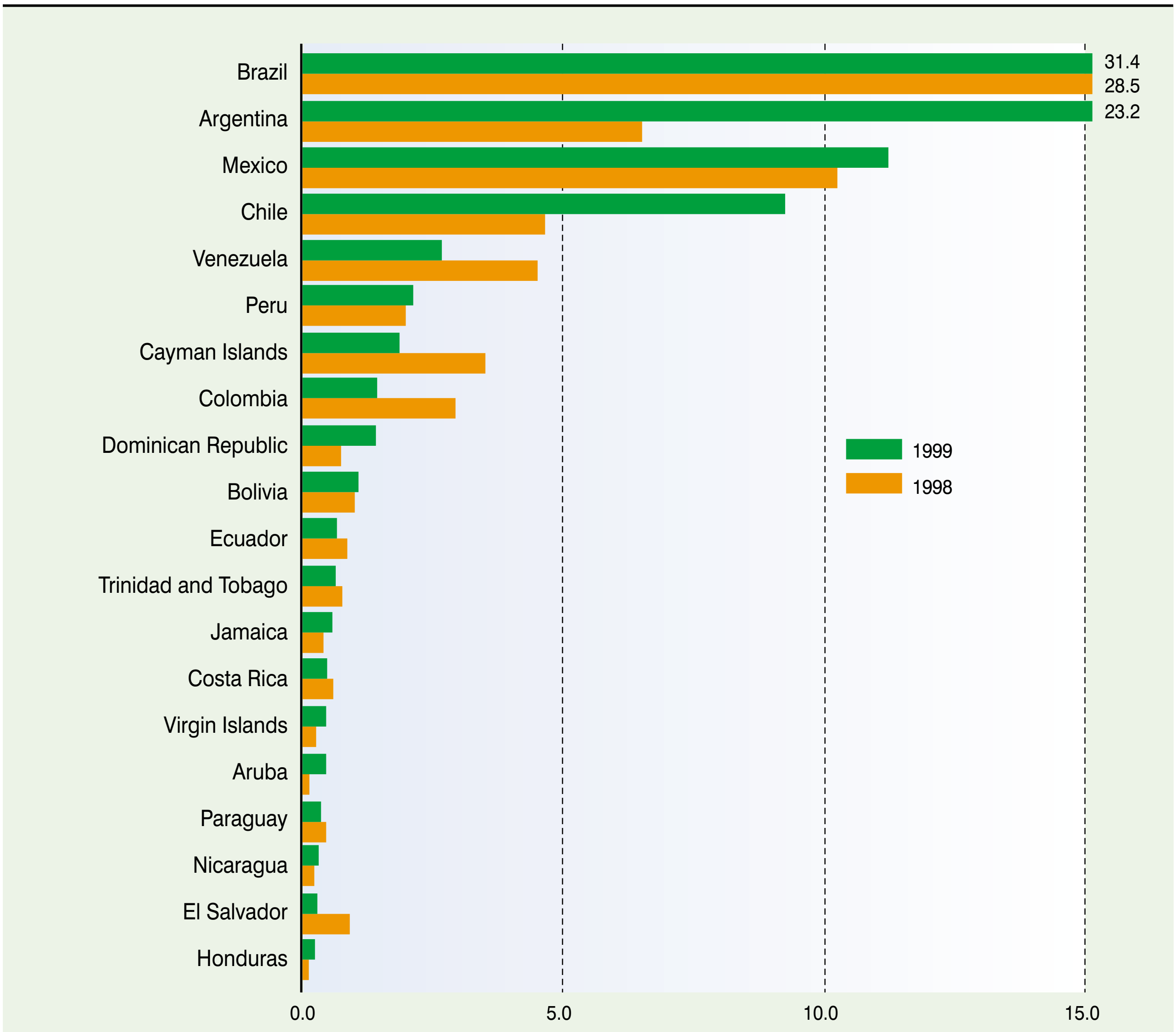
Source: UNCTAD, based on ECLAC, 2000 and UNCTAD, cross-border M&A database.

Argentina more than tripled its 1998 level of FDI inflows, to reach $23 billion. The country replaced Mexico as the second largest regional recipient in the region. Though precise figures for the share of privatization-related FDI in total FDI are difficult to calculate (see chapter IV), it is clear that privatization contributed significantly to the increase of FDI inflows into Argentina: in 1999, the Spanish TNC Repsol acquired the oil company Yacimientos Petrolíferos Fiscales (YPF) for over $13 billion (box II.4). The case of Chile is similar. That country increased its relative importance as a host country significantly, almost doubling its total receipts to more than $9 billion in 1999. This was largely the result of the acquisition of the Chilean electricity generator and distributor Enersis-Endesa Chile by the Spanish TNC Endesa España for $3.5 billion (ECLAC, 2000).[26] As in recent years, most FDI in both countries was concentrated in services (including energy) and natural-resource-intensive activities. Among the smaller countries in the southern cone, Uruguay, which has promoted itself as a regional headquarters location for MERCOSUR, received levels of FDI higher than those of 1998, while inflows into Paraguay, which suffered from political and financial instability, fell by more than a quarter from 1998.

FIGURE II.25

Latin America and the Caribbean: FDI *inflows*, top 20 economies, 1998 and 1999[a]

(Billions of dollars)



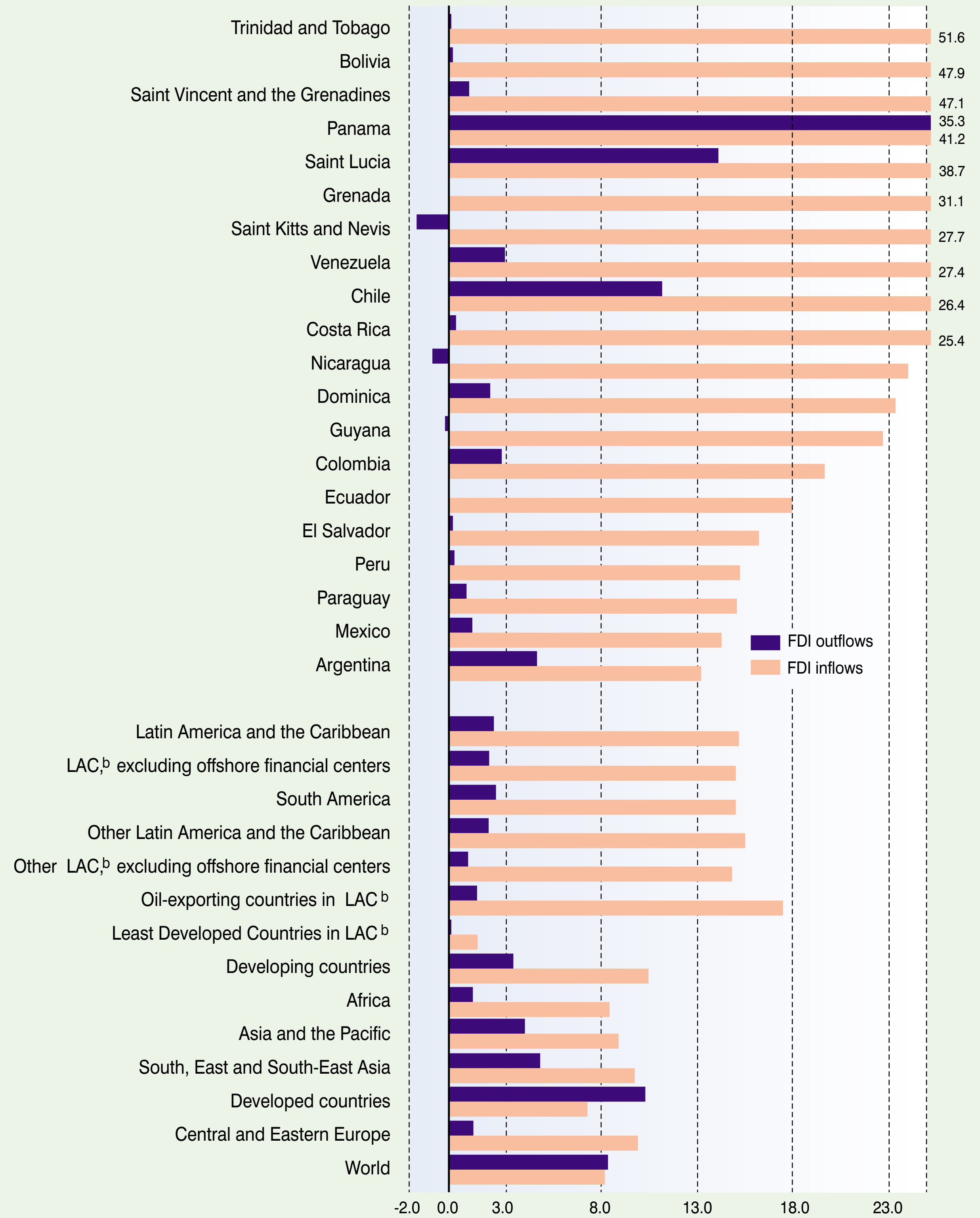
Source: UNCTAD, FDI/TNC database and annex table B.1.

[a] Ranked on the basis of the magnitude of 1999 FDI inflows.

FIGURE II.26

Latin America and the Caribbean: FDI flows as percentage of gross fixed capital formation, top 20 countries, 1996-1998[a]

(Percentage)



Source: UNCTAD, FDI/TNC database and annex table B.5.

[a] Ranked on the basis of the magnitude of 1996-1998 FDI inflows as a percentage of gross fixed capital formation.
[b] Latin America and the Caribbean.

Within the Andean Community (Bolivia, Colombia, Ecuador, Peru and Venezuela), Bolivia and Peru maintained relatively stable levels of FDI inflows of $1.0 billion and $2.1 billion, respectively. The other three countries, experiencing political and institutional instability, suffered a sharp contraction. In Colombia, the insecurity associated with guerrilla activity, high levels of crime and economic difficulties contributed to large levels of disinvestment. As a result, FDI inflows fell from $2.9 billion in 1998 to around $1.4 billion in 1999. Venezuela, affected by a severe economic crisis and undergoing a process of radical institutional change, experienced a fall from more than $4 billion in 1998 to $2.6 billion in 1999. Inflows of FDI into Ecuador, which suffered from a deep economic and political crisis in 1999, fell by a quarter to around $636 million.

In the Northern end of the region, Mexico received $11 billion in 1999, close to the average of the 1995-1998 period. As in the past, FDI continued to be directed mainly to the manufacturing sector for exports, contributing to the rapid expansion of this sector: Mexico's exports to the NAFTA market (Canada and the United States) increased more than five-fold during the period 1990-1998 (UNCTAD, 2000c). This process, initially led by TNCs from the United States, has been increasingly sustained by the involvement of European and Asian TNCs investing in Mexico to comply with NAFTA rules of origin. The free trade agreement concluded between Mexico and the European Union could have similar effects in terms of FDI inflows. Under-capitalization and under-provision in some service industries (including energy and infrastructure), combined with changes in regulatory frameworks are attracting investors in banking, commerce, telecommunications and energy among other industries. These industries still receive relatively small amounts of FDI, but may provide significant investment opportunities in coming years.

Flows of FDI into the smaller economies of Central America and the Caribbean (excluding offshore financial centres) went into assembly operations for re-export during most of the decade. In recent years, there has been an explicit effort in some of these countries (particularly Costa Rica and the Dominican Republic) to upgrade their manufacturing and export base by attracting investment in high-technology industries. These involve higher levels of domestic value added, particularly in human capital, and can generate large positive externalities in the domestic economy. Costa Rica has been particularly successful in this respect, and high-technology products and components produced largely by the United States TNC Intel generated over 40 per cent of total exports in 1999.[27] As the privatization and concessions processes have gathered pace in recent years in some of these countries, investments in manufacturing operations have been complemented by inflows going into services (including infrastructure). During 1998-1999, foreign investors participated in the privatization of electricity services in the Dominican Republic, El Salvador and Guatemala, telecommunications in El Salvador and Guatemala, and won airport concessions in Costa Rica and the Dominican Republic.

Direct investors seemed indifferent to short-term macroeconomic difficulties in countries with relatively stable institutional and policy frameworks, such as Argentina, Brazil, Bolivia, Chile or Peru. Long-term growth prospects in these countries were not substantially affected by their recent economic slowdown. Investors in the region took a long-term perspective. In contrast, investors reduced their involvement in countries with unstable institutional frameworks, such as Paraguay, Colombia, Ecuador and Venezuela. Given the investment potential of these countries (particularly in the oil industry in the case of the Andean countries), inflows should resume rapidly as stability and predictability increase.

There is an interesting difference between the role and structural consequences of FDI in Mexico and the Caribbean Basin countries and most other Latin American countries. Recent FDI in South America has tended to concentrate in non-tradable services, manufacturing for local markets and natural-resource-intensive activities. It has thus not helped much to transform the export structure of these countries, highly concentrated on natural-resource-based commodities. In Mexico and in some Caribbean Basin countries, in contrast, manufacturing TNCs have used the region as a production and export platform for the North American market. They have transformed the competitive position of the host economies and are shifting their production and trade structures towards exports in dynamic automobile, electronics and textile industries.

As regards the modes of entry in Latin America and the Caribbean, cross-border M&A sales reached $37 billion in 1999 (annex table A.IV.6), a $27 billion decline from the previous year due to the slowdown of privatization in much of the region in 1999.

The southern cone countries were the most advanced in privatization in the region. In value terms, privatization in 1998-1999 was concentrated in Argentina and Brazil (annex table A.IV.21): these two countries accounted for more than four-fifths of all privatization operations involving foreign firms during this period in the region. In 1999, the most important operation in Argentina was the sale of a residual of public participation in the ownership of YPF (box II.4) to Repsol. Argentina had three privatization deals involving foreign TNCs in that year. In Brazil, following the large sale of Telebras in 1998, the largest privatization deal was the sale of a gas distribution company in São Paulo (Cia de Gas do Estado de São Paulo) for almost $1 billion to United Kingdom investors in 1999. There were sales of some regional electricity generators to United States and European companies. Chile sold two large sanitary and water companies (Empresa Metropolitana de Obras Sanitarias and Empresa de Servicios Sanitarios) to Spanish firms in 1999.

Partially reflecting economic and political difficulties, privatization in the Andean group was very low in 1999. Only Peru, Ecuador and Venezuela had privatization operations involving $100 million or more. The Government of Peru sold concessions for the development of electricity-generating capacity to a Brazilian and a Swedish company; Venezuela sold the concession for some oil fields to the Chinese National Petroleum Corporation; and Ecuador sold a concession for electricity-generation to a Finnish corporation. In Mexico, the only operations of more than $100 million in 1999 involved the concession of airport services to TNCs from Denmark, France and Spain. Central American countries started relatively late with their privatization processes, and the total amount of FDI raised through privatization reached only about $2 billion in 1999 — a level very similar to that registered in 1998 (ECLAC, 2000).

The interest shown by extraregional TNCs in the acquisition of leading Latin American private companies in recent years has also had consequences on the internationalization of the region's companies, partially reversing the process of intraregional investment observed earlier in the decade. The cases of YPF and Enersis illustrate this trend (box II.4). With its acquisition of YPF in 1999, *Repsol* was not only aiming at the market of Argentina but, through the holdings of YPF in other South American countries, positioned itself to penetrate in the region at large. The operation thus may have truncated an incipient process of internationalization of the company in Argentinean hands. The case of *Enersis* in Chile is even more striking. The Chilean holding company had developed through the 1990s one of the most successful processes of intraregional expansion by a Latin American company, acquiring important interests in the electricity industries of Argentina, Brazil, Colombia and Peru. The acquisition of a controlling stake in the company by *Endesa España* will serve to consolidate this process of regional expansion, but not as part of intraregional investment. More generally, Latin American companies — which expanded through the region in the 1990s and fostered the process of intraregional investment — seem to be facing increasing difficulties to compete with leading extraregional TNCs, which have found in the acquisition of these Latin American firms a platform for their own regional expansion.

TNCs based in Latin America have engaged in *outward* investment. Bermuda was the largest home country in 1999, followed by Chile, Virgin Islands, Brazil and Argentina (figure II.27). Much of outward FDI originating in this region is intraregional. For example, more than 70 per cent of outward FDI stock from Colombia is concentrated in the region. Traditional investors such as those based in Brazil and Mexico, however, do invest in countries other than those in the region: in 1999, three-quarters of M&A deals made by Brazilian TNCs took place outside the region, while the largest four cross-border M&As from Mexico were concluded either in the United States or the Philippines.

C. Central and Eastern Europe

In 1999, FDI flows into Central and Eastern Europe[28] increased for the third consecutive year. For the second time since the transition to the market economy started, annual inflows exceeded $20 billion (annex table B.1). The Czech Republic, Hungary, Poland and the Russian Federation continued to be leading recipients of FDI inflows (figure II.28).

By the end of 1999, the inward FDI stock of Central and Eastern Europe reached $110 billion. This stock was mainly concentrated in four countries: Poland ($30 billion), Hungary ($19 billion), the Russian Federation ($17 billion) and the Czech Republic ($16 billion), together accounting for almost three-fourths of total inward FDI stock in Central and Eastern Europe (annex table B.3). The FDI stock in Central and Eastern Europe continued to be dominated by EU investors, whose share accounted for 60 per cent of the total (figure II.29). The United States accounted for 16 per cent of the region's total (figure II.29) and was in the leading position only in Croatia, Ukraine and the Russian Federation (annex table A.II.1).

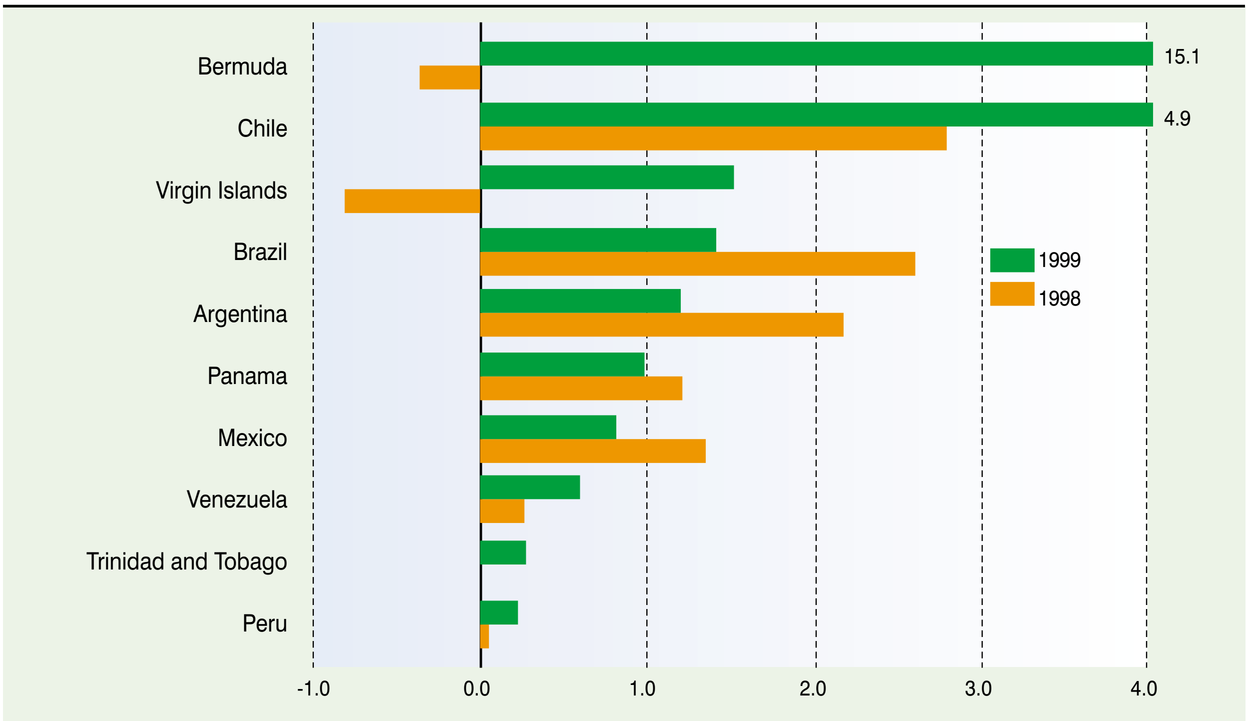
In the sectoral breakdown of inward FDI stocks, the share of services increased at the expense of manufacturing to about 56 per cent (figure II.30 and annex table A.II.2) compared to less than 50 per cent in 1998. This may have a positive impact on the economic transition as efficiency gains in manufacturing are now being complemented by efficiency gains in services, improving the performance of the host economies more generally.

In Poland, by far the leading recipient ($7.5 billion) for a second consecutive year (figure II.28), FDI inflows have increased in every year since 1990. Foreign investors were obviously attracted by the large domestic market (the second after the Russian Federation in terms of GDP and the third largest after the Russian Federation and Ukraine in terms of population). Inflows of FDI into the Czech Republic in 1999 ($5.1 billion) exceeded the previous record of 1998, owing largely to a recent turnaround in privatization policies

FIGURE II.27

Latin America and the Caribbean: FDI outflows, top 10 economies, 1998 and 1999[a]

(Billions of dollars)



Source: UNCTAD, FDI/TNC database and annex table B.2.

[a] Ranked on the basis of the magnitude of 1999 FDI outflows.

(figure II.28). While privatization policies during the first half of the 1990s excluded foreign participation in the Czech Republic, the second round of privatization followed the example of other countries such as Hungary, which had successfully involved foreign firms.

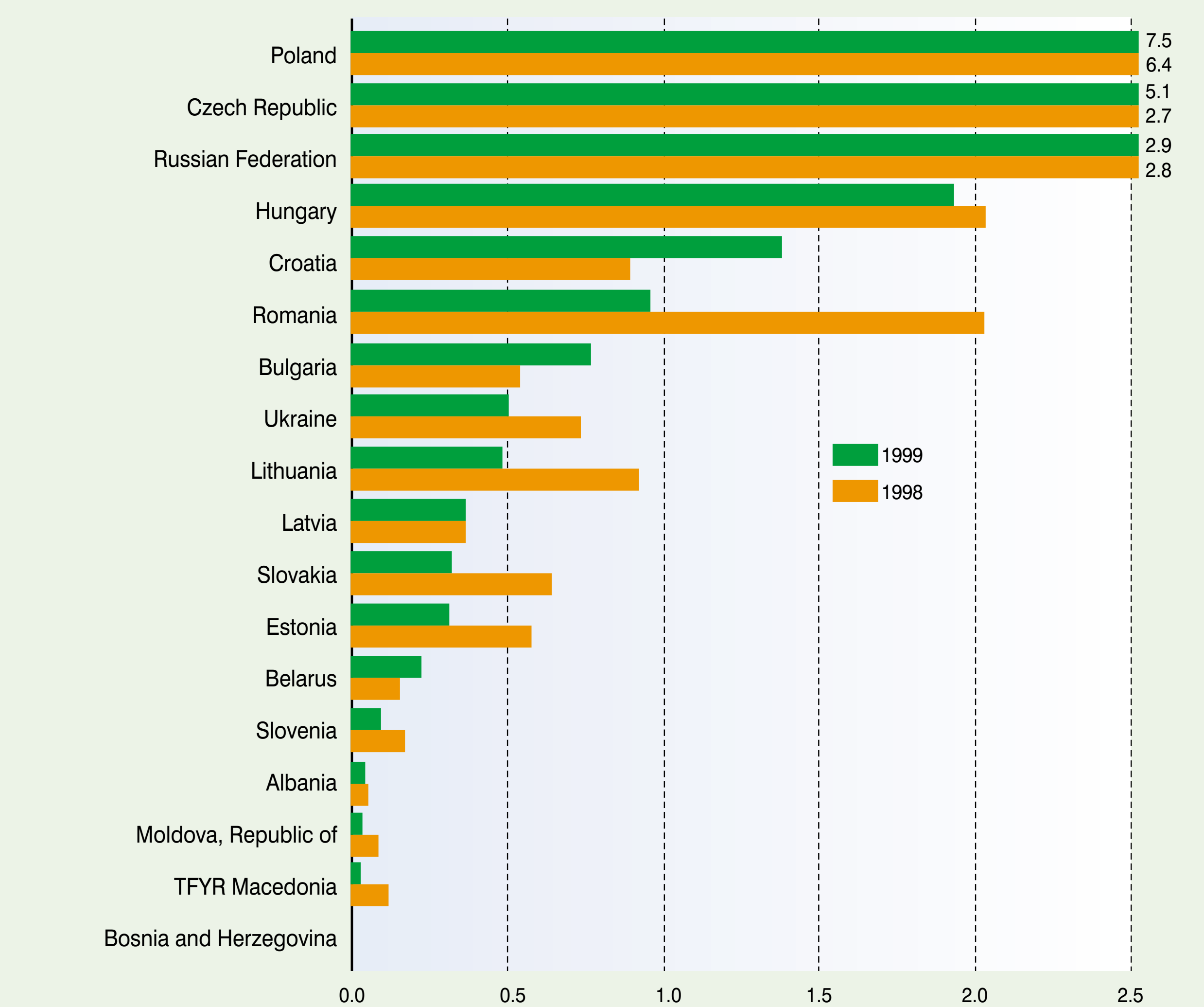
In the Russian Federation, after the dramatic drop in 1998 (from $6.6 billion to $2.8 billion), FDI inflows rose again in 1999 (to $2.9 billion), but were still far from the previous record and low relative to the size of that economy. "Round-tripping" was still prevalent, as suggested by the continued high share of inflows from Cyprus (8 per cent in the first half of 1999, compared to 23 per cent in inward FDI stock) (annex table A.II.1). Nonetheless, 1999 saw the second highest level of inflows into the Russian Federation since economic transition began. At the same time, portfolio and other investment inflows continued to decline and turned negative in 1999. FDI regained its dominant position among capital inflows.

In the light of a series of crises (Asia, Russian Federation, Kosovo) that shook confidence in emerging markets generally, the resilience and continued increase of Central and Eastern European FDI inflows is quite remarkable. In 1998, the Russian crisis did not keep the rest of the region from setting a new record. And in 1999, even in the most affected South-Eastern European countries such as

FIGURE II.28

Central and Eastern Europe: FDI *inflows*, 1998 and 1999[a]

(Billions of dollars)



Source: UNCTAD, FDI/TNC database and annex table B.1.

[a] Ranked on the basis of the magnitude of 1999 FDI inflows.

Bulgaria and Croatia, FDI inflows were resilient (annex table B.1).

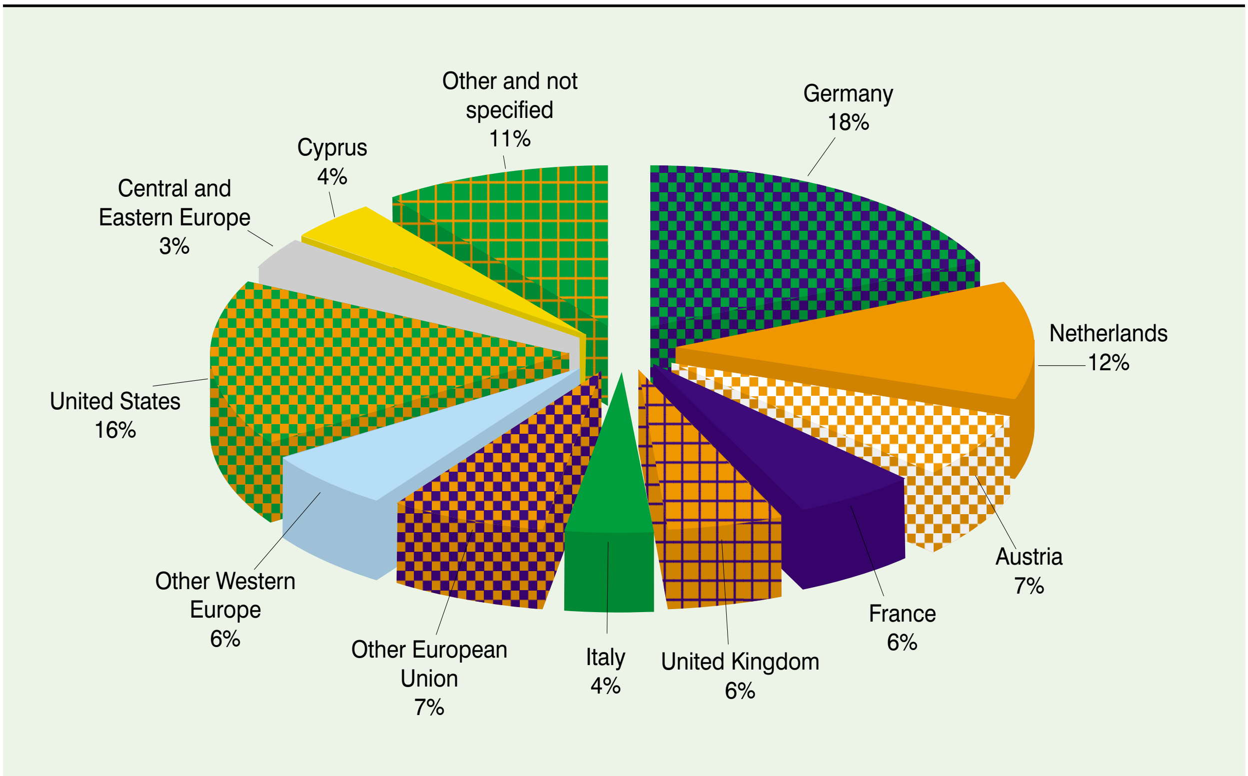
In South-Eastern Europe, the experience varied country-by-country. In Bulgaria and Croatia, inflows increased significantly. In other countries there was a decline of varying degrees. This was only partly due to the Kosovo conflict, which prompted some investors to put projects on hold. Some countries reacted to the crisis with an increased openness to FDI, an increased focus on privatization and an increased readiness to implement major privatization projects involving foreign investors. In many countries major privatization deals were accelerated (e.g. Bulgarian and Croatian telecommunications companies, a Macedonian oil refinery, a Romanian car producer), although some of these deals did not materialize in actual FDI inflows before the beginning of 2000. And in Romania, where the telecommunication company had already been privatized in 1998 (and that transaction alone had accounted for almost half of the cash equity FDI inflows in that year), total inflows decreased significantly in 1999. In Albania and Bosnia and Herzegovina, FDI inflows remained very low.

A disaggregation by type (equity in cash, equity in kind, reinvested earnings and intra-company loans) of reported FDI inflows shows two types of situations (annex table A.II.3): in the Czech Republic and Hungary, where some of the components are not reported (intra-company loans in the Czech Republic, reinvested earnings in Hungary), equity flows account for at least 90 per cent of registered inflows; in Poland, the Russian Federation and Romania, where all types of flows are reported, they account for only around 60 per cent. Consequently, judged solely by equity inflows, the lead of Poland over the Czech Republic is much smaller than its lead in all inflows. In the same vein, Hungary's equity cash inflows are higher than those of the Russian Federation, although the reverse is the case when it comes to total inflows.

FIGURE II.29

Central and Eastern Europe: geographical sources of inward FDI stock, 1999[a]

(Percentage)



Source: UNCTAD, FDI/TNC database.

[a] Estimates.

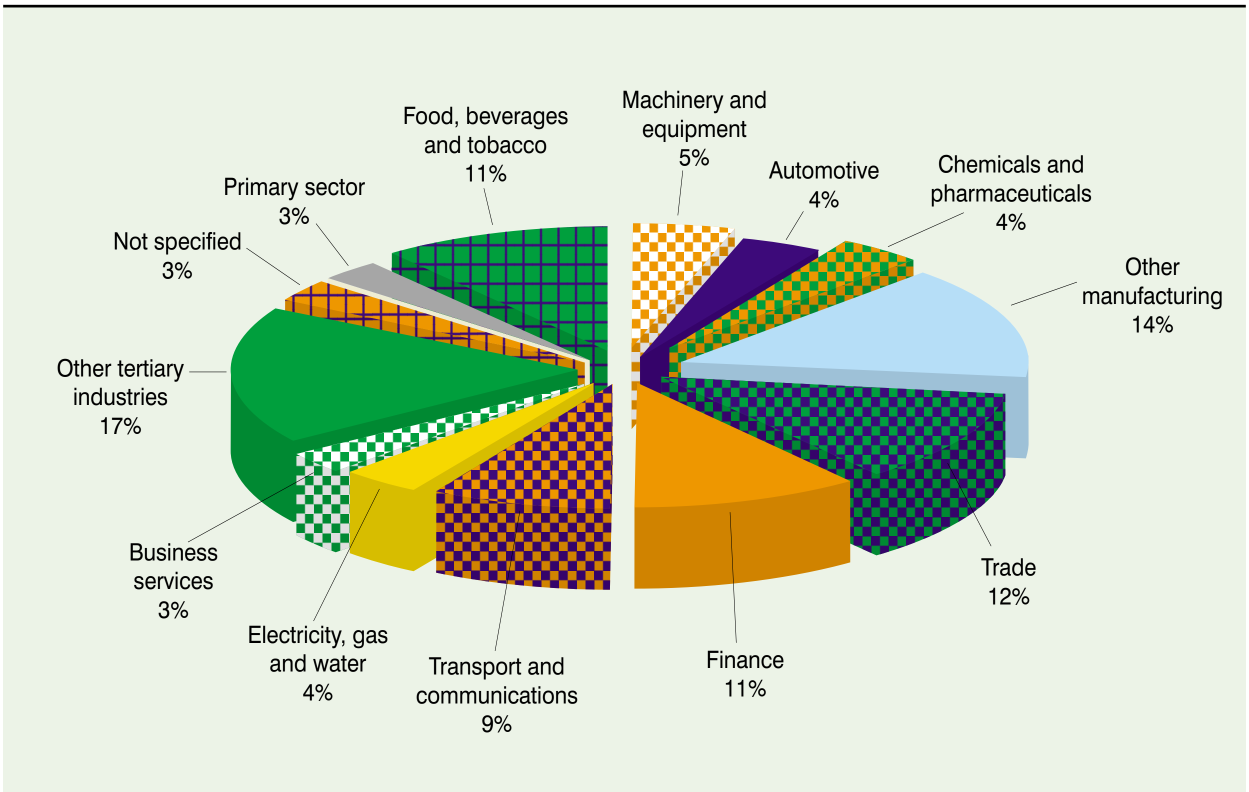
In relative terms — FDI inflows as a percentage of gross fixed capital formation and FDI stocks compared with the size of GDP — smaller countries continue to be more internationalized by way of FDI than bigger ones. In terms of FDI inflows as a percentage of gross fixed capital formation (figure II.31), Bulgaria, Estonia and Latvia are the region's leaders, while the Russian Federation and Ukraine are among the region's laggards. (They are the two biggest economies of the region in terms of population.) In terms of FDI stocks as a percentage of GDP in 1999, the small countries (Hungary: 40 per cent; and Czech Republic: 31 per cent) and very small countries (Latvia: 31 per cent; and Estonia: 42 per cent) again show higher ratios than bigger countries (Poland: 18 per cent; Russian Federation: 9 per cent; and Ukraine: 11 per cent).

In 1999, FDI *outflows* from Central and Eastern Europe recovered somewhat from the decline of 1998. But the current level ($2.6 billion) is still lower than that of 1997 ($3.6 billion). In the Russian Federation, FDI outflows started to recover in 1999. In the Czech Republic too, they increased. But in Hungary and Poland, they temporarily decreased (figure II.32). Not all countries report on the destination of FDI outflows. Data indicate that the share of Central and Eastern Europe in outward FDI varies from country to country: it accounts for an overwhelming majority of outflows and outward stocks in Croatia, Estonia and Slovenia, is also dominant in Slovakia and the Czech Republic, and is sizeable (though only in second position) in the case of Hungary and the Russian Federation (annex table A.II.4). On the other hand, the share of Central and Eastern Europe was minimal in Latvia's outward FDI stock in 1999. In most cases, intraregional FDI takes place between countries that are each other's neighbours (annex table A.II.4). The rest of outward FDI is typically directed to Western Europe.

FIGURE II.30

Central and Eastern Europe: industry composition of inward FDI stock, 1999[a]

(Percentage)



Source: UNCTAD, FDI/TNC database.

[a] Estimates.

FIGURE II.31

Central and Eastern Europe: FDI flows as percentage of gross fixed capital formation, 1996-1998[a]

(Percentage)

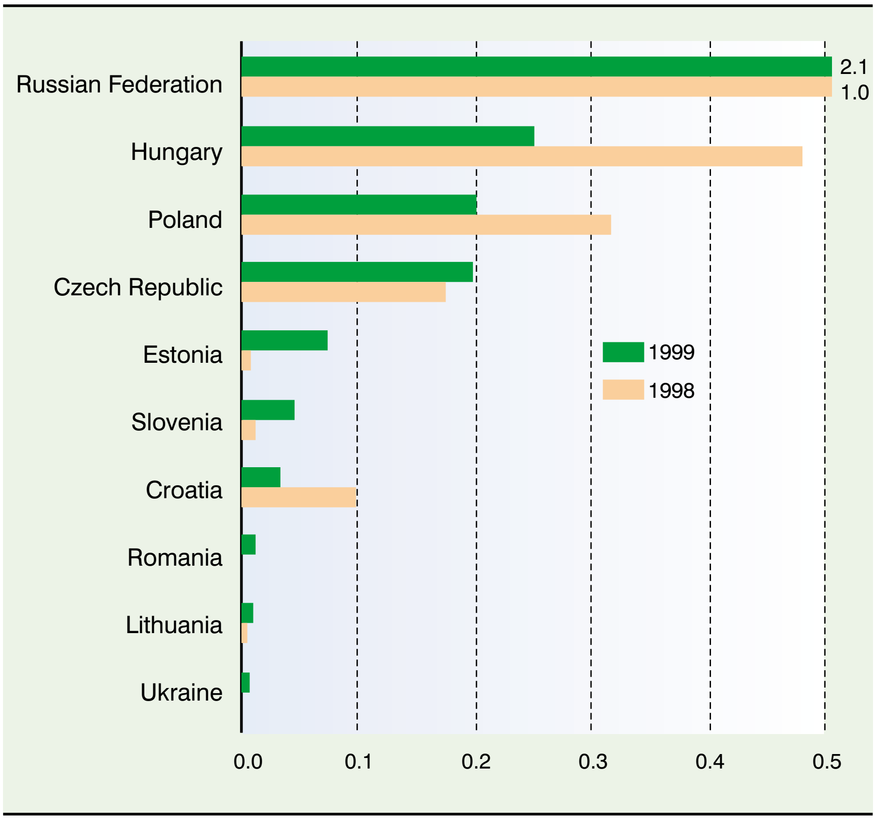
Source: UNCTAD, FDI/TNC database and annex table B.5.

[a] Ranked on the basis of the magnitude of 1996-1998 FDI inflows as a percentage of gross fixed capital formation.

FIGURE II.32

Central and Eastern Europe: FDI outflows, top 10 countries, 1998 and 1999[a]

(Billions of dollars)



Source: UNCTAD, FDI/TNC database and annex table B.2.

[a] Ranked on the basis of the magnitude of 1999 FDI outflows.

Notes

1 Including the countries of the former Yugoslavia.

2 Excluding tax heavens, this region received $12 billion in 1999.

3 UNCTAD, cross-border M&A database, based on data from Thomson Financial Securities Data Company.

4 Data from *Survey of Current Business*, March 2000.

5 Data on cross-border M&As can not be directly compared with FDI figures. For a discussion on the comparability of the two sources of statistics, see box IV.3.

6 "Europe's new capitalism", *The Economist*, 12 February 2000.

7 "Economists for EMU", *The Economist*, 17 April 1999. In addition, a recent survey of 15 important inward investors in the United Kingdom indicated that all but one were in favour of the United Kingdom joining the Euro. A number of them expressed warnings about the impact of currency fluctuations on future investment in the United Kingdom. The survey included companies such as Robert Bosch, Caterpillar, Siemens, SCA, Toyota, Samsung and Sony. (Kevin Brown and Peter Marsh, "Top executives warn on euro", *Financial Times*, 27 June 2000).

8 The data are on a notification basis and for the fiscal year. Transport equipment here includes general and electric machinery as well.

9 All of the 17 city (major) banks recorded income deficits in the fiscal year 1998 (end-March 1999). The mergers among these banks is an example of restructuring in this industry: examples include the mergers of Dai-Ichi Kangyo Bank, Fuji Bank and the Bank of Japan planned in 2001; Sanwa Bank, Tokai Bank and Asahi Bank planned in 2002; and Sumitomo Bank and Sakura Bank planned in 2002.

10 For example, the number of foreign affiliates newly established by Japanese companies in fiscal year 1999 was only 1,713, compared to 2,489 in fiscal year 1997 (1,597 in fiscal year 1998). A significant decline was recorded in FDI by SMEs; they established only 47 new affiliates in 1998 and 80 in 1999, compared to 476 in 1997 (Japan, Small and Medium-sized Enterprise Agency, 1999 and 2000).

11 It is to be noted that it is not possible to calculate precisely what percentage of FDI flows are accounted for by cross-border M&As. For details, see box IV.4.

12 For example, Japanese automobile affiliates in Thailand (Isuzu, Mazda-Ford) and Malaysia (Mitsubishi Motors), and various other manufacturing affiliates (e.g. an affiliate of Toshiba in Thailand) which were affected by the crisis, started to increase employment in 1999 (*Nihon Keizai Shimbun*, 29 September 1999, p. 1).

13 Survey conducted by the Japan Bank for International Cooperation, 2000, of 472 Japanese manufacturing TNCs.

14 Survey conducted by Japan's MITI. Quoted in *Nihon Keizai Shimbun,* 7 July 1999.

15 In this section, South Africa (which is categorized as a developed country according to the United Nations country classification) is included in Africa.

16 These figures include portfolio investment. Therefore, they are different in nature from the data on privatization used elsewhere in WIR00.

17 All of the industries cited were mentioned in more than 10 per cent of the responses.

18 After two years of legislative process, this bill was adopted recently by the House of Representatives, and is awaiting the Senate's approval.

19 For a detailed analysis of these factors, see UNCTAD, 1998a, pp. 202-204.

20 Hong Kong (China) reported FDI data (both flows and stocks) for the first time in 2000 for the data for 1998 and 1999. For details, see definitions and sources in annex B.

21 Press Release issued by the administration of Hong Kong (China), 19 June 2000.

22 Guy Dinmore, "Total and Gazprom tipped in Iran gas deal", *Financial Times,* 9 May 2000, p. 8.

23 *Islands Business*, June 1999, p. 25.

24 Official data on overseas divestment are not available; therefore, the net outward flows of FDI are likely to be over-estimated.

25 It is to be noted that payments of dividends and distributed branch profits contribute to current account deficits. In 1998, for instance, the current account deficit of the Latin America and Caribbean region amounted to about $89 billion, while dividend and distributed branch profit outflows reached about $13 billion.

26 The transaction was not completed in 1999. Therefore this deal is not included in the cross-border M&A database of UNCTAD.

27 Information from Banco Central de Costa Rica (www.bccr.fi.cr).

28 Central and Eastern Europe includes (both in statistics and in analysis) Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, the Former Yugoslav Republic of Macedonia, the Republic of Moldova, Poland, Romania, the Russian Federation, Slovakia, Slovenia, Ukraine and the Federal Republic of Yugoslavia (Serbia including Kosovo and Montenegro). No FDI data are available for the Federal Republic of Yugoslavia.