

United Nations Conference on Trade and Development

World Investment Report

**2004 The Shift Towards
Services**



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PART ONE

FDI SET TO RECOVER

CHAPTER I

GLOBAL FDI GROWTH SET TO RESUME

A. FDI inflows down again – but recovery is on its way

Global FDI inflows fell again in 2003. But outflows increased and that, together with the improved economic climate, suggests that a recovery is under way in 2004.

FDI inflows declined by 18% (to \$560 billion) in 2003, following a massive decline of 41% in 2001 (from \$1.4 trillion in 2000 to \$818 billion) and another 17% in 2002 (to \$679 billion) (figure I.1). But FDI outflows rose in 2003 by 3%, to \$612 billion,¹ and prospects are good for 2004 and beyond (section D below). Flows to developing countries rose already by 9%.² Excluding Luxembourg, China was the largest host country ahead of France and the United States. Cross-border mergers and acquisitions (M&As) – the key driver of global FDI since the late 1980s – remain weak, but they started to pick up in 2004, joining other healthy factors. Policies on FDI continue to become more liberal, and both countries and enterprises have been increasing their degrees of transnationality.

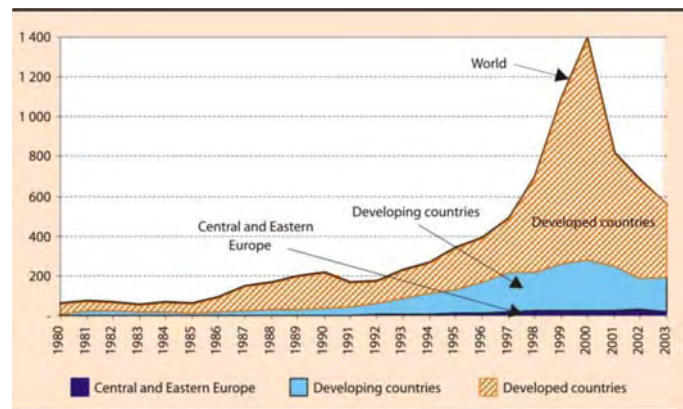
1. An uneven picture

FDI flows to *developed countries* fell by 25%, from \$490 billion in 2002 to \$367 billion in 2003. This latter figure represents only two-thirds of the peak of \$1.1 trillion reached in 2000. Flows to the United States declined to the lowest level since 1992, only one-tenth of their peak in 2000-2001. Members of the European Union (EU), notably Germany and the United Kingdom, recorded much lower flows than in 2002, as did Japan.

Flows to *developing countries*, on the other hand, rose by 9% from \$158 billion in 2002 to \$172 billion in 2003, but they varied by region. *Africa* recorded 28% higher inflows in 2003 (\$15 billion, up from \$12 billion in 2002), driven mainly by natural-resource projects. Inward FDI to the *Asia-Pacific region* reached \$107 billion, up from \$95 billion. *Latin America and the*

Caribbean, however, experienced a fourth consecutive year of decline, although it was marginal, from \$51 billion in 2002 to \$50 billion. The share of developing countries in global FDI inflows rose by 8 percentage points, to 31% in 2003. The top ten recipients accounted for almost three-fourths of total flows to developing countries – 11 percentage points less than in 2000 when concentration was the highest.

Figure I.1. FDI inflows, global and by group of countries, 1980–2003
(Billions of dollars)



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

After a record year in 2002, when inflows reached \$31 billion, FDI to *Central and Eastern Europe* (CEE) fell sharply in 2003, to \$21 billion. Inflows into the “accession-eight”³ shrunk from \$23 billion to \$11 billion. In the Russian Federation also, inward FDI plunged from \$3.5 billion in 2002 to \$1.1 billion in 2003.

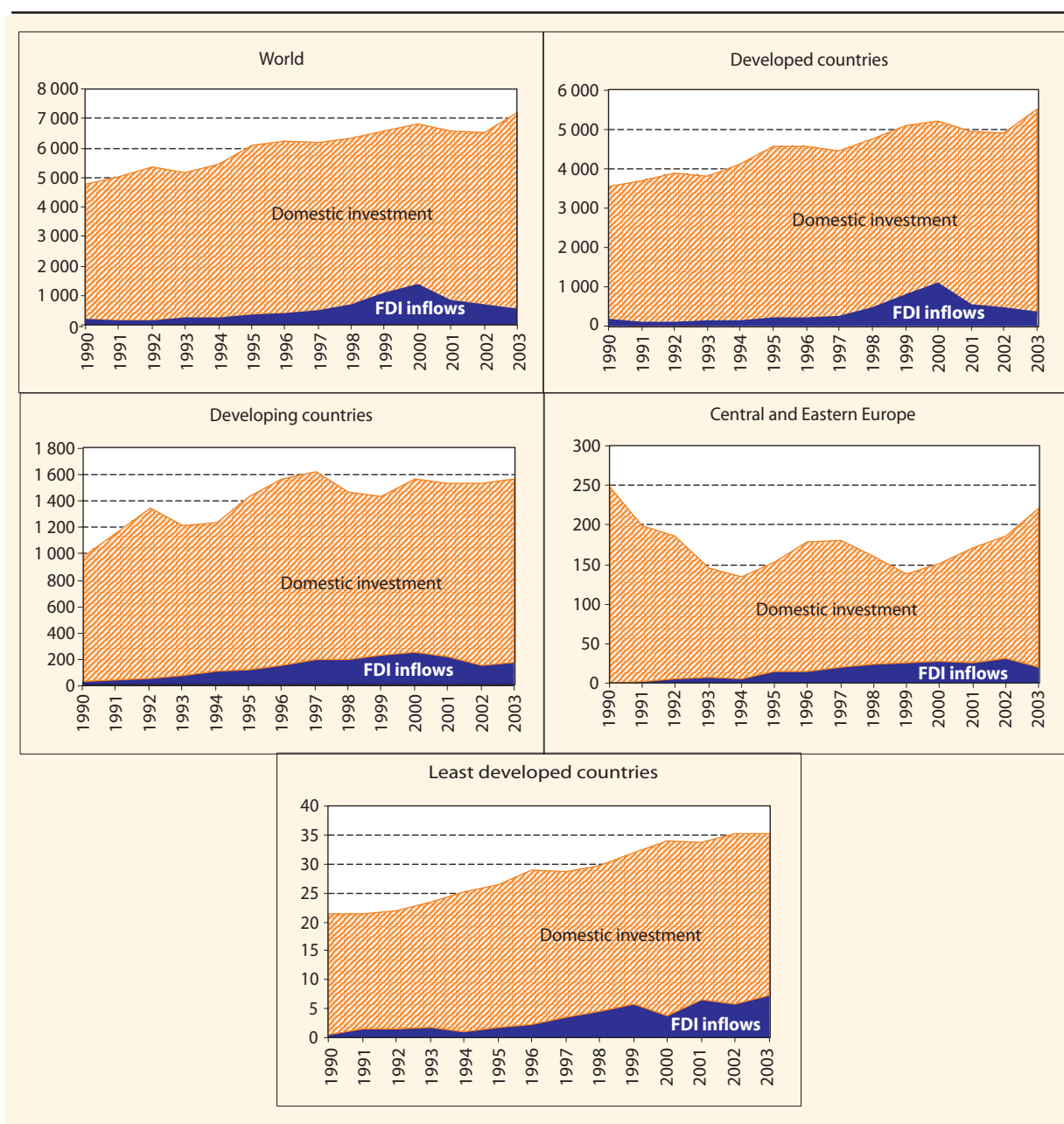
While world FDI flows have been in decline for three years in a row (from 2000 to 2003), this needs to be juxtaposed with domestic investment. For countries to maintain high levels of income and employment and to grow, of importance is the total amount of investment, regardless of its foreign and domestic mix. During the period 1990–2003, world FDI flows accounted for 8% of world domestic investment (gross fixed capital formation), which underlies the fact that FDI only complements domestic investment. This ratio was slightly higher in both developing countries and CEE than in developed

countries, and for the least developed countries (LDCs) the ratio was close to that of developing countries as a group. Foreign and domestic investors may be expected to respond in a similar way to economic fundamentals (such as economic growth) and structural features of countries. But, FDI and domestic investment do not always move in the same direction.⁴ This suggests that FDI may be influenced by factors that do not necessarily or equally affect domestic investment.

In the period 2000-2003, the decline in FDI inflows followed the same trend as overall investment in most of the countries in the world (figure I.2).

FDI flows need to be seen within the context of all other capital flows to developing countries. They continued to be the largest component of such flows, and their share is increasing (figure I.3). FDI Inflows accounted for 72% of all resource flows to developing

Figure I.2. FDI flows and gross fixed capital formation, by group of countries,^a 1990-2003
(Billions of dollars)

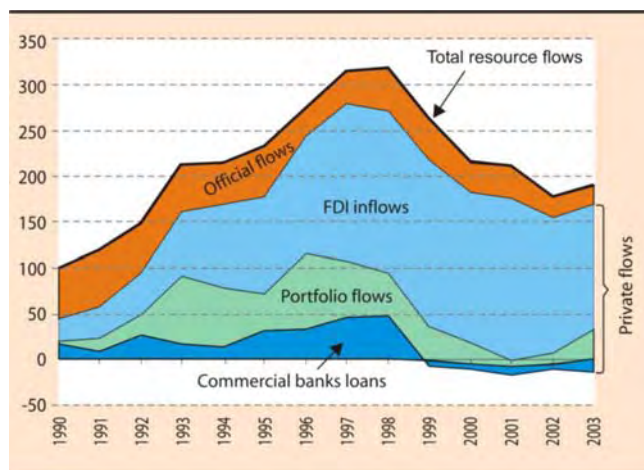


Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

^a Domestic investment is defined as the difference between gross fixed capital formation and FDI inflows.

countries, six times higher than official flows. This contrasts with the latter half of the 1980s and the early 1990s, when official flows and FDI flows were almost the same, and with the mid-

Figure I.3. Total resource flows^a to developing countries,^b by type of flow, 1990-2003
(Billions of dollars)



Source: UNCTAD, based on World Bank 2004a.

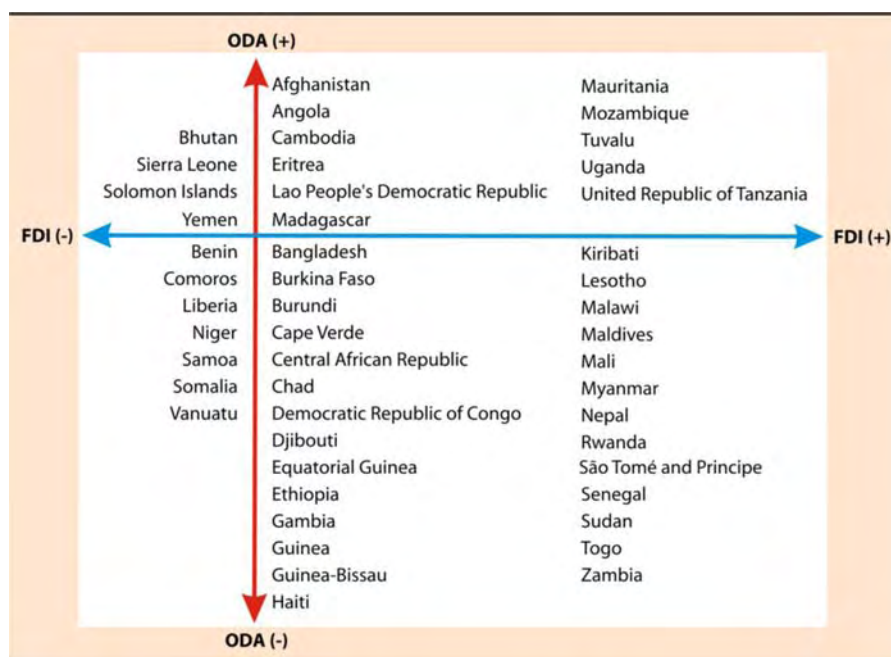
^a Defined as net liability transactions or original maturity of greater than one year.

^b The World Bank's classification of developing countries is different from that of UNCTAD. Central and Eastern Europe is included in developing countries.

1990s, when portfolio flows and FDI flows were roughly equal. FDI is therefore recognized in the Monterrey Consensus as an important source of financing for development.⁵ In the LDCs, official flows were larger than FDI flows between 2000 and 2002; but in six LDCs (Angola, Chad, Equatorial Guinea, Myanmar, the Sudan, Togo) FDI inflows exceeded total official development assistance (ODA). In 27 out of 50 LDCs, FDI flows grew between 1990 and 2002, while ODA declined (figure I.4).

The continued decline in inward FDI flows in 2003 reflected the impact of a combination of macro, micro and institutional factors (*WIR03*). At the macroeconomic level, growth prospects for many countries remained uncertain. In spite of some recovery in the second half of the year, major stock markets remained well below their historical peak of early 2000.⁶ At the microeconomic level, increased profitability starting from the latter half of 2003 helped, but did not move FDI inflows upwards.⁷ High debt-equity ratios⁸ continued to force large companies to downsize their operations. At the institutional level, several new accounting scandals in 2003 may have deterred investors. Reflecting the interaction of these factors, the value of M&As fell from \$370 billion in 2002

Figure I.4. Growth trends^a in FDI and total ODA flows to LDCs, 1990-2002



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and OECD Development Assistance Committee, International Development Statistics, online databases.

Note: Not including Timor-Leste, which joined the group of LDCs in 2004.

^a Calculated as the slope of the linear regression for FDI and ODA flows between 1990 and 2002.

to \$297 billion in 2003 – a decline of 20% (annex tables B.7 and B.8). There were only 56 mega deals (of \$1 billion and over in transaction value) in 2003, a third of the peak number achieved in 2000 (table I.1 and annex table A.I.1). The largest single deal was the acquisition of Household International Inc. (United States) by HSBC Holdings Plc. (United Kingdom) for \$15.3 billion.

In 2003, over 9,300 greenfield and expansion FDI projects worldwide were announced, at an estimated value of \$440 billion.⁹ China was the leading location for such projects worldwide, followed by the United States, India, the Russian Federation, the United Kingdom and Brazil. In terms of the announced values of investment, Australia and Canada were the leading locations, due to major capital-intensive, resource-extraction projects. The United States retained its position as the leading source for FDI projects (accounting for over one-fifth in terms of both number and value), followed by Japan, Germany, the United Kingdom and France.

The number of cross-border M&As in 2003 was, with more than 4,500 deals, much lower than the number of greenfield projects. Three of the six countries leading in terms of the number of greenfield projects also led in cross-border M&As. The United States was the largest target country (722 M&A deals), followed by the United Kingdom (459) and Germany (296). In

the developing world, China (214) ranked first (4th place in the world), followed by Hong Kong (China) (108), India (83) and Brazil (69).¹⁰ In terms of value, the top nine were all developed countries, followed by the Russian Federation and Hong Kong (China) (annex table B.7).

An important factor in the decline of FDI, and particularly of M&As, has been a slowdown or end in privatization. The total sale of State-owned assets fell from about \$50 billion in 2000 to less than \$20 billion in 2003 (World Bank 2004a). Privatization-related FDI in developing countries fell to one-tenth the level of 1998, from a record \$33 billion that year to \$3.5 billion in 2003.¹¹ Liquidity and other problems at home lowered TNCs' interests in privatization. At the same time, some developing countries, particularly in Latin America, became more sceptical of its benefits. Privatization-related FDI in CEE declined as well.

The pattern of FDI financing (new equity investment, intra-company loans, reinvested earnings) also reflected the macro and micro factors noted above. Intra-company loans by parent firms to their foreign affiliates have fallen since 2001 and were negative in 2003 (figure I.5). They were negative for United States FDI inflows in both 2002 and 2003 (-\$21 billion and -\$34 billion, respectively) and fell in 2003 in countries as diverse as Argentina, Indonesia, Sweden and Switzerland. Equity investment remained volatile. Reinvested earnings were the single largest component of FDI in developing countries, accounting for about 40% (compared to 17% in developed countries) of total FDI inflows to that part of the world (figure I.5). This underlines the importance of policies aimed at retaining established foreign affiliates through appropriate aftercare services.

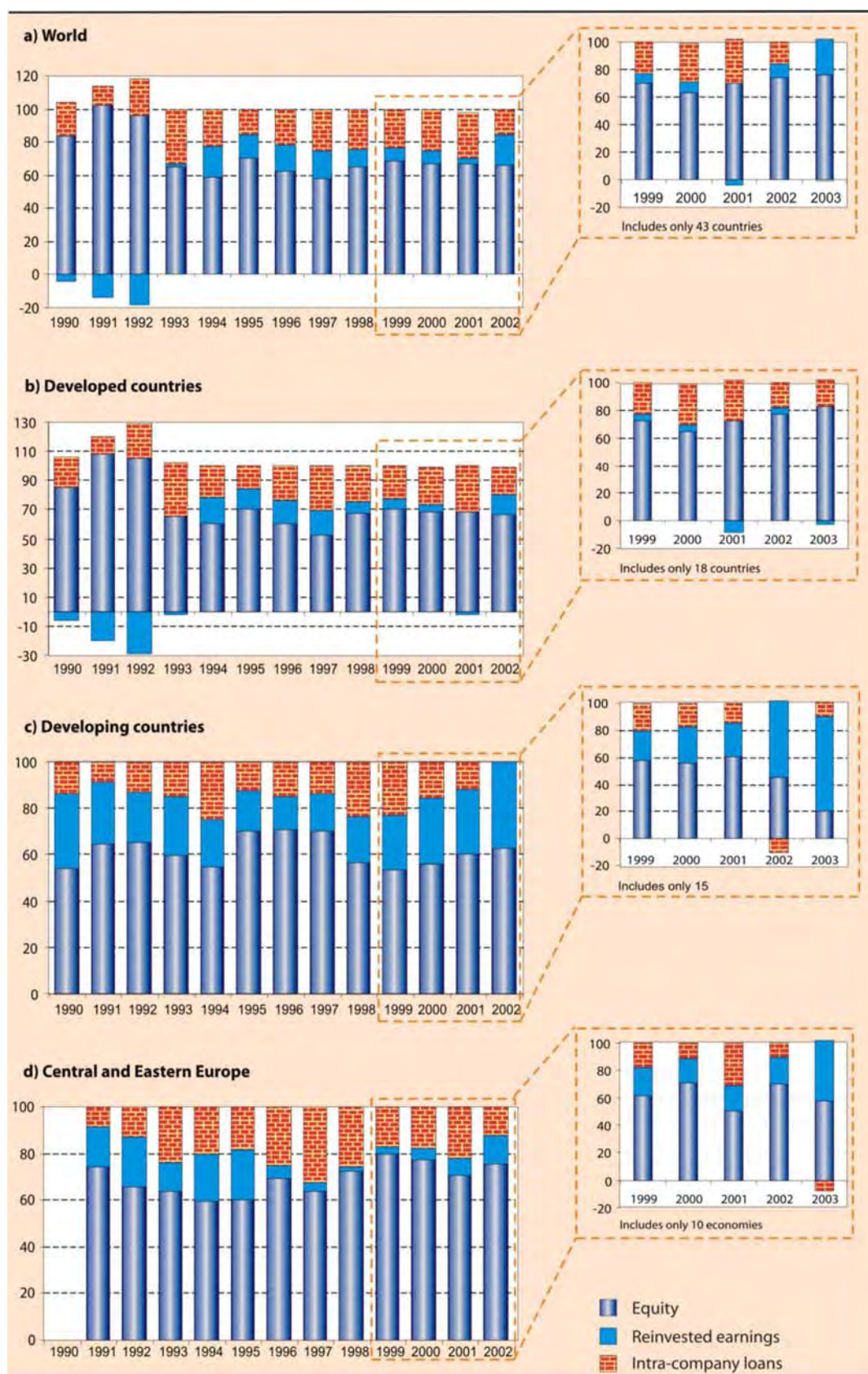
The continued liberalization of FDI regimes may have been another factor that helped reverse the downturn of new TNC activity in developing countries in 2003. Worldwide, there were 244 changes in laws and regulations affecting FDI, 220 of which were in the direction of more liberalization (table I.2). At the bilateral level, 86 bilateral investment treaties (BITs) and 60 double taxation treaties (DTTs) were concluded that year, bringing the totals to 2,265 and 2,316, respectively (figure I.6). However, the annual number of such treaties concluded has been declining since 2002 in the case of BITs and 2000 in the case of DTTs. By contrast, the number of bilateral free trade agreements (FTAs)

Table I.1. Cross-border M&As with values of over \$1 billion, 1987-2003

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

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

Figure I.5. FDI inflows, by type of financing, 1990-2003^a
(Per cent)



Source: UNCTAD, based on IMF *Balance of Payments Statistics, CD-ROM, April 2004* and UNCTAD FDI/TNC database (www.unctad.org/fdistatistics).

^a The left set of figures is based on full country coverage. The right set of figures is based only on those countries for which data on all three components are available throughout the period 1999-2003.

Table I.2. Changes in national regulations on FDI, 1991-2003

Item	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65	76	60	63	69	71	70	82
Number of regulatory changes of which:	82	79	102	110	112	114	151	145	140	150	208	248	244
More favourable to FDI ^a	80	79	101	108	106	98	135	136	131	147	194	236	220
Less favourable to FDI ^b	2	-	1	2	6	16	16	9	9	3	14	12	24

Source: UNCTAD, database on national laws and regulations.

^a Including liberalizing changes or changes aimed at strengthening market functioning, as well as increased incentives.

^b Including changes aimed at increasing control as well as reducing incentives.

and regional free trade agreements (RTAs) – which, today, typically include provisions covering FDI – continues to increase, particularly in Asia (chapter II).

The failure of the WTO Ministerial Conference held in Cancún in September 2003 meant that no decision was taken on any of the issues under negotiation or consideration in the Doha Work Programme. Intensive consultations conducted since the Cancún meeting have focused on subjects that had proved to be particularly controversial at that meeting, including investment (one of the four Singapore Issues). A generally shared view emerging from these consultations appears to be (as of June 2004) that each of the Singapore Issues should be treated on its own merits. However, at the time of writing, no decision had been taken with regard to these Issues. The chairpersons of the Working

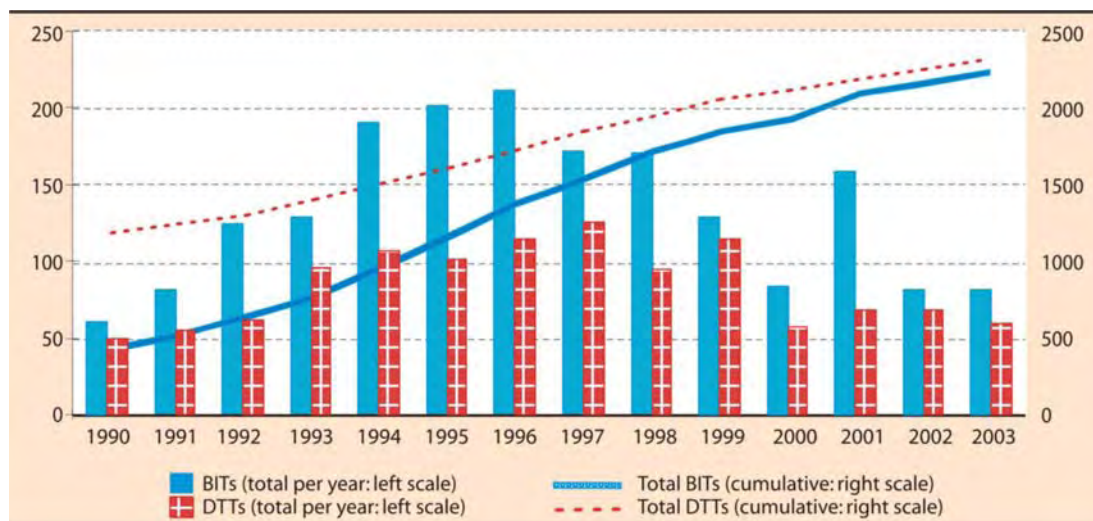
Groups in which the Singapore Issues had been discussed before Cancún had not been designated, and these Groups had not met since Cancún.

2. International production continues to grow

The role of FDI and TNC activity in the global economy continues to grow, as reflected in the sales, assets, value-added (gross product), employment and exports of foreign affiliates. The degree of transnationalization is increasing for both TNCs and the countries in which they operate. Each of the above variables has resumed an upward trend since 2002 (table I.3).

UNCTAD's data show that international production is carried out by over 900,000 foreign affiliates of at least 61,000 TNCs worldwide (annex table A.I.2). These affiliates account for

Figure I.6. Number of BITs and DTTs concluded, cumulative and year to year, 1990–2003



Source: UNCTAD, BIT/DTT database (www.unctad.org/fdistatistics).

Table I.3. Selected indicators of FDI and international production, 1982-2003
(Billions of dollars and per cent)

Item	Value at current prices (\$ billion)			Annual growth rate (Per cent)						
	1982	1990	2 003	1986-1990	1991-1995	1996-2000	2000	2001	2002	2003
FDI inflows	59	209	560	22.9	21.5	39.7	27.7	-41.1	-17.0	-17.6
FDI outflows	28	242	612	25.6	16.6	35.1	8.7	-39.2	-17.3	2.6
FDI inward stock	796	1 950	8 245	14.7	9.3	16.9	19.1	7.4	12.7	11.8
FDI outward stock	590	1 758	8 197	18.1	10.7	17.1	18.5	5.9	13.8	13.7
Cross-border M&As ^a	..	151	297	25.9 ^b	24.0	51.5	49.3	-48.1	-37.7	-19.7
Sales of foreign affiliates	2 717	5 660	17 580 ^c	16.0	10.2	9.7	16.7	-3.8	23.7 ^c	10.7 ^c
Gross product of foreign affiliates	636	1 454	3 706 ^d	17.4	6.8	8.2	15.1	-4.7	25.8 ^d	10.1 ^d
Total assets of foreign affiliates	2 076	5 883	30 362 ^e	18.2	13.9	20.0	28.4	-5.4	19.6 ^e	12.5 ^e
Exports of foreign affiliates	717	1 194	3 077 ^f	13.5	7.6	9.9	11.4	-3.3	4.7 ^f	16.6 ^f
Employment of foreign affiliates (thousands)	19 232	24 197	54 170 ^g	5.6	3.9	10.8	13.3	-3.2	12.3 ^g	8.3 ^g
GDP (in current prices) ^h	11 737	22 588	36 163	10.1	5.1	1.3	2.7	-0.9	3.7	12.1
Gross fixed capital formation	2 285	4 815	7 294	13.4	4.2	2.4	3.8	-3.6	-0.6	9.9
Royalties and licence fee receipts	9	30	77 ⁱ	21.3	14.3	7.7	9.5	-2.5	6.7	..
Exports of goods and non-factor services ^h	2 246	4 260	9 228	12.7	8.7	3.6	11.4	-3.3	4.7	16.6

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

^a Data are available only from 1987 onward.

^b 1987-1990 only.

^c Based on the following regression result of sales against FDI inward stock (in \$ million) for the period 1980-2001: Sales = 1 542.5036+1.945042*FDI inward stock.

^d Based on the following regression result of gross product against FDI inward stock (in \$ million) for the period 1982-2001: Gross product = 493.8792+0.389537*FDI inward stock.

^e Based on the following regression result of assets against FDI inward stock (in \$ million) for the period 1980-2001: Assets = - 1 389.4785+3.850915*FDI inward stock.

^f For 1995-1998, based on the regression result of exports of foreign affiliates against FDI inward stock (in \$ million) for the period 1982-1994: Exports = 288.4750+0.454011*FDI inward stock. For 1999-2003, the share of exports of foreign affiliates in world exports in 1998 (33.3 per cent) was applied to obtain the values.

^g Based on the following regression result of employment (in thousands) against FDI inward stock (in \$ million) for the period 1980-2001: Employment = 1,5162.6220+4.731003*FDI inward stock.

^h Based on data from the International Monetary Fund, *World Economic Outlook*, April 2004.

ⁱ 2002.

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

an estimated one-tenth of world GDP and one-third of world exports, and their shares are increasing.

As a result, the degree of transnationality of host countries¹² is continuing to rise. The most transnationalized host economy in 2001 was Hong Kong (China), followed by Ireland, and Belgium and Luxembourg (figure I.7). There are, however, large differences in the transnationality indices of different host countries. Estonia, Ireland, The Former Yugoslav Republic of Macedonia and Singapore saw their transnationality index increase by more than 10 percentage points over the previous year. Among the three groups of economies, CEE experienced

a notable increase of 4 percentage points in the degree of transnationality over the previous year.

The bulk of international production is undertaken by a relatively small number of TNCs: the top 100 (less than 0.2% of the total number of TNCs worldwide) accounted for 14% of the sales of foreign affiliates worldwide, 12% of their assets and 13% of their employment in 2002, compared with 27%, 21% and 21%, respectively, in 1990.

There have been interesting developments in the world's 100 largest TNCs (box I.1; annex table A.I.3). As measured by UNCTAD's Transnationality Index – the average of three

Figure I.7. Transnationality index^a of host economies,^b 2001

Source: UNCTAD estimates.

^a Average of the four ratios: FDI inflows to gross fixed capital formation for 1999-2001; FDI inward stocks to GDP in 2001; value added of foreign affiliates to GDP in 2001; and employment of foreign affiliates to total employment in 2001.

^b Only the economies for which data for all of these four shares are available were selected. Data on value added are available only for Belarus, Czech Republic, Finland, France (1998), Hungary, Ireland (2000), Italy (1997), Japan (1999), Netherlands (1996), Norway (1998), Poland, Portugal, Sweden (2000), United Kingdom (1997), United States, China, India (1995), Malaysia (1995), Singapore (2000) and Taiwan Province of China (1994). For Albania, Bosnia and Herzegovina, Latvia, Lithuania, Republic of Moldova, Serbia and Montenegro and Slovakia, the value added of foreign owned firms was estimated on the basis of the per capita inward FDI stocks. The corresponding ratios for value added refer to 1999. For the other economies, data were estimated by applying the ratio of value added of United States affiliates to United States outward FDI stock to total inward FDI stock of the country. Data on employment are available only for Austria, Denmark (1996), Finland, France (1998), Germany, Ireland, Italy (1999), Japan, Netherlands (1996), Norway (1996), Portugal, Sweden, United Kingdom (1997), United States, Hong Kong (China) (1997), Indonesia (1996) and Singapore. For Albania and Bosnia and Herzegovina, the employment impact of foreign owned affiliates was estimated on the basis of their per capita inward FDI stocks. The corresponding ratios for employment refer to 1999. For the remaining countries, data were estimated by applying the ratio of employment of Finnish, German, Japanese, Swedish, Swiss and United States affiliates to Finnish, German, Japanese, Swedish, Swiss and United States outward FDI stock to total inward FDI stock of the economy. Data for France, Netherlands, Norway, Sweden and United Kingdom refer to majority-owned foreign affiliates only.

Box I.1. Developments in the world's 100 largest TNCs in 2002

Activities of the largest TNCs are picking up again. Having stagnated in 2001 for the first time after years of expansion, the operations of TNCs on UNCTAD's list of the world's 100 largest TNCs resumed growth, as measured by the rise in aggregate and foreign assets and sales in 2002, the latest year for which complete data are available (box table I.1.1). Foreign employment in the top 100, however, did not grow. By contrast, total and foreign sales and total assets of the top 50 TNCs from developing countries declined between 2001 and 2002, while their employment, both total and foreign, grew (box I.3). The 25 largest non-financial TNCs from CEE showed positive and relatively stronger growth in 2002 in terms of all indicators: assets, sales, employment, both domestic and foreign.

Box table I.1.1. Snapshot of the world's 100 largest TNCs, 2001, 2002

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

Variable	2001		2002		Change 2002 vs. 2001 (Per cent)
	Value	share	Value	share	
Assets					
Foreign	2 958	48.9	3 317	48.1	12.1
Total	6 052		6 891		13.9
Sales					
Foreign	2 247	50.5	2 446	57.5	8.9
Total	4 450		4 749		6.7
Employment					
Foreign	7 038	51.1	7 036	49.1	-2.8
Total	13 783		14 332		4.0
Average index of transnationality	58		57		-1.7 ^a

Source: UNCTAD/Erasmus University database.

^a The change between 2001 and 2002 is expressed in percentage points.

Overall, the rankings in the top 100 list remained fairly stable in 2002 as compared to 2001 (annex table A.I.3; *WIR03*, annex table A.I.1). In particular, the top end of the list – which was subject to major changes during the stock market boom and the subsequent bursting of the dotcom bubble – remained largely unchanged. Motor vehicle and petroleum companies, along with telecom firms, dominated the top ten spots. Given the deflation of assets,

Source: UNCTAD.

particularly in the telecom industry, it is somewhat surprising that so few companies at the top end dropped from their 2001 rankings. Further down the list, fewer changes occurred than might have been expected.

Two-thirds of the new entrants on the 2002 list were from the services sector, continuing a trend that has characterized the top 100 over the past ten years, with retailing, utilities and telecoms notably up. The number of newcomers in services (nine) in 2002 was the same as in the previous year. Overall, the top 100 list is more evenly balanced, with the number of industries increasing over a longer period. In manufacturing, the number of pharmaceutical firms fell, possibly because of market consolidation; there were fewer electronics TNCs too.

By and large, the size of international production activities of the companies on the top 100 list continued to expand. While there were some companies with reduced foreign and/or total assets and sales, aggregate values of most indicators rose, albeit at a modest pace. The majority of companies appear to have responded to the challenging environment facing them in 2002 by sticking to their course of internationalizing their operations, as indicated by the faster growth, overall, of foreign assets as compared to total assets. However, in many cases this internationalization drive seems to have been “jobless”: employment, both foreign and total, fell. Since aggregate foreign employment shrank less than total employment, job cuts apparently took place more often at home than abroad. The average Transnationality Index of the top 100 TNCs declined marginally in 2002.

Almost 90% of the top 100 TNCs are headquartered in the Triad (the EU, Japan, the United States). The EU leads with more than half of the top 100. The United States accounts for slightly more than a quarter, while Japan's share has decreased over the years to fewer than ten. The number of TNCs from non-Triad countries has risen to more than ten over the years. Altogether, the top 100 TNCs now come from 19 countries. Although non-Triad TNCs, including a number from smaller economies, account for a relatively small proportion of the top 100 TNCs, their average Transnationality Index is higher.

ratios related to the size of TNCs' operations: foreign sales to total sales, foreign assets to total assets and foreign employment to total employment – the world's most transnationalized TNC among the top 100 in 2002 was NTL (United States). Naturally, the transnationality of firms can be measured in several different ways (see annex to chapter I). If the network spread index (annex table A.I.4) is used, reflecting the geographic spread of foreign affiliates, the most transnationalized TNC was Deutsche Post World Net,¹³ and if the composition of headquarters' management board members is considered, Hutchison Whampoa (Hong Kong, China) led the pack, with 11 of 14 board members being foreign nationals.¹⁴

3. Many countries have not realized their potential

a. Indices of Inward FDI Performance and Potential

This is the fourth set of *WIR* benchmarks of inward FDI performance and potential.

The UNCTAD *Inward FDI Performance Index* is a measure of the extent to which host countries receive inward FDI. The Index ranks countries by the amount of FDI they receive relative to their economic size, calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. A value greater than one indicates that the country attracts more FDI in proportion to its economic size, a value below one shows that it receives less (a negative value indicates that foreign investors disinvested in that period). Thus, a higher index implies success in the competition, explicit or implicit, to attract FDI.¹⁵

By region. How did regions fare in the Inward FDI Performance Index in 2003? The group of developed countries suffered a slight decline in its relative position, reflecting the large drop in FDI (on account of the slowdown in M&As) in these countries. Within the group, the largest declines were in the EU

and North America. "Other developed countries" – mainly Japan, Australia – improved (table I.4).

All of the developing regions improved their performance index rank in 2001-2003, but remained below the peak reached in 1993-1995 (except Latin America). This is in contrast to the relative stagnation of the developed regions. However, large regional variations exist (figure I.8).

The best performer in the Index was Central Asia, both in the index score and its rise over the previous period; the sharp rise in its index reflects lumpy resource-based (oil and gas) foreign investments in a few countries. The second best performer in index value was East and South-East Asia and, in terms of improvement over the previous period, "other Africa" (i.e. sub-Saharan Africa). Over the period as a whole, however, South America showed the largest improvement in the index.

Two regions had indices below unity in the last period: West Asia and South Asia. Since the former region saw high political instability, its low ranking may not be surprising. South Asia

Table I.4. Inward FDI Performance Index, by region, 1988-2003^a

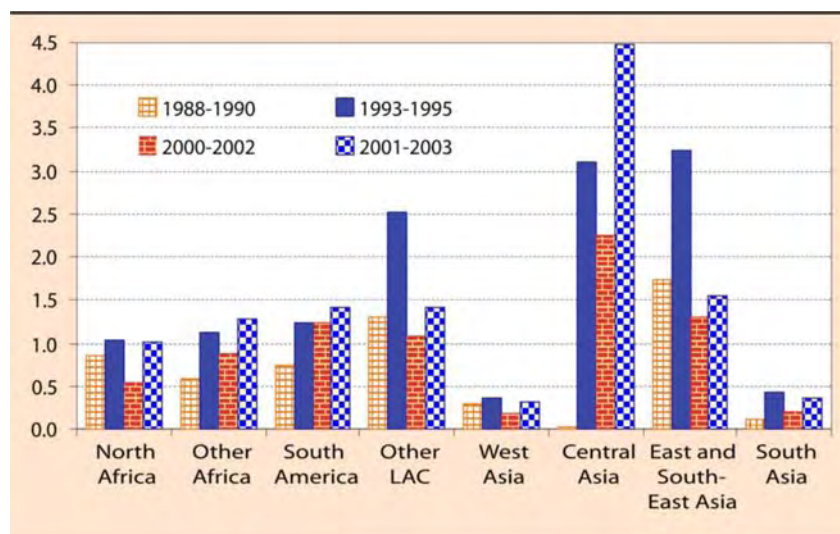
Region	1988-1990	1993-1995	2000-2002	2001-2003
World	1.00	1.00	1.00	1.00
Developed regions	1.03	0.76	0.99	0.92
Western Europe	1.33	1.11	1.87	1.84
European Union	1.33	1.12	1.91	1.88
Other Western Europe	1.31	0.95	1.10	1.12
North America	1.13	0.76	0.67	0.45
Other developed countries	0.29	0.21	0.16	0.21
Developing regions	0.99	1.99	1.00	1.25
Africa	0.70	1.09	0.73	1.16
North Africa	0.85	1.05	0.55	1.00
Other Africa	0.59	1.12	0.89	1.28
Latin America and the Caribbean	0.90	1.60	1.18	1.42
South America	0.74	1.23	1.24	1.42
Other Latin America and the Caribbean	1.30	2.52	1.08	1.43
Asia	1.09	2.34	0.96	1.19
West Asia	0.30	0.36	0.18	0.31
Central Asia	..	3.11	2.26	4.49
South, East and South-East Asia	1.31	2.74	1.11	1.33
East and South-East Asia	1.73	3.25	1.30	1.54
South Asia	0.11	0.43	0.21	0.37
The Pacific	7.35	6.12	0.65	1.01
Central and Eastern Europe	1.04 ^b	1.36	1.17	1.35

Source: UNCTAD.

^a Three-year averages.

^b 1992-1994. As most of the countries in this region did not exist in their present form before 1992, the period for the index is adjusted.

Figure I.8. Inward FDI Performance Index, by developing region, 1988–1990, 1993–1995, 2000–2002, 2001–2003



Source: UNCTAD.

underperformed for other reasons, mainly a historic legacy of inward-looking industrialization, poor infrastructure and (in some countries) political uncertainties.

By country. Belgium/Luxembourg continued to lead the performance index (table I.5; annex table A.I.5 for time-series data), having been the leader since 1998-2000. In part, this reflects Luxembourg's regime that favours financial FDI and involves transshipped FDI (*WIR03*). Azerbaijan came third (having risen from 35th place in 1999-2001 and 13th in 2000-2002) as a result of large investments in its oil and gas industry. In fourth place was Ireland, which had held the same rank in 1998-2000 and third place in the previous period; Ireland is a success story, with a history of steadily improving its locational advantages and competitiveness over time (it held 50th place in the mid-1990s). The bottom place continued to be held by Suriname, with Indonesia just ahead.

Of the top 20 performers, 3 were developed countries, 2 mature East Asian newly industrializing economies, 5 transition economies and 10 other developing countries (including 3 from sub-Saharan Africa). Many high performers in the developing and transition economies were relatively small, with lumpy FDI inflows in resource-based activities or privatization (the three leading developing countries, holding ranks 2, 3 and 5, are all small resource-based economies).

The spread of countries over the Index reflects a mixture of economic, political and policy-induced factors; the ranks do not appear to reflect any consistent correlation with levels of development. Of the highly developed countries, Japan continued to come last, at 132nd place, a continuing legacy of its small FDI receipts, despite recent proactive FDI policies (box II.21). The United States also ranked relatively low (112th place), a sharp deterioration over the previous period when it came 92nd (and from even earlier when it was 77th). The decline reflects a sharp drop in inward M&As, with GDP remaining relatively steady. Over the long term, despite being the largest recipient of FDI, the United States has always ranked comparatively low relative to its GDP. Other developed countries performed better, with Sweden at 42nd place, France 50th, the United Kingdom 83rd, Italy 98th and Germany 102nd.

Among the major developing economies, China ranked 37th, an improvement over its previous rank of 50th. Rather like the United States, China is a small recipient of FDI relative to its GDP, even though it dominates the developing world as an FDI host. Brazil ranked 46th, a worsening over 37th the two previous years. India ranked 114th, a gradual improvement over 121st in the previous year (and roughly the same as the previous few years). Mexico gained its ranking steadily from 73rd in the four earlier periods to 61st in the most recent period. One striking feature of the Index calculation is the

Table I.5. Rankings by Inward FDI Performance Index, 2001-2003

1	Belgium and Luxembourg	36	Spain	71	Portugal	106	Paraguay
2	Brunei Darussalam	37	China	72	Venezuela	107	Niger
3	Azerbaijan	38	Dominican Republic	73	Ukraine	108	Norway
4	Ireland	39	Viet Nam	74	Congo, Democratic Republic of	109	Malawi
5	Angola	40	Denmark	75	Malaysia	110	Turkey
6	Singapore	41	Latvia	76	Zambia	111	Ethiopia
7	Gambia	42	Sweden	77	South Africa	112	United States
8	Kazakhstan	43	Finland	78	Austria	113	Uzbekistan
9	Hong Kong, China	44	Albania	79	Australia	114	India
10	Estonia	45	Panama	80	Papua New Guinea	115	Kyrgyzstan
11	Bolivia	46	Brazil	81	Malta	116	Libyan Arab Jamahiriya
12	Slovakia	47	United Republic of Tanzania	82	Tajikistan	117	Taiwan Province of China
13	Czech Republic	48	Costa Rica	83	United Kingdom	118	Argentina
14	Trinidad and Tobago	49	Switzerland	84	Jordan	119	Russian Federation
15	Mongolia	50	France	85	Myanmar	120	Korea, Republic of
16	Netherlands	51	Bahrain	86	Uruguay	121	Syrian Arab Republic
17	Nicaragua	52	Mali	87	Thailand	122	Sierra Leone
18	Namibia	53	Slovenia	88	El Salvador	123	Egypt
19	Croatia	54	Togo	89	Iceland	124	Yemen
20	Jamaica	55	Lithuania	90	Lebanon	125	Guinea
21	Bulgaria	56	Bahamas	91	Algeria	126	Oman
22	Congo	57	Botswana	92	Benin	127	Greece
23	Mozambique	58	Tunisia	93	Cameroon	128	Rwanda
24	Cyprus	59	Honduras	94	Ghana	129	Kenya
25	Moldova, Republic of	60	Israel	95	Gabon	130	Nepal
26	Guyana	61	Mexico	96	Philippines	131	Burkina Faso
27	Georgia	62	Romania	97	Pakistan	132	Japan
28	Ecuador	63	Peru	98	Italy	133	Bangladesh
29	Sudan	64	Colombia	99	Belarus	134	Haiti
30	Armenia	65	New Zealand	100	Guatemala	135	Zimbabwe
31	TFYR Macedonia	66	Côte d'Ivoire	101	United Arab Emirates	136	Iran, Islamic Republic of
32	Morocco	67	Qatar	102	Germany	137	Kuwait
33	Hungary	68	Poland	103	Senegal	138	Saudi Arabia
34	Chile	69	Nigeria	104	Sri Lanka	139	Indonesia
35	Uganda	70	Canada	105	Madagascar	140	Suriname

Source: UNCTAD calculations.

sharp deterioration in Malaysia's FDI performance. From ranking among the top 10 till the mid-1990s, Malaysia fell in ranking every year in the latter part of the decade, reaching 75th place in 2001-2003. For an economy that depends heavily on FDI to drive its exports, this may be cause for concern, especially since the reasons are not clear.

In the South-East Asian region, Indonesia continued to perform poorly, coming 139th in the last two periods; however, the reason here is clearer – the persistence of political and financial uncertainty following the Asian financial crisis. The two mature Asian Tigers that have, like Japan, been fairly restrictive towards FDI, are the Republic of Korea and Taiwan Province of China; they continued to rank low on the Index, at positions 120 and 117, respectively.

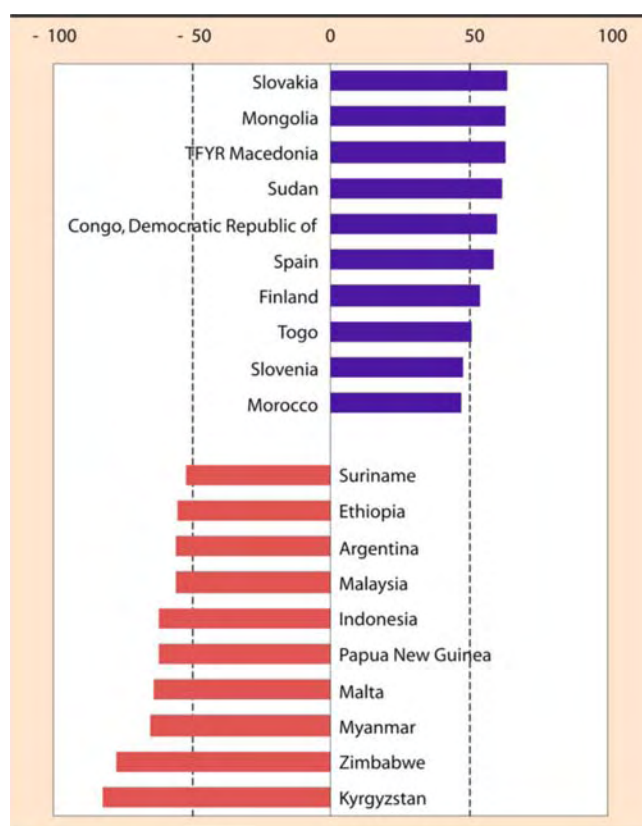
There have been some unexpected “winners” and “losers” in the FDI Performance

Index over the five-year span from 1996-1998 to 2001-2003 (figure I.9). Slovakia showed the largest improvement, moving up 64 places; then came Mongolia, The Former Yugoslav Republic of Macedonia, the Sudan and the Democratic Republic of the Congo, all small economies that have only recently opened up to FDI. The largest losers included Zimbabwe (due to political uncertainty), Malaysia (reasons unclear as noted) and Argentina (macroeconomic disturbances).

Given the volatility inherent in any FDI flow index, too much importance should not be given to changes in ranking. Performance ranks are very unstable.¹⁶ It is not possible to separate the elements causing instability; nor is it desirable, since political or economic turbulence, policy changes, privatizations and the like are central to TNC location decisions. Nevertheless, as noted in listings of the Index in earlier *WIRs*, there is a tendency for the more advanced and larger countries to be relatively stable in the

Figure I.9. Main winners and losers in the Inward FDI Performance ranking, 1996-1998 to 2001-2003

(Changes in ranking)



Source: UNCTAD.

Table I.6. Inward FDI Potential Index, by group of economies, average scores, 1988-2002^a

Period ^a	World	Developed countries	Developing countries	Central and Eastern Europe
1988-1990	0.187	0.374	0.138	..
1989-1991	0.186	0.373	0.137	..
1990-1992	0.208	0.371	0.169	..
1991-1993	0.208	0.372	0.172	..
1992-1994	0.209	0.373	0.173	0.184
1993-1995	0.225	0.407	0.185	0.201
1994-1996	0.221	0.395	0.184	0.187
1995-1997	0.217	0.393	0.180	0.180
1996-1998	0.224	0.398	0.186	0.203
1997-1999	0.224	0.402	0.184	0.204
1998-2000	0.221	0.403	0.179	0.204
1999-2001	0.220	0.400	0.178	0.211
2000-2002	0.220	0.396	0.177	0.221

Source: UNCTAD.

Note: Data for the world and the major country groups shown above are averages of the scores for 140 economies, as follows: 24 developed countries; 99 developing economies; and 17 Central and Eastern Europe economies. They are based on 12 economic and policy variables.

^a Three-year moving averages.

Index, though their rankings shift due to the changes in “newcomers” with more volatile positions.

The UNCTAD *Inward FDI Potential Index*, consisting mainly of structural variables, is far more stable than the Performance Index. Of the 12 variables comprising the Potential Index (see annex table A.I.6 for the raw data on individual variables),¹⁷ only country risk and, to a lesser extent, trade-related measures, tend to vary sharply from one period to the next. Thus, the correlation coefficient between the Potential Index values for the sample countries over previous years is high and rises steadily over time (*WIR03*). This testifies to the structural nature of the measure.

This *WIR* presents, for the first time, Inward FDI Potential Indices averaged across different groups of countries: the world as a whole, developed countries, developing economies and Central and Eastern Europe (table I.6).

For the world as a whole, the average potential for attracting FDI has remained fairly stable. At the country level, the United States

Table I.7. Top 25 rankings by the Inward FDI Potential Index, 1988-2002

Economy	1988-1990	1996-1998	2000-2002
United States	1	1	1
Norway	4	3	2
United Kingdom	3	5	3
Singapore	12	2	4
Canada	2	4	5
Belgium and Luxembourg	10	8	6
Ireland	24	18	7
Qatar	22	20	8
Germany	7	6	9
Sweden	5	7	10
Netherlands	9	9	11
Hong Kong, China	17	14	12
Finland	8	13	13
France	6	10	14
Iceland	15	19	15
Japan	13	12	16
United Arab Emirates	29	11	17
Korea, Republic of	20	21	18
Denmark	16	16	19
Switzerland	11	17	20
Taiwan Province of China	21	24	21
Australia	14	15	22
Israel	27	25	23
Austria	19	22	24
Spain	25	26	25

Source: UNCTAD, based on annex table A.I.7.

remained in first place throughout the period 1988-2002 (table I.7). Among the 25 leading economies, the countries showing biggest improvements in rank were Ireland and Qatar (annex table A.I.7 for all economies). The leading economies in the Potential Index were, as before (*WIR03*), developed countries, the four Asian Tigers and, in the period 2000-2002, two oil-rich economies from West Asia. China, the largest recipient of FDI in the developing world, was 39th by FDI potential ranking.

A comparison between national performance according to the FDI Potential and Performance indices yields insights in terms of the factors that may cause a discrepancy between actual FDI inflows and the structural variables that affect FDI (table I.8). Countries can be grouped according to a matrix divided into four quadrants:

- Front-runners: countries with high FDI potential and performance.
- Above potential: countries with low FDI potential but strong FDI performance.
- Below potential: countries with high FDI potential but low FDI performance.
- Under-performers: countries with both low FDI potential and performance.

As before, there are no real surprises for the first and last groups. The first group includes many developed, newly industrializing and advanced transition economies as well as a few developing countries. The last group mainly has poor (or unstable) economies, but it also includes countries affected by economic shocks such as Argentina and Indonesia. It too has some large economies such as India and Nigeria, and resource-rich countries like Venezuela, which, for various reasons, are performing below their economic potential. In policy terms, the first group has to ensure its continuing success and the latter group to boost its performance in both attracting FDI and enhancing its potential.

The other two groups are of more interest. The above-potential countries are “hitting above their weight” in drawing more FDI than their potential warrants, and the below potential ones are doing the opposite. The first set should be concerned about raising their potential if they are to sustain past FDI performance, and the second should address the shortcomings that prevent their structural FDI

potential from being realized. The below-potential economies include the United States, Australia, Egypt, Italy, Japan, the Republic of Korea, South Africa, Taiwan Province of China and Thailand.

b. The Outward FDI Performance Index

WIR04 introduces an index of *Outward FDI Performance*, calculated in the same way as the Inward FDI Performance Index: the world share of a country’s outward FDI as a ratio of its share in world GDP. The Outward FDI Index captures two aspects of performance:

- A high index value indicates that a country’s firms have strong “ownership advantages” that they are exploiting abroad, or wish to augment through foreign expansion. Ownership advantages are firm-specific competitive strengths of TNCs (or potential TNCs) arising from e.g. innovation, brand names, managerial and organizational skills, privileged access to information, financial or natural resources, historical or cultural links and size and network advantages. In the case of utilities, ownership advantages may arise from recent privatization and financial strength (to buy up privatized utilities elsewhere). Although they are firm-specific, many of these advantages are closely related to a home country’s economic characteristics and competitive strengths. They may also capture strategic factors such as the need to establish a production presence in a dynamic new market, to follow major competitors abroad or to decentralize regional operations to diversify risk.
- A high index value may also indicate that a home country may be less desirable as a place to undertake (specific) productive activities relative to foreign locations; hence firms choose to deploy ownership advantages elsewhere. These “location factors” may reflect purely economic factors in home and host economies (e.g. relative market size, production or transport costs, skills, supply chains, infrastructure, technology support), but they can also reflect policy and institutional differences (such as protection, taxes or labour regulations and FDI-related policies).

Table I.8. Matrix of inward FDI performance and potential, 1988-1990, 1993-1995, 2000-2002

	High FDI performance	Low FDI performance
	2000-2002	
	Front-runners	Below potential
High FDI potential	Bahamas, Belgium and Luxembourg, Botswana, Brazil, Brunei Darussalam, Bulgaria, Canada, Chile, China, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominican Republic, Estonia, Finland, France, Germany, Guyana, Hong Kong (China), Hungary, Ireland, Israel, Jordan, Latvia, Lithuania, Malaysia, Malta, Mexico, Mongolia, the Netherlands, New Zealand, Panama, Poland, Portugal, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Trinidad and Tobago, United Kingdom, Viet Nam.	Australia, Austria, Bahrain, Belarus, Egypt, Greece, Iceland, Islamic Republic of Iran, Italy, Japan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Norway, Oman, Philippines, Qatar, Republic of Korea, Russian Federation, Saudi Arabia, South Africa, Taiwan Province of China, Thailand, United Arab Emirates, United States.
	Above potential	Under-performers
Low FDI potential	Albania, Angola, Armenia, Azerbaijan, Bolivia, Colombia, Congo, Ecuador, Gambia, Georgia, Honduras, Jamaica, Kazakhstan, Mali, Morocco, Mozambique, Namibia, Nicaragua, Republic of Moldova, Sudan, TFYR Macedonia, Togo, Tunisia, Uganda, United Republic of Tanzania.	Algeria, Argentina, Bangladesh, Benin, Burkina Faso, Cameroon, Côte d'Ivoire, Democratic Republic of the Congo, El Salvador, Ethiopia, Gabon, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, Kyrgyzstan, Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Romania, Rwanda, Senegal, Sierra Leone, Sri Lanka, Suriname, Syrian Arab Republic, Tajikistan, Turkey, Ukraine, Uruguay, Uzbekistan, Venezuela, Yemen, Zambia, Zimbabwe.
	1993-1995	
	Front-runners	Below potential
High FDI potential	Argentina, Australia, Bahamas, Bahrain, Belgium and Luxembourg, Brunei Darussalam, Canada, Chile, China, Costa Rica, Czech Republic, Denmark, Dominican Republic, Estonia, France, Guyana, Hong Kong (China), Hungary, Indonesia, Ireland, Jamaica, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Panama, Papua New Guinea, Poland, Qatar, Republic of Moldova, Singapore, Slovakia, Spain, Sweden, United Kingdom.	Austria, Botswana, Bulgaria, Cyprus, El Salvador, Finland, Germany, Greece, Iceland, Islamic Republic of Iran, Israel, Italy, Japan, Jordan, Kuwait, Libyan Arab Jamahiriya, Oman, Portugal, Republic of Korea, Russian Federation, Saudi Arabia, Slovenia, South Africa, Suriname, Switzerland, Taiwan Province of China, Thailand, Ukraine, United Arab Emirates, United States, Uruguay, Uzbekistan, Venezuela.
	Above potential	Under-performers
Low FDI potential	Albania, Angola, Azerbaijan, Bolivia, Colombia, Congo, Côte d'Ivoire, Ecuador, Egypt, Gambia, Ghana, Honduras, Kazakhstan, Kyrgyzstan, Latvia, Mali, Morocco, Mozambique, Myanmar, Namibia, Nicaragua, Nigeria, Paraguay, Peru, Philippines, Tajikistan, Trinidad and Tobago, Tunisia, Uganda, United Republic of Tanzania, Viet Nam, Yemen, Zambia.	Algeria, Armenia, Bangladesh, Belarus, Benin, Brazil, Burkina Faso, Cameroon, Croatia, Democratic Republic of the Congo, Ethiopia, Gabon, Georgia, Guatemala, Guinea, Haiti, India, Kenya, Lebanon, Lithuania, Madagascar, Malawi, Mongolia, Nepal, Niger, Pakistan, Romania, Rwanda, Senegal, Sierra Leone, Sri Lanka, Sudan, Syrian Arab Republic, TFYR Macedonia, Togo, Turkey, Zimbabwe.
	1988-1990	
	Front-runners	Below potential
High FDI potential	Australia, Bahrain, Belgium and Luxembourg, Botswana, Canada, Chile, China, Colombia, Costa Rica, Cyprus, Denmark, France, Greece, Hong Kong (China), Indonesia, Ireland, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Oman, Portugal, Singapore, Spain, Sweden, Switzerland, Taiwan Province of China, Thailand, Trinidad and Tobago, United Kingdom, United States, Venezuela.	Algeria, Austria, Bahamas, Brazil, Brunei Darussalam, Finland, Germany, Hungary, Iceland, Islamic Republic of Iran, Israel, Italy, Japan, Kuwait, Libyan Arab Jamahiriya, Panama, Poland, Qatar, Republic of Korea, Saudi Arabia, South Africa, Suriname, United Arab Emirates, Uruguay.
	Above potential	Under-performers
Low FDI potential	Argentina, Benin, Bolivia, Dominican Republic, Ecuador, Egypt, Gabon, Gambia, Guatemala, Guyana, Honduras, Jamaica, Malawi, Myanmar, Niger, Nigeria, Papua New Guinea, Paraguay, Philippines, Sierra Leone, Syrian Arab Republic, Togo, Tunisia, Viet Nam, Zambia.	Angola, Bangladesh, Burkina Faso, Cameroon, Côte d'Ivoire, Congo, Democratic Republic of the Congo, El Salvador, Ethiopia, Ghana, Guinea, Haiti, India, Jordan, Kenya, Lebanon, Madagascar, Mali, Morocco, Mozambique, Namibia, Nepal, Nicaragua, Pakistan, Peru, Rwanda, Senegal, Sri Lanka, Sudan, Turkey, Uganda, United Republic of Tanzania, Yemen, Zimbabwe.

Source: UNCTAD.

The fact that some activities are no longer performed at home by a TNC does not mean that its home country is uncompetitive in a general sense. On the contrary, as a country develops and wages rise, its comparative advantages move up the skills and technology scale. The relocation of simpler activities overseas may well be an integral part of such upgrading. TNCs rarely move *all* their activities overseas; they generally retain the highest value functions (e.g. R&D, strategic decision-making) at home. In addition, overseas investment may be part of a firm's efforts to assemble a portfolio of locational assets (WIR95) as a source of global competitiveness. Indeed, often FDI is necessary to maintain export competitiveness, regardless of production costs. Increasingly, firms also invest abroad to tap specialized innovation and skills in other countries. Thus, location factors are a mix of "push" and "pull" forces in home and host economies.

The Outward FDI Performance Index does not distinguish between ownership and location factors. Theory suggests that the more industrialized countries – whose firms have greater ownership advantages and fewer locational advantages in simple activities – have higher index values than less developed ones. Given levels of development, larger home countries can be expected to have less outward FDI in relation to their size than smaller economies. And, given development and size, historical and location factors should affect the ratio. Finally, special factors can affect outward FDI: tax havens or offshore financial centres should have high values relative to their size.

The Index can be calculated on the basis of outward FDI flows or stocks: flows reflect current FDI activity, while stocks reflect accumulated activity. Both are subject to caveats on FDI data and the ambiguous nature of the origin of some FDI flows and stocks. "Roundtripping", where investment is made abroad for tax reasons and ends

up back in the home country (e.g. in China), is one such problem.

Bearing in mind these qualifications, the Outward FDI Performance Index for flows for 2000-2002 is considered here (see table I.9 for the top 20 performers and annex table A.I.8 for all countries). As expected, the list of leaders contains several tax havens and offshore financial centres, the outward FDI of which originates elsewhere. Apart from these, most of the leaders are high-income economies. Of 11 economies with ratios above two, six are European; the remaining five are developing economies, including Hong Kong (China) and Singapore, both of which are rich and also act as conduits for investment from elsewhere. The larger developed economies – Germany, the United States, Japan – have low values, suggesting that even these major outward investors (in absolute terms) have some way to go before they reach the levels of outward FDI that would be expected of them.

Most developed countries have seen an increase in their outward FDI indices over time. The faster rise in FDI than their share of global GDP indicates that their enterprises are building ownership advantages more rapidly and/or are

Table I.9. Outward FDI Performance Index for the 20 leading investor economies, 1988-2003^a

Rank	Economy	1988-1990	1993-1995	1999-2001	2000-2002	2001-2003
1	Belgium and Luxembourg	2.676	2.087	12.620	16.160	22.741
2	Panama	7.243	2.671	1.254	3.049	6.548
3	Singapore	2.892	4.783	3.579	3.695	5.104
4	Netherlands	3.872	3.964	4.904	5.090	4.643
5	Azerbaijan	0.993	1.057	3.764
6	Hong Kong, China	3.370	14.911	5.760	6.813	3.477
7	Sweden	4.540	2.688	3.035	3.120	2.329
8	Bahrain	0.559	1.203	0.540	0.647	2.309
9	Switzerland	3.442	3.562	4.040	3.541	2.303
10	France	1.844	1.292	2.996	2.914	2.209
11	Spain	0.429	0.636	2.317	2.500	2.178
12	Denmark	1.107	1.650	3.624	3.524	1.921
13	Canada	0.905	1.402	1.459	1.865	1.869
14	United Kingdom	2.963	2.927	3.559	2.791	1.603
15	Portugal	0.161	0.357	1.718	2.052	1.487
16	Australia	0.947	0.722	0.343	0.687	1.421
17	Iceland	0.059	0.277	1.091	1.462	1.407
18	Cyprus	0.036	0.181	0.649	0.966	1.382
19	Botswana	0.076	0.405	0.776	1.022	1.334
20	Ireland	1.895	0.778	1.579	1.397	1.251

Source: UNCTAD.

Notes: Economies are ranked in descending order of their performance index in 2001-2003. Figures were calculated based on outward flows.

^a Three-year moving averages.

choosing to exploit their advantages in foreign locations. Some, such as Finland, are going overseas at a particularly fast pace, driven in this case by Nokia, a firm in an industry that is highly dynamic and transnationalized. The index for Hong Kong (China) has risen at an exceptionally fast pace, but this reflects in part its peculiar situation as a staging post for FDI into China and as a recipient of roundtripping by Chinese enterprises.

The Index based on outward FDI stock shows similar patterns (annex table A.I.9): there are nine economies with performance ratios above two, of which six are European; and the other three are Hong Kong (China), Panama and Singapore. Belgium-Luxembourg and Hong Kong (China) are again outliers. Germany is not below average by this measure, but the United States and Japan are. Among developing economies other than the three mentioned above, the highest performance ratios are seen for Malaysia, Bahrain and Bahamas, followed by Taiwan Province of China, Botswana and South Africa.

B. Outward FDI from developing countries is becoming important

As in the past, TNCs from developed countries will drive the recovery of world FDI flows. But those from developing countries, too, will contribute, increasingly so in manufacturing and especially in services. Some developing economies (e.g. Malaysia, the Republic of Korea, Singapore) already have an established track record. Others – such as Chile, Mexico, South Africa – have become players relatively recently. And again others – Brazil, China, India – are at the take-off stage. This reflects the recognition of firms that, in a globalizing world economy, they need a portfolio of locational assets to be competitive internationally (*WIR95*). Their investments span all sectors and country groups and involve complex as well as simple industries (annex table A.I.19). If outflows are viewed in relation to gross fixed capital formation (table I.10), a number of developing economies (Singapore, Hong Kong (China), Taiwan Province of China) rank higher than a number of developed countries (Germany, Japan, the United States). This suggests that a number of developing countries, relatively

speaking, are already among top investors. (When stock is taken as the basis, this is also the case (annex table B.6).)

What is happening?

Annual FDI outflows from developing countries have grown faster over the past 15 years than those from developed countries. Negligible until the beginning of the 1990s (figure I.10), outward FDI from developing countries accounted for over one-tenth of the world total stock and some 6% of world total flows in 2003 (\$0.9 trillion and \$36 billion, respectively). FDI

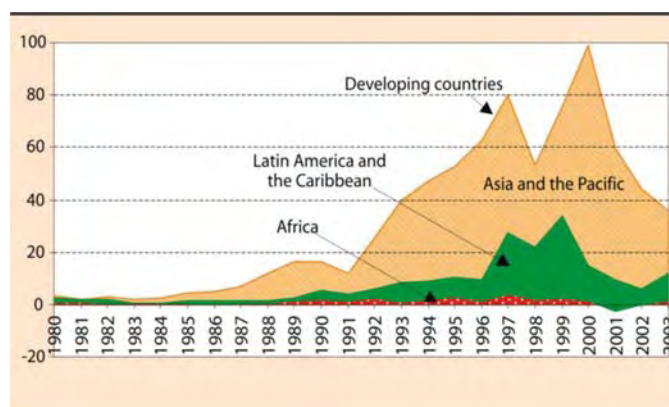
Table I.10. FDI outflows as a percentage of gross fixed capital formation in selected developing economies, 2001-2003^a
(Per cent)

Economy	Value
Singapore	36.3
Hong Kong, China	28.2
Taiwan Province of China	10.5
Chile	7.4
Malaysia	5.3
India	1.0
China	0.8
Brazil	0.2
<i>Memorandum:</i>	
Sweden	27.4
France	22.0
United Kingdom	19.0
United States	6.6
Germany	4.1
Japan	3.2
Greece	1.8

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

^a Annual average.

Figure I.10. FDI outflows from developing countries, by region, 1980–2003
(Billions of dollars)



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

from developing countries to other developing countries seems to be growing faster than that from developing countries to developed countries (box I.2). Some developing economies are now large investors by global standards. In 2003, for instance, Hong Kong (China) had a larger outward FDI stock than Sweden, even if roundtripping and indirect FDI is taken into account.¹⁸ Its TNCs figure prominently among the leading TNCs from the developing world, along with those from Singapore, Mexico and, more recently, South Africa (box I.3).

There is, however, considerable regional variation in outward FDI performance. Asia, led by South, East and South-East Asia, was by far the largest outward investor in the developing world, followed by Latin America (table I.11). In recent years, FDI from Africa and Asia has been rising, while outflows from Latin America and the Caribbean have stagnated. Overall, however, the share of developing countries in outward FDI may rise as developing-country governments increasingly realize its benefits and encourage it further.¹⁹ The following briefly

Box I.2. South-South FDI flows rose in the 1990s

In the 1990s, many developing countries emerged as significant sources of FDI to other developing countries. Due to the lack of data at the desired level of disaggregation, indirect data (Aykut and Ratha 2004) suggest that by the end of the decade, more than one-third of the FDI in developing countries originated from other developing countries. According to these estimates, South-South FDI flows appear to have grown faster than FDI from high-income countries to developing countries (North-South FDI) in the late 1990s, and have remained relatively more resilient in the post-Asian-crisis period as well.

The rise in South-South FDI flows has been motivated by similar push and pull factors, and similar structural, cyclical and policy factors, as the surge in North-South FDI flows. Some of the push factors include increased competition or limited growth opportunities in their domestic markets (e.g. South African retailing companies in Africa), efficiency-seeking (e.g. Malaysian manufacturing companies in Indonesia and Viet Nam) and procurement of raw materials (e.g. China's investments in iron ore and steel mills in Peru, oil in Angola and the Sudan). In addition to low labour costs and market-access opportunities, the most important pull factors for South-South FDI flows appear to be geographic proximity and ethnic and cultural ties. Since the cost of acquiring reliable information about foreign markets can be high for relatively small companies from the South, they tend to invest in neighbouring countries, where they have established a certain familiarity through trade or ethnic and cultural ties. For example, perhaps because of ethnic ties, companies from the Republic of Korea invest in

Kazakhstan, and ethnic Chinese companies invest in the East Asia and Pacific region.^a

South-South FDI also benefits from fiscal and other incentives provided by developing-country governments. For example, China is promoting outward FDI by offering loans on preferential terms, tax rebates and investment insurance (*WIR01*). The Government of Malaysia encourages South-South FDI flows through special deals signed with such countries as India, the Philippines, Viet Nam and the United Republic of Tanzania (Mirza 2000). Regional trading arrangements also contribute to the growth in South-South FDI. Since the late 1990s, increasing wealth in some emerging-market economies has increased the supply of capital; and capital-account liberalization in developing countries has enabled their companies to invest in other developing countries.

The growing importance of South-South FDI indicates that developing countries are more financially integrated with one another than was previously believed. Thus, a typical developing country has access to more sources of investment than before. This is particularly important for small economies, as TNCs from the South, because of their comparative advantages, tend to invest in countries with similar or lower levels of development than their home countries.

South-South FDI is expected to remain significant for developing countries (World Bank 2004). In particular, investment from China is bound to increase as the Government has decided to relax restrictions on outward investment, partly to ease the pressure of rising international reserves on the fixed currency regime (UNCTAD 2003).

Source: Aykut and Ratha 2004.

^a For a different interpretation, see Mathews 2002.

Box I.3. The top 50 TNCs from developing economies

UNCTAD has published a list of the largest TNCs from developing countries since 1995 (*WIR95*). The average Transnationality Index value of the top 50 increased between 1995 and 2002. The composition of the largest TNCs among the top 50 did not change much during this period, and the ten largest accounted for almost two-thirds of foreign assets, almost the same as between 1995 and 2002. However, they now come from fewer economies (11) than in 1995 (14).

While many enterprises from the previous year's list disappeared from the list in 2002 and were replaced by newcomers, the top remained almost unchanged. Asia continued to dominate the top 50, with 32 enterprises. Hutchison (Hong Kong, China) and Singtel (Singapore) remained in the top positions. Telecom firms also retained their strong positions in the list (box table I.3.1).

The increase in the average Transnationality Index value in 2002 occurred against a backdrop of a decline of almost all indicators – foreign as well as total – in their operations. The exception was employment: foreign and total employment rose significantly (box table I.3.2). The TNCs with the largest increases in the Transnationality Index were from the food, steel, motor vehicle and telecom industries, along with diversified companies.

As in previous years, the number of exits and entries of the top 50 firms from developing economies was higher than for the top 100. The newcomers to the top 50 list were mostly companies entering the list for the first time. Most newcomers were from Asia, notably from Singapore and Hong Kong (China). From Latin America, there were only two new companies, both Mexican. There were also four new entrants from South Africa.

Source: UNCTAD.

Box table I.3.2. Snapshot of the top 50 TNCs from developing economies, 2002
(Millions of dollars, number of employees and per cent)

Variable	2001		2002		Change 2002 vs. 2001 (Per cent)
	Value	Foreign share	Value	Foreign share	
Assets					
Foreign	186 471	35.3	195 196	42.0	4.7
Total	527 928		464 271		-12.1
Sales					
Foreign	145 318	40.1	139 991	45.4	-3.7
Total	362 249		308 440		-14.8
Employment					
Foreign	541 361	42.4	713 624	47.5	31.8
Total	1 275 493		1 503 279		17.8
Average TNI	44.8		49.2		4.4 ^a

Source: UNCTAD/Erasmus University database.

^a The change between 2001 and 2002 is expressed in percentage points.

The top 50 TNCs span a wide range of activities. The main ones were electrical and electronic equipment (gradually declining in importance), food and beverages. The export-competitiveness of the electronics industry, especially in Asia, helped it maintain a dominant position. The strength of food and beverages was based more on home markets, again led by Asia and also, to a lesser extent, Latin America. Some service industries featured prominently, in particular transport (many Asian firms benefited from the region's rapidly expanding trade).

The degree of transnationality of the top 50 is lower than that of the top 100 TNCs worldwide. Most of the former have a much shorter history and are in the first stages of their transnationalization.

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examines outward FDI performance by region and analyses FDI outflows from a few of the major investors in the developing world.

In *Africa*, five countries – South Africa, Nigeria, the Libyan Arab Jamahiriya, Liberia, Botswana (in that order) – dominated outward FDI in 2003. They accounted for 84 % of Africa's total outward stock of \$39 billion (table I.11 and annex table B.4). The continent's outward FDI, small as it is, has been rising since the late 1980s

(figure I.11), mainly because of the expansion of South African firms within and, especially, outside Africa (South Africa accounted for about 60% of Africa's FDI outflows as well as FDI outward stock in 2003; annex tables B.2 and B.4). Outflows from the region were almost \$2 billion during the first half of the 1990s.²⁰

South Africa is by far the most important African outward investor. It ranked ninth among developing economies in 2003 in terms of

Box table I.3.1. The top 50 non-financial TNCs from developing economies, ranked by foreign assets, 2002^a
(Millions of dollars, number of employees)

Ranking by Foreign assets	TNI ^b	Corporation	Home economy	Industry ^c	Assets		Sales		Employment		TNI ^b (Per cent)
					Foreign	Total	Foreign ^e	Total	Foreign	Total	
1	10	Hutchison Whampoa Limited	Hong Kong, China	Diversified	48 014	63 284	8 088	14 247	124 942	154 813	71.1
2	14	Singtel Ltd.	Singapore	Telecommunications	15 775 ^d	19 071	3 247	5 801	9 877	21 716	61.4
3	44	Petronas - Petroliam Nasional Berhad	Malaysia	Petroleum expl./ref./distr.	13 200	46 851	6 600	21 433	4 979	25 940	26.0
4	11	Cemex S.A.	Mexico	Construction Materials	12 193 ^d	16 044	4 366	7 036	17 568	26 752	67.9
5	33	Samsung Electronics Co., Ltd.	Republic of Korea	Electrical & electronic equipment	11 388	51 964	28 298	47 655	28 300 ^f	82 400	38.5
6	26	LG Electronics Inc. ^f	Republic of Korea	Electrical & electronic equipment	5 845	16 214	11 387	23 553	30 029	55 053	46.3
7	15	Jardine Matheson Holdings Ltd	Hong Kong, China	Diversified	5 729 ^d	8 255	4 449 ^j	7 398	60 000 ^f	114 000	60.7
8	2	Neptune Orient Lines Ltd. ^f	Singapore	Transport and storage	4 580 ^d	4 771	4 501	4 642	11 187	12 218	94.8
9	17	Citic Pacific Ltd.	Hong Kong, China	Construction	4 170	7 328	1 567	2 861	7 388	11 643	58.4
10	9	Sappl Limited	South Africa	Paper	3 733 ^d	4 641	2 941	3 729	9 807 ^f	17 572	71.7
11	6	Shangri-La Asia Limited	Hong Kong, China	Hotels and motels	3 663 ^d	4 593	463	601	13 000 ^g	16 300	78.9
12	34	Sasol Limited	South Africa	Industrial chemicals	3 623	8 960	3 687	7 114	7 107	31 150	38.4
13	3	Guangdong Investment Limited	Hong Kong, China	Diversified	3 601	3 924	815	876	5 994	6 580	92.0
14	5	Flextronics International Ltd. ^k	Singapore	Electrical & electronic equipment	3 488 ^d	4 897	5 903	7 812	76 187	78 000	81.5
15	25	Capitalland Limited	Singapore	Real estate	3 165	9 403	1 114	1 823	5 111 ^l	10 333 ^l	48.1
16	13	City Developments Limited ^m	Singapore	Hotels	2 954 ^d	6 490	806	1 278	11 001	13 940	62.5
17	50	Petroleo Brasileiro S.A. - Petrobras	Brazil	Petroleum expl./ref./distr.	2 863	32 018	1 085	22 612	2 200 ^f	46 723	6.1
18	22	MTN Group Limited	South Africa	Telecommunications	2 582	3 556	729	1 991	1 970	4 192	52.1
19	21	Anglogold Limited	South Africa	Gold ores	2 301	3 964	831	1 761	30 821 ^g	53 097	54.4
20	12	First Pacific Company Limited	Hong Kong, China	Electrical & electronic equipment	2 276 ^d	2 313	1 892	1 892	25 ^f	46 422	66.1
21	35	Companhia Vale do Rio Doce	Brazil	Mining & quarrying	2 265 ^f	7 955	2 928	4 268	1 493 ^f	13 973	35.9
22	31	Metalurgica Gerdau S.A. ^f	Brazil	Metal and metal products	2 089	4 093	1 340	3 136	5 977	18 995	41.7
23	27	Perez Companc	Argentina	Petroleum expl./ref./distr.	2 052	4 090	567	1 484	1 633 ^g	3 255	46.2
24	39	América Móvil	Mexico	Telecommunications	2 002	10 966	1 664	5 953	6 629	14 572	30.6
25	42	Singapore Airlines Limited	Singapore	Transport and storage	1 969 ^h	10 866	2 472	5 260	2 613	14 418	27.7
26	49	CLP Holdings	Hong Kong, China	Electricity, gas and water	1 905 ^f	7 793	130	3 350	37 ^f	4 303	9.7
27	45	Samsung Corporation	Republic of Korea	Electrical & electronic equipment	1 897 ^h	6 370	5 316 ^l	29 533	1 223 ^g	4 105	25.9
28	29	Kulim (Malaysia) Berhad	Malaysia	Food & beverages	1 729	3 689	166	516	10 800	22 112	42.6
29	40	Keppel Corporation Limited	Singapore	Diversified	1 657	6 609	604	3 087	8 722	19 947	29.5
30	32	Naspers Limited	South Africa	Media	1 655 ^d	2 498	412	1 148	1 742 ^f	10 711 ^f	39.5

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Box table I.3.1. The top 50 non-financial TNCs from developing economies, ranked by foreign assets, 2002^a (concluded)

(Millions of dollars, number of employees)

Ranking by Foreign assets	TNI ^b	Corporation	Home economy	Industry ^c	Assets		Sales		Employment		TNI ^b (Per cent)
					Foreign	Total	Foreign ^e	Total	Foreign	Total	
31	20	Barloworld Ltd	South Africa	Diversified	1 596	2 569	1 984	3 409	9 973	23 192	54.5
32	41	United Microelectronics Corporation	Taiwan Province of China	Electrical & electronic equipment	1 531	9 418	1 320	2 180	1 002 ^f	10 136	28.9
33	19	Fraser & Neave Limited	Singapore	Food & beverages	1 466	4 374	1 037	1 931	9 130	11 816	54.8
34	46	Hyundai Motor Company	Republic of Korea	Motor vehicles	1 461 ^h	16 694	9 746	21 070	4 379 ^g	50 038	21.3
35	48	Nan Ya Plastics Corporation	Taiwan Province of China	Rubber and plastics	1 403 ^d	9 743	850	5 011	10 394 ^g	72 174	15.3
36	36	Grupo Bimbo SA De Cv	Mexico	Food	1 400	3 077	1 389	4 286	16 235	72 500	33.4
37	16	Orient Overseas International Ltd ^k	Hong Kong, China	Transport and storage	1 148	2 189	1 012	2 458	4 039	4 743	59.6
38	1	CP Polphand Company Limited	Thailand	Food	1 086	1 107	1 542	1 542	52 976 ^g	54 000	98.7
39	18	Gruma S.A. De C.V.	Mexico	Food & beverages	1 084	2 148	1 301	1 986	8 314	14 887	57.3
40	38	Swire Pacific Limited	Hong Kong, China	Business services	1 000 ^d	8 880	963	1 951	17 969	55 700	31.0
41	7	Savia SA De Cvf	Mexico	Diversified	941	1 362	633	682	5 316	7 375	78.0
42	37	Grupo Imsa	Mexico	Metal and metal products	831	3 037	1 182	2 827	4 149 ^f	15 800	31.8
43	8	Asia Pacific Breweries Ltd.	Singapore	Food & beverages	814	1 056	754	1 093	2 023 ^g	2 624	74.4
44	24	Nampak Limited	South Africa	Rubber and plastics	782 ^d	1 281	328	1 317	10 962 ^f	18 062	48.9
45	23	Kumpulan Guthrie Berhad	Malaysia	Rubber and plastics	780	2 397	369	811	40 199 ^f	56 143	49.9
46	4	Li & Fung Limited	Hong Kong, China	Wholesale trade	765	781	4 642	4 779	3 466	5 313	86.8
47	43	Cintra	Mexico	Air courier services	748 ^d	1 937	1 169	2 969	629 ^f	19 928	27.1
48	30	Advanced Semiconductor Engineering Inc	Taiwan Province of China	Computer and related activities	724 ^d	3 020	990	1 317	5 340	20 401	41.8
49	28	Hong Kong And Shanghai Hotels Ltd.	Hong Kong, China	Hotels	650	2 404	135	332	3 653	5 953	43.0
50	47	San Miguel Corporation	Philippines	Food & beverages	623 ^d	3 318	277	2 639	5 114 ^g	27 259	16.0

Source: UNCTAD/Erasmus University database.

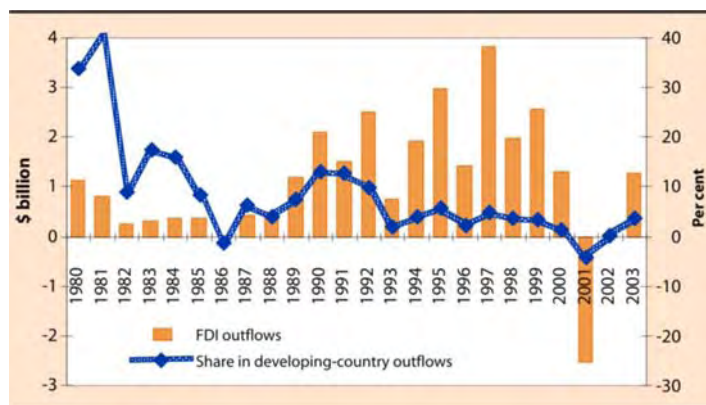
^a All data are based on the companies' annual reports unless otherwise stated.^b TNI, or "Transnationality Index", is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.^c Industry classification for companies follows the United States Standard Industrial Classification as used by the United States Securities and Exchange Commission (SEC).^d In a number of cases, companies reported only partial foreign assets. In these cases, the ratio of the partial foreign assets to the partial (total) assets was applied to calculate the total foreign assets. In all cases, the resulting figures have been sent for confirmation to the companies.^e Foreign sales are based on the origin of the sales. In a number of cases companies reported only sales by destination.^f Data were obtained from the company as a response to an UNCTAD survey.^g Foreign employment data were calculated by applying the share of foreign assets in total assets to total employment.^h Foreign assets were calculated by applying the share of foreign employment in total employment to the balance total assets.ⁱ Foreign sales were calculated by applying the share of foreign assets in total assets to total sales.^j Data for outside Hong Kong (China) and mainland China.^k Data for outside Asia.^l Data are for September 2003.^m Data for outside East and South-East Asia.

Table I.11. FDI from developing economies, by region and major economy, 1980-2003
(Billions of dollars)

Region/economy	FDI outflows (annual average)				FDI outward stock				
	1980-1989	1990-1994	1995-1999	2000-2003	1980	1990	1995	2000	2003
Developing economies	5.7	28.1	64.9	59.6	60.2	128.6	308.6	793.3	858.7
Africa	0.5	1.8	2.6	-	6.9	20.9	32.9	45.6	39.5
South Africa	0.2	0.7	1.9	-0.6	5.7	15.0	23.3	32.3	24.2
Latin America and the Caribbean	0.9	4.7	18.0	10.6	46.9	58.8	86.3	155.5	183.8
Brazil	0.2	0.6	1.3	0.7	38.5	41.0	44.5	51.9	54.6
Chile	-	0.4	1.5	1.8	-	0.2	2.4	11.2	13.8
Mexico	0.1	0.4	0.7	1.9	-	1.1	2.6	7.5	13.8
Asia and the Pacific	4.3	21.6	44.3	49.0	6.5	48.9	189.5	592.3	635.4
South, East and South-East Asia	3.7	21.6	43.6	45.8	4.5	41.0	181.8	577.8	607.5
China	0.4	2.4	2.2	3.0	-	2.5	15.8	25.8	37.0
Hong Kong, China	1.2	10.5	22.5	23.0	0.1	11.9	78.8	388.4	336.1
India	-	-	0.1	1.0	-	-	0.3	1.9	5.1
Korea, Republic of	0.4	1.5	4.3	3.4	0.1	2.3	10.2	26.8	34.5
Malaysia	0.2	0.8	2.2	1.4	0.2	2.7	11.0	21.3	29.7
<i>Memorandum</i>									
World	93.3	234.8	603.1	779.3	559.6	1758.2	2897.6	5983.3	8196.9

Source: UNCTAD, based on annex tables B.2 and B.4; FDI/TNC database (www.unctad.org/fdistatistics).

Figure I.11. Africa: FDI outflows and their share in total developing-country outflows, 1980-2003
(Billions of dollars and per cent)



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

outward stock (annex table B.4), though the value of its stock that year was lower than in 2000 (figure I.12). Outward flows amounted to \$720 million in 2003, about 3% of gross fixed capital formation (annex table B.5).²¹ While 90% of its FDI stock is in developed countries (75% in Western Europe alone) (annex table A.I.10), an increasing number of large investments have been going to other African countries recently (annex table A.I.11). And in 2002, South Africa's FDI stock in Africa accounted for 7% of the country's total outward FDI. In absolute terms, the amounts invested in African countries may be small, but

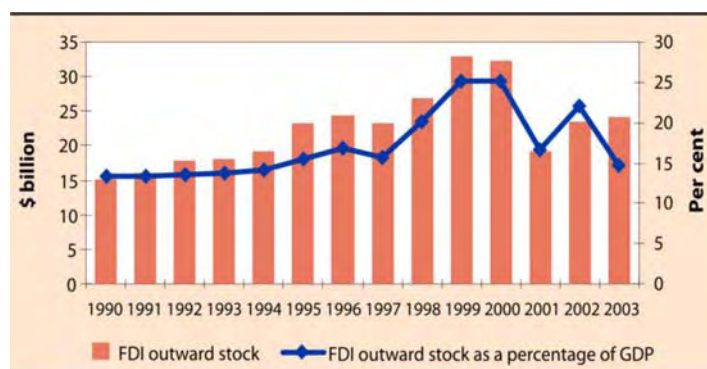
they account for a significant share of FDI for some African economies (e.g. Mozambique).

Several factors have driven South Africa's outward FDI in the rest of Africa:

- The liberalization of South Africa's regulatory regime for outward FDI has facilitated the expansion abroad of firms from that country. In addition, the country has signed 6 BITs and 14 DITs in the region.
- The liberalization of the country's trade and exchange controls has raised competition in local markets and encouraged firms to look abroad. At the same time, privatization and liberalization in other African countries have allowed South African companies to acquire firms in the region.
- South African firms often have technological advantages over local competitors in Africa and greater familiarity with African conditions than TNCs from other regions.

By the end of the 1990s, South Africa had over 900 TNCs (annex table A.I.2); seven of them were among the top 50 non-financial TNCs from developing economies in 2002. Some TNCs –

Figure I.12. South Africa: outward FDI stock and its share in GDP, 1990-2003^a
(Billions of dollars and per cent)



Source: UNCTAD.

MTN, Eskom, Sasol, Vodacom SA – have started to expand regionally in the past few years such as in the Democratic Republic of the Congo, Mozambique, Namibia, the United Republic of Tanzania and Zimbabwe (annex table A.I.11). Others have become major world players in their industries: AngloGold of South Africa became the world's largest gold producer when it acquired the Ashanti gold mine of Ghana in 2003, and SABMiller (with its primary listing in the United Kingdom) has become one of the world's largest breweries, controlling more than 160 factories in over 40 countries.

Developing Asia is the largest and fastest growing outward investor in the developing world. With an outward FDI stock amounting to \$635 billion in 2003, the region accounted for three-quarters of the total outward FDI stock of developing economies (annex table B.4). It also accounted for some four-fifths of total outflows of \$46 billion, on annual average, during 2000-2003 (figure I.13 and table I.11). Hong Kong (China) registered the highest levels of outward FDI, but those data need to be interpreted with caution: they include significant amounts of roundtripping and indirect FDI (box I.4). Other large investors are China, the Republic of Korea, Malaysia, Singapore and Taiwan Province of China. The key drivers of Asian FDI are the growing capabilities of Asian firms, their strong export orientation and their need to access technology, brand names and strategic assets abroad. Realizing the value of FDI, most governments in the region are actively encouraging their firms to become transnational. The

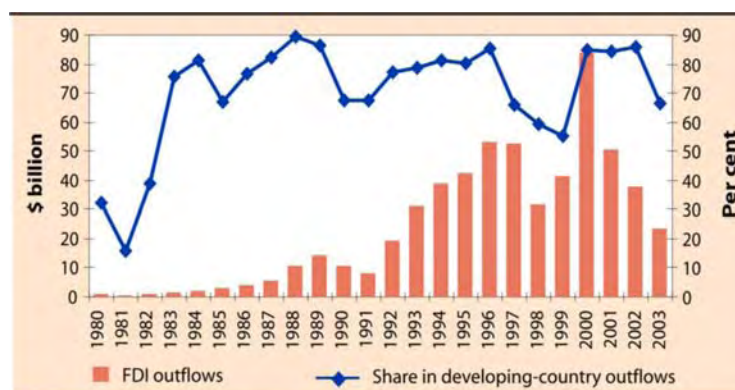
growing number of regional FTAs, particularly involving economies in North-East and South-East Asia, is also increasing investor interest in the region.

The rapid rise of *China* as an outward investor, particularly in resource extraction, is noteworthy: its average annual outward FDI flows grew from \$450 million in the 1980s to \$2.3 billion in the 1990s, and its outward FDI stock was estimated at \$37 billion by end 2003 (figure I.14). Its ranking in the Outward FDI Performance Index in 2001-2003 was 58, almost at the middle of the 128 country list (annex table A.I.8). Chinese TNCs invest not only in neighbouring countries, but also in Africa, Latin America, North America and Europe. Their main destinations, however, remain by far Hong Kong (China), followed by the United States: together these two destinations accounted for more than half of approved Chinese outward FDI during the period 1979-2003 (annex table A.I.12).

The expansion abroad of Chinese enterprises is driven by:

- their desire to support exports, expand their market presence and acquire foreign skills;
- their desire to establish local distribution networks, especially in industries with excess production capacity (such as machinery and electronic appliances);²²
- growing exposure to international business and their increasing financial strength;
- intensified domestic competition and the need to relocate mature industries to lower

Figure I.13. Asia and the Pacific: FDI outflows and their share in total developing-country outflows, 1980-2003
(Billions of dollars and per cent)



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

Box I.4. FDI flows from Hong Kong (China)

Indirect FDI (undertaken by foreign affiliates in Hong Kong (China)) and roundtripping characterize a good part of investment from this economy. The territory is the largest outward direct investor among developing economies and the seventh overall largest contributor to global outward FDI stock.

Its outward FDI *stock* amounted to \$309 billion in 2002. Four tax havens – the British Virgin Islands, Bermuda, Panama and the Cayman Islands, in that order – accounted for 54% of the total Hong Kong (China) outward FDI stock (box table I.4.1). If the channelling of funds to non-operating companies in these four offshore financial centres (as well as other locations) set up by Hong Kong (China) companies were excluded (which amount to \$92 billion, i.e. more than half of the amount that corresponds to 54%), the outward FDI stock of the economy would shrink to \$217 billion in 2002 (box table I.4.1). Mainland China accounted for another 35%. These four economies and China together received 89% of their FDI from Hong Kong (China) – they also contributed 66% of the total inward FDI to the economy.

Foreign affiliates established in Hong Kong (China) are also important outward investors, which represents indirect FDI. The close relationship between mainland China and Hong Kong (China) continues to attract such indirect FDI, as foreign affiliates (and domestic) based in the territory can take advantage of the privileges accorded under the Closer Economic Partnership Arrangement for investing in the mainland (box II.8).

In terms of FDI *outflows*, at least 14% of the total between 2000 and 2002 can be attributed to the channelling of funds to non-operating companies in tax-havens alone (China, Census and Statistics Department of Hong Kong 2004). Roundtripping FDI from China through Hong Kong (China) and back to China has been estimated at about 25% of outward FDI flows (*WIR03*, p. 45). However, according to a recent estimate by the Bank of China Group, roundtripping FDI to China accounts for 10-20% of FDI outflows (China, Hong Kong Trade and Development Cooperation 2003). Therefore, roundtripping involving China and tax havens probably amounts to 25-40% of total FDI outflows from Hong Kong (China).

Box table I.4.1. Hong Kong (China): outward FDI stock at market value, 2000-2002
(Billions of dollars)

Economy	Including outward FDI stock in non-operating companies in offshore financial centres set up by Hong Kong (China) companies to channel funds			Excluding outward FDI stock in non-operating companies in offshore financial centres set up by Hong Kong (China) companies to channel funds			Difference		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Total	388.4	352.6	309.4	221.1	218.6	217.2	167.3	134.0	92.2
China	129.8	108.2	108.1	129.8	108.2	108.1	-	-	-
British Virgin Islands	201.3	184.3	147.3	56.5	73.7	68.7	144.8	110.6	78.5
United States	3.1	3.2	4.1	3.1	3.2	4.1	-	-	-
Malaysia	2.6	3.7	3.6	2.6	3.7	3.6	-	-	-
Singapore	3.3	3.1	3.3	3.3	3.1	3.3	-	-	-
Thailand	2.0	2.6	2.7	2.0	2.6	2.7	-	-	-
United Kingdom	3.0	2.6	2.6	3.0	2.6	2.6	-	-	-
Bermuda	11.4	11.8	9.8	0.7	1.6	1.9	10.7	10.1	8.0
Panama	3.0	4.2	5.0	0.4	0.4	1.9	2.6	3.7	3.1
Cayman Islands	9.1	10.6	3.6	-	-	-	9.1	10.6	3.6
Others	19.8	18.2	19.3	19.9	19.2	20.3	-0.1	-1.0	-1.0

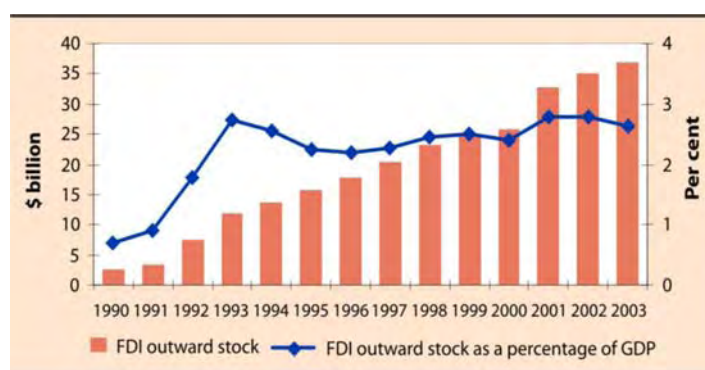
Source: China, Census and Statistics Department of Hong Kong 2004.

Note: Individual figures may not add up exactly to the total due to rounding.

Source: UNCTAD.

Figure I.14. China: outward FDI stock and its share in GDP, 1990–2003

(Billions of dollars and per cent)



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

wage sites (e.g. bicycle production in Ghana and video players in South-East Asia); and

- their aspiration to build international brands and access advanced technologies, including through M&As and alliances, as well as to establish R&D centres in developed countries such as Germany, Japan, Sweden and the United States.²³

The need to access natural resources (in oil, gas, mining) is also a powerful driving force. Today, China has investments in the oil industry in 14 countries, including Indonesia, Kazakhstan, Myanmar, the Sudan and Yemen. In May 2004 alone, Chinese FDI projects worth several billion dollars in alumina, steel and coke, were announced in Brazil.²⁴

The Government of China, as well as some provincial administrations such as Guangdong and Shanghai, have been encouraging firms to invest abroad by relaxing approval procedures and offering them financial support and corporate income tax incentives. Interestingly, some investment promotion agencies (from Denmark, Malaysia, Singapore, Sweden, Thailand, the United Kingdom (Scotland and Wales)) have already responded to the increased investment activity by Chinese firms, and set up offices in China to court outward investors.

India also stands out among Asian investors, not so much because of its recent and significant increase in outward FDI (figure I.15) and because of its potential to be a large outward investor,

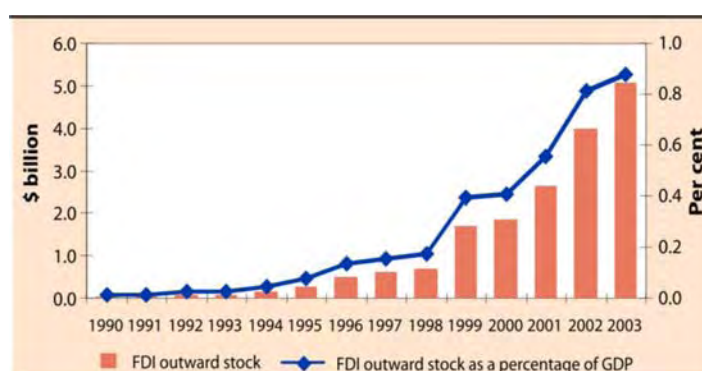
but because of the new trend set by some of its information technology (IT) firms (chapter IV). Its total FDI outflows in 2001–2003²⁵ were comparable to those of Malaysia. In the same period, the average annual outflows reached \$1 billion (annex table B.2). Its ranking in the Outward FDI Performance Index has improved over the years, placing it 61st in 2001–2003, close to China (58th) (annex table A.I.8). The most important destination for Indian FDI has been the United States (annex table A.I.13), accounting for 19% of its total outward flows over the past eight years, followed by the Russian Federation (with 18%), due mainly to acquisitions in the oil and gas industries. Overall, however, about half of total Indian outward FDI has gone to other developing countries.

Most Indian outward FDI is in manufacturing (about 55%), but non-financial services also account for a significant share (25%) (annex table A.I.14). FDI in IT services in particular has begun to grow rapidly. The top 15 Indian software and related service companies have all invested abroad, almost entirely in developed countries (annex table A.I.15),²⁶ while Indian call centres and business-process outsourcing companies are setting up foreign affiliates, particularly in the Philippines and Mexico.²⁷

The growing technological capabilities of Indian firms and their rising exports, particularly in IT services and pharmaceuticals, are driving the FDI growth. Access to markets, distribution networks, foreign technology and strategic assets such as brand names, are the main

Figure I.15. India: outward FDI stock and its share in GDP, 1990–2003

(Billions of dollars and per cent)



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

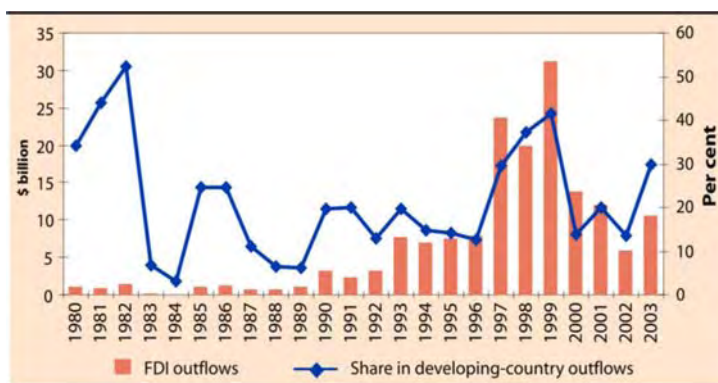
motivations. Securing natural resources is also becoming an important driver for FDI in the oil and gas industries and mining.²⁸ The Government’s liberalization of investment policies has helped the expansion abroad of Indian firms. In addition, India had signed 51 BITs and 41 DTTs by end 2003.

Latin America and the Caribbean remains the second largest investing region in the developing world, with its outward FDI stock reaching \$184 billion in 2003. Although its FDI outflows fell – even more than FDI inflows – in the period 2000–2002 (annex table B.2 and figure I.16), they started to rise again thereafter. Apart from offshore financial centres (accounting for 56% of regional outflows), the main investors were Argentina, Brazil, Chile, Colombia, Mexico and Venezuela. Outflows from some countries such as Argentina and Brazil fluctuated significantly. In Argentina, they were negative in 2002, as companies sold foreign assets to overcome liquidity problems at home (*WIR03*, p. 55), but became positive again in 2003. Brazil, which registered negative outflows in 2001, became the largest investor in the region in 2002 (\$2.5 billion); however, its flows fell back in 2003 (to \$0.2 billion). Mexican outflows were stable at about \$1 billion annually, except in 2001 (\$4.4 billion), with most outward investors focusing on the region.

Brazil has the largest outward FDI stock of all Latin America and the Caribbean – \$55 billion in 2003 (figure I.17) – and the fourth largest outward FDI stock of the

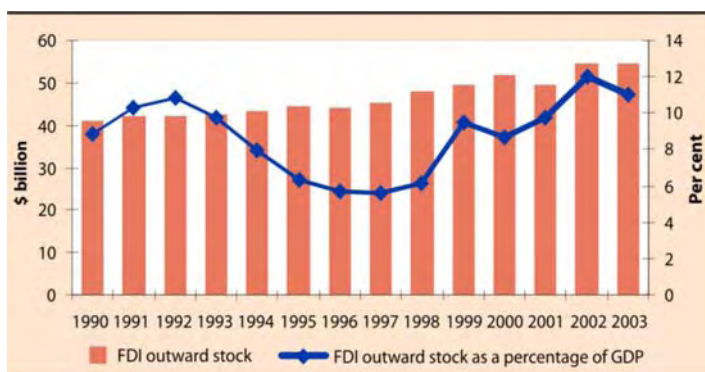
developing world (after Hong Kong (China), Singapore and Taiwan Province of China) (annex table B.4). However, in 2002, most of the stock was located in tax havens: the Cayman Islands, Bahamas and British Virgin Islands accounted for about two-thirds of the country’s outward FDI stock, with the rest in the United States and a few other countries in the region. According to a 2001 survey by the Central Bank of Brazil,²⁹ a large proportion of outward FDI was driven by financial rather than production motives (to avoid taxes and to undertake currency transactions). The large share going to tax havens was reflected in the sectoral concentration of Brazilian outward FDI in services (95%), particularly financial services (annex table A.I.16). FDI in the primary

Figure I.16. Latin America and the Caribbean: FDI outflows and their share in total developing-country outflows, 1980–2003
(Billions of dollars and per cent)



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

Figure I.17. Brazil: outward FDI stock and its share in GDP, 1990–2003
(Billions of dollars and per cent)



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

sector was negligible, and in processing activities it was low (4% of outward stock in 2002) (annex table A.I.16).

Compared to the size of its economy, Brazil has a relatively low level of outward FDI. In terms of the Outward FDI Performance Index, this country ranked 91st in 2001–2003, well below other major countries in the region (Panama ranked first, Chile second, Trinidad and Tobago third) (annex table A.I.8). Its FDI outflows as a percentage of gross fixed capital formation barely reached 1%, that is one-eighth of the average for the region and one-tenth of that for all developing countries (annex table B.5). Hence, there is potential for more investment abroad. A recent survey by FUNCEX (Iglesias and Veiga 2002), indicated that 29% of the firms

surveyed had plans to invest abroad, mainly in Western Europe, the United States and Mexico (annex table A.I.17).

Brazil has concluded (but not ratified) 14 BITs, 10 of which are with developed countries. It has also concluded 34 DTTs: 23 with developed countries, 8 with developing countries and 3 with CEE countries. None of these are with tax havens.

TNCs from developing countries in all regions are acquiring ownership advantages. They are becoming a force in the world FDI market. With outward FDI stock of already \$859 billion, they are building their own international production systems. They are driven by the same pressures as their counterparts in developed countries to remain competitive in the global economy. However, few developing countries' governments have paid much attention to this aspect of their integration into the world economy. Nonetheless, it is a challenge that more and more of them will face.

C. Changing sectoral distribution

FDI has grown over time in all three economic sectors – primary, manufacturing and services. But the sectoral composition has shifted towards services. Moreover, when indicators of FDI or TNC activity in various sectors in different countries are compared with the size of the respective countries' markets, or other measures of economic size, the significance of FDI in the various sectors and industries is different from that indicated by the distribution of FDI flows, stock or shares. FDI in manufacturing is increasingly geared to capital- and technology-intensive activities, while FDI in services has generally been growing in both capital-intensive and labour- or human-resource-intensive industries.

The global stock of both inward and outward FDI in the *primary* sector more than doubled between 1990 and 2002 (annex tables A.I.18 and A.I.19). Reflecting slower FDI growth than in manufacturing and services, the primary sector's share in world FDI *stock* decreased noticeably from 9% in 1990 to 6% in 2002 (figure I.18). In the case of FDI *flows* between 1989-

1991 and 2001-2002 the share of the primary sector did not decline: it rose from 7% to 9% (annex figure A.I.1). Nearly all FDI in the sector continues to originate from developed countries. The main source countries in 2002 were Canada, the Netherlands and the United States. Among the developing economies, Brazil, Kazakhstan and the Republic of Korea were the leading sources.

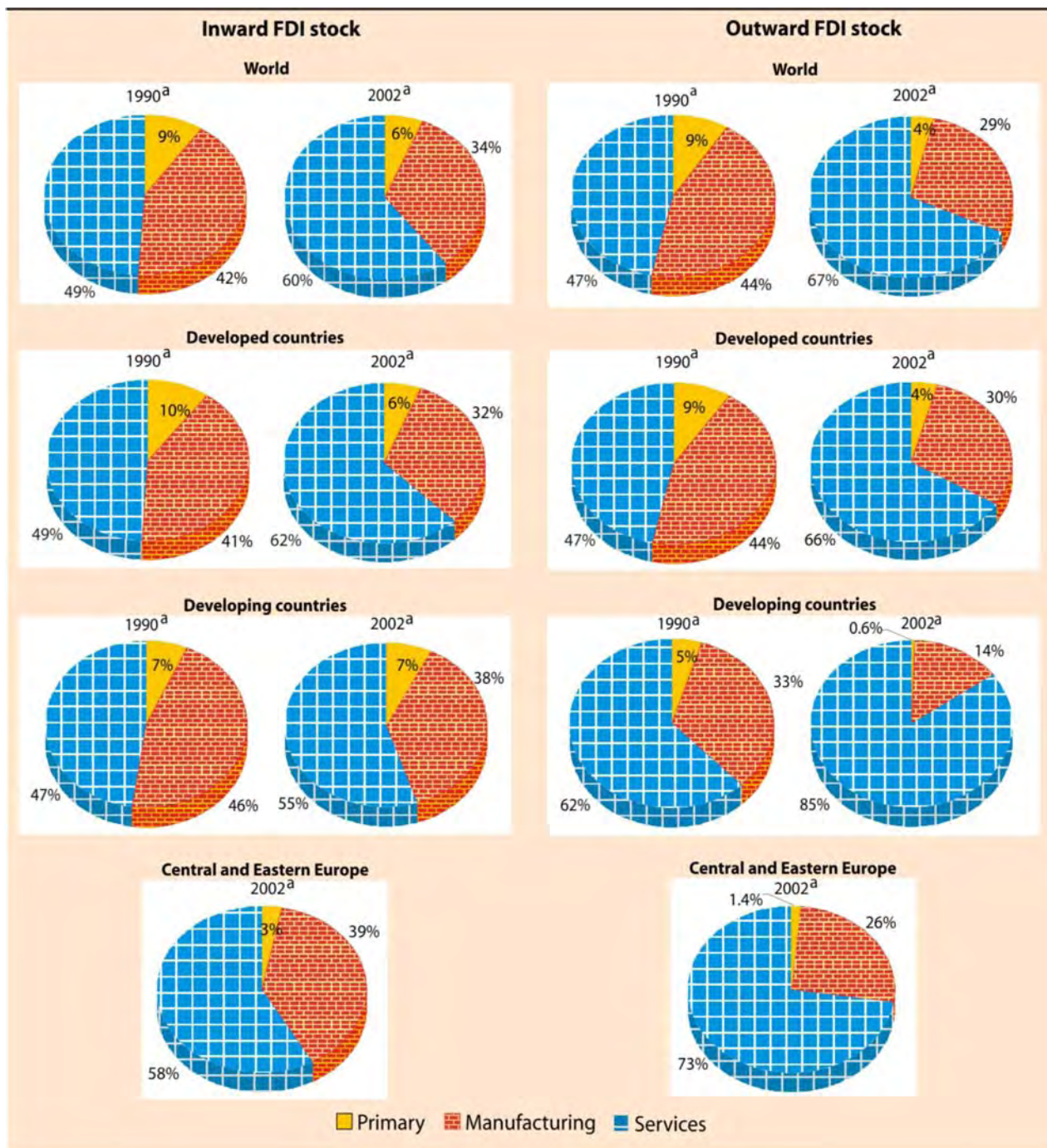
On the host-country side, however, developing countries – many of them rich in natural resources, but lacking internationally competitive national firms – attract considerable FDI (32% of total primary-sector FDI in 2002) (annex table A.I.18). Top host countries are Canada, the Netherlands and the United Kingdom among developed countries, and Chile, South Africa and Venezuela among developing countries.

FDI flows relative to GDP in the primary sector show a great deal of variation among countries. They are particularly high in Australia and Canada from the developed world, and Bolivia, Chile, Ecuador and Kazakhstan from the developing world. In these natural-resource-rich countries, the share of FDI flows in GDP in the primary sector has fluctuated widely over the past decade (annex figure A.I.2).

Within the primary sector, mining, quarrying and petroleum dominate: over 90% of inward FDI stock in the sector was in those industries in both 1990 and 2002 (annex table A.I.18). The share of agriculture, hunting, forestry and fishing in primary-sector FDI has been small, but it rose noticeably (from 4% to 6% of inward FDI stock) during the period 1990-2001. In 2002, developing countries attracted more than twice as much FDI as developed countries in these activities, but only about half as much in mining, quarrying and petroleum (annex table A.I.18).

FDI stock in *manufacturing* rose nearly threefold during the period 1990-2002 (annex tables A.I.18 and I.19). Given slower growth than in services, however, its share in global FDI stock worldwide fell from 42% in 1990 to 34% in 2002 (figure I.18). Developed countries accounted for more than 95% of outward FDI in manufacturing in 2002 – a lower share than the 99% they held in 1990. Their inward FDI stock in this sector was also several times larger than that in developing countries, but the gap is shrinking: in 1990, the manufacturing stock in developing countries was one-fifth of that in developed

Figure I.18. Sectoral distribution of FDI stock in the world, developed and developing countries and CEE, 1990, 2002



Source: UNCTAD, based on annex tables A.I.18 and A.I.19.

Note: In calculating the shares of the respective sectors, amounts recorded under "Private buying and selling of property" and "unspecified" are excluded from the totals.

^a Or latest year available.

countries; in 2002, it was one half. Industries in which the gap narrowed considerably during this period included food, beverages and tobacco, wood, machinery and equipment and, especially, coke and petroleum products. The United States is still the largest FDI recipient, while China's inward stock of FDI in manufacturing was more

than \$300 billion in 2002, second only to the United States (over \$500 billion).

Within manufacturing, chemicals and electronics accounted for one-third of the stock of inward manufacturing FDI in 1990, but their share fell slightly (to less than 30%) in 2002

(annex table A.I.18). As manufacturing is a mature FDI sector, few of its individual industries are as dynamic as many service industries (chapter III). Manufacturing FDI is increasingly geared to more capital- and knowledge-intensive activities. For example, the shares of food, beverages and tobacco, textiles, clothing and leather, and rubber and plastic products in total inward FDI stock in manufacturing fell significantly between 1990 and 2002 (annex table A.I.18). There are two major reasons for the declining importance of labour-intensive FDI in manufacturing:

- There has been a decline in labour-intensive manufacturing in general, and the share of traditional manufacturing employment has also steadily declined (ILO 2001, p. 109).³⁰ Technological change (including advances in telecommunications and information-processing technology) has been a key element in the decline of labour-intensive FDI in manufacturing. Labour is increasingly being replaced by capital and knowledge.
- Firms in more and more countries, especially developing countries, have developed their own ownership-specific advantages based on different factor endowments, particularly low-cost labour, vis-à-vis developed countries. Certain developing countries with low-cost labour are increasingly attracting capital- and technology-intensive FDI.

The industrial pattern of FDI in manufacturing varies among different home and host countries (annex tables A.I.18 and A.I.19). Developed countries' outward FDI in manufacturing shows that FDI is concentrated in technology-intensive industries, while TNCs based in those countries having abundant low-cost labour often develop ownership advantages in more labour-intensive industries. In the case of inward FDI, its industrial distribution largely reflects, on the one hand, the size of markets (reflecting GDP and per capita GDP), and on the other, the structure of the comparative advantages of the countries, based on immobile location advantages.

The pattern of FDI may be different among countries with similar endowments and resources. The locational choices of TNCs between countries are increasingly related to advantages arising from other factors that influence the supply capacities of host countries, such as scale economies (particularly in the

manufacturing sector) and clustering (agglomeration economies), as well as institutional and policy variables. Indeed, TNCs are more and more attracted to clusters of knowledge, and seek to upgrade ownership advantages by tapping into location-bound sources of collective learning and innovation; incentive structures in host countries also play a role. This is particularly so for TNCs in more technology-intensive activities (including innovative activities), as evidenced by its concentration in a limited number of countries (*WIR01*).

In the *services* sector, the global FDI stock more than quadrupled during the period 1990-2002 (annex tables A.I.18 and A.I.19). As a result of more rapid growth in this sector than in the other sectors, services accounted for about 60% of the global stock of inward FDI in 2002, compared to less than 50% a decade earlier (figure I.18). In terms of inflows, the increase in the share of services between 1989-1991 (54%) and 2001-2002 (67%) was even larger than that of the stock (annex figure A.I.1 and figure I.18). Inward and outward FDI, both flows and stock, in services grew in most countries (annex tables A.I.20 and A.I.21), as did the share of services in overall FDI flows and stock (annex table A.I.22 and A.I.23). The dynamic growth of FDI in services, which is reshaping FDI, is examined more closely in chapter III.

D. Prospects: growth set to resume

FDI flows are set to rebound in 2004 – by how much was difficult to say as of July 2004. A few large cross-border M&As may make all the difference, and they are impossible to predict. The recovery of the world economy and improved corporate profits are the major drivers. UNCTAD's survey results support this expectation. Other forecasts (box I.5) arrive at a similar conclusion. This convergence of views lends credibility to the renewed optimism about the recovery of FDI.

As examined in *WIR03*, FDI prospects depend largely on the following three factors:

Macroeconomic factors. Global growth forecasts for 2004 range between 3.5% and 4.2%.³¹ In the developing world, growth is expected to exceed 5%, though regional performance may vary.³² The revival of growth, especially in the largest source countries, augurs

well for FDI. Given the two-year lag observed for flows to respond to a pick-up in growth (*WIR03*), the rebound in FDI is expected to continue in 2005.

Microeconomic factors. Share prices rose in 2003, and are expected to climb further in 2004 (World Bank 2004a). During the first four months of 2004, the value of share trading in the world increased by 60% over the corresponding period in 2003; in the United States, the volume of trading on the New York Stock Exchange rose by 36%.³³ Higher stock valuations boost the value of cross-border M&As, even if their number remains unchanged. Corporate profits, a key driver of stock values, are also on the rise. In 2003, corporate profitability increased significantly in the main source countries. In the United States, companies posted the strongest quarterly profit growth since 1993 (United States, Department of Commerce 2004a), with technology and financial service companies posting significant gains.³⁴ Profit growth and liquidity are expected to boost FDI flows in the near future (IIF 2004). For example, Japanese plant and equipment investment expenditures abroad are expected to rise by 12.3% in all industries in fiscal year 2004, compared with a decline of 3.5% in fiscal year 2003, according to a survey of 757 firms in May 2004 by Nikkei.³⁵

Institutional factors. Cross-border M&As are increasing. The number of deals was slightly higher in 2003 (4,562) than in 2002 (4,493 deals). In the first half of 2004, 27 mega deals (with a value of more than \$1 billion) were concluded.³⁶ Some TNCs from developing countries are active as well. For example, Singapore investors purchased Mayne Group, a health services company, for \$569 million; China Huaneng Group purchased OzGen (Australia), an electrical services company, for \$227 million; and Jubilant Organosys Ltd. (India) acquired Pharmaceutical Services NV (Belgium), for \$17 million. The total value of cross-border M&As during the first six months of 2004 was \$150 billion, 3% higher than that of the corresponding period in 2003.

On the other hand, privatization in many developing countries is winding down. In Brazil, for example, FDI in privatization all but ceased in 2003. Even in countries that are still active privatizers, the number of large projects is declining. Bucking the declining trend, however, is China, which now allows foreign investors to buy majority stakes in previously barred

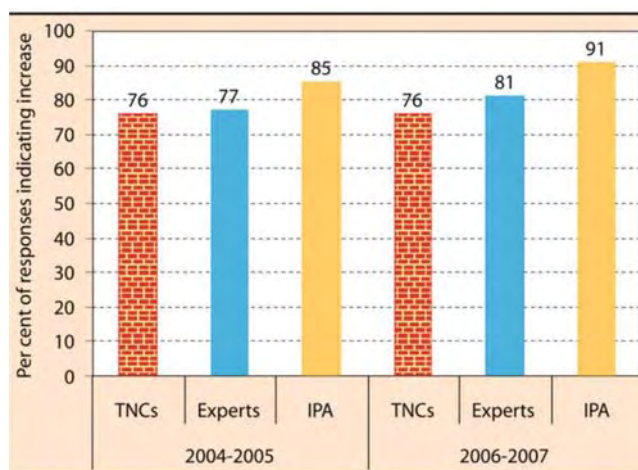
enterprises.³⁷ Its privatization plans include China Power, China Construction Bank, Air China and Semiconductor Manufacturing International.³⁸ In several other countries, privatization is at an early stage and may accelerate (e.g. Kyrgyzstan, the Libyan Arab Jamahiriya, Turkey, Viet Nam), but the amounts involved are likely to be small.

Greenfield investment grew robustly in 2003, and continued to grow in 2004. Data for the first four months of 2004 showed significant growth compared with the same period in 2003, with associated announced investment amounting to \$155 billion in some 3,500 FDI projects.³⁹

Complementing these data are the results of UNCTAD's Global Investment Prospects Assessment, meant to gauge future FDI trends. It seeks to do this by undertaking and then combining surveys of the largest TNCs, location experts advising firms where to locate FDI projects and investment promotion agencies (IPAs) (box I.6). The results of the first round of these surveys, undertaken in early 2004, support expectations of a recovery this year (UNCTAD 2004 a, b, c).⁴⁰

More than three-quarters of the companies surveyed and almost four out of five location experts expressed optimism for FDI prospects over the next two years (figure I.19). TNCs, however, were less optimistic than location experts as regards the strength of recovery, with almost a fifth of the respondents expecting no major change in FDI prospects over the next year. There was no change expected as

Figure I.19. Overall FDI prospects, 2004-2007, as reported by TNCs, location experts and IPAs



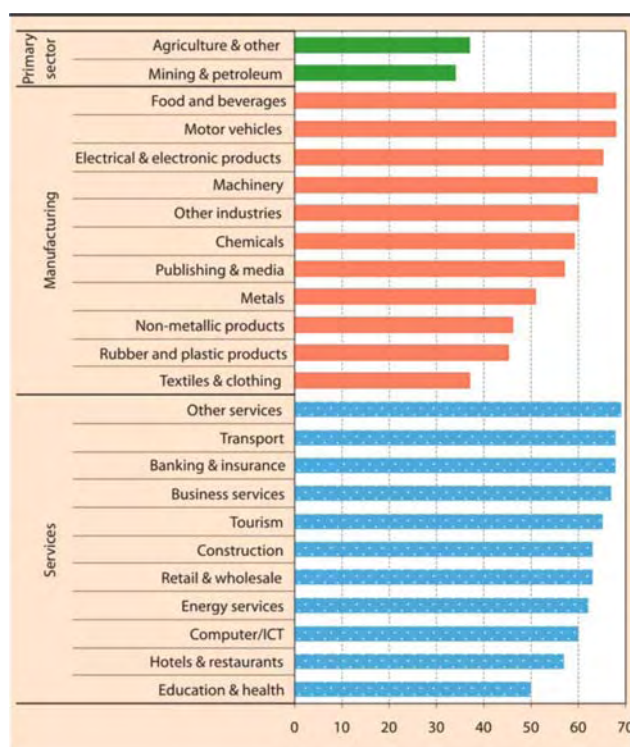
Source: UNCTAD, www.unctad.org/fdiprospects.

regards the preferred mode of investing abroad: greenfield facilities were favoured in the developing countries and M&As in the developed world.

Both top TNCs and international location experts also expected important inter- and intra-regional differences (chapter II examines each region separately). TNCs forecast that FDI flows will pick up, particularly in Asia and the Pacific and in CEE. For the first of these two groups, China emerged as the top destination for both TNCs and location experts. For CEE both TNCs and location experts ranked Poland highest. In Africa, South Africa was the most attractive country for both TNCs and international location experts. In Latin America and the Caribbean, Brazil was placed on the top list by TNCs and Mexico by location experts. In the developed world, the United States led for both TNCs and location experts.

Location experts indicated that the rebound in FDI would be geared more towards services, especially transport, banking and insurance and management (figure I.20). Selected manufacturing industries also did well, especially food and beverages, motor vehicles and electrical and electronic products. Concerning the relocation of corporate functions abroad, location experts expect this will occur mainly in production, logistics and support services, and R&D, while TNCs expect production, distribution and sales, and logistics and support services to relocate (figure I.21).

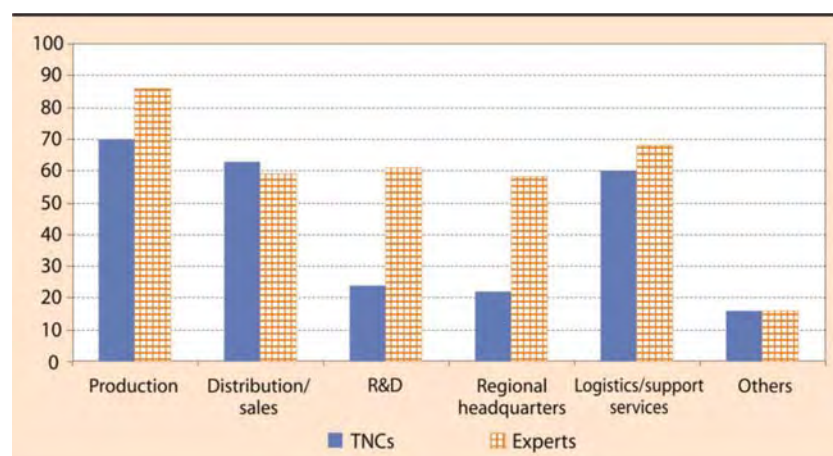
Figure I.20. FDI prospects by industry, 2004-2005, as reported by location experts
(Per cent of respondents)



Source: UNCTAD, www.unctad.org/fdiprospects.

The survey of IPAs indicates that they more than share the optimism of TNCs and international location experts. More importantly, they expect to step up efforts to lure FDI by focusing on investor targeting (figure I.22) – presumably especially of investors in the United States, Germany, the United Kingdom and France, followed by China and Japan, as these are viewed as the most important sources of FDI. IPAs are prepared to support their efforts through the greater use of incentives. In fact, nearly half of the respondents were prepared to introduce additional incentives or further liberalize their countries' FDI regimes. The findings of UNCTAD's IPA survey support the view that intense competition for FDI no longer takes place only during an FDI recession; rather it has become embedded in IPA strategy, even when investment is expected to pick up.

Figure I.21. Corporate functions expected to be relocated, 2004-2005, as reported by TNCs and location experts
(Per cent of respondents)



Source: UNCTAD, www.unctad.org/fdiprospects.

These various data sets combine to present an optimistic picture for 2004 and, indeed, 2005. But prospects are uneven across geographic regions – extending the mixed picture that prevailed in 2003.

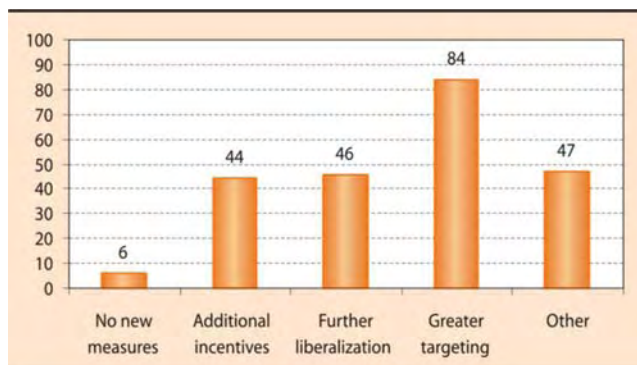
Box I.5. FDI prospects: reports paint a rosy picture

Most reports published in the first half of 2004 forecast an upturn in FDI for 2004 and 2005. The following are findings of some of them:

- In April 2004, the Institute for International Finance forecast an increase in FDI flows in 29 emerging-market economies, to an estimated \$113.8 billion in 2004 from \$94.9 billion in 2003 (IIF 2004).
- According to the April 2004 issue of the International Monetary Fund's *World Economic Outlook* (IMF 2004), FDI flows to emerging-market economies are expected to increase to \$134 billion in 2004 from \$128.2 billion in 2003. For 2005, the Fund predicts another increase to \$141 billion.
- The World Bank, in its *Global Development Finance 2004* (World Bank 2004a), projected FDI flows to developing countries in 2004 of \$152 billion, compared with \$135 billion in 2003. For 2005, the Bank projects these flows to reach \$165 billion.
- The *7th Annual Global CEO Survey*, carried out by PricewaterhouseCoopers in the fourth quarter of 2003, found that chief executive officers (CEOs) worldwide are optimistic about their companies' growth potential; more than 80% of the nearly 1,400 CEOs surveyed were confident about revenue growth over the next 12 months, as well as over the next three years (PricewaterhouseCoopers 2004a).
- The world survey of business sentiment by the International Chamber of Commerce and the IFO Research Institute found global economic confidence at a ten-year high; the overall economic climate indicator of the joint ICC/IFO poll, conducted in January 2004, hit 7.3 out of a possible 9. More than 1,100 experts from 92 countries took part in this survey (ICC and IFO Research Institute 2004).
- Drawing on the results of a survey of 527 senior executives worldwide, the Economist Intelligence Unit (EIU) found much greater business confidence at the outset of 2004 than a year ago (EIU 2004).

/...

Figure I.22. Policy responses, 2004-2005, as reported by IPAs
(Per cent)



Source: UNCTAD, www.unctad.org/fdiprospects.

Box I.5. FDI prospects: reports paint a rosy picture (concluded)

- PricewaterhouseCoopers' latest quarterly *Manufacturing Barometer* (first quarter 2004) surveyed senior executives from large manufacturing TNCs about their future business prospects (PricewaterhouseCoopers 2004b). Of the executives surveyed, 79% were optimistic about the United States economy's prospects over the next 12 months, and 65% were optimistic about prospects for the world economy. In addition, 82% expected positive revenue growth in 2005.
- Business sentiment among Japanese TNC executives regarding 12 East Asian countries improved in April 2004 over the previous month, according to an April survey published by the Japan External Trade Organization, but the overall outlook over the next 2-3 months remained roughly unchanged. Business sentiment has improved in Thailand, Singapore and Indonesia, as well as in North Asia and China (JETRO 2004).
- The Japan Bank for International Cooperation (JBIC) published the report of a survey carried out in the second half of 2003, of 578 Japanese manufacturing TNCs (JBIC 2004). Three-fourths (78%) of the respondents indicated they would strengthen and expand their overseas operations in the medium term, while 21% said they would maintain their current level. Only 0.2% of the surveyed companies said they would withdraw from overseas business operations. These findings represent an improvement over those of the previous survey.

Source: UNCTAD.

Box I.6. Global Investment Prospects Assessment by UNCTAD

UNCTAD's Global Investment Prospects Assessment project analyses expected future patterns of FDI flows at the global, regional, national and industry levels as seen from the perspectives of global investors, host countries and international FDI experts. It also analyses evolving trends in the strategies of TNCs as well as FDI policies.

UNCTAD bases its assessments on the findings of three large-scale surveys:

- A worldwide survey of the largest TNCs with headquarters in developed and developing countries and in Central and Eastern Europe regarding their strategies and investment plans in the industries that they are operating.
- A worldwide survey of international FDI experts who typically assist TNCs in their

overseas location decisions regarding their observations on future trends in FDI flows and policies.

- A worldwide survey of national IPAs regarding their perception of FDI prospects for and investment policies and promotion strategies of their respective countries and regions.

The surveys complement each other and allow for direct comparison of the results obtained.

The surveys involved 335 of the largest TNCs (ranked by size of their foreign assets) from developed, developing and transition economies (for a response rate of 24%), 87 international location experts interviewed and 158 IPAs (for a response rate of 63%).

Source: UNCTAD.

Notes

- 1 Growth rates of FDI inflows and outflows do not necessarily move in parallel. This is because inflows and outflows do not balance, even though they should do so in principle. This imbalance is due to various reasons, including different methods of data collection between host and home countries, different data coverage of FDI flows (i.e. treatment of reinvested earnings), and different times used for recording FDI transactions. Growth rates of these two flows moved in opposite directions also in 1974, 1980, 1981, 1983 and 1985.
- 2 The World Bank reported a decline of 9% in FDI inflows to developing countries in 2003 (World Bank 2004). This discrepancy is partly due to differences in coverage, as the World Bank's classification of developing economies includes Central and Eastern Europe (CEE), but excludes, among others, Hong Kong (China), Singapore and Taiwan Province of China.
- 3 These are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and Slovakia, which acceded to the EU in 2004. Cyprus and Malta are the other two accession countries.
- 4 The correlation coefficient between the share of FDI inflows in GDP and the share of gross fixed capital formation in GDP during the period 1990-2003 was 0.11 for the world, 0.66 for developed countries, -0.62 for developing countries and -0.64 for CEE. For LDCs, these two types of investment are positively correlated (0.67).
- 5 "Report of the International Conference of Financing for Development", Monterrey, Mexico, 18-22 March 2002, United Nations document, A/CONF.198/11.
- 6 Based on 49 markets in 47 countries, the value of stocks traded rose by 13% in 2003, but it was still 40% lower than the peak level of 2000 (World Federation of Exchanges: www.world-exchanges.org).
- 7 Many large firms reported higher profits in 2003. For example, Japanese firms listed in stock markets registered record profits in 2003. Profits also rose by 18%, on average, for United States companies (United States, Department of Commerce 2004a). The market capitalization of Asian firms rose more than twofold in Thailand and by 50% in Hong Kong (China), Malaysia and Singapore (World Federation of Exchanges). However, the recovery in profits was concentrated in selected firms in certain industries such as electronics and IT-related companies.
- 8 For example, the debt-equity ratio for United States non-farm, non-financial companies was 49% at the end of 2003, lower than that in 2002, but still higher than in the previous years (United States, Board of Governors of the Federal Reserve System 2004).
- 9 Based on the OCO Consulting's LOCOMonitor database. Not all projects were implemented in that year. This does not include M&As and privatization-related FDI.
- 10 Data from UNCTAD cross-border M&A database (www.unctad.org/fdistatistics).
- 11 Ibid.
- 12 Measured as the average of four ratios: FDI inflows to gross fixed capital formation, inward FDI stock to GDP, value added of foreign affiliates to GDP and employment of foreign affiliates to total employment.
- 13 Deutsche Post World Net has majority-owned foreign affiliates in as many as 99 countries.
- 14 Based on 42 TNCs surveyed.
- 15 In effect, the Index captures the influence of factors *other than market size* on FDI flows, assuming, *ceteris*

paribus, that size is the “baseline” for attracting investment. These other factors are diverse, ranging from the business climate, economic and political stability, the presence of natural resources, infrastructure, skills and technologies, to opportunities for participating in privatization or the effectiveness of FDI promotion.

- ¹⁶ A correlation of the changes in rank over these five periods with the previous eight periods (1988-1990 to 1996-1998) turns out to be negative and significant (-0.29).
- ¹⁷ The methodology for building the index is the same as in *WIR02*. It is an unweighted average of the following 12 variables, as measured on a score of 0-1: GDP per capita, the rate of growth of GDP, the share of exports in GDP, telecom infrastructure (the average of telephone lines per 1,000 inhabitants and mobile phones per 1,000 inhabitants), commercial energy use per capita, share of R&D expenditures in gross national income, the share of tertiary students in the population, country risk, exports of natural resources as a percentage of the world total, imports of parts and components of electronics and automobiles as a percentage of the world total, exports in services as a percentage of the world total and inward FDI stock as a percentage of the world total (annex table A.I.6).
- ¹⁸ It is assumed that roundtripping and indirect FDI account for 25-40% of FDI from Hong Kong (China) (box I.4).
- ¹⁹ For an analysis of the economic benefits of outward FDI for home developing countries, and policies pursued by them, see *WIR95*.
- ²⁰ The FDI outflow data for the latter half of the 1990s and early 2000s are distorted because of exceptional transactions related to the unbundling of cross-share holdings or the de-listing of two firms in the United Kingdom and South Africa (*WIR02*).
- ²¹ The decline registered in 2001-2002 was largely due to the shift of De Beers’ headquarters from South Africa to the United Kingdom.
- ²² This is the case, for instance, of Chinese TV producers such as Konka Electronics, Skyworth and Changhong Electronic Groups, and household appliance manufacturers like Haier and Guangdong Midea Group.
- ²³ Huawei Technologies and ZTE Corporation have done this in Sweden, Guangdong Glanz Group in Seattle, Konka (an electronics company) in Silicon Valley in the United States, Haier in Germany (and in a design centre in Boston, United States), and Kelon in a design centre in Japan.
- ²⁴ *Financial Times*, 25 May 2004.
- ²⁵ Fiscal year covers April of the current year to March of the following year.
- ²⁶ This trend is continuing in 2004. For example, Infosys Technologies Ltd announced in 2004 that it would establish a new affiliate in the United States (Infosys Consulting) to expand consulting businesses.
- ²⁷ Daksh eServices, India’s largest business-process outsourcing company, which was acquired by IBM in 2004, had established a facility in the Philippines; Msource established a Spanish language centre in Tijuana, Mexico, in 2003; and Hinduja TMT Ltd acquired a controlling interest in c3, a call centre in the Philippines, in 2003.
- ²⁸ In 2003, Hindalco acquired two copper mines in Australia. The Oil and Natural Gas Commission (ONGC) Ltd, a State-owned company, bought a 25% stake in a Sudan oil field from Talisman Energy (Canada) for \$720 million.
- ²⁹ It was conducted for the first time in 2001 to obtain reliable information on the value and the forms of stock of Brazilian capital abroad. For further information, see Brazil, Central Bank of Brazil 2004.
- ³⁰ Manufacturing employment worldwide fell by 11% during the period 1995-2002. This trend was not confined to developed countries only. In China, for example, manufacturing employment fell from 98 million in 1995 to 83 million in 2002. Estimates by Alliance Capital Management, as cited in “Study undermines charge China is stealing U.S. factory jobs”, *Philadelphia Enquirer*, 22 October 2003.
- ³¹ Forecasts by the IMF (2004) expect the world economy to grow by 4.6% in 2004, while the Economist Intelligence Unit (2004) expects it to grow by 4.2%, after expanding by an estimated 3.5% in 2003. UNDESA and UNCTAD (2004) forecast world growth at 3.5% in 2004. For further discussion on growth prospects, see UNCTAD 2004j.
- ³² The IMF forecasts growth in developing countries to rise to 6%. The Institute of International Finance (2004) expects growth in emerging markets to be 5.3% for 2004, up from an estimated 4.6% in 2003. The Economic Commission for Latin America and the Caribbean (2003a) forecasts the region’s economy to grow by 3.5% in 2004, having grown by an estimated 1.5% in 2003. The Economic Commission for Africa (2003) had forecast the region’s growth in 2004 to be 4.2%.
- ³³ Data from the World Federation of Exchanges (www.world-exchanges.org). Data for the world based on 49 stock exchange markets in 47 countries.
- ³⁴ *Business Week*, 9 February 2004.
- ³⁵ *Nihon Keizai Shimbun*, 17 May 2004. The survey shows that investment in the United States is expected to decline by 4.1% (due to drastically reduced investment in the non-manufacturing sector), and that in China to increase by 22.5%.
- ³⁶ The largest cross-border M&A deal concluded in the first six months was the acquisition of John Hancock Financial Services (United States) by Manulife Financial Corp. (Canada) for \$11 billion.
- ³⁷ *Washington Post*, “China accelerates privatization, continuing shift from doctrine”, 12 November 2003, <http://www.globalpolicy.org/soecon/ffd/fdi/2003/1112chinaprivatization.htm>.
- ³⁸ *International Herald Tribune*, “China Power readies \$1 billion share sale”, 14 January 2004, <http://www.iht.com/articles/124955.html>.
- ³⁹ Based on data from the OCO Consulting’s LOCOMonitor database.
- ⁴⁰ For an integrated analysis of these three surveys, see UNCTAD (forthcoming a).

Annex to chapter I. How transnational are TNCs?

The transnationality of TNCs can be considered from a number of perspectives: their operations, stakeholders and the spatial organization of management. From each perspective, various dimensions can be considered:

- From the *operations perspective*, key dimensions include the intensity or relative importance of a TNC's foreign operations, as measured by various variables: the geographical spread of its operations, the modalities of foreign operations and the degree of integration of the production process across locations.
- From the *stakeholders' perspective*, key dimensions include the composition of managers or board members, the nationality composition of shareholders by nationality, the international mobility and international experience of managers and the composition of the labour force by nationality.
- From the perspective of the *spatial organization of management*, key dimensions include: the extent and spread of the location of regional headquarters in host countries and the legal nationality(ies) of a TNC.

Given the range of perspectives and dimensions that can be considered for each, the degree of transnationality of a TNC cannot be fully captured by a single synthetic measure – it requires a variety of indicators. Some of these can be expressed as indices calculated or estimated on the basis of empirical data; others may consist of empirical data not expressed as indices; and still others may be expressed in qualitative rather than quantitative form.

UNCTAD's Transnationality Index (TNI) measures the degree of transnationalization of the top TNCs worldwide (box I.1; annex table A.1.3) and the top TNCs in the developing countries (box I.3; box table I.3.1) and CEE (annex table A.II.2) from an operations perspective. It uses three variables (sales, assets, employment) to measure the intensity of foreign, relative to total, operations. Some aspects of the transnationalization of the top TNCs according to the TNI are highlighted in box I.1.

One aspect of transnationality from the operations perspective not included in UNCTAD's TNI is the intensity of foreign operations according to the number of foreign affiliates. The "internationalization index" – the ratio of the number of foreign to the total number of affiliates – shows that, on average, some two-thirds of the affiliates of the top 100 TNCs are located abroad (annex table A.I.4). The information on foreign affiliates by TNCs' home country and industry shows that the internationalization index (like the TNI) is highest for top TNCs from small countries (Belgium, Finland, Ireland, Switzerland) and for machinery and equipment, construction and building materials, and chemicals and pharmaceuticals industries (annex tables A.I.24 and A.I.25). The TNI as well as the internationalization index give an idea of the degree of embeddedness and interests of a company in the home country versus abroad. The level and pattern of trade can also be affected by the intensity of foreign operations, i.e. by the share of business activities abroad.

Another aspect of transnationality from the operations perspective is the extent of geographic spread of a company's operations and interests – whether spread over several countries or concentrated in one or two. This concept of transnationality has several aspects: the spread of operations across many countries affects the strategic stance of a company; it also affects its ability to develop and spread knowledge and innovation, as well as its strategies concerning labour or governments. The indicators used for this concept are: the number of foreign countries in which the TNC has affiliates and the (closely related) network spread index (NSI), both reported in annex tables A.I.4, A. I.24 and A. I.25, along with values for the internationalization index. The notes to table A.I.4 explain how the NSI is calculated. On average, the top TNCs have affiliates in 35 foreign countries and a NSI of almost 18%. These indicators of the spread of TNCs' operations have the limitation that they are derived using the number of affiliates, and cannot be complemented, as in the case of the internationalization index, by an indicator similar to the TNI, which takes the value or magnitude of activities in each country into account, because no reliable data exist on the latter.

A subsidiary perspective refers to *regionality*. It may be relevant to ask whether the operations and interests of a firm are concentrated in a region or equally spread among several regions. Annex tables A.I.26-A.I.27 give insights into the *regional dimension of transnationality* in terms of the number of foreign countries in which a TNC has affiliates. The breakdown by home country and by industry of TNCs (annex tables A.I.26 and A.I.27) shows that the EU is a favourite region for the location of foreign affiliates of the top TNCs from most countries. Top TNCs from Japan, however, spread their affiliates largely in three regions: the EU, North America and South-East Asia.

The indicators of intensity, as well as of the spread of TNCs' operations concentrate on the operations of foreign affiliates in which TNCs have an equity interest, and therefore underestimate the interest that companies have via non-equity modes. For example, McDonald's is listed as operating in only 14 foreign countries, having, therefore, a Network Spread Index of 7.18 (annex table A.I.4) – well below the average for the entire top 100 TNCs (17.93). This is because the information from which the data are gathered does not include its franchising activities. This shows that the *modalities* perspective is also important. Does a company operate abroad directly (via FDI) or through alliances or trade or franchising (as in the case of McDonald's)? Operations via different modalities have implications for the host countries and their firms, as well as for the integration of production.

Information and communications technologies are making a new modality of operations possible: the electronic delivery of final or intermediate products. This affects the velocity of international operations, the international division of labour and the integration of the production process (Ietto-Gillies 2002). The last point has implications for another aspect of transnationality from an operations perspective: the international integration of production processes. Such integration has, so far, been more common in manufacturing than in services, but is also being extended to the latter. It is not easy to develop indicators of international integration; however, intra-firm trade might be a good proxy, if and when available.

In addition to assessing transnationality from an operational perspective by indicators such as those discussed above, one can also try to do so from other perspectives, as also mentioned above. For example, annex table A.I.28 shows the regional composition of directors from the boards of 42 of the top 100 TNCs, thereby providing an indicator based on *the stakeholders' perspective*. It shows that top TNCs originating in Europe have a much higher representation of non-home-country nationals among their directors than do top TNCs from the United States and Japan. The percentages are 33 for the EU, 47 for Switzerland, 18 for the United States and 2 for Japan. Within the EU, the highest percentage applies to TNCs from the United Kingdom (52%).