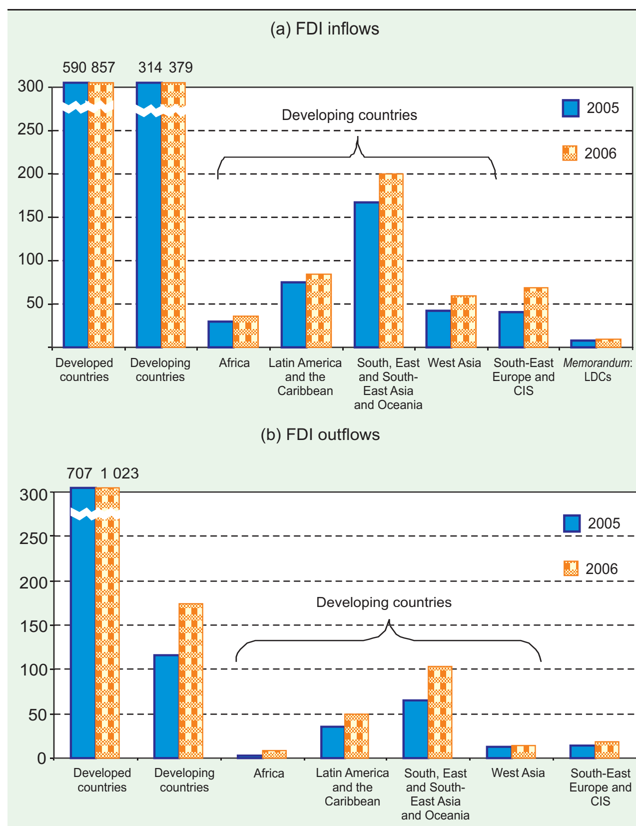
CHAPTER II

REGIONAL TRENDS

INTRODUCTION

Inward FDI flows in 2006 rose in all regions (figure II.1), though their rates of growth differed and some new trends emerged. FDI inflows to developing countries grew at a slower rate than those to developed countries, but all developing regions except Latin America and the Caribbean registered record flows. FDI inflows to the transition economies of South-East Europe and the Commonwealth of Independent States (CIS) also reached record levels. Flows to all developing and transition economies remained at more than one third of the world total, but their share in global FDI inflows fell somewhat in 2006 due to higher rates of increase in flows to developed countries. At the same time, the share of developing and transition economies in global FDI outflows has risen continuously since 2003, and reached nearly 16% in 2006. Compared to other types of capital flows to developing economies, FDI inflows have been the largest component of total resource flows since 1994, and their share in 2006 was 51% (figure II.2; chapter I).[1]

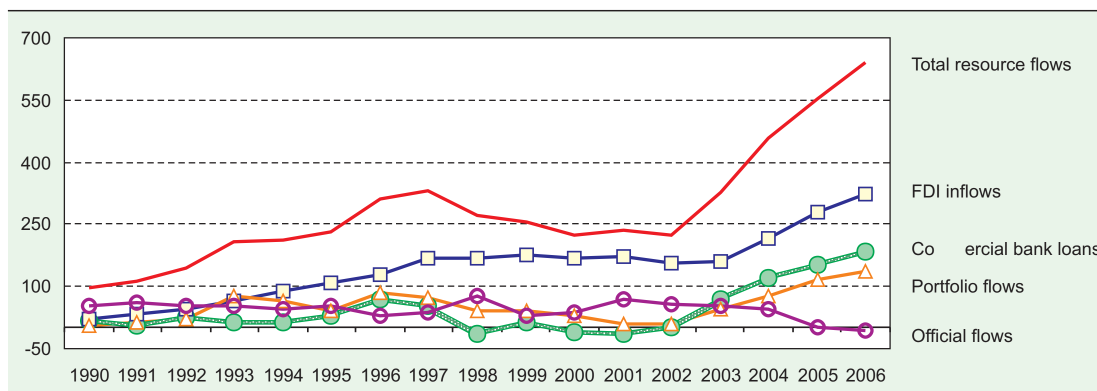
Figure II.1. FDI flows by region, 2005 and 2006
(Billions of dollars)



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

In terms of sectoral distribution, judging from data on cross-border M&As (as data on FDI flows by sector for 2006 were not available at the time of writing this Report), FDI in the services sector grew in all economies in 2006, while the primary and manufacturing sectors experienced uneven patterns of growth, which also differed by region (table II.1). The pattern confirms not only the increasing importance of services in FDI (*WIR04*) over the past several years, but also the recent re-emergence of the primary sector in developing and transition economies due to a significant rise in FDI in mining, quarrying and petroleum – extractive industries that are the focus of Part Two of this *WIR*.

Figure II.2. Total net resource flows[a] to developing countries,[b] by type of flow, 1990-2006
(Billions of dollars)



Source: UNCTAD, based on World Bank, 2007a.

[a] Defined as net liability transactions or original maturity of more than one year.

[b] The World Bank's classification of developing countries is used here. It differs from UNCTAD's classification in that it includes new EU member States from Central and Eastern Europe, and excludes high-income countries such as the Republic of Korea and Singapore under developing countries.

Table II.1. Cross-border M&A sales, by sector and by group of economies, 2005-2006
(Millions of dollars)

	2005				2006			
Group of economies	All industries	Primary	Manufacturing	Services	All industries	Primary	Manufacturing	Services
World	716 302	115 420	203 730	397 152	880 457	86 133	274 406	519 918
Developed economies	604 882	110 474	171 020	323 388	727 955	65 119	247 233	415 602
Developing economies	94 101	2 858	25 963	65 280	127 372	16 639	22 603	88 130
Transition economies	17 318	2 088	6 747	8 483	25 130	4 374	4 570	16 185

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

This chapter examines the trends and patterns of FDI in 2006 by major regions. The discussion in the following sections focuses on recent trends in FDI flows to and from each region, as well as their subregions and countries, and provides a picture of the changing geographical, sectoral and industrial patterns of FDI flows by region. Policy developments underlining these patterns, and prospects for FDI flows to and from each region are also analysed.

A. Developing countries

1. Africa

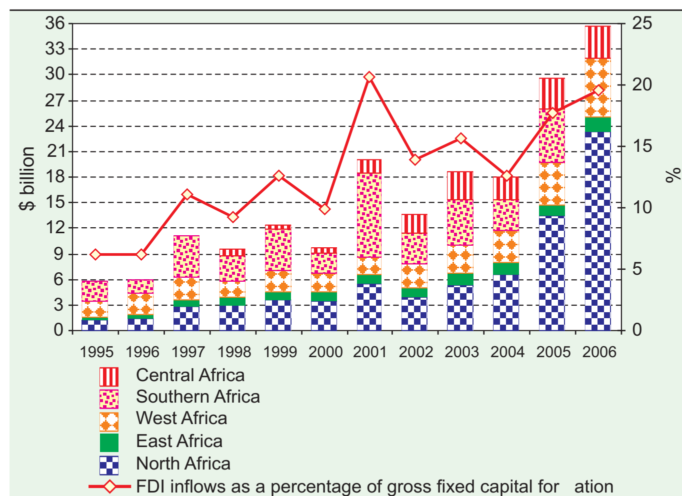
FDI to Africa amounted to $36 billion in 2006 – a new record level. The surge was in large part related to investments in extractive industries, but FDI also rose in various service industries. As a result, inflows as a percentage of the region's gross fixed capital formation increased to 20% in 2006, from 18% in 2005 (figure II.3). As in other years, there were wide variations among the different African countries. FDI inflows rose in 33 countries and fell in 21. Some Asian developing countries have become major sources of cross-border M&As and other forms of FDI in Africa. Outward FDI from Africa also reached a record level in 2006, largely driven by TNCs from South Africa. Policy developments indicate a further opening up to foreign investment, although some countries have also made changes in their regulatory frameworks with a view to securing greater benefits from inward FDI.

a. Geographical trends

(i) Inward FDI: natural resources drove the surge

In 2006, FDI inflows to Africa rose by 20% to $36 billion (figure II.3), twice their 2004 level. Following substantial increases in commodity prices, many TNCs, particularly those from developed countries already operating in the region, significantly expanded their activities in oil, gas and mining industries. TNCs from Asia expanded even more rapidly, through both greenfield investments and cross-border M&As (table II.2). At the same

Figure II.3. Africa: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

time, the services sector continued to attract considerable FDI, in particular in transport, storage and communications. An estimated 442 greenfield investments were undertaken in Africa in 2006, 258 by developed-country TNCs, particularly Europe (161), 175 by developing economies (134 from Asia and the remaining from within Africa), and a few from South-East Europe and the CIS.[2] The value of cross-border acquisitions of African enterprises reached a record level ($18 billion) in 2006, almost half of this in the form of M&As by Asian TNCs, which represents a huge expansion of activity since the start of the decade (table II.2), particularly in oil, gas and mining activities. Despite the increased FDI inflows, however, Africa's share in global inflows fell, from 3.1% in 2005 to 2.7% in 2006.

FDI inflows contributed to a strengthening of the balance of payments in several African countries. In 2006, foreign reserves in the region as a whole grew by some 30%, and by even more in some major oil-exporting countries such as Nigeria and the Libyan Arab Jamahiriya.[3] Income on inward FDI grew by 14%, which was more than in Asia and Oceania (9%) but much less than in Latin America and the Caribbean (36%) (section A.3).[4]

The extractive industries accounted for most of the increase in inflows to Africa in 2006.[5] While such investments can help boost exports and government revenues, concerns have arisen in several mineral-rich countries about the impact on exchange rates and the prospects for other export-oriented activities (EIU, 2007a). In Zambia, for instance, a tenfold increase in copper exports since 2000 to $2.7 billion in 2006 led to an appreciation of the real exchange rate.[6] As a consequence, Zambia's attractiveness for FDI suffered in export-oriented clothing and horticulture, as well as in those products that are entitled to preferences under the African Growth and Opportunity Act (AGOA)[7] and the Euro-Mediterranean Partnership. Similar concerns have been raised for Algeria, the Libyan Arab Jamahiriya, Mauritania, Nigeria, South Africa, Swaziland and Uganda. Moreover, the appreciation of the real exchange rate exacerbated the situation even further in countries with already high costs of production, capacity shortage or low competitiveness. This may have led to the closure of some foreign-owned production facilities in garments and other manufactures, for example in Kenya, Lesotho, Mauritius and Swaziland.[8] These disinvestments were partly offset in some cases by higher inflows into new natural resource exploration activities, particularly in some least developed countries (LDCs) (box II.1).

The top 10 FDI recipients in Africa accounted for $32 billion (or nearly 90%) of the region's inflows in 2006, up from $20 billion in 2005 (annex table B.1). Eight of them attracted FDI in excess of $1 billion in 2006, the same as the previous year; and in four of them such flows were higher than $3 billion: Egypt, Nigeria, Sudan and Tunisia

Table II.2. Distribution of cross-border M&A purchases in Africa by home region, 1999-2006
(Millions of dollars)

Acquiring regions	1999	2000	2001	2002	2003	2004	2005	2006
World	3 117	3 199	15 524	4 684	6 427	4 595	10 509	17 569
Developed economies	2 534	2 380	14 964	3 668	3 156	2 571	9 564	7 173
Developing economies	583	819	559	1 016	3 270	2 024	476	9 721
Africa	52	769	520	809	569	1 849	360	746
Latin America and the Caribbean	373	-	-	67	166	-	-	125
Asia	158	50	39	141	2 536	175	116	8 850

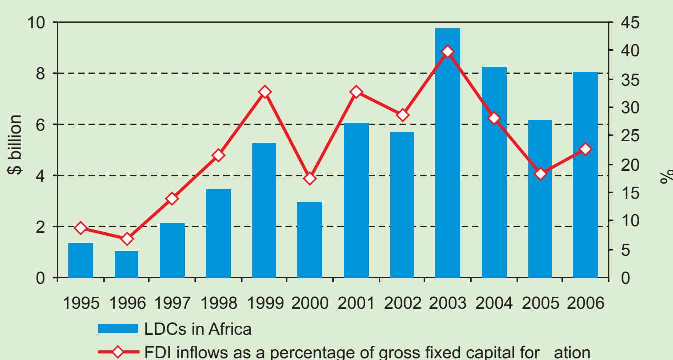
Source: UNCTAD cross-border M&A database.

Box II.1. FDI flows to African LDCs[a] rise, led by investment in extractive industries

FDI flows to African LDCs increased from $6 billion in 2005 to $8 billion in 2006 (box figure II.1.1) following two consecutive years of decline. The increase was driven by investors seeking new mining locations in response to rising global demand and high commodities prices. As a result, the share of LDCs in FDI to Africa rose from 21% in 2005 to 23% in 2006, and, as with many other African host economies, such investment was mainly from developed countries and Asian developing countries. TNCs in telecommunications activities have also started to invest in African LDCs, especially those LDCs that were previously considered risky due largely to conflicts, leading to a small but positive improvement in inflows to these countries.[b]

The 10 major recipients of FDI among African LDCs in 2006 were (in declining order): Sudan, Equatorial Guinea, Chad, the United Republic of Tanzania, Ethiopia, Zambia, Uganda, Burundi, Madagascar and Mali. FDI grew particularly fast (by 50% or more) in Burundi, Djibouti, Guinea-Bissau, Somalia, Madagascar, Ethiopia, Cape Verde, Gambia and Sudan. CNOOC (China), Ophir Energy (South Africa), Soma Petroleum (Canada), Range Resources and Woodside (both Australia) were among the TNCs that contributed to FDI in natural resource exploration in these countries.

Box figure II.1.1. African LDCs: FDI inflows and their share in gross fixed capital formation, 1995–2006



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

In contrast, Angola and Liberia registered negative FDI inflows in 2005 and 2006. In Angola, this was because of acquisitions by the State-owned oil company, Sonangol, of ongoing oil exploitation and refinery projects owned by foreign TNCs. In Liberia, while the negative inflows of $82 million in 2006 were reduced from the previous year's negative level of $479 million, investor confidence is recovering at a slow pace following the end of a series of civil wars and the establishment of a democratically elected government in that country. Inflows stagnated in Lesotho, mainly due to a slowdown in the textile industry and the withdrawal of a number of TNCs involved in that industry.

Source: UNCTAD.

[a] The 34 African LDCs are: Angola, Benin, Burkina Faso, Burundi, Cape Verde, the Central African Republic, Chad, Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Somalia, Sudan, Togo, Uganda, the United Republic of Tanzania and Zambia.

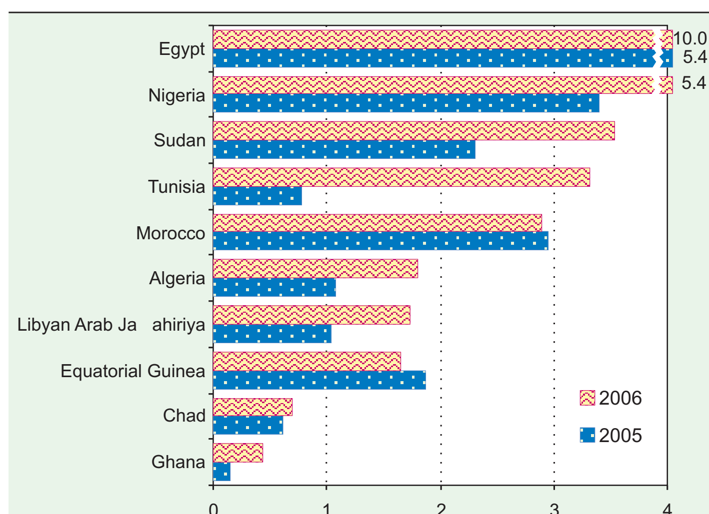
[b] Examples include MTN of South Africa in Guinea-Bissau and Liberia, Maroc Télécom in Burkina Faso and Burundi, Telsom Mobile of the United Kingdom in Somalia, Portugal Telecom in Angola and MTC Kuwait in Sudan.

(figure II.4, table II.3). Both cross-border M&As and greenfield investments contributed to increased inflows to several of the top host countries, particularly Egypt, Nigeria, Sudan, Tunisia and Morocco.[9] While most of the FDI to the region as a whole went to extractive industries, in Egypt – the top FDI recipient in 2006 – 80% of the more than $10 billion of its inflows were in non-oil activities such as agriculture, manufacturing, banking and tourism.

FDI inflows to the five subregions of Africa in 2006 were uneven, reflecting the influence of different factors, particularly the availability of natural resources, as discussed below.

North Africa.[10] North African countries received record FDI inflows (partly from Asian TNCs) that were fairly diversified. All countries in the subregion, except Morocco (where flows remained relatively large), received increased inflows, most of which were concentrated in agriculture, communications, construction, manufacturing[11] and tourism; they were driven partly by investments for expansion and privatizations. As a result, FDI flows to the subregion surged to a record level of $23 billion in 2006, accounting for 66% of inflows to Africa. Egypt attracted an exceptional level of inflows, amounting to 43% of the total to the subregion,[12] but the share of investments in oil and gas activities, though still large, declined from 60% in 2005 to 21% in 2006. In the Libyan Arab Jamahiriya, FDI inflows rose by 67% over those of 2005, to reach $1.7 billion, the highest level since the end of international sanctions imposed on that

Figure II.4. Africa: top 10 recipients of FDI,[a] 2005-2006
(Billions of dollars)



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

[a] Ranking based on FDI inflows in 2006.

country. In Tunisia, inflows more than quadrupled, mainly as a result of privatizations in the telecommunications industry.[13] Algeria, Sudan and Tunisia also received more FDI in the petroleum and telecommunication industries, mainly from China, India, Kuwait and Malaysia. In contrast to other North African countries, FDI inflows to Morocco declined due to fewer privatization sales.

West Africa.[14] FDI inflows to West Africa rose to $7 billion in 2006, following larger investments in all sectors by European and Asian TNCs. The subregion's share in FDI inflows to Africa rose to 19% from 17% in 2005. Nigeria was the main destination in West Africa, accounting for 80% of the FDI to the subregion, dominated by FDI in its oil industry, mostly from China. In Ghana, inflows tripled to $435 million, largely as a result of investment by two United States firms: Newmont Gold Company and Alcoa (in an aluminium company, Valco). Most of the other inflows into the subregion went to the services sector. Cape Verde saw a major disinvestment, with the Government re-acquiring a majority stake in the country's electricity and water utility, Empresa Pública de Electricidade e Água de Cabo Verde, thereby reversing a controversial privatization. On the other hand, FDI in tourism in the country experienced strong growth.[15]

Central Africa.[16] In Central Africa, Asian TNCs made significant investments in many sectors, nudging FDI inflows up to $4 billion in 2006. The subregion accounted for 11% of Africa's total inflows, most of it going to the primary and services sectors, including infrastructure. Equatorial Guinea, Chad, Congo and Cameroon (in that order) were the destinations. A large part of the increase in investment to the subregion reflected greater spending by TNCs on oil and mining exploration. In Cameroon, investments by Total (France) and Pecten Cameroon were the major cause of the surge in its FDI inflows.[17]

East Africa.[18] East African countries recovered from a decline in their FDI inflows as a result of new oil exploration activities in non-traditional producer countries and privatizations. FDI inflows to the subregion rose to about $2 billion

Table II.3. Africa: distribution of FDI flows among economies, by range, 2006

Range	Inflows	Outflows
Over $3.0 billion	Egypt, Nigeria, Sudan and Tunisia	South Africa
$2-2.9 billion	Morocco	..
$1-1.9 billion	Algeria, Libyan Arab Jamahiriya and Equatorial Guinea	..
$0.5- 0.9 billion	Chad	..
$0.2-0.4 billion	Ghana, United Republic of Tanzania, Ethiopia, Zambia, Congo, Namibia, Cameroon, Uganda, Burundi, Botswana, Gabon, Côte d' Ivoire and Madagascar	Morocco, Liberia and Nigeria
Less than $0.1 billion	Mali, Democratic Republic of the Congo, Mozambique, Seychelles, Cape Verde, Djibouti, Guinea, Mauritius, Somalia, Gambia, Benin, Senegal, Lesotho, Togo, Kenya, Sierra Leone, Guinea-Bissau, Zimbabwe, Swaziland, Malawi, Burkina Faso, Central African Republic, Niger, Rwanda, Eritrea, Comoros, São Tomé and Principe, Mauritania, Liberia, South Africa and Angola	Egypt, Libyan Arab Jamahiriya, Angola, Algeria, Tunisia, Kenya, Botswana, Mauritius, Sudan, Seychelles, Senegal, Congo, Sierra Leone, Swaziland, Niger, Malawi, Mali, Mozambique, Cape Verde, Zimbabwe, United Republic of Tanzania, Benin, Burkina Faso, Guinea-Bissau, Côte d' Ivoire, Namibia, Togo and Gabon

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

[a] Countries are listed according to the magnitude of FDI.

in 2006 compared with $1 billion the previous year. However, this subregion still ranks low in FDI inflows to Africa. Four countries (Djibouti, Ethiopia, Kenya and Madagascar) that had registered a decline in their inward FDI in 2005 saw increased inflows in 2006. The United Republic of Tanzania had the highest inflows in the subregion, amounting to $377 million in 2006 (most of it due to investment for expansion in the mining industry). FDI into Uganda rose by 19%, partly as a result of investments from Australia (e.g. by Hardman Resources) in the oil industry and from Egypt, India, Kenya, South Africa and the United States in services and agro-processing. In Kenya, FDI increased due to large privatization sales in the telecommunications industry and investments in railways. The recovery of FDI to Ethiopia in 2006 was a result of increased oil exploration activities in the Ogaden region.

Southern Africa.[19] A significant decline in FDI inflows, particularly to the two principal host countries (Angola and South Africa) in the subregion led to negative inflows amounting to $195 million in 2006. This contrasted with the high growth experienced in 2005 when inflows reached $6 billion. Although South Africa experienced negative FDI inflows, caused by the sale of a foreign equity stake in a domestic gold-mining company to a local firm, there were a number of cross-border M&A deals in the country. For instance, Vodafone (United Kingdom) paid $2.9 billion to raise its stake in Vodacom of South Africa, Tata (India) bought a 26% stake in InfraCo (a telecommunications company), valued at $60 million, and some other Asian TNCs (such as Istithmar, the investment arm of the Government of Dubai) bought V&A Waterfront (South Africa) for more than $1 billion.[20] In Angola, Sonangol's takeover of major oil-related projects from foreign companies, such as the Lobito oil refinery, also resulted in an overall negative FDI inflow, though some foreign investments took place in banking, telecommunications and mining.

(ii) Outward FDI hit new heights

FDI outflows from Africa hit record levels in 2006, to reach $8 billion, nearly four times those of 2005, and more than twice the previous peak in 1997 (annex table B.1).[21] Investors from South Africa accounted for four fifths of these. Other source countries, including Morocco, Liberia, Nigeria, Egypt and the Libyan Arab Jamahiriya, in that order, recorded their highest level of outflows. A large proportion of FDI by South African TNCs in 2006 was in natural resource exploration and exploitation. For example, AngloGold Ashanti invested in a gold-mining expansion project in Brazil (in Cuiaba) and in underground gold extraction development in Australia (at Sunrise Dam); and Ophir Energy invested in offshore oil exploration in the United Republic of Tanzania. AngloGold also established an alliance worth $58 million with Trans-Siberian Gold of the Russian Federation.[22]

A number of African TNCs in services (many of them from South Africa) also expanded abroad, including into Europe. Outward FDI in telecommunications involved, for example, Orascom (Egypt), MTN (South Africa), Maroc Telecom (Morocco), Naguib Sawiris (Egypt) and Telkom (South Africa).[23] Significant cross-border acquisitions by African firms took place in industries as diverse as health-care services, printing and media, and construction.

b. Sectoral trends: primary sector's share rose

There was a surge of FDI flows to Africa in the primary sector, mainly in oil and gas (table II.4). In addition, the growing services sector, particularly transport, storage and communications, continued to attract FDI, as reflected by the data on cross-border M&As in 2006. However, it grew at a lower rate than the primary sector.

Inflows into the manufacturing sector continued to grow in North African countries at a slow but stable rate, while in sub-Saharan Africa, no significant manufacturing FDI took place. Conversely, disinvestments occurred in textile processing. Limited production capabilities continue to be a major factor behind the relatively low FDI inflows in manufacturing and the difficulties faced by African countries in seizing the opportunities offered by preferential market access initiatives such as AGOA, Everything but Arms (EBA) and the Cotonou Agreement between the European Commission (EC) and the African Caribbean and Pacific group of countries.

c. Policy developments

The rapid growth of inflows to Africa partly reflects the steps taken by countries of this region to open up their economies to foreign investment. UNCTAD's annual survey on changes to national laws and regulations shows that in 2006, 40 African countries introduced 57 new measures affecting FDI, of which 49 encouraged inward FDI.

Of these measures, 14 were related to sectoral liberalization, more specifically:

- Botswana, Burkina Faso, Burundi, Cape Verde, Ghana, Kenya and Namibia allowed partial or full foreign ownership of their telecommunications industries;
- Congo, Egypt and Nigeria wholly or partially opened up their banking industries;

Table II.4. Africa: distribution of cross-border M&As, by sector and main industry, 2005-2006
(Millions of dollars)

Sector/industry	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
Total industry	10 509	17 569	15 505	11 208
Primary	908	4 788	249	356
Mining, quarrying and petroleum	908	4 788	249	356
Mining and quarrying	873	524	237	335
Petroleum	34	4 265	12	21
Secondary	1 676	2 017	35	159
Food, beverages and tobacco	17	1 136	3	-
Chemicals and chemical products	12	3	-	120
Stone, clay, glass, and concrete products	967	-	29	-
Metals and metal products	12	783	3	-
Machinery	545	-	-	39
Electrical and electronic equipment	-	8	-	-
Motor vehicles and other transport equipment	3	13	-	-
Services	7 925	10 763	15 221	10 693
Electricity, gas, and water distribution	58	307	-	-
Hotels and restaurants	32	10	-	-
Trade	312	1 001	47	87
Transport, storage and communications	1 534	8 321	1 307	698
Finance	5 398	1 086	13 787	9 315
Health and social services	587	-	-	-

Source: UNCTAD cross-border M&A database.

- Ethiopia approved foreign concessions to its railway company and Mauritius opened its legal professional services industry to FDI;
- Morocco permitted foreigners to own vast areas of land; and
- Swaziland opened up to FDI in insurance.

A number of African countries introduced measures aimed at improving the admission and/or establishment processes applied to foreign investors. For example, Burkina Faso created a one-stop shop for new businesses; Kenya strengthened its investment promotion agency (IPA); several countries eased or improved registration and fiscal procedures for various business start-ups.[24] For example, Nigeria cut the average property registration time from 274 to 80 days.

Many countries introduced various other measures to promote foreign investment. These mainly involved tax reductions (Algeria, Egypt, Ghana, Lesotho, Mozambique, Tunisia, Uganda and the United Republic of Tanzania), the establishment of specialized investment zones or parks (Botswana, Eritrea, Morocco, the United Republic of Tanzania and Zambia), or the setting up of advisory councils for investment promotion (Ethiopia).

In some countries, however, governments adopted policies that were less favourable to foreign investment. For example, in Algeria, Egypt, Equatorial Guinea and Zambia, Governments raised various taxes or royalties that may affect foreign investment. Algeria ended majority foreign ownership in its oil and gas industries; Lesotho extended State monopoly over its fixed-line telephone services for a further 12 months; Swaziland closed its retail sector to foreign investors, and Zimbabwe prohibited money transfer operations by foreign or domestic agencies and main banking institutions. In the Libyan Arab Jamahiriya, new measures were adopted, requiring foreign investors to give priority to Libyan nationals in the manufacturing and agricultural sectors, and in construction, electricity, transport and communications in the services sector, as well as to provide training to locals, and ensure equal payments between Libyan and foreign staff.

At the international level, the region's development partners under the umbrella of the fourth Africa-Asia Business Forum (AABF) and the Tokyo International Conference for Africa's Development (TICAD) implemented measures to boost the region's FDI inflows. The Forum sought to boost the expansion of investments by Asian firms, including small and medium-sized enterprises (SMEs), in Africa (box II.2).

However, changing regulatory frameworks and improving the business climate may not be enough to attract greater FDI into manufacturing and to benefit from such investments. In countries with small domestic markets, FDI in manufacturing depends particularly on export markets and on the international competitiveness of African products in terms of unit factor costs relative to other countries (Golub and Edwards, 2003). Natural resources are attractive assets for export-oriented production, but they may not provide a sufficient basis for sustainable economic growth (Part Two). Moreover, natural resources provide rents only for as long as the resources last and are in demand; without technological and skills upgrading and development of downstream industries resource-exporting countries may eventually face stagnant prices and the risk of specializing in products that may become outdated (Nwokeabia, 2007). Accordingly, it is important for host countries to adopt policies that help improve their local capacities, and in particular their labour skills and technological capabilities.

d. Prospects: moderate growth expected in 2007

Prospects for FDI inflows into Africa in 2007 and beyond are expected to remain positive – albeit moderately – due to high commodity prices, particularly of oil. UNCTAD's *World Investment Prospects Survey* (UNCTAD, 2007b)[25] shows that only 20% of the investors interviewed planned to increase investment in Africa between 2007 and 2009, with no significant differences by subregion

Box II.2. A renewed push for Asian FDI in Africa

In 2006, TNCs from developing Asia accounted for over half of the cross-border M&As to Africa, worth close to $9 billion, up from $0.1 billion in 2005 (table II.2). This followed previous but slower growth in Asian FDI to Africa, which averaged $1.2 billion annually during the period 2002-2004. Singapore, India and Malaysia are the top Asian sources of FDI to the region, with a combined investment stock estimated at $3.5 billion (i.e. of cumulative approved flows from 1996 to 2004), followed by China, the Republic of Korea and Taiwan Province of China. Malaysia's FDI was the most diversified, by country and by industry, while about 3% of China's total outward FDI stock was spread over some 500 FDI projects in 48 African countries. Moreover, FDI from China to Africa has been increasing rapidly in recent years (UNCTAD, 2007d).

As part of efforts by the Government of Japan to boost trade and investment flows between the two regions, the fourth Africa-Asia Business Forum (AABF IV) took place in Dar es Salaam, United Republic of Tanzania in February 2007. The forum aims at increasing trade opportunities available to Asian TNCs in Africa taking into account the various trade agreements in place, such as AGOA and various new economic programmes for Africa's development (e.g. the New Partnership for Africa's Development (NEPAD)). It also aims to encourage the transcontinental exchange of knowledge and expertise and foster stable and sustainable economic growth and development between the regions within a South-South framework. The sectors targeted by AABF IV are: agro-industry and food processing, building materials, construction and engineering, information and communication technologies, medical equipment and pharmaceuticals, and textiles, garments and leather products.

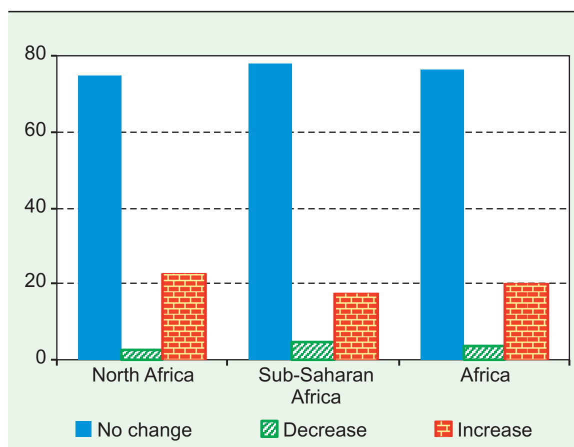
Participation in AABF IV was open to businesses from African and Asian countries.

Source: UNCTAD, based on information from AABF IV.

(figure II.5). Returns on capital in the region are expected to remain strong. While FDI in oil and gas and other minerals is likely to remain robust in the medium term, in manufacturing it is likely to fall further, due to tough international competition in garment exports and to the removal of trade preferences. But in the long-term it should revive as new initiatives, such as the African Investment Incentive Act (AIIA) by the United States Government, are implemented.[26]

FDI inflows into Africa in 2007 are likely to remain unevenly distributed by sector/industry and subregion and country, especially because most new investments will be in oil, gas and natural resources

Figure II.5. FDI prospects in Africa, 2007-2009, by subregion: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

which are geographically concentrated. In *North Africa,* prospects for the region as a whole are bright under initiatives being negotiated or concluded with the EU (box II.3), with significant new investments expected in Algeria and the Libyan Arab Jamahiriya. In *West Africa, Central Africa* and *Southern Africa* FDI inflows will also be concentrated in a few countries, for example, in oil exploration in Nigeria, in mining and associated activities in South Africa, and in oil and related infrastructure development in Equatorial Guinea. FDI inflows into countries with few natural resources are likely to remain slow, including in almost the entire *East African* subregion, though even here there will be relatively higher flows to countries such as Mauritius because of privatizations and other M&A activity.

Prospects are also good for larger FDI outflows from Egypt, Morocco, Nigeria and South Africa, as TNCs from these countries (in particular in mining and services) are set to continue expanding abroad.

2. Asia and Oceania

FDI inflows to Asia and Oceania reached a record of $260 billion, marking the fourth consecutive year of growth and representing more than two thirds of inflows to developing countries. Outward flows from this region grew by 50%, to $117 billion. Six out of the seven developing-country TNCs listed in the world's top 100 non-financial TNCs are from this region. This section examines South, East and South-East Asia, West Asia and Oceania.

Box II.3. North Africa: EU initiatives aimed at boosting FDI inflows and industrial growth

The North Africa subregion is a vital trade and investment partner of the EU, and the flow of FDI is in both directions: TNCs from the EU have purchased significant assets, particularly in Morocco and Egypt, in the context of privatizations that started in the 1980s, while more recently North African investors have begun to acquire EU firms. In 2005, for instance, Orascom Telecom (Egypt) acquired Wind Telecommunicazioni (Italy) for $12.8 billion (*WIR06*). FDI flows between North African countries and the EU are set to grow further as a result of the conclusion or negotiation of some recent free trade agreements between the EU and countries in the region. These agreements include the outcomes of the Barcelona Process[a] and a network of association agreements such as the Euro-Mediterranean Partnership and the Euro-Mediterranean Free-Trade Area.[b] The Euro-Mediterranean Partnership specifically aims at constructing a zone of shared prosperity through the gradual establishment of a free-trade area. The funding priorities of the MEDA programme of the Euro-Mediterranean Association Agreement focus on support for SMEs, privatization and trade facilitation.

The agreement on the Euro-Mediterranean Free Trade Area aims at assisting private sector development including improvement of the business environment, facilitating privatization, support for SMEs, promotion of investment and industrial cooperation. It can thereby assist in attracting FDI to stimulate industrial and commercial competitiveness in the North African region.

Source: UNCTAD, based on information from Euromed (europa.eu.int/comm./external relations) and other sources.

[a] The Barcelona Process is the result of the Euro-Mediterranean Conference of Ministers of Foreign Affairs, held in Barcelona on 27-28 November 1995. It marked the starting point of the Euro-Mediterranean Partnership, a wide framework of political, economic and social relations between the Member States of the European Union and 10 country partners of the Southern Mediterranean.

[b] The Mediterranean Partnership and Euro-Mediterranean Free Trade area include four North African countries: Algeria, Egypt, Morocco and Tunisia, with the Libyan Arab Jamahiriya as an observer.

a. South, East and South-East Asia

FDI inflows into South, East and South-East Asia maintained an upward trend in 2006. The bulk of these flows went to East Asia, with growth particularly pronounced in the inflows to South and South-East Asia. In East Asia, FDI flows are shifting towards more knowledge-intensive and high value-added activities, reflecting an increasing emphasis on the quality of FDI in investment promotion. Outward FDI from the region also soared. China has consolidated its position as an important source of investment, and India is rapidly catching on. Resource-seeking FDI from the two countries continued to increase, as did large acquisitions by their firms in developed countries.

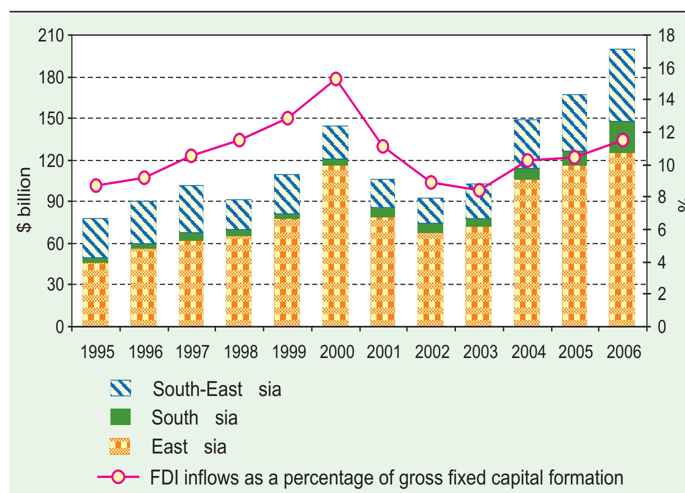
(i) Geographical trends

(a) Inward FDI: continued shift in favour of South and South-East Asia

FDI inflows to South, East and South-East Asia rose by 19% to $200 billion. At the subregional level, FDI continued to grow at a faster rate in South and South-East Asia than in East Asia (figure II.6). Nevertheless, the East Asian economies of China and Hong Kong (China) remained the largest FDI recipients among all developing economies, attracting $69 billion and $43 billion in 2006 respectively. Singapore was the third largest destination in the region with $24 billion worth of inflows, followed by India, which registered a substantial increase in FDI, amounting to $17 billion (figure II.7).

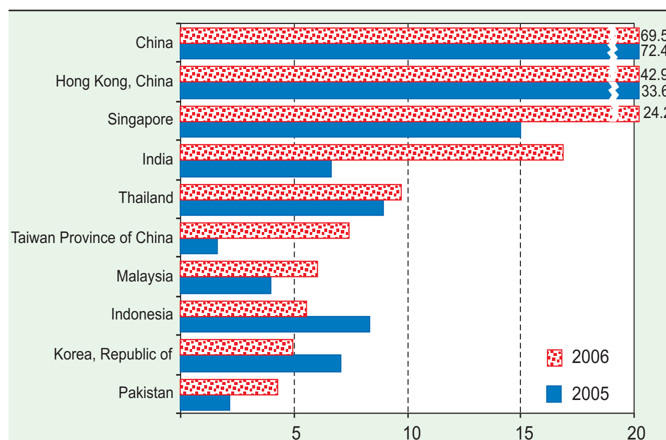
The value of cross-border M&As in the region rose by 19%, to $54 billion (annex table B.4), driven partly by large intraregional deals. In 2006, 47% of cross-border M&As in South, East and South-East Asia were intraregional, compared to 43% in 2005 and 32% in 2004. Meanwhile, the number of recorded greenfield projects climbed by

Figure II.6. South, East and South-East Asia: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

Figure II.7. South, East and South-East Asia: top 10 recipients of FDI inflows, 2005-2006
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked on the basis of the magnitude of FDI inflows in 2006.

19%, reaching a peak of 3,515 projects (annex table A.I.1).

East Asia

FDI inflows to East Asia[27] rose by 8% in 2006. Despite slower investment growth over the past two years, this subregion still accounted for about two thirds of total FDI flows to South, East and South-East Asia. China was East Asia's largest FDI recipient, followed by Hong Kong (China), Taiwan Province of China and the Republic of Korea.

Inward FDI flows to *China* declined for the first time in seven years. The modest decline (by 4% to $69 billion) was due mainly to reduced flows to financial services.[28] Rising production costs and labour shortages in China's coastal regions,[29] as well as policy measures for promoting the development of the inner areas, have begun to influence the geographic distribution of FDI. Some provinces in the middle and western regions of the country received higher FDI inflows than in previous years, while in the more advanced areas, such as the Pearl River and Yangtze River Deltas, investments have been shifting towards higher value-added activities such as computer peripherals, telecom equipment and semiconductors.

FDI flows to *Hong Kong (China)* rose to $43 billion, its second highest level ever. *Taiwan Province of China* saw the highest growth rate of FDI in the subregion in 2006, with inflows jumping by about 360% to $7 billion. FDI increases recorded for both economies were driven by rising cross-border M&As. In Taiwan Province of China, private equity firms from the United States, such as Carlyle Group and Newbridge, were involved in some of the largest M&As, including the acquisitions of Eastern Multimedia for $1.5 billion and of some banks.

Inflows to the *Republic of Korea* declined considerably in 2006, due mainly to a significant fall in the value of cross-border M&As (annex table B.4) and divestment by foreign investors. There were a number of large divestments from the country by foreign investors, particularly retailers such as Carrefour of France (about $1.6 billion) and Wal-Mart of the United States (about $900 million). New flows were nevertheless directed into high value-added activities in fields such as parts and materials, research and development (R&D) centres and distribution centres. For example, FDI in the parts and materials industry rose by 50% to $3.2 billion (on a notification basis).[30]

South-East Asia

FDI inflows into South-East Asia (comprising the 10 ASEAN member States[31] and Timor-Leste) registered a 25% increase in 2006, to reach their highest ever level of $51 billion. In particular, FDI flows to *Singapore* rose by 61%, representing a new high of $24 billion. As a distribution hub and financial centre in the subregion, the country accounts for almost half of total inflows to South-East Asia and continues to receive most of its FDI in services (mainly trade and finance). FDI inflows to *Thailand* continued to rise, by 9% in 2006, reaching a record $10 billion and consolidating the country's position as the second largest FDI recipient in South-East Asia. Large intraregional M&A deals, particularly the acquisition of Shin Corp. by Temasek Holdings (Singapore), accounted for a large part of the total inflows. Inflows to *Malaysia* and *the Philippines* rose substantially: by 53% in the former, to its highest level since the Asian financial crisis ($6 billion), and by 26% in the latter to its highest level ever ($2.3 billion). The Philippines' potential to attract FDI has been highlighted by the decision of Texas Instruments (United States) to invest around $1 billion in the country over 10 years in a new testing and assembly facility.[32] *Indonesia* saw a substantial decline (33%) in FDI inflows, thus breaking the positive trend from 2005.

The performance of other ASEAN member countries in attracting FDI in 2006 was generally good. The *Lao People's Democratic Republic* witnessed a sixfold growth, the highest among countries in the subregion, while inflows to *Cambodia* also rose. In *Viet Nam* they rose by 15% to reach $2.3 billion, and the country is increasingly considered an attractive location for efficiency-seeking FDI and some view it as an alternative

destination to countries such as China.[33] With its accession to the World Trade Organization (WTO) in 2007, market-seeking FDI is likely to increase.

South Asia

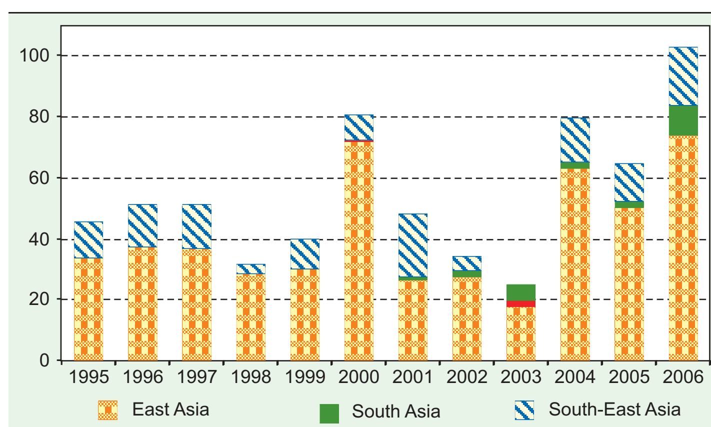
FDI inflows to South Asia[34] surged by 126%, amounting to $22 billion in 2006, mainly due to investments in *India*. The country received more FDI than ever before ($17 billion, or 153% more than in 2005), equivalent to the total inflows to the country during the period 2003-2005. Rapid economic growth has led to improved investor confidence in the country. According to the Government of India, the country's economy is expected to grow by 9.2% in the 2006/07 fiscal year. The sustained growth in income has made the country increasingly attractive to market-seeking FDI. Indeed, foreign retailers such as Wal-Mart have started to enter the Indian market. At the same time, a number of United States TNCs, such as General Motors and IBM, are rapidly expanding their presence in the country, as are several large Japanese TNCs, such as Toyota and Nissan. Private equity firms are also playing a role. For instance, Kohlberg Kravis Roberts & Co. (United States) acquired a controlling stake (85%) of Flextronics Software Sys Ltd. with an investment of $900 million.

Other important recipients of FDI in the subregion include Pakistan, Bangladesh and Sri Lanka. The performance of *Pakistan* in attracting FDI ($4.3 billion in 2006) has been promising. Strong economic growth and an aggressive privatization programme have led to booming FDI inflows during 2004-2006. In terms of sources of FDI, there has been a shift from developed countries to West Asian countries, particularly the United Arab Emirates and Saudi Arabia. After playing a leading role in a number of large M&A deals in Pakistan's privatization process, West Asian companies announced a series of large greenfield projects in the country.[35] Inflows to *Sri Lanka* rose significantly, reaching a record high of $480 million. However, *Bangladesh* has not yet realized its potential: the country is still categorized as an underperformer according to UNCTAD's *Inward FDI Potential and Performance Indices* (figure I.8), with FDI inflows of $625 million in 2006 (10% less than in 2005). Despite liberalization in some sectors (such as telecommunications) and recent efforts in establishing itself as an attractive location for FDI in South Asia, political uncertainty, poor infrastructure and a weak business environment tend to deter investors (World Bank, 2006).

(b) Outward FDI increased substantially from all subregions

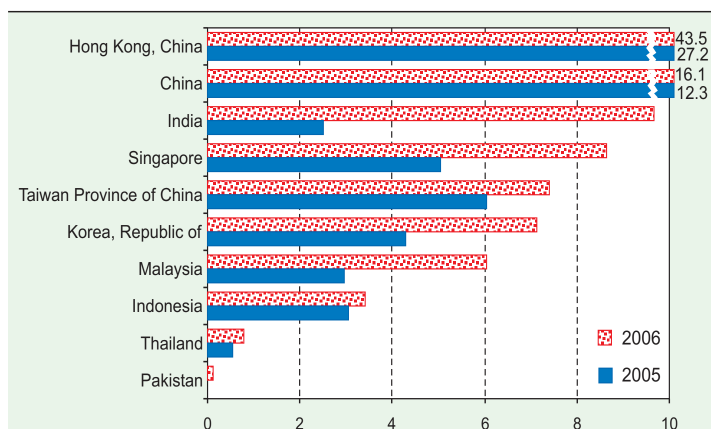
Outward FDI from South, East and South-East Asia soared by 60% to $103 billion, increasing from all three subregions (figure II.8), and particularly from Hong Kong (China), China, India, Singapore and the Republic of Korea (figure II.9). The total value of cross-border M&As undertaken by TNCs based in the region rose to $47 billion. Outflows from *Hong Kong (China)*, the largest FDI source in the region, rose by 60%, to $43 billion. The rebound in outflows from *Singapore* was

Figure II.8. South, East and South-East Asia: FDI outflows, 1995-2006
(Billions of dollars)



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

Figure II.9. South, East and South-East Asia: top 10 sources of FDI outflows, 2005-2006
(Billions of dollars)



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

[a] Ranked by magnitude of FDI outflows in 2006.

driven by large M&As within the region as well as in developed countries,[36] while increased outward FDI from the *Republic of Korea* was driven more by greenfield investments, prompting some concerns of a hollowing out.[37] FDI outflows from the region are targeting mainly offshore financial centres, but investments in developed countries as well as intraregional investments are also on the rise.

Rising outflows from China and India

China and India are beginning to challenge the dominance of the Asian newly industrializing economies (NIEs) – Hong Kong (China), the Republic of Korea, Singapore and Taiwan Province of China – as the main sources of FDI in developing Asia. Since 2004, their share of the total outflows from the Asian region as a whole has risen from 10% to 25%.

China's outflows increased by 32% to $16 billion in 2006, and its outward FDI stock reached $73 billion, the 6th largest in the developing world. Part of this overseas expansion involves considerable investment in other developing and transition economies. For example, China is establishing the first group of eight overseas economic and trade cooperation zones[38] in the following countries: in Nigeria, Mauritius and Zambia in Africa, in Mongolia, Pakistan and Thailand in Asia and in Kazakhstan and the Russian Federation in South-East Europe and the CIS. With a total investment of $250 million, for example, the zone in Pakistan is a joint venture between Haier (China) and Ruba Group (Pakistan). According to China's Ministry of Commerce, 50 similar zones will be established over the next few years, facilitating more FDI from China into other developing and transition economies.

In addition, China established in 2007 a government investment company to manage a $200 billion fund drawn from the country's huge foreign currency reserves.[39] This follows the example of the proactive approach to reserves management implemented in countries such as the Republic of Korea and Singapore. Although the investment strategy and policy of this company has not yet been clarified, it is expected to invest in foreign companies, partly through direct investment. In May 2007, for example, the company, though not yet formally established, invested $3 billion for a 9.9% stake in the private-equity firm Blackstone (United States).

India's outflows were almost four times higher than those of 2005. Compared to China, where FDI outflows are driven by the international expansion of State-owned enterprises encouraged by proactive government policies, booming outflows from India have been dominated by privately owned conglomerates, such as the Tata Group. With a total investment of $11 billion, for example, Tata Steel acquired Corus Group (United Kingdom and the Netherlands) in early 2007, creating Tata-Corus, the world's fifth largest steel maker (by revenue). It is one of a series of large cross-border M&As undertaken by Tata Steel and other members of the Tata Group in the past two years,[40] and by far the second largest deal ever made by a company from a developing country, the largest being the CVRD (Brazil)-Inco (Canada) deal in 2006 (section A.3).

The emergence of China and India as important sources of FDI, coupled with active M&A activities by investors based in the Asian NIEs (particularly Singapore), has led to increased FDI flows from Asia to developed countries. Asian investors have become a driving force in the M&A boom in Europe, in particular, in 2006. According to Think London (the local IPA of London in the United Kingdom), FDI in the city from Asia, particularly India, has risen significantly in recent years.[41]

Intraregional FDI

Intraregional FDI flows are important for many economies in the region, and a few of the bilateral FDI stocks are among the largest in the world (table II.5). The past two years have seen a rise in intraregional flows, as highlighted by data on cross-border M&As: in 2005 and 2006, about 55% of cross-border M&As undertaken by TNCs based in the region were intraregional, as compared to 40% in 2004.

Intraregional FDI flows take place both within and between subregions. Within subregions, two clusters stand out: intra-Greater-China FDI – flows among China, Hong Kong (China), Taiwan Province of China and Macao (China) – and intra-ASEAN FDI. Within the former cluster, bilateral FDI stocks between Hong Kong (China) and China are the second largest in the world (table II.5), after those between the United Kingdom and the United States (chapter I). Mutual flows between the two economies have grown significantly since the mid-1990s, but round-tripping FDI as well as trans-shipping FDI account for a large share of these flows (*WIR06*:12-13). FDI flows from Taiwan Province of China into China have increased since the early 2000s. Accordingly, a number of affiliates established by electronics companies based in Taiwan Province of China now rank among the largest foreign affiliates in China.[42] Within the intra-ASEAN cluster, Singapore is the leading investor (table II.5), while Malaysia has also become an important source of FDI. Further economic integration driven by the common objective of achieving an ASEAN Investment Area by 2015 has been stimulating stronger intra-ASEAN FDI flows.

Table II.5. Intraregional FDI in South, East and South-East Asia: largest bilateral flows and stocks, 2005, ranked by FDI flows

Rank	Home country - host country	FDI flows in 2005			FDI stock in 2005[c]	
		Amount ($ million)[a]	Share in home economy outflows[b] (%)	Share in host economy inflows[a] (%)	Amount ($ million)[d]	Rank in the world
1	Hong Kong (China) - China	17 949	61.6	24.8	241 573	2
2	China - Hong Kong (China)	9 373	27.9	27.9	164 063	8
3	Republic of Korea - China	5 168	46.0	7.1	25 936	63
4	Thailand - Hong Kong (China)	3 613	..	10.7	4 282	[e]
5	Singapore - China	2 204	43.8[f]	3.0	25 539	65
6	Taiwan Province of China - China	2 152	35.7[f]	3.0	39 604	43
7	Singapore - Hong Kong (China)	1 414	28.1[f]	4.2	10 874	123
8	Hong Kong (China) - Singapore	771[b]	2.8	5.1[g]	5 160	[e]
9	Malaysia - Singapore	627	2.2	3.1	4 046	[e]
10	Macao (China) - China	600	8.0	0.8	6 337	[e]
11	Singapore - Malaysia	575	11.4[f]	14.5	7 623	159
12	Malaysia - China	361	3.6	0.5	3 833	[e]
13	Singapore - Thailand	301	6.0[f]	7.5	6 150	194
14	India - Singapore	289	11.6[f]	1.4	1 101	[e]
15	Hong Kong (China) - Thailand	238	1.2	5.9	2 737	[e]

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

[a] Based on data on FDI inflows as reported by the host economy.
[b] Based on data on FDI outflows as reported by the home economy.
[c] Or latest year available.
[d] Based on data on inward FDI stock as reported by the host economy.
[e] >200.
[f] Estimated share, based on data on inward flows from the home economy to the reporting host economy (numerator) and total outward flows of the reporting home economy (denominator).
[g] Estimated share, based on data on outward flows from the reporting home economy to the host economy (numerator) and total inward flows of the reporting host economy (denominator).

Chinese FDI in ASEAN is also rising fast, complementing the traditionally large investors from Hong Kong (China) and Taiwan Province of China. Chinese companies have focused on energy, infrastructure and related services in a number of ASEAN member States.[43] Rising inflows to low-income countries such as Cambodia and the Lao People's Democratic Republic have also been driven mainly by FDI from China, which has become the largest source of FDI inflows to those countries.

(ii) Sectoral trends

(a) Inward FDI increased in primary and services sectors

Judging by the data on cross-border M&A sales, in 2006, the primary and services sectors in South, East and South-East Asia received significantly higher FDI inflows in 2006, while M&A sales in manufacturing dropped (table II.6).

Extractive industries. In comparison with Africa and Latin America, extractive industries and related activities account for a relatively small share of total FDI to South, East and South-East Asia, but they nevertheless continue to be resilient in attracting FDI. For example, high oil prices have been encouraging investment by TNCs in large projects in coal mining and processing in China.[44] In the region as a whole, the value of cross-border M&As in extractive industries rose nearly fivefold to $1.7 billion in 2006, and the number of recorded greenfield projects in the sector also increased significantly.

Manufacturing. In 2006, cross-border M&As in the region soared in textiles and clothing, machinery and chemicals, but declined considerably in food, beverages and tobacco, electrical and electronic equipment and motor vehicles and other transport equipment (table II.6). Greenfield investments also rose significantly in textiles and clothing. China remains the region's top recipient of FDI in manufacturing, and it is climbing up the value chain.[45] An increasing number of TNCs have established regional headquarters in Chinese cities such as Beijing and Shanghai. IBM has even relocated its global procurement headquarters to Shenzhen. India is gaining strength in attracting FDI in traditional manufacturing industries such as steel and petrochemicals. Its FDI inflows in manufacturing rose from $11 billion in the 2004/05 fiscal year to $17 billion in the 2006/07.[46] POSCO (Republic of Korea) announced in 2006 that it would invest $12 billion in a steel plant in India. Automobile manufacturing TNCs have been rapidly expanding their presence in India's automotive industry (box II.4).

Services. The shift towards services (*WIR04*) continues in the region, particularly on account of investments in communications, real estate, retailing and financial services. Intraregional M&A deals in service industries such as telecommunications and transportation (annex table A.I.3 for large deals) have been one of the driving forces behind this shift, and the growth of FDI in financial services has been particularly significant in recent years. In the banking industry, a new wave of liberalization in economies such as China, India, Pakistan, Taiwan Province of China and Viet Nam – often linked to WTO commitments – has resulted in significant flows of FDI. Investors are from Asian countries with existing thriving banking industries (e.g. the Overseas Union Bank of Singapore, which recently expanded into Viet Nam) as well as from outside the region (e.g. the Standard Chartered Bank of the United Kingdom, which acquired a bank in Taiwan Province of China; and Dubai Islamic Group of the

Table II.6. Sector/industry breakdown of cross-border M&As in South, East and South-East Asia, 2005-2006
(Millions of dollars)

Sector/industry	2005	2006	Growth rate (%)
Primary	469	1753	273.5
Agriculture, forestry and fisheries	120	89	-25.7
Mining, quarrying and petroleum	350	1664	376.0
Mining and quarrying	3	63	1926.8
Petroleum	347	1601	362.1
Secondary	13 300	12 906	-3.0
Food, beverages and tobacco	6 256	3 099	-50.5
Textiles, clothing and leather	100	1720	1624.8
Woods and wood products	997	419	-57.9
Chemicals and chemical products	659	970	47.1
Stone, clay, glass and concrete products	401	734	83.0
Metals and metal products	812	856	5.4
Machinery	432	2 640	510.9
Electrical and electronic equipment	2 368	1 462	-38.2
Motor vehicles and other transport equipment	1 047	275	-73.8
Services	31 363	39 063	24.6
Electricity, gas and water distribution	932	161	-82.7
Construction firms	108	58	-45.9
Hotels and restaurants	1 845	1 387	-24.8
Trade	1 863	786	-57.8
Transport, storage and communications	6 604	16 139	144.4
Finance	14 529	11 645	-19.9
Business activities	4 804	5 048	5.1
Health and social services	294	140	-52.5
Community, social and personal service activities	371	3172	754.0
Total	45 132	53 723	19.0

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

United Arab Emirates, which is expanding into Pakistan). Private equity firms from the United States, such as Carlyle Group and Newbridge, are also actively investing in the banking industry in the region. In the retailing industry, China and India have large potential to attract both equity and non-equity investments from TNCs. In India the retail market has begun to open up to foreign retailers.[47] In China, this industry has already become an important FDI recipient, with accumulated flows of $5 billion. Based on a first-mover strategy, Carrefour (France) has become the fifth largest retailer in China, while Wal-Mart (United States), which ranked the 14th largest, recently expanded its presence in China through the acquisition of Trust-Mart.[48] In contrast to their expansion in China and India, as noted, Carrefour and Wal-Mart divested from the Republic of Korea.[49]

(b) Outward FDI: resource-seeking FDI continued to rise

Resource-seeking FDI from South, East and South-East Asia rose again in 2006, driven by large M&As involving oil and gas companies from China and India (annex table A.I.3 for large deals). Chinese and Indian oil companies have jointly acquired companies in several countries,

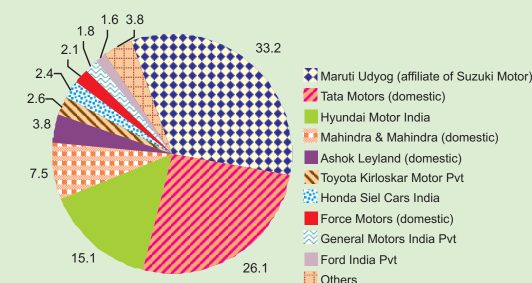
Box II.4. Market-seeking FDI in India's automotive industry is booming

Production of motor vehicles by India's automotive industry reached 1.7 million vehicles in 2005/06. Suzuki Motor (Japan) was the leading investor in India in this industry, ranking first in market share, followed by the domestic firm Tata Motors and then Hyundai Motor (Republic of Korea) (box figure II.4.1). Other significant foreign players in India's automotive industry include Toyota Motor (Japan), Honda Motor (Japan), General Motors (United States) and Ford Motor (United States). Driven by market-seeking motives, these car-manufacturing TNCs have started or are planning large-scale investment projects in India. Accordingly, the landscape of the country's automotive industry is likely to witness a dramatic change in the next few years.

- To strengthen its leading position, Suzuki Motor has announced an expansion plan of $1.65 billion, which will help to increase its annual production capacity to a million vehicles by 2010.
- General Motors is investing $300 million in a car-assembly plant in Maharashtra. The plant will start production in the fourth quarter of 2008, producing 100,000 compact cars annually. The capacity of General Motors' factory in neighbouring Gujarat is also being expanded.
- Cooperating with Mahindra & Mahindra, an Indian jeep and tractor producer, Nissan (Japan) and Renault (France) are planning to invest $908 million in a car-assembly plant in Chennai. With an annual capacity of 400,000 vehicles, the plant will start production in 2009.
- In order to double its market share to 10% in four or five years, Toyota Motor is preparing to invest $500 million in quadrupling the capacity of its plant in Bangalore (from 50,000 vehicles in 2006 to 200,000 by 2010).

Source: UNCTAD, based on various newspaper accounts.

Box figure II.4.1. Market shares[a] of automobile producers in India, 2005/06
(Per cent)



Source: UNCTAD, based on the Automotive Component Manufacturers Association of India.

[a] Calculated based on production.

such as Colombia, Sudan and the Syrian Arab Republic. By actively investing abroad, these State-owned companies are spearheading their Governments' drive to secure overseas energy sources (chapter IV).

In manufacturing, FDI from South, East and South-East Asia has been largely driven by the international expansion of firms in their bid to acquire created assets such as brands and technologies, which has become an important motive for their FDI. Aggressive acquisitions have placed some of these Chinese and Indian companies onto a fast track of internationalization. However, the experience of some Chinese companies highlights the risks inherent in this approach towards international expansion.[50]

In the services sector, Chinese banks have started to take serious steps in recent years to go global, through both cross-border M&As and greenfield investments. Despite policy restrictions in some host countries such as the United States,[51] the total foreign assets of China's State-owned banks had reached $28.4 billion by the end of 2006 and are expected to grow rapidly in the coming years.

(iii) Policy developments

A number of policy measures favourable to FDI were introduced in South, East and South-East Asia in 2006. For example, Mongolia introduced a package of tax reforms that may help improve the investment climate by reducing the corporate tax rate. In India, new legislation on special economic zones came into force. Companies that choose to invest in those zones are offered tax concessions such as a 15-year direct tax holiday and full exemption of import duties. In 2007, the Indonesian Government is in the process of promulgating a new law on energy under which foreign firms in oil and gas and coal mining will be provided incentives for investment (chapter VI). A number of countries also took steps to liberalize inward FDI in services. For example, the Lao People's Democratic Republic introduced a new banking law, and Viet Nam deregulated its banking industry to allow FDI in that industry.

Some policy measures have been adopted with a view to prioritizing various objectives related to FDI. For instance, the Chinese Government is increasingly emphasizing the quality rather than the quantity of FDI as a policy objective.[52] In addition, it has unified two income tax systems for foreign affiliates and domestic enterprises, respectively, which will take effect in 2008.[53] New policy measures have also been introduced to address various concerns related to inward FDI. For example, potential FDI in such industries as telecommunications has given rise to national security concerns for the Government of India, leading to more restrictive measures.[54] The Chinese Government has implemented new policy measures on M&As by foreign firms and on the foreign purchase of real estate,[55] and has formulated a list of industries over which the State will maintain control.[56]

Some countries have adopted new measures to encourage the internationalization of their enterprises. The Chinese Government has abolished quotas on the purchase of foreign exchange for overseas investment since 1 July 2006 and has strengthened its support for overseas investments by Chinese enterprises. The Republic of Korea also plans to relax foreign exchange regulations, including a complete removal of the investment ceiling for outward FDI by individuals (currently $10 million). In recent years, dependence on imported oil has increased significantly in some countries in the region. Therefore, energy security concerns have played an increasingly important role in their policies concerning outward FDI in extractive industries (chapter IV). In the Republic of Korea, for example, it was announced that investment in large overseas resource development projects would be backed by increased financial support by the Export-Import Bank of Korea.

Countries in South, East and South-East Asia concluded 31 new BITs and 39 new DTTs in 2006. Among the most important developments in international agreements in 2006 were the conclusion of free trade agreements between the Republic of Korea and the United States and between China and Pakistan; as well as the Trade and Investment Framework Agreement between the United States and ASEAN, and the Economic Partnership Agreements between Japan and the Philippines and between Japan and Malaysia (chapter I).

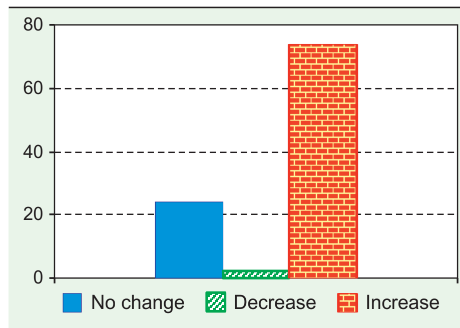
(iv) Prospects: most-favoured region for FDI

Rapid economic growth in South, East and South-East Asia is likely to continue, underpinned by the strong performance of China and India (ADB, 2006; IMF, 2007a). Growth in market-seeking FDI to the region should keep pace with rapid economic growth in the next few years. In addition, the region may become more attractive to efficiency-seeking FDI, owing to the plans of several countries such as China, India, Indonesia and Viet Nam to develop their infrastructure.[57] During the first half of 2007, the value of cross-border M&As increased by nearly 20% over the corresponding period in 2006. FDI outflows from the region are also expected

to keep growing, with the internationalization efforts of some Chinese State-owned enterprises and Indian privately owned conglomerates set to continue.

According to UNCTAD's *World Investment Prospects Survey*, South, East and South-East Asia is the region most favoured by TNCs, followed by North America and the EU (UNCTAD, 2007b). Of the TNCs interviewed in the survey, 65% already have FDI stocks in the region, and over 74% of respondents anticipate increasing investments to it (figure II.10). In terms of the investment locations, China (52% of respondents) and India (41%) rank numbers one and two, respectively, among the five most attractive sites (table I.14). The respondents who mentioned the two countries are mainly attracted by the size and growth of their domestic markets and the availability of cheap labour. Viet Nam was considered an attractive location for FDI by 11% of the respondents and is ranked number six globally.

Figure II.10. FDI prospects in South, East and South-East Asia, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

China will remain a magnet for FDI, but is becoming more selective with respect to the quality of FDI it seeks. India has shown huge potential for market-seeking FDI, but faces a number of disadvantages that could impede progress in attaining its goal of raising annual FDI to $50 billion by 2010.[58] Viet Nam appears to be poised to become an important site for manufacturing FDI, while Thailand appears to attract high-value-added FDI. According to a 2006 survey, these four countries are also among the top five in which Japanese manufacturing TNCs expect to invest the most (JBIC, 2007). Meanwhile, investors from West Asia may continue to drive FDI to South Asian countries such as Pakistan to new heights.

b. West Asia

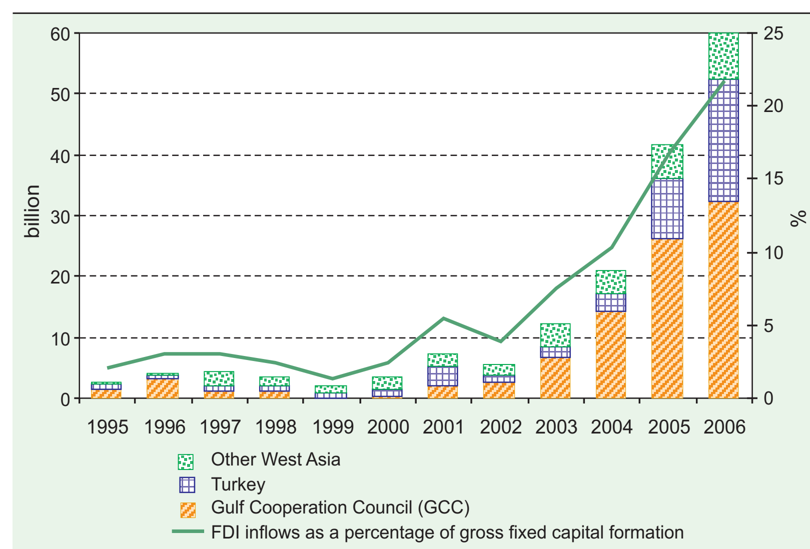
FDI flows to West Asia[59] continued their upward trend in 2006. High rates of economic growth, diversification strategies, ongoing reforms and privatizations contributed to the increase. While the services sector was by far the largest recipient of FDI in the region, inward FDI in manufacturing, especially in industries related to oil and gas, increased significantly. Outward FDI flows, driven partly by rising revenues from natural resources, remained high. Developed countries accounted for the lion's share of FDI flows to and from West Asia, but flows to and from other developing Asian countries have also been on the rise. Despite the geopolitical uncertainties that are likely to persist in the region, both inward and outward FDI can be expected to rise in 2007, judging from the record number of investor commitments. This is confirmed by UNCTAD's *World Investment Prospects Survey,* in which about one third of the respondents indicated that they would increase FDI in the region in 2007-2009.

(i) Geographical trends

(a) Inward FDI maintained its upward trend

In 2006, FDI inflows into West Asia increased by 44%, to $60 billion (figure II.11). The region's share in total FDI flows to developing countries rose from 13% in 2005 to 16% in 2006. FDI inflows as a percentage of gross fixed capital formation remained higher than in other subregions in Asia, at 22%. Inflows, as previously,

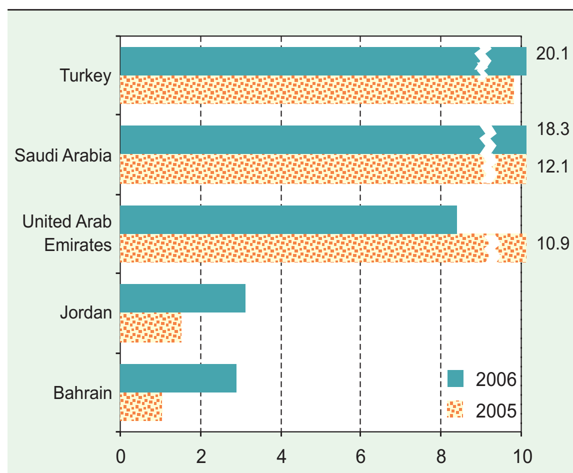
Figure II.11. West Asia: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

were concentrated in three countries: Turkey, Saudi Arabia and the United Arab Emirates, which together accounted for 78% of the total (figure II.12).

Figure II.12. West Asia: top five recipients of FDI inflows, 2005-2006[a]
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of FDI inflows in 2006.

Several factors explain this upward trend in recent years. First, regulatory frameworks for FDI are becoming more relaxed in several countries of the region, particularly in services such as finance, real estate and telecommunications (see section on policy developments below). Privatizations of these services have also attracted more investments by TNCs. Second, the business climate in several West Asian economies has improved (World Bank, 2006), and economic growth has been robust, at an average rate of 5.6% in 2005–2006 (IMF, 2007a). Third, high oil prices encouraged more FDI in oil- and gas-related manufacturing and services in 2006. Greenfield investments as well as cross-border M&As were attracted by booming local economies and prospects for continuing high prices of oil and gas.

A few mega cross-border M&As (including through privatization), particularly in financial services contributed to *Turkey* becoming the top recipient country in the region, with FDI inflows more than twice the amount registered in 2005 ($20 billion).[60]

The *Gulf Cooperation Council (GCC) member countries* – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates – attracted 54% of total FDI inflows to the subregion in 2006. Saudi Arabia was the second largest recipient in West Asia, with inflows of $18 billion, 50% more than in 2005.[61] The United Arab Emirates was the third largest, with FDI inflows going mainly to the country's 15 free trade zones. There were several cross-border M&A deals and a noticeable increase in greenfield FDI projects in the country (annex table A.I.1).

FDI inflows to the *other West Asian economies*[62] amounted to $7.3 billion. Inflows to Jordan doubled to $3.1 billion, partly owing to the acquisition of Umniah Telecom and Technologies by Batelco (Bahrain) (IMF, 2007d). However, the Islamic Republic of Iran, Iraq, the Palestinian Territory and Lebanon attracted limited FDI (table II.7), due largely to geopolitical problems.

The value of cross-border M&As in West Asia in 2006 rose by 26% over the previous year (table II.8). M&A by TNCs from developed countries jumped considerably from $3 billion to $15 billion (table II.8): Greece, the United Kingdom and Belgium, followed by the United States, were the main home countries of those TNCs, in that order, accounting for over 75% of total M&As. The value of cross-border M&As by firms from developing countries fell markedly to $3 billion from $9 billion in 2005. In consequence, developing countries' share of total M&A sales was 15% (of which 11% represented cross-border M&As within West Asia), significantly lower than in the previous year (66%).

Table II.7. West Asia: distribution of FDI flows among economies,[a] by range, 2006

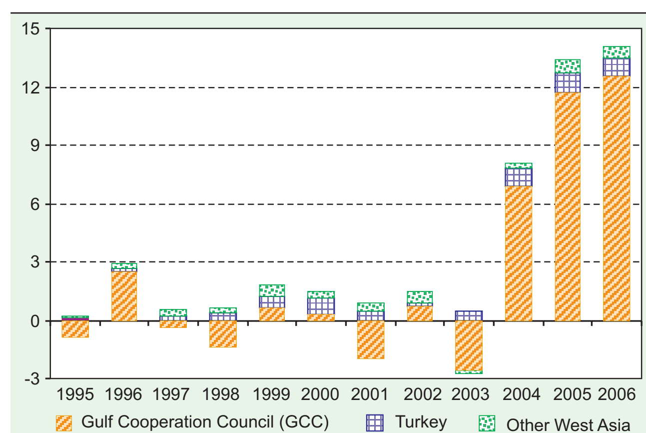
Range	Inflows	Outflows
Over $5 billion	Turkey, Saudi Arabia, United Arab Emirates	Kuwait
$3-4.9 billion	Jordan	..
$1-2.9 billion	Bahrain, Lebanon and Qatar	United Arab Emirates
$0.5-0.9 billion	Oman, Islamic Republic of Iran and Syrian Arab Republic	Bahrain, Turkey and Saudi Arabia
$0.1-0.4 billion	Iraq and Kuwait	Islamic Republic of Iran, Qatar and Oman
Less than $0.1 billion	Palestinian Territory and Yemen	Lebanon, Syrian Arab Republic, Yemen, Palestinian Territory and Jordan

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

(b) Outward FDI increased slightly

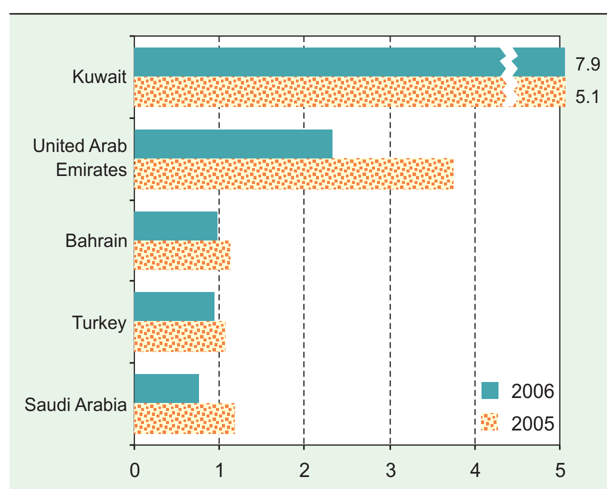
FDI flows from West Asia totalled $14 billion, a modest rise of 5% over the 2005 level (figure II.13). The GCC countries led by Kuwait accounted for 89% of this outward FDI, with about $13 billion worth of flows (figure II.14). The value of cross-border M&As by investor firms from West Asia as a whole amounted to $32 billion,[63] which corresponded to a 78% increase over that in 2005.

Figure II.13. West Asia: FDI outflows, 1995-2006
(Billions of dollars)



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

Figure II.14. West Asia: top five sources of FDI outflows, 2005-2006 [a]



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by the magnitude of FDI outflows in 2006.

The United Arab Emirates was by far the largest acquirer (annex table B.4). Acquisitions were largely targeted at developed countries, that accounted for 66% of the value of cross-border M&As by firms from West Asia (table II.8), and in particular the United Kingdom (35% by value), Canada (11%) and the United States (9%). With 8% of the value of such purchases, companies in Pakistan were also important targets in 2006.

FDI from West Asia was mainly concentrated in oil and gas and related industries, tourism, telecommunications and financial services (annex table A.I.3 for mega deals). MTC, one of Kuwait's mobile telephone companies is expanding its presence in 14 sub-Saharan countries, investing in greenfield projects in Saudi Arabia and bidding for another licence for mobile telecommunications in Qatar. The National Bank of Kuwait is engaged in deals in Jordan, Qatar and Turkey.[64]

In the case of greenfield FDI, the United Arab Emirates was also the most active investor, with more than 200 announced projects undertaken by its investors abroad out of a total of 429 by all the countries of the subregion in 2006 (annex table A.I.1). Around 40% of the outward greenfield investments from the United Arab Emirates were in the property/tourism and leisure industries, both within the region and in countries such as China, India, Morocco and Pakistan. The projects in real estate vary from offices and hotels, to marina and hub developments. Companies from the United Arab Emirates are also investing in logistical and distribution facilities mainly in the region. Saudi Arabian outward greenfield investments are concentrated in the chemical, plastic and rubber industries, including in Australia, New Zealand and Viet Nam.

Table II.8. West Asia: Cross-border M&As, by home/host region, 2005-2006
(Millions of dollars)

Home/host region	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
World	14 134	17 857	18 221	32 426
Developed countries	3 265	15 112	8 856	21 540
Europe	1 574	13 864	7 539	15 064
European Union-25	1 574	13 864	7 539	13 769
United Kingdom	97	4 811	1 564	11 407
United States	1 557	1 130	1 222	2 835
Developing countries and territories	9 276	2 723	9 363	10 590
Africa	..	55	5	4 581
Latin America and the Caribbean	..	..	50	..
Caribbean and other America	..	..	50	..
Asia and Oceania	9 276	2 669	9 358	6 009
Asia	9 276	2 669	9 358	6 009
West Asia	9 208	1 971	9 208	1 971
South, East and South-east Asia	68	697	150	4 038
South-East Europe and CIS	1 593	22	2	297

Source: UNCTAD cross-border M&A database.

(ii) Sectoral trends: all sectors attracted higher flows

Data on cross-border M&As in the region suggest that all three sectors – primary, manufacturing and services – received higher FDI inflows than in 2005 (table II.9). While West Asia's inward and outward FDI flows are highly concentrated in the services sector, the shares of primary and manufacturing sectors in cross-border M&As increased. Jordan and the United Arab

Emirates provide examples of successful cases of attracting FDI into free zones as part of efforts by their Governments to diversify FDI into the manufacturing sector (box II.5).

Few West Asian countries permit FDI in oil and gas exploration and extraction (Part Two), which explains the low levels of FDI in the region's *primary sector*. Nevertheless, the sector's share in cross-border M&As rose markedly in 2006 (table II.9). Initiatives by some countries of the region, including Qatar and Saudi Arabia, to develop their natural gas industries and to open them to foreign investment may explain part of this increase.[65]

In the *secondary sector,* manufacturing FDI in the region has been concentrated primarily in energy-related industries, including oil refining and petrochemicals.[66] FDI also continues to flow into Turkey's automotive sector, which has been a major beneficiary of outsourcing by the European motor vehicle industry over the past two decades.[67] In the United Arab Emirates following that country's economic diversification drive aimed at promoting the non-oil sector, manufacturing now accounts for about one fifth of GDP. This has been achieved mainly through the provision of incentives to attract investors to special economic zones of various kinds (box II.5). In 2006, 95% of total FDI inflows to Jordan were directed to the country's manufacturing sector.[68]

S*ervices* have remained the dominant sector for FDI in the region, often through cross-border M&As and privatizations. Continued liberalization

Box II.5. Free industrial zones in the United Arab Emirates and Jordan

As part of its diversification initiatives aimed at developing the manufacturing sector, the Government of the United Arab Emirates has been setting up free trade and industrial zones in which investors are offered special incentives and facilities for setting up industrial establishments.[a] In order to encourage foreign participation, 100% foreign ownership is allowed in the free zones. At present, there are 15 free zones in operation in the country, the largest of which is Dubai's Jebel Ali Free Zone (JAFZ), with more than 5,000 business entities from over 100 countries (box table II.5.1).In general, all of the zones are used mainly to locate warehousing and distribution facilities for local and international business operations.[b] Transnational manufacturing and distribution companies with investments in JAFZ include Black & Decker, Daewoo, Honda, Johnson & Johnson, Nestlé, Nissan, Philips, Samsung, Sony, Nokia, Daimler Chrysler and Toshiba. Another free zone, the Ras al Khaimah Free Trade Zone has attracted 2,400 companies, many of which are foreign, with $27.2 billion in total investments (including foreign and domestic). Out of the foreign entities, 623 companies are owned by Indian investors. Manufacturing companies in the zone make up about 25% of the total.[c]

Box table II.5.1. Number of foreign firms operating in Jebel Ali Free Zone, by nationality, 2005-2006

	Number		Growth rate
Economy	2005[a]	2006[b]	(%)
Iraq	673	954	41.8
United Arab Emirates	609	856	40.6
India	530	627	18.3
Islamic Rep. of Iran	412	452	9.7
United Kingdom	367	389	6.0
United States	195	230	17.9
Germany	139	170	22.3
Pakistan	104	115	10.6
Japan	85	98	15.3
British Virgin Islands	84	96	14.3
Others	1 380	1 601	16.0
Total	4 578	5 588	22.1

Source : JETRO, 2006: 358.
[a] As of 24 May.
[b] As of 31 May.

The objective of Jordan's Qualified Industrial Zones (QIZs) is to attract investment, strengthen economic integration in the region and provide incentives for economic cooperation between Jordan and Israel.[d] They operate on joint rules of origin between Jordan and Israel, whereby products produced in the zone can be exported duty-free and quota-free to the United States.[e] These rules and incentives have been particularly helpful in attracting foreign investors wishing to benefit from the exemption of quota restrictions on textile exports to United States markets. Firms from other West Asian countries are also investing in the QIZs in Jordan. Many Turkish companies have plans to invest there to benefit from Jordan's preferential trade agreements with both the United States and Europe and the lower labour costs that prevail. By 2004, Jordan's QIZs had attracted $379 million in foreign investment, helping to create more than 40,000 jobs in 79 projects. Approximately 88% of the capital invested is classified as non-Arab (Kardoosh, 2004). In addition to QIZs, the Aqaba Special Economic Zone had already attracted more than $6 billion on an approval basis by the end of 2006.[f]

Source: UNCTAD.
[a] "JAFZA milestones", *Gulf Industry,* at: www.gulfindustryonline.com/bkArticlesF.asp?IssueID=244&Section=840&Article=5077, 2006.
[b] "Welcome Message", Jebel Ali Free Zone, at: http://www.jafza.co.ae/jafza/content/section1.asp, 2006.
[c] "Global Investment House KSCC", *Ras Al Khaimah Economic and Strategic Outlook, February* 2007.
[d] State of Israel, Ministry of Industry. Trade and Labour, "QIZ – Qualified Industrial Zones", at: www.moit.gov.
[e] Jordan and the United States concluded an FTA in 2000, the first between an Arab State and the United States. This FTA will eliminate all tariff and non-tariff barriers to bilateral trade in virtually all industrial goods and agricultural products within 10 years (*source*: Office of the United States Trade Representative, at: www.ustr.gov).
[f] "Incentives make Jordanian port a haven for investors", *Financial Times*, 21/22 October 2006.

Table II.9. West Asia: cross-border M&As, by sector/industry, 2005-2006
(Millions of dollars)

Sector/industry	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
Total industry	14 134	17 857	18 221	32 426
Primary	111	1 274	45	1 043
Mining, quarrying and petroleum	111	1 270	45	1 043
Mining and quarrying	-	112	-	-
Petroleum	111	1 158	45	1 043
Secondary	55	2 499	19	1 078
Food, beverages and tobacco	-	925	-	18
Oil and gas; petroleum refining	-	1 054	-	-
Chemicals and chemical products	-	90	-	893
Stone, clay, glass, and concrete products	-	291	-	167
Motor vehicles and other transport equipment	55	131	-	-
Services	13 968	14 084	18 157	30 305
Transport, storage and communications	8 146	5 687	11 231	13 084
Telecommunications	8 143	5 687	9 950	5 868
Finance	5 513	7 934	6 690	15 664

Source: UNCTAD cross-border M&A database.

has spurred inward FDI into real estate and financial services. In GCC countries, the latter has received the major share of the FDI in services. There are signs that FDI in Islamic finance by enterprises from within and outside the subregion is growing.[69] In the telecommunications industry, significant M&A deals have taken place, particularly in Jordan and Turkey.[70]

(iii) Policy developments

Most policy measures introduced in West Asia in 2006 were favourable to foreign investors: out of 14 regulatory changes related to FDI, 12 aimed at making the investment environment more favourable to FDI.[71] Several countries continued to liberalize sectors, but generally not the extractive industries.

For instance, the trend towards liberalization in financial services continued in 2006. In Bahrain, measures taken by the Central Bank of Bahrain and the Bahrain Monetary Agency (BMA) enable offshore banks to do business onshore for the first time. Saudi Arabia announced a plan to construct a financial district in Riyadh by 2010 at a cost of 250 billion Saudi Arabian riyal ($6.7 billion) to accommodate growing financial activities. The Qatar Financial Centre Regulatory Authority signed a memorandum of understanding with the BMA to enable the two agencies to cooperate in the supervision of financial institutions operating in both the Qatar Financial Centre (QFC) and Bahrain.[72] In Turkey, new legislation on insurance was adopted in 2007.

There are examples of liberalization in other industries as well. Oman, for example, has allowed foreign ownership of real estate, which should encourage FDI in tourism.[73] In the extractive industries, Qatar has announced several changes in contractual and tender conditions, which will facilitate the process of bidding for and securing contracts managed by Qatar Petroleum. These changes, when implemented, could have a positive impact on FDI inflows, especially in the context of Qatar's gas initiative.[74] Broader measures affecting the investment climate have also been adopted, or are being considered. For instance, Turkey in June 2006 lowered the corporate income tax rate from 30% to 20%,[75] and the Kuwaiti Government has announced plans to reduce the corporate income tax rate from 55% to 25% in order to attract more FDI into non-oil industries. Legislation to that effect is expected to be passed in 2007.

In general, the need for FDI reform in West Asia is being acknowledged and addressed (World Bank, 2006). Iraq and Jordan, for example, have either revised or are revising their investment laws. In December 2006, the United Arab Emirates decided to draft a foreign investment law aimed at improving its investment climate. However, in order to promote local employment, the Labour Ministry issued a decree in June 2006 that requires all firms – domestic and foreign – to replace within 18 months all expatriate secretaries and human resource managers with United Arab Emirates nationals.[76]

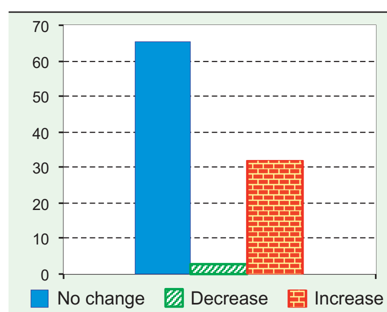
At the international level, while the FTA between Oman and the United States was the only international agreement signed in the region in 2006, several others are being negotiated. These include an FTA between Jordan and the GCC, which is set to include all commercial services and agricultural products, as well as the free movement of individuals working in construction, insurance and banking institutions. An FTA is also being negotiated between the GCC countries and India that may encourage investment from the Gulf into India, particularly in financial services; another one between the GCC and Japan is expected to be concluded in 2007. In February 2007, the EU Trade Commissioner called on members of the GCC to work on creating an FTA between the GCC and the EU.[77]

(iv) Prospects: upward trend should continue

In light of the region's high GDP growth, ongoing economic reforms, high oil prices and the conclusion of investment agreements, the upward trend in inward FDI flows to West Asia is likely to be maintained, especially in services such as finance, telecommunications and health care,[78] oil and gas (in some countries)[79] and related industries. In the first half of 2007, cross-border M&As in West Asia increased by 3% over the same period of 2006.

Nearly 66% of the respondents to UNCTAD's *World Investment Prospects Survey* expected their FDI in 2007-2009 to remain at the same level as in 2006, and about one third expected it to increase (figure II.15).

Figure II.15. FDI prospects in West Asia, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

The geographical distribution of FDI in this subregion is likely to remain uneven, mainly due to geopolitical uncertainty in some areas. Liberalization of policies and deregulation should progress and strengthen prospects for increased inward FDI, although overregulation and trade barriers are still viewed as significant deterrents to FDI and internationalization in general (PricewaterhouseCoopers, 2007a). Moreover, continuing global external imbalances and sharp exchange-rate fluctuations, as well as political tensions and even open conflict in some parts of West Asia, pose risks that may discourage FDI inflows. Outward FDI from West Asia is likely to expand further, particularly in services, with petrodollars remaining one of the major sources of finance.

c. *Oceania*[80]

In 2006, FDI inflows to Oceania declined by 11%, to $339 million. Inflows remained concentrated in Fiji, New Caledonia, Vanuatu and Papua New Guinea, which together accounted for 82% of the total. Fiji was the major recipient, with $103 million in FDI inflows. Relative to their economic size, however, Fiji and Papua New Guinea have performed less well than several other economies in the region in recent years.[81]

FDI flows were mainly concentrated in the *primary sector*, in particular in nickel (in Papua New Guinea)[82] gold mining (in Fiji and Papua New Guinea), and in logging activities (in Papua New Guinea and the Solomon Islands). In *manufacturing*, FDI has been primarily in onshore fish-processing activities, while in the *services sector*, tourism remains very important. While China is increasingly becoming a significant investor in the region, in particular in mining, traditional investors such as Australia, France and New Zealand have retained a strong presence. Malaysia is a significant investor in the forestry industry of the Solomon Islands.

In Oceania, mining and tourism potential as well as the implementation of the China-Pacific Island Countries Economic Development and Cooperation Guiding Framework[83] are all factors favourable to FDI. However, in light of recent political turmoil in some countries of Oceania that are regular recipients of FDI,[84] prospects for FDI in the region seem bleak, at least in the short-term. In Papua New Guinea, on the other hand, despite persistent political uncertainty and the suspension of the project by Oil Search[85] to establish a pipeline between Papua New Guinea and Queensland, the prospects for FDI inflows in 2007 remain bright. This is mainly because of the economy's potential in the production of liquefied natural gas (LNG). Following the initial backlash from the decline in the tourism sector in Fiji, the neighbouring islands, such as Vanuatu, Samoa and Cook Islands, are now seeking to further develop their tourism industry by attracting FDI inflows.

3. Latin America and the Caribbean[86]

FDI flows to Latin America and the Caribbean rose by 11% in 2006, to reach $84 billion. However, the increase was entirely attributable to investment in the region's offshore financial centres. Excluding these centres, FDI inflows remained unchanged at $70 billion. Important changes have occurred in the mode of entry of FDI and in its components. Reinvested earnings are becoming a major component of inward FDI in South America, the result of large increases in profits. Moreover, greenfield investments have replaced cross-border M&As as the main mode of FDI. Manufacturing has overtaken services as the most important recipient sector during the past three years. Although FDI inflows to the services sector increased slightly in 2006, TNCs continued to withdraw from public utilities, especially electricity distribution. The primary sector remained attractive for foreign investors due to the high commodity prices, although regulatory changes dampened their enthusiasm in some countries and inflows in 2006 actually fell somewhat. FDI outflows from Latin American and Caribbean countries soared, reflecting the increasing capacity of local companies to internationalize their production. On the policy front, the trend towards less FDI-friendly measures continued in some countries. These policy changes – concentrated mainly in the extractive industries – are extending to other industries considered "strategic".

a. *Geographical trends*

(i) Inward FDI remained stable

FDI inflows to South and Central America and the Caribbean (excluding offshore financial centres) remained more or less stable, at $45 billion and $25 billion respectively. In contrast, FDI into offshore financial centres soared from $6 billion to $14 billion, reversing the decline in 2005 following the adoption of the Homeland Investment Act in the United States.[87] Mexico and Brazil, with inflows of $19 billion each, remained the region's leading FDI recipients, followed by Chile, the British Virgin Islands and Colombia (figure II.16). FDI inflows as a percentage of gross fixed capital formation fell from 16% in 2005 to 15% in 2006 (figure II.17).

Important changes have occurred in the mode of entry of FDI and in its components. First, there have been fewer M&As: the ratio of cross-border M&As to total FDI inflows was 47% in 1997-2001 and 34% in 2002-2006.[88] The 37% increase in cross-border M&As in 2006 (table II.10) was largely due to acquisitions by foreign firms of local assets owned by other foreign affiliates rather than to the acquisition of local assets owned by nationals.[89] The decline in FDI entry through cross-border M&As occurred throughout the region (excluding financial centres).

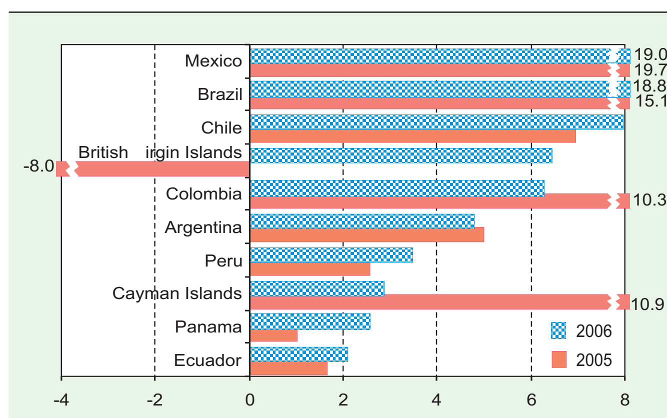
Second, in South America, income on inward FDI has grown steadily since 2003 (figure II.18). In 2006, it increased by 49% to reach $59 billion, thus exceeding total FDI inflows ($45 billion) for the first time since economic liberalization began in the 1990s (figure II.18). Income on FDI was particularly high in Brazil and Chile, at $14 billion and $20 billion respectively. The reinvested earnings – part of such income[90] – also surged, its share in total FDI inflows in South American countries for which data are available[91] soaring from 44% in 2005 to 61% in 2006, compared to a mere 10% in 2000-2003.

In South America, the stability of FDI inflows in 2006 masks variations among countries. Most of the countries (e.g. Bolivia, Brazil, Chile, Ecuador, Paraguay, Peru and Uruguay) registered high FDI growth rates, but these were offset by significant decreases in two countries: Colombia and Venezuela. Argentina was the only country where FDI inflows remained relatively stable.

The reasons for increases in FDI inflows are diverse. In Brazil, the rise was mainly in manufacturing and, within this sector, in resource-based activities (pulp and paper, and basic metallurgy). In addition, the $2.6 billion acquisition of Banco Pactual by UBS (Switzerland) in 2006 reversed the negative FDI flows registered in the financial services industry. In Chile, the main reason was the 14% increase in reinvested earnings, supported by high profits in the mining industry. Some cross-border M&A transactions also contributed to the growth in FDI. Mining-related FDI accounted for most of the increase in inflows to Ecuador and Peru, while in Uruguay it was the pulp and paper sector.

In Colombia, FDI inflows fell after an exceptional wave of cross-border M&As in 2005 (*WIR06*); still, it remained relatively high ($6.3 billion) due to the resumption of the privatization

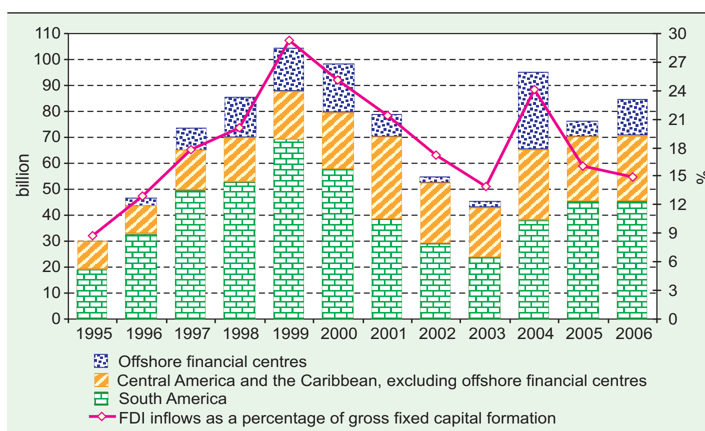
Figure II.16. Latin America and the Caribbean: top 10 recipients of FDI inflows,[a] 2005-2006
(Billions of dollars)



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

[a] Ranked by magnitude of FDI inflows in 2006.

Figure II.17. Latin America and the Caribbean: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

Table II.10. Latin America and the Caribbean[a]: distribution of cross-border M&As by sector/ industry, 2005-2006
(Millions of dollars)

Sector / industry	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
Total industry	22 532	30 824	10 179	31 350
Primary	814	8 201	881	17 679
Mining, quarrying and petroleum	814	8 201	881	17 679
Secondary	10 793	5 152	5 492	5 605
Food, beverages and tobacco	5 710	2 157	127	1 436
Metals and metal products	3 129	480	3 306	3 327
Services	10 926	17 471	3 806	8 067
Electricity, gas and water distribution	125	3 917	101	1 618
Transport, storage and communications	4 164	4 803	2 532	4 499
Finance	1 077	5 125	1 107	1 437

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

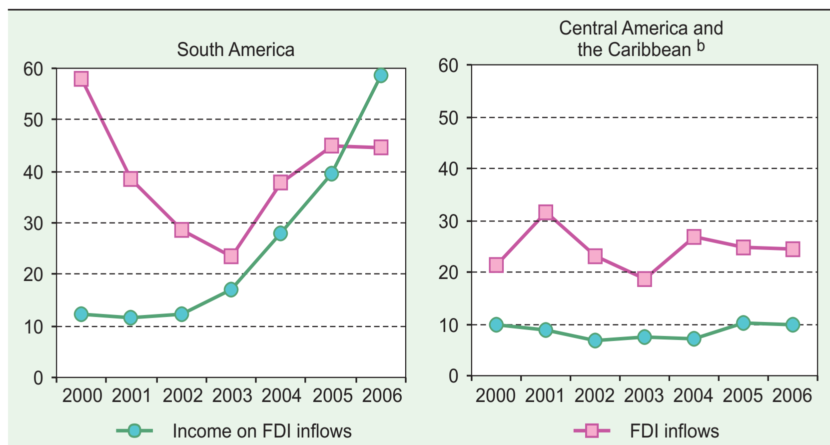
programme (see section c below). In contrast, the large decline in FDI inflows to Venezuela, from $2.6 billion in 2005 to -$540 million in 2006, was due to negative inflows to the oil industry – mostly attributable to financial transactions between foreign oil TNCs and the State-owned oil company PDVSA, while FDI to non-oil activities remained stable.

In Central America and the Caribbean (excluding offshore financial centres) overall FDI inflows were unchanged. While Mexico saw a slight decline (nevertheless still accounting for 77% of all FDI into this subregion) in 2006, other countries compensated for this with increases. In Costa Rica, for example, inward FDI increased by 71%, partly due to a large sale in the financial sector and partly to rising FDI in tourism. In the Dominican Republic, flows increased especially in telecommunications.[92] Other countries of the subregion received less than $1 billion in FDI inflows (table II.11).

(ii) Outward FDI soared

FDI outflows from Latin America and the Caribbean, excluding offshore financial centres, surged by 125% to $43 billion (figure II.19).[93] The primary sector was the main target of the outward FDI, followed by resource-based manufacturing and telecommunications. Brazil was the region's principal source country, with $28 billion in FDI outflows (figure II.20), the country's highest level ever and, for the first time its outflows were higher than its inflows. The $17 billion purchase of Inco (a Canadian nickel producer) by the country's mining company, CVRD, was responsible for a significant share of the increase (see also chapter IV). It was the largest acquisition ever undertaken by a Latin American company, and reflects CVRD's strategy of diversification away from Brazil and iron ore. In addition, a series of other acquisitions and investments by Brazilian companies, such as Itaú (banking), Petrobras (oil and gas), Votorantim (cement, pulp and paper, steel and mining), Gerdau (steel), Odebrecht (construction services, petrochemicals) Camargo Corrêa (cement), Weg (motors and generators) and Marcopolo (buses), also contributed to the country's outward FDI (ECLAC, 2007). It suggests an increasing tendency for large Brazilian companies to pursue a strategy of internationalization through FDI (box II.6). Brazilian FDI has traditionally flowed mainly to offshore financial centres, which, in 2005, hosted 57% of Brazilian outward FDI stock (*WIR05*). However, in recent years, its FDI has mainly targeted developed countries other than financial centres: their share in Brazil's total outward FDI stock jumped from 13% in 2001 to 35% in 2005, while that of developing and transition

Figure II.18. FDI inflows and income on FDI inflows in countries in South America and Central America and the Caribbean,[a] 2000-2006
(Billions of dollars)



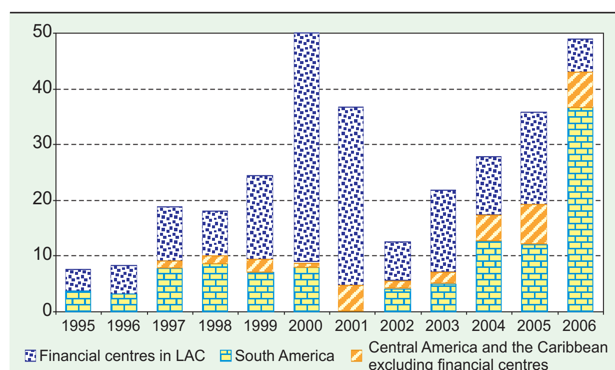
Source: UNCTAD, based on the balance of payments data from the central banks of the respective countries.
[a] The countries covered are those for which income on inward FDI data were available for 2006. In South America they are: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Uruguay and Venezuela. Their share in total FDI inflows to South America in 2006 was 99%. In Central America and the Caribbean they are: Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, and Trinidad and Tobago. Their share in total FDI inflows to Central America and the Caribbean (excluding offshore financial centres) in 2006 was 99%.
[b] Excludes offshore financial centres such as Belize, Panama, and the Caribbean countries other than Cuba, the Dominican Republic, Haiti, Jamaica and Trinidad and Tobago.

Table II.11. Latin America and the Caribbean: country distribution of FDI flows, by range [a], 2006

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

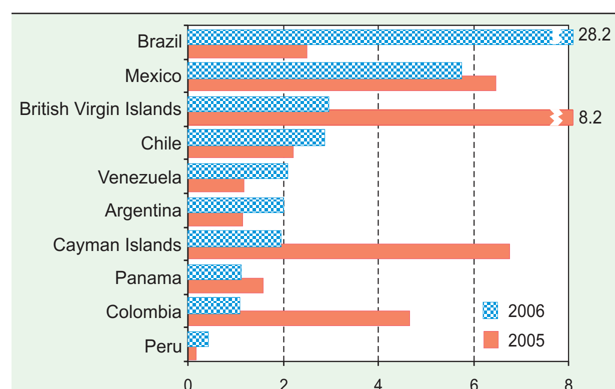
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Countries are ordered according to their magnitude of FDI.

Figure II.19. Latin America and the Caribbean: FDI outflows, 1995-2006
(Billions of dollars)



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

Figure II.20. Latin America and the Caribbean: top 10 sources of FDI outflows,[a] 2005-2006
(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.
[a] Ranked by magnitude of FDI outflows in 2006.

economies other than financial centres fell from 13% to 8%.[94]

The second largest source of FDI from the region was Mexico with outflows of $5.8 billion, 11% lower than in 2005. Mexican investments abroad were concentrated in telecommunications, but they were also undertaken in other industries such as banking, cement, and food and beverage, and were mainly directed to other Latin American and Caribbean countries. Chile, Venezuela and Argentina were also important and dynamic investors, with outflows increasing by 30%, 77% and 74%, respectively, and surpassing $2 billion each in 2006 (figure II.20). The main target industries for Chile were mining and retailing, for Venezuela, it was petroleum (ECLAC, 2007), and for Argentina, petroleum and steel pipes and tubes.

b. Sectoral trends

In 2006, the manufacturing sector continued to receive the largest share of FDI inflows in Latin America and the Caribbean (excluding offshore financial centres), almost the same as in 2005 at 41%. The share of the services sector increased slightly, from 35% to 37%, while that of the primary sector fell marginally, from 23% to 21%. FDI flows to the services sector increased by an estimated 8%, and those to the primary sector fell by 7% (figure II.21).

(i) Primary sector: modest decline in inflows but foreign investors' interest remains strong

The decline in FDI to the region's primary sector in 2006 was mainly the consequence of agreements between Venezuela's State-owned oil company PDVSA, and foreign TNCs that resulted in significant negative FDI inflows being recorded in that country's oil and gas sector, as noted above. Nevertheless, foreign investors remain interested in the country's vast oil and gas potential, in spite of regulatory changes designed to maximize fiscal revenue and increase State control of the industry (*WIR06,* and section c below). The Government signed new contracts with Chevron (United States), Statoil (Norway), Total (France) and BP (United Kingdom), while ConocoPhilips, ExxonMobil (both United States) and PetroCanada (Canada) opted to end their operations in the country. Many other TNCs are also interested in entering Venezuela, especially the very promising Orinoco Belt. Although large, privately owned foreign companies are still important partners for PDVSA, it is showing an increasing preference for working with other

Box II.6. Brazilian enterprises expanded abroad and consolidated at home

Investments abroad by Brazilian companies soared to a record $28 billion in 2006, exceeding the amount of inward FDI ($19 billion) for the first time. A large part of the outward FDI was attributed to the $17 billion acquisition of Inco (Canada) by CVRD, which has been seeking to expand its non-ferrous metal division and raise its international profile. With this acquisition, CVRD may have become the world's top metal mining company in 2006 in terms of production value (see chapter IV). The company is set to continue its diversification and expansion strategy with an agreement to purchase 100% of the coal mining company AMCI (Australia) for $661 million. The steel company Companhia Siderúrgica Nacional (CSN) had similar ambitions in its attempt to acquire Corus (United Kingdom/Netherlands), but it lost the bid to rival Tata Steel (India), which won for $11 billion. The steel maker Gerdau has also been actively acquiring foreign assets, but at a more modest level: it acquired enterprises in Argentina and Colombia at the end of 2005, and in Peru, the United States and Spain in 2006, while in 2007, it agreed to buy the Mexican steel mill Siderúrgica Tultitlán (Sidertul).

Brazilian companies have begun to invest abroad following years of record exports. In some cases, Brazilian suppliers sought to move closer to their customers, as in the automotive industry: Sabó now has plants in Europe, and Marcopolo (specialized in bus manufacturing) is producing in China. The strong currency, the real, has favoured such moves. Sluggish economic growth at home has been another motivating factor behind some groups' decisions to expand abroad.

Outward investments by Brazilian firms are to some extent part of an expansion and consolidation process that is taking place at home as well as abroad. Brazilian businesses are seeking to consolidate some industries, such as steel and mining, by buying foreign competitors so as not to lose market shares or become a takeover target themselves. Within Brazil itself, domestic buyers were involved in 58% of the 560 M&A deals in 2006 (including both domestic and cross-border), which reached record highs both in volume and value terms. There has been increased consolidation among Brazilian companies themselves, as well as through a large number of Brazilian companies buying foreign-owned assets in Brazil. Examples of the latter included the $2.2 billion purchase of the Brazilian affiliate of BankBoston (United States) by Itaú (Brazil), and Bradesco's (Brazil) purchase of American Express's (United States) assets in Brazil. Some foreign companies that were involved in utilities industries sold their assets to local investors. For example, in the electricity industry, EDF (France) and four United States companies (Alliant Energy, El Paso, Public Service Enterprise Corporation Global and AES) divested their assets to local investors in 2006, and CMS Energy (United States) announced in 2007 that it would do the same.

Source: "Brazil outward bound", *Business Latin America*, 12 February 2007, 12 March 2007 and 24 April 2007 (London, EIU); Gerdau press release, 28 June 2006 and 5 May 2006 (http://www.gerdauaza.com/ing/pressroom/index.asp); and American Express press release, 20 March 2006 (http://home3.americanexpress.com/corp/pc/2006/bradesco_brazil.asp).

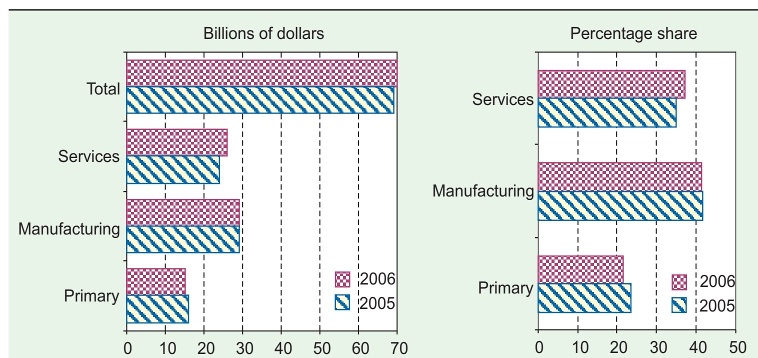
State-owned oil companies. For example, Petrobras is now its preferred partner in efforts to develop extra-heavy oil reserves in the Orinoco Oil Belt and for participating in offshore drilling to produce gas for liquefaction and export. Venezuela's petroleum industry is also attracting investments from China, the Islamic Republic of Iran and the Russian Federation.[95]

In Bolivia, most companies froze new investments after a Government decree in May 2006 that changed the regulations pertaining to the oil and gas industry (*WIR06*). However, after contracts were adapted to the new legislation at the end of 2006 (section c below), enterprises resumed investments. Indeed, in January 2007, eight oil companies, including Brazil's State-owned Petrobras, Repsol YPF (Spain), Total (France), BP and BG (both United Kingdom) bid on a project to export Bolivian natural gas to Argentina.[96] In addition, Gazprom (Russian Federation) is negotiating with the Bolivian State-oil company YPFB for a possible joint venture for gas exploration and production.

In Peru, there has been steady investment in the oil and gas industry. Petroperu, the State oil company, has signed a record 31 oil and gas exploration contracts over the past two years. Peru also intends to expand value-added activities related to its gas reserves by involving TNCs in the development of a $2.8 billion petrochemical complex to produce fertilizers and polyethylene.[97] In Colombia, foreign oil companies are increasingly interested in investing in the oil industry due to new investment incentives, including low royalty rates and the possibility of 100% ownership in some cases. The Government is also seeking to privatize 20% of State-owned Ecopetrol. FDI inflows to the oil industry increased by 57% in 2006, reaching a total of $1.8 billion.[98]

Foreign investment in mining in Latin America and the Caribbean remained buoyant in 2006. In Chile and Colombia, the high levels of FDI in 2005 were maintained in 2006: $1.25 billion and $2 billion respectively, while in Peru, investments amounted to $1.6 billion (Proinversión,

Figure II.21. Latin America and the Caribbean:[a] FDI inflows by sector, 2005-2006



Source: UNCTAD, based on official data from Brazil, Colombia, Costa Rica, Ecuador, Mexico and Venezuela (for the petroleum industry only), and on estimates for the rest.

[a] Excluding offshore financial centres such as Belize, Panama, and the Caribbean countries other than Cuba, the Dominican Republic, Haiti, Jamaica and Trinidad and Tobago.

2007), up from $1 billion in 2005 (*WIR06*), and the Government anticipates continued rapid growth in mining FDI, estimated to total nearly $10 billion over the next five years. In Bolivia, despite uncertainties created by revisions to the country's mining tax regime, several foreign mining companies have initiated projects that are due to start production in 2007. Finally, Guyana and Suriname are attracting FDI into the bauxite industry.[99]

(ii) Manufacturing continued to attract the largest inflows

FDI flows to the manufacturing sector in Latin America and the Caribbean are estimated to have remained the same as in 2005, despite a significant decline in cross-border M&As, which suggests an increase in greenfield FDI. High commodity prices and rising world demand encouraged FDI in resources-based manufacturing. On the other hand, the increased FDI in the automotive industry was fuelled by strong domestic demand in, and rising exports from Argentina, and by exports from Mexico. Finally, the *maquila* apparel industry in the Central American and Caribbean countries continues to face increasing competition for FDI from Asian countries, especially since the phasing out of the Multi-Fibre Arrangement (MFA).

In resource-based manufacturing, soaring oil prices raised the demand for ethanol, driving an investment rush by both domestic and foreign investors in sugar production and refining in Latin America. In Brazil, where there has been domestic investment in this industry for a long time, foreign interest rose only after oil price hikes. Sugar production and refining is prospering and attracting FDI also in countries that have signed FTAs with the United States. Other industries that have registered increases in FDI include smelting, refining, metallurgy and petrochemicals in countries such as Bolivia, Brazil, Colombia and Trinidad and Tobago. For example in Brazil, a €3 billion crude steel production facility is being set up by CSA (Brazil-Germany).[100] Finally, in the pulp and paper industry in which FDI has become more prominent since the early 2000s (Barbosa and Mikkilä, 2006), inflows in Brazil rose to $1.5 billion in 2006 mainly due to a $1.2 billion pulp mill project by International Paper (United States); while in Uruguay FDI inflows were boosted by the World Bank's approval of a loan and political risk insurance for a pulp and paper plant being built by Botnia (Finland). The region's advantages in this industry include an abundance of water and land for plantations of fast growing trees and cheaper labour costs. In addition, in Brazil, there is a history of investments in research in genetics, forestry and biotechnology, which has led to improvements in the quality of trees and forest management (Santos Rocha and Togeiro de Almeida, 2007).

In other manufacturing, the automotive industry is an important FDI recipient in Argentina, Brazil and Mexico, where the world's largest automobile and auto parts manufacturers have production facilities. In Mexico, motor vehicle exports rose by 30% in 2006, with 1.5 million units exported (AMIA, 2006), as a result of increased investments by the top five automakers (all foreign) in the country: General Motors, Ford Motor, DaimlerChrysler, Nissan and Volkswagen. Among the factors contributing to Mexico's attractiveness for FDI in the automotive industry is its access to the NAFTA market, and more recently to Europe under the Mexico-EU FTA (effective in 2000) (which also reduces its excessive reliance on a single market).[101]

In Argentina, where output expansion in the automotive industry was boosted by rapid growth in both the domestic and export markets, investments in car terminals are estimated to have amounted to $800 million in 2006.[102] In contrast, in Brazil, FDI flows to the automobile sector fell by 24% in 2006,[103] because of the appreciation of the exchange rate. Nevertheless, significant investment plans – mainly focused on the domestic market – have been announced by companies such as Fiat (Italy), General Motors (United States), Ford (United States), and Volkswagen (Germany), which dominate the domestic market with a combined share of 75%.[104]

Finally, the *maquila* apparel industry an important target of investors, especially from the United States, suffered a significant decline in exports to the United States (practically the only market): Mexican *maquila* apparel exports fell by 13% and those of members of the Central American Free Trade Area and the Dominican Republic (DR-CAFTA) fell by 7%. As a consequence, the share of Mexico and Central American and Caribbean countries in total apparel exports to the United States fell significantly, while those of their Asian competitors rose.[105] Haiti and Nicaragua are the only countries in the region that registered a significant increase in apparel exports in 2006 (11% and 23% respectively) (Asociación Hondureña de Maquiladoras, 2006).

(iii) Modest increase of FDI in services

FDI in the services sector (excluding offshore financial centres) increased by an estimated 8% in 2006. A number of foreign companies expanded their existing activities, or acquired new assets, or established new operations in the region, which more than compensated for withdrawals by other firms (*WIR05* and *WIR06*). For instance, in the telecommunications industry the Mexican companies, América Móvil and Telmex, and Telefónica (Spain), continued to expand in the region and also to consolidate their telecommunications services and media operations by acquiring cable TV operators and broadband Internet services.[106] On the other hand, firms such as Verizon (United States) and Telecom Italia continued their strategy of divestments.[107] Similarly in the financial services industry, Bank of America sold its BankBoston units in Brazil, Chile and Uruguay to the Brazilian bank Itaú (*WIR06*), while UBS (Switzerland) acquired the Brazilian Banco Pactual. In retail, large TNCs, such as Wal-Mart, Carrefour and Casino, have been expanding their investments in Brazil, Colombia, Mexico and Central America (ECLAC, 2007). Finally, in the electricity industry there has been a wave of divestments by foreign companies in Brazil that have sold their assets to domestic investors (box II.6).

c. Policy developments

As in 2005, some countries in Latin America adopted a number of measures less favourable to foreign investors, reversing to some extent the trend that had been dominant from the early 1990s until 2004. These changes concerned mainly the extractive industries and led to the revision of contracts and/or tax regimes with a view to securing for the State a greater share in the windfall profits resulting from soaring commodity prices, and/or its greater control over the industry (chapter VI). The changes also related to some other industries, particularly in Bolivia and Venezuela.

In Venezuela, having taken a majority control in 2006 of 32 marginal oil fields that were managed by foreign oil companies, in 2007 the Government adopted a decree that gave PDVSA a majority equity share and operational control of four joint ventures in the oil-rich Orinoco River basin. Four TNCs involved in the ventures agreed to sign the new agreements that granted PDVSA an average stake of 78%, up from the original 39%, while two refused. The Government of Venezuela assumed State control of other industries, such as telecommunications, electricity and non-fuel mining. In public utilities, after creating a new State-controlled power company in late 2006 to boost electricity generation and halt frequent power supply cuts, the Government declared the energy and telecommunications industries to be strategic and therefore subject to nationalization in 2007. As a result, it negotiated a deal with Verizon, AES and CMS (all United States TNCs) whereby the three agreed to divest their assets to the Government, which now controls the country's largest telecom company, CANTV, and the electricity company, EDC. In non-fuel mining, in 2006 Venezuela's national assembly approved a bill to reform the mining law, and launched a series of public meetings to discuss the reform project with interested parties.

In Bolivia, all foreign oil TNCs agreed to convert their production-sharing contracts into operating contracts, and to turn control over sales to YPFB, Bolivia's State-run oil company, as stipulated in the decree for the nationalization of oil and gas resources of May 2006. In addition, the Government reached a deal in 2007 with Petrobras (Brazil) to renationalize the country's only two oil refineries acquired by Petrobras in 1999 as part of a broad privatization programme. The Government is also moving to take over Empresa Nacional de Telecomunicaciones (Entel), now controlled by Telecom Italia, which was privatized in 1996. Moreover, according to the Minister of Mining, reform of the mining sector's tax regime to secure a higher tax take for the Government is a priority for 2007.[108]

In Peru, where thriving mining activities have been causing social conflicts, the Government created a high-level commission to address this issue. At the same time, it reached a deal with mining companies whereby they agreed to make "voluntary contributions" to avoid tax increases. Under this agreement, the companies will contribute $772 million over the next five years towards fighting poverty, malnutrition and

social exclusion. The payment is intended to appease demands by various civil society groups for increased taxes on mining companies.[109]

In Argentina, where foreign companies largely control oil and gas production and exports, the Government increased taxes on natural gas exports from 20% to 45% to offset higher costs of imported gas from Bolivia and to avoid domestic price increases. Moreover, in the mineral-rich province of Mendoza, lawmakers voted to block all mining activity if mining companies failed to come up with proposals for a plan to mitigate environmental costs. In public utilities, in December 2006 Argentina's Congress approved an extension for one more year of the Economic Emergency Law, which allows the executive branch to maintain a price freeze on privatized public services and renegotiate contracts with their owners. In January 2007, the Government authorized power distributors Edenor (Argentina) and Edesur (Spain) to increase tariffs by close to 15% for industrial and business clients.[110]

In contrast to some of the above-mentioned policy changes, in Colombia the Government decided to revitalize the privatization programme of the 1990s and launched a series of sales of State assets in financial services and telecommunications. Privatizations of the largest gas distribution company, Ecogas, local electricity distributors, and part of the largest transmission company, are in the pipeline for 2007. The country's Congress also approved the privatization of 20% of the State-owned oil company Ecopetrol, and approved the reduction of corporate and personal income tax rates to 34% in 2007 and 33% in 2008 from the current 38.5%.[111]

In other Latin American and Caribbean countries, various other changes in FDI-related policy were introduced. Brazil, for instance, ended the monopoly on reinsurance by the State-owned Instituto de Resseguros do Brasil in December 2006. Foreign investment will be allowed, though it will be restricted to 40% of Brazil's market during the first three years of the market opening.[112]

Latin American and Caribbean countries continued to sign trade agreements that are likely to affect FDI flows to and from their economies. Chile signed FTAs with China in 2006 [113] and with Japan in 2007. In addition, the Andean Community of Nations has agreed to make Chile an associate member of its trading bloc; the country quit the group 30 years ago. Moreover, the DR-CAFTA agreement became effective during 2006 and 2007 in all signatory countries (Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua), except Costa Rica.

d. Prospects: moderate growth of inflows, reduced outflows

FDI inflows into Latin America and the Caribbean, excluding the offshore financial centres, are expected to increase moderately in 2007. Commodity prices (see chapter III) and regional economic growth should remain strong in 2007,[114] boosting TNCs' profits and FDI. This forecast is confirmed by the results of UNCTAD's *World Investment Prospects Survey* in the region, with 47% of foreign companies indicating plans to increase their investments in the period 2007-2009, 2% to decrease them, and 50% to maintain them at the same level (figure II.22).

However, as cross-border M&As involving the acquisition of assets owned by nationals are not expected to recover significantly, and the withdrawal of TNCs from service activities is likely to continue, the growth of FDI inflows is expected to be driven mainly by greenfield investments, and could therefore be rather moderate. Preliminary cross-border M&A data for the first six months of 2007 show almost the same level as in the corresponding period of 2006. Acquisitions by foreign companies of assets owned by nationals amounted to $9.5 billion – half the total amount of 2006. Moreover, a number of foreign companies sold their assets to local investors during the first months of 2007, or announced their intention to do so,[115] confirming the likelihood of a slowdown in FDI growth.

FDI outflows from Latin America and the Caribbean, excluding offshore financial centres, are expected to decline in 2007 following strong growth in 2006. Preliminary data from Brazil support this forecast: they indicate negative outflows of FDI (-$3.5 billion) during the first five months (because of the high amount of loan payments from Brazilian affiliates to their parent company in Brazil).[116] But a sharp increase in FDI outflows from Mexico should partly compensate for the reduced outflows from Brazil.

Figure II.22. FDI prospects in Latin America and the Caribbean, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)

Source: UNCTAD, 2007b.

B. South-East Europe and the Commonwealth of Independent States[117]

1. Geographical trends

Inward FDI grew significantly in both South-East Europe and the Commonwealth of Independent States (CIS) in 2006. In South-East Europe, most of the FDI inflows were driven by the privatization of State-owned enterprises and by large projects benefiting from a combination of low production costs in the region and the prospective entry of Bulgaria and Romania into the EU. In the CIS, all resource-based economies experienced strong inward-FDI growth. FDI flows to the Russian Federation grew markedly despite an apparent tightening of national legislation on extraction contracts and on foreigners' access to resources. One reason may be that these legal changes in effect codified and clarified de facto restrictions on foreign investors' involvement in natural resources instead of introducing new constraints. Developed countries, mainly EU members, continued to account for the largest share of flows to the region in the form of both greenfield projects and cross-border M&As. Outward FDI in 2006 also increased, notably from the Russian Federation. There are indications that FDI will grow further in 2007, especially in the large countries and in the two new EU members.

a. Inward FDI surged

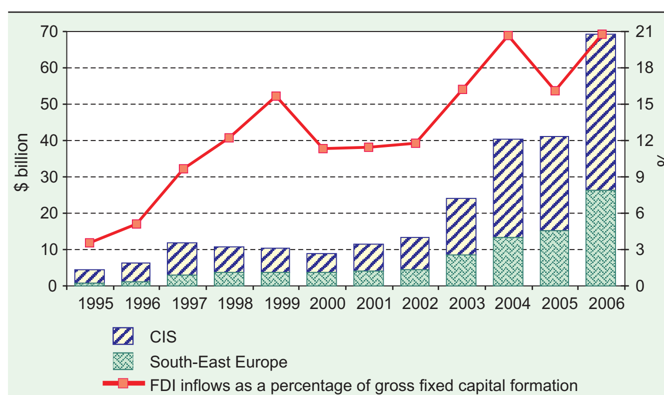
In 2006, FDI flows to South-East Europe and the CIS grew by 68%, to $69 billion, marking the sixth consecutive year of growth and a significant rise over the two previous years (figure II.23). As a result, the share of inward FDI in gross fixed capital formation rose from 16% in 2005 to 21% in 2006.

As in previous years, inflows remained unevenly distributed, with five countries (the Russian Federation, Romania, Kazakhstan, Ukraine and Bulgaria in that order) accounting for 82% of the total. Inflows to the region's largest economy, the Russian Federation, more than doubled (figure II.24), reaching a record $29 billion.

Flows to Romania and Bulgaria also grew significantly in 2006, in anticipation of their joining the EU on 1 January 2007 (box II.7). Romania was the second largest FDI recipient, with most of the $11.4 billion worth of flows linked to privatization.[118] There was a substantial increase in inflows to Kazakhstan, which reached an unprecedented level of more than $6 billion (figure II.24 and annex table B.1), mainly due to oil and gas projects, making it the third largest recipient in the region. In contrast, inflows into Ukraine fell in 2006, possibly due to the reduction in privatization-related FDI, combined with the abolition of incentives in special economic zones. In 12 countries of the region, FDI flows remained below $1 billion, but in certain economies such as Montenegro, they are still considerable in relation to the size of economy. FDI inflows rose in 17 countries in South-East Europe and the CIS in 2006, compared to nine in 2005 (annex table B.1).

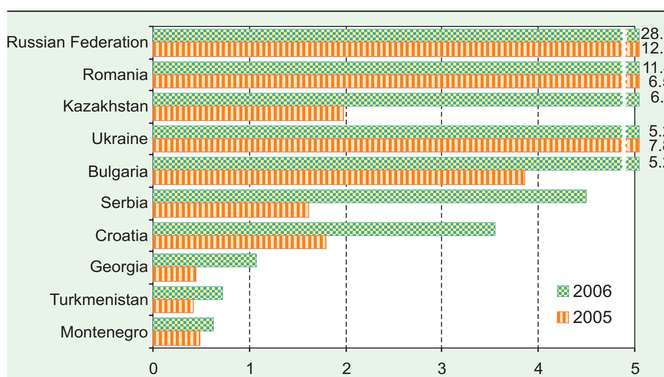
Developed countries were the main investors in the region's greenfield FDI projects. EU countries accounted for 70% of such projects, followed by the United States with 9%. The share of the Russian Federation as a source of greenfield FDI projects remained low (4%).

Figure II.23. South-East Europe and CIS: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

Figure II.24. South-East Europe and CIS: top 10 recipients of FDI inflows, 2005-2006[a]
(Billions of dollars)



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

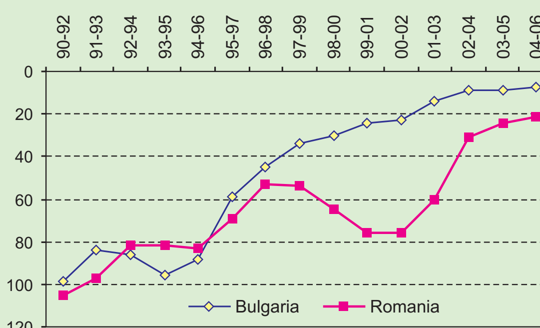
[a] Ranked on the basis of the magnitude of the 2006 FDI inflows.

Box II.7. The accession of Bulgaria and Romania to the EU: impact on FDI

In contrast with FDI flows to the eight Eastern European countries that joined the EU on 1 May 2004, inflows to Bulgaria and Romania remained small for most of 1990s due to an inadequate business infrastructure, economic instability, slow privatization and regional conflicts. Only in the beginning of the 2000s[a] did they begin to receive sizeable FDI, partly driven by privatizations, as well as important greenfield investments. In 2006, the FDI stock in Bulgaria and Romania together reached $62 billion, representing a 18-fold increase over the past decade.

After several years of negotiations, the two countries became members of the EU in January 2007. The pre-accession process gradually transformed the business environment of the two new member States and had a significant impact on FDI. Consequently Bulgaria's rank in the UNCTAD FDI Performance Index moved up to 7th place in 2004-2006 from 92nd in 1990-1992, while Romania's ranking improved from 101st to 21st (box figure II.7.1). Competitive labour costs remain an important factor for efficiency-seeking FDI, but higher value-added industries are also attracting FDI.

Box figure II.7.1. Inward FDI Performance Index ranking, Bulgaria, Romania, 1990-2006[a]



Source: UNCTAD.

[a] For the calculation of the Inward FDI Performance Index, see notes to table I.7, chapter I. Ranking out of 141 countries.

EU accession will help anchor the ongoing reforms and support the convergence of the economies of Bulgaria and Romania with those of the rest of the EU. Apart from adopting the EU law (the acquis communautaire), these countries are expected to meet the "benchmarks" established by the European Commission in areas such as judicial independence, fight against crime and corruption, and mandatory structural reform to increase transparency and accountability in public administration. These steps could further increase competitiveness in these countries.

Source: UNCTAD.

[a] Romania's FDI flows reached $2 billion in 1998 due to large privatizations that year (*WIR99*: 70), but this was only a temporary surge.

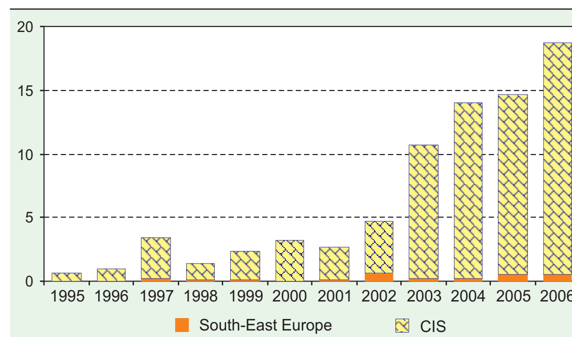
In cross-border M&As, the acquisition of private companies dominated in the CIS countries, whereas in South-East Europe most of the M&As involved privatization deals. With the acquisition of Banca Comerciala Romana (Romania) by Erste Bank (Austria), Austria once again became the leading source of cross-border M&A-based investment in the region, followed by the United States and Norway. FDI from developing countries and from sources within the region has also recently emerged (table II.12 and *WIR06*). The share of developing-country TNCs as buyers in cross-border M&As of enterprises in South-East Europe and CIS increased to 16% in 2006, from a mere 1% on 2005. China was the leading buyer from developing countries, while the Russian Federation accounted for 5% of total cross-border M&As in the region.

b. Outward FDI growth was sustained

FDI outflows increased for a fifth consecutive year, amounting to $18.7 billion (figure II.25). The Russian Federation alone accounted for $18 billion, representing more than 96% of the total and a significant increase (41%) from the FDI outflows in 2005. Some large resource-based Russian TNCs such as Norisk Nickel and the Evraz Group continue to invest abroad. Similarly, Rusal and Sual merged with part of Glencore International (Switzerland) to create the world's largest aluminium and alumina producer (box II.8 and chapter IV).[119]

Russian banks also increased their presence in the region, extending for instance into Kazakhstan and Ukraine. FDI outflows from other countries in

Figure II.25. South-East Europe and CIS: FDI outflows, 1995-2006
(Billions of dollars)



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

the region remained modest in 2006 – less than $1 billion.

In greenfield operations, half the projects by investors from South-East Europe and the CIS were undertaken within the region, and were concentrated mainly in the development of extraction activities, such as mining, metals and oil fields. For example, Petrom Romania (now an affiliate of Austria's OMV) invested $190 million to develop the Komsomolksoe oil field in Kazakhstan. In terms of value, cross-border M&A purchases by TNCs from the region decreased in 2006 compared to 2005, but within the region they increased by 59% (table II.12).

2. Sectoral trends: FDI in services was buoyant

The data on cross-border M&As in 2006 indicates that the primary and services sectors of South-East Europe and the CIS received higher inflows while flows into manufacturing declined.

Table II.12. South-East Europe and CIS: Cross-border M&As, by home/host region, 2005-2006
(Millions of dollars)

Home/host region	Sales		Purchases	
	2005	2006	2005	2006
World	17 318	25 130	6 812	5 034
Developed countries	16 224	19 619	3 801	2 793
Europe	14 075	16 305	3 340	2 445
European Union-25	14 075	13 969	3 340	2 445
Austria	3 239	5 632	-	-
Czech Republic	635	278	284	-
France	505	1 951	-	-
Germany	569	1 477	15	10
Greece	362	821	-	143
Hungary	497	1 490	-	-
Italy	731	452	653	700
Netherlands	6 189	409	-	-
Poland	51	60	383	-
United Kingdom	286	539	2 005	1 488
Other developed Europe	-	2 336	-	-
Norway	-	1 956	-	-
United States	1 948	3 038	-	348
Japan	14	-	-	-
Developing economies	145	4 006	2 062	736
Africa	22	81	469	675
South Africa	-	81	469	675
Latin America and the Caribbean	102	28	-	-
Asia	21	3 897	1 593	61
Turkey	-	297	1 593	22
China	-	3 500	-	-
India	20	100	-	-
Transition economies	949	1 505	949	1 505
South-East Europe	32	149	91	149
Bulgaria	22	78	20	78
CIS	916	1 356	857	1 356
Russian Federation	910	1 249	237	264

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

Primary sector. The primary sector continued to attract investors, despite new restrictions, especially in oil and gas extraction, in some members of the CIS, and uncertainty over access to and the use of oil and gas transportation (box II.9). However the recent wave of domestic M&As in countries of the region may deter further FDI, especially in extractive industries (box II.8). According to cross-border M&A sales data for 2006, the share of this sector in total sales increased to 17%, from 12% in 2005 (table II.13). Particularly notable was the purchase of OAO Udmurneft by Sinopec (China) (for $3.5 billion).

Manufacturing. According to cross-border M&A data, FDI inflows to the manufacturing sector were lower than in 2005 (table II.13). However, within manufacturing, there was a significant increase of flows to the chemical industry due to large cross-border acquisitions in the pharmaceutical industry in South-East Europe (Croatia, Serbia and Romania). Projects in manufacturing represented 55% of all greenfield investments in the region in 2006.

Services sector. FDI in services was particularly buoyant, as reflected in cross-border M&A sales in services which almost doubled in value from 2005 (table II.13) due to increased cross-border M&As in the banking industry. For example Russia Raiffeisen International (Austria) signed an agreement to buy 100% of Impexbank (Russian Federation) for up to $550 million; OTP Bank (Hungary) acquired Investsberbank (Russian Federation) for $477 million.[120] Additionally, large investments were made in energy generation: for example, the energy giant AES (United States) started the rehabilitation of the Maritsa East 1 complex in Bulgaria, with an investment of $1.4 billion. And in telecommunications, Norwegian Telenor acquired Mobi 63 (Serbia) for $1.5 billion.

The number of greenfield projects in services rose by 28% from that of 2005, with construction attracting the highest share. Efficiency-seeking investment in industries such as information technology and business services was particularly significant because of the region's skilled labour force. FDI inflows also continue to be important in high value-added activities such as research and development.

As far as the sectoral distribution of outward FDI is concerned, data on cross-border M&As purchases show that petroleum extraction as well as financial services remained the most important targets for the region's TNCs.

Box II.8. The Rusal/Sual/Glencore merger creates the largest integrated aluminium TNC in the world

In the mid-2000s, cross-border M&As in mining revived, particularly in the aluminium industry. Three main trends are emerging in this current wave (Humphreys, 2006): first, it is happening at the peak of the production and price cycle; second, the main driver for the cash-rich companies is their long-term strategy to meet rapidly increasing world demand, especially in East and South-East Asia; third, companies from emerging markets are increasingly involved in M&As. An example is the merger of Rusal, the Russian Federation's largest aluminium company, with its domestic upstream competitor Sual and with Switzerland-based Glencore's aluminium business in 2007. This follows the merger of BHP Billiton/WMC Resources Ltd. in 2005 and that of Xstrata/Falconbridge in 2006. The Rusal merger, concluded on 27 March 2007,[a] has created a world leader in aluminium production (by tonnage), with an estimated share of 12.5% in global aluminium sales and 16% of global alumina production, and locations in 17 countries.

One of the main questions concerning the Rusal/Sual/Glencore merger is whether it has been driven by industrial and commercial logic, or whether national interests have also played a part, as in the case of the oil and gas industry in the Russian Federation.

While cross-border M&As in developed countries have been largely horizontal, in emerging markets, especially in the former centrally planned economies, more vertical or "integrated" M&As are taking place. This is a replication of the past experience of huge State-owned enterprises having almost complete control over the supply chain. Similarly, the Rusal/Sual/Glencore merger aims at restoring control over the entire value chain, while also entering new markets. Hence the merger has been both vertical and horizontal: Rusal has surplus bauxite in its supply chain but is short of alumina, while Sual and Glencore have excess refining capacity, and will benefit from Rusal's bauxite surplus.

The merger has wide-ranging implications for the geography of outward FDI from the Russian Federation. Even though both Russian companies (box table II.8.1) had extended their global reach for accessing natural resources through overseas M&As, they were still largely concentrated in the Russian Federation. With the integration of Glencore's assets, their foreign reach will have increased significantly. Moreover, the merger will have given them control of almost the entire Russian aluminium market, rendering competition from foreign companies virtually impossible.

Box table II.8.1. Main assets of Rusal, Sual and Glencore, 2006

Rusal	Sual	Glencore
In the Russian Federation	**In the Russian Federation**	Alumina Partners of Jamaica (Jamaica)
Achinsk alumina refinery	Bogoslovsk aluminium plant	Aughinish Alumina Ltd.(Ireland)
Boksitogorsk alumina refinery	Irkutsk aluminium smelter	EurAllumina Spa (Italy)
JSC Bratsk aluminium plant	Kandalaksha aluminium smelter	Kubikenborg Aluminium Sundsvall AB (Sweden)
Krasnoyarsk aluminium smelter	Nadvoitsy aluminium smelter	West Indies Alumina Co. (Jamaica)
Novokuzneck aluminium smelter	North Ural bauxite mine	
Sayanal	Pikalevo alumina refinery	
Sayanogorks aluminium smelter	Sual-PM Ltd.	
	Ural Silicon	
In other countries	Urals aluminium smelter	
Armenia foil mill (Armenia)	Urals Foil	
Bauxite Co. of Guyana Inc. (Guyana)	Volgograd aluminium smelter	
Cathode plant (China)	Volkhov aluminium smelter	
Compagnie de Bauxite de Kindia (Guinea)		
Friguia alumina refinery (Guinea)	**In other countries**	
Nikolaev alumina refinery (Ukraine)	Zaporozhye aluminium combine (Ukraine)	
Queensland Alumina ltd. (Australia) 20%		

Source: "Oleg Deripaska answers Alcoa; Now, the real questions begin", *American Metal Market*, 16 October 2006:13.

Source: UNCTAD.

[a] "RUSAL, SUAL and Glencore deal completed" , Press Release of United Company RUSAL, 27 March 2007.

3. Policy developments

Countries of South-East Europe and the CIS continued to adopt policies aimed at attracting FDI. However different groups of countries have followed different policy priorities.

In some natural-resource-based economies of the CIS, such as the Russian Federation, Kazakhstan and Uzbekistan, the State continues to increase its control of strategic industries. In the Russian Federation, for instance, the Government is pursuing a two-pronged strategy. The first aims to prevent or limit the direct control of resources by foreign investors by producing a list of strategic industries[121] that cannot be privatized, or by blocking 25% of the shares or 50.1% majority shares in those industries for the State or other national investors. Second, it has adopted some indirect measures, such as stricter environmental standards, which are putting pressure on foreign companies to sell part of their stakes to local firms, as in the case of the Sakhalin-2 project.[122] In Kazakhstan, the

Box II.9. Who controls the pipelines?

For both producers and consumers of oil and gas, the question of who controls access to, and the use of, transportation infrastructure is of strategic importance. This is particularly true of pipelines, which offer the cheapest, safest and most efficient way of transporting large volumes of oil and gas. Indeed, in the current era of energy security, a concern of many countries, pipelines are considered an integral and perhaps the most vital part of the oil and gas value chain (Liuhto, 2007).[a] This is also a key factor in determining FDI decisions in extraction, because private investment may be impossible if access to pipelines is denied or is too expensive. In the CIS, the Russian Federation occupies the largest land area in the world, while other major oil and gas producers, such as Azerbaijan, Kazakhstan and Turkmenistan are landlocked. For the other resource-based countries in the CIS the disadvantages of landlockedness are further exacerbated by the fact that all pipelines pass through the Russian Federation, making them overly dependent on a single export route.

Since ownership of pipelines gives leverage, or even control, over extracting and producing companies, the pipelines have remained in States' control in all members of the CIS even during the much-contested privatization of the early 1990s. Indeed, in all countries of the region the transport facilities are controlled by majority State-owned companies such as Gazprom and Transneft in the Russian Federation, Beltransgas in Belarus and Naftogas in Ukraine. Recently, both the Russian giants mentioned above have increased their ownership of the transport routes of other countries in exchange for lower export prices that they charge for oil and gas. For example Gazprom[b] has full control over the gas pipelines running through the Republic of Moldova and Armenia, as well as majority shares in the pipelines in the Baltic States, Belarus, Serbia and other countries.

Discriminatory access to transit pipelines is one of the main reasons for distortions and inefficiencies in the energy sector in the CIS, hindering both intraregional and extraregional trade.[c]

Strategically, ownership has implications for access of third parties to the pipelines. New national borders after the break-up of the Soviet Union created additional difficulties for both importing and exporting countries, as the fragmentation of ownership increased the number of governments that extract rents from their own respective segments of the pipelines. Access to regional and European markets fell largely under the control of neighbouring countries, whose national governments took advantage of monopolistic positions to extract rents by limiting pipeline access (Mathieu and Shiells, 2002). Turkmenistan and Uzbekistan, for instance, are large producers and exporters of natural gas, but they find it difficult to export due to restrictions on their access to the Russian Federation transit pipelines.

The episodes of gas and oil supply interruption in Belarus in early 2007, and gas supply interruption in early 2006 in Ukraine also showed that final customers in the EU are susceptible to uncertainties in the energy market. Producers and consumers who have to pay monopoly rents for access to pipelines are therefore seeking to improve their energy security by diversifying the transportation routes. The construction of alternative pipelines such as the Baku-Tbilisi-Ceyhan oil pipeline linking the Azeri-Chirag-Guneshli oil field in the Caspian Sea to the Mediterranean Sea as well as the Nord Stream gas pipeline linking the Russian Federation with Germany under the Baltic Sea are thus long-term strategic investments, irrespective of their immediate costs.

Source: UNCTAD.

[a] Liuhto (2007) argues that hydrocarbon pipelines are strategically even more important for the Russian Government than the hydrocarbon reserves.

[b] Gazprom owns and operates the Unified Gas Supply System, which is the largest gas transportation, storage and processing system in the world.

[c] See Mathieu and Shiells (2002) for a discussion of the energy sector in the CIS.

Government decreed a pre-emptive right to block the sale of energy assets on its territory[123] while in Uzbekistan, the mining company Newmont (United States) had its 50% share in the gold-extraction joint venture Zarafshan-Newmont expropriated in a dispute over taxes.[124]

At the same time, the business climate for foreign investors has improved in non-strategic industries. In 2006, in the context of their bid for WTO membership, some countries harmonized their legislation with WTO norms and standards. In Ukraine, for instance, foreign banks were allowed to establish their branches in the country, and foreigners were allowed to provide legal services. In the Russian Federation, in addition to some improvements in legislation related to intellectual property rights, foreign investors have obtained similar rights as those of domestic investors to buy Russian banking assets (although the Russian banks have to obtain permission from the central bank when selling more than 10% of their assets, compared to 20% previously). In Kazakhstan, a new law to attract investments in the securities market was approved, while in Kyrgyzstan a 10% flat tax rate replaced an earlier corporate tax of 20%.

In South-East European countries, policies are in line with their accession (or aspirations for accession) to the EU as well as with their interest

Table II.13 South-East Europe and CIS: cross-border M&As, by sector/industry, 2005-2006
(Million of dollars)

Sector/industry	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
Total industry	17 318	25 130	6 812	5 034
Primary	2 088	4 374	2 022	1 799
Mining, quarrying and petroleum	2 088	4 360	2 022	1 784
Mining and quarrying	57	543	-	22
Petroleum	2 031	3 817	2 022	1 762
Secondary	6 747	4 570	2 553	1 265
Food, beverages and tobacco	1 112	739	217	201
Textiles, clothing and leather	1	81	-	-
Chemicals and chemical products	232	3 491	484	4
Metals and metal products	5 323	166	1 851	917
Machinery	12	4	-	-
Electrical and electronic equipment	-	25	-	143
Motor vehicles and other transport equipment	65	15	-	-
Services	8 483	16 185	2 237	1 971
Electricity, gas, and water distribution	1 488	950	52	31
Construction firms	-	49	-	-
Trade	108	298	-	5
Hotels and restaurants	128	35	-	30
Transport, storage and communications	3 155	3 150	327	860
Telecommunications	3 105	2 870	327	860
Finance	2 677	10 961	1 858	1 045
Business activities	153	492	-	-

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

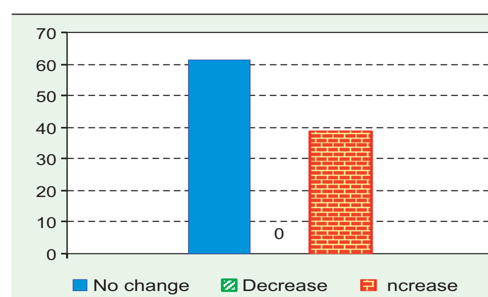
in accelerating the privatization of State assets especially in the telecom and energy industries.[125] As part of the accession process, Bulgaria and Romania, for instance, have to undertake reforms related to judicial independence, accountability, fighting corruption, and tackling of organized crime (box II.7). Such efforts should further improve the climate for all investments, including FDI. In Albania, Croatia and Serbia also measures favourable to foreign investors were adopted.[126]

4. Prospects: brighter for larger economies and new EU members

FDI in South-East Europe and CIS is expected to be particularly buoyant in the larger economies such as the Russian Federation and Ukraine, as well as in the new EU members: Bulgaria and Romania. Even though FDI prospects for Kazakhstan and the Russian Federation could be affected by the tighter grip of their Governments on strategic industries, foreign investors are eager to access these countries' natural resources, even under stricter conditions.[127] FDI in the Russian Federation is also likely to grow in other activities such as the retail trade (e.g. Ikea of Sweden), the automotive industry (Ford, General Motors, and Toyota) and banking (Citibank). With strong real income growth, a booming consumer market, and GDP growth averaging 7% in the last five years (IMF, 2007a), the country will continue to attract market-seeking FDI. The Government's privatization plan for 2007 includes 1,500 companies and more than 300 real estate properties with total proceeds exceeding $1.5 billion (IIF, 2007). The business environment in the Russian Federation improved in 2006 (World Bank, 2006). The values of cross-border M&A sales and purchases in the first half of 2007 in the Russian Federation were already larger than those for the whole year in 2006.

According to UNCTAD's *World Investment Prospects Survey*, South-East Europe and the CIS[128] was the only region where no TNC participating in the survey expected a decrease in FDI inflows in 2007-2008, while 39% anticipated an increase and 61% expected no change (figure II.26). About 21% of the responding TNCs expected an increase in FDI inflows to the Russian Federation, making it the fourth among the most preferred FDI destinations in the world. This was confirmed as well by other corporate surveys. In an annual survey of Japanese manufacturing TNCs (JBIC, 2007), for instance, the largest number of respondents stated an intention to strengthen or expand their activities in the Russian Federation.

Figure II.26. FDI prospects in South-East Europe and CIS, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

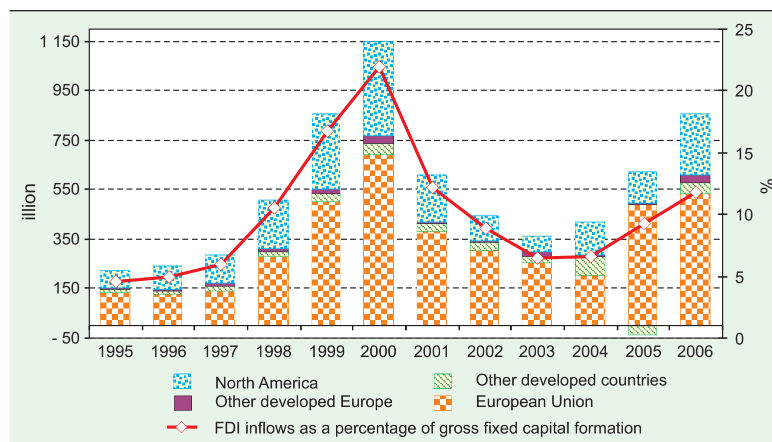
C. Developed countries

FDI inflows to developed countries surged to $857 billion, more than twice that in 2004. As in 2005, FDI was driven mainly by cross-border M&As, spurred by favourable financing conditions, high corporate profits, sustained economic growth and rising stock market prices. In contrast to the upward phase of the previous FDI cycle at the end of the last decade, the current expansion was widespread across all the developed regions and economic sectors. Increasing market integration promoted higher cross-border

investments in manufacturing, energy, telecommunications and transportation. Private equity and hedge funds played an important role.

While the United States recovered its position as the largest single FDI host country in 2006, the 25 countries of the EU together accounted for about 41% of total FDI inflows. Flows to most countries in Europe remained stable or rose as compared to those in 2005. Japan's FDI inflows were negative for the first time since 1989. FDI outflows from developed countries rose by 45%, to $1,023 billion, marking their fifth consecutive year of growth. The largest share of such flows was directed towards other developed countries. Trends in cross-border M&As as well as UNCTAD's *World Investment Prospects Survey* suggest that FDI into developed countries will reach a new high in 2007.

Figure II.27. Developed countries: FDI inflows and their share in gross fixed capital formation, 1995-2006



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

1. Geographical trends

a. *Inward FDI grew in all regions and all sectors*

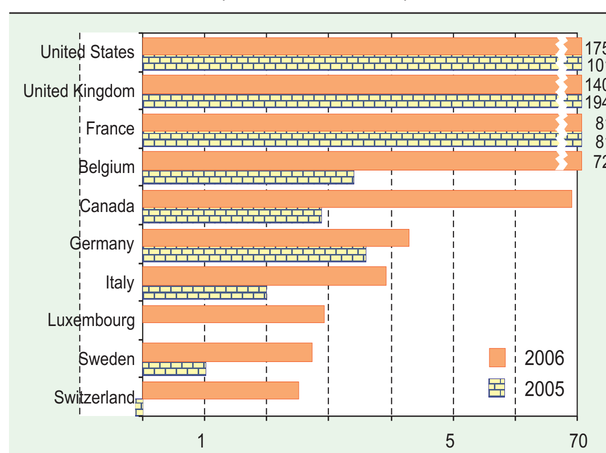
FDI inflows to developed countries rose for the third consecutive year, by 45% in 2006, to reach $857 billion (figure II.27). Inflows rose in 24 out of the 36 developed countries (annex table B.1), and their share in world FDI inflows increased from 62% to about 66%.

FDI inflows into *North America* rose by 88%, to $244 billion (figure II.27). With its economy growing at more than 3% in 2006, fuelled by buoyant consumer demand and high corporate profits, FDI inflows to the *United States* rebounded to $175 billion (figure II.28). Reinvested earnings, boosted by the continued high profitability of foreign affiliates in the country, grew by 65% to an all-time high of $65 billion. There was an unprecedented surge of investments in the chemical industry, which attracted $26 billion, accounting for 15% of total inflows. This growth was linked to some large cross-border M&As in the pharmaceutical industry and a weaker dollar.[129] Flows to finance and banking grew almost fivefold compared to 2005, reaching $31 billion, while those to the wholesale trade rose by 34% to $21 billion. Germany was the top source country of FDI in the United States, followed by France, Japan and the Netherlands in that order (United States, Bureau of Economic Analysis, 2007).

After a sharp rise in 2005, FDI inflows into *Canada* doubled to $69 billion in 2006, mainly due to a wave of cross-border M&As in the mining industry, notably the acquisitions of Inco by CVRD (Brazil) and of Falconbridge by Xstrata (Switzerland), each valued at more than $17 billion (annex table A.I.3, chapter IV). FDI in the buoyant mineral industry, among other activities, was stimulated by the country's strong economic growth, tax cuts in recent years and a very competitive business environment (box II.10).

FDI flows into the 25 EU countries rose by 9% in 2006, to a total of $531 billion. Much of the growth was again driven by cross-border corporate

Figure II.28. Developed countries: top 10 recipients of FDI inflows, 2005-2006[a]
(Billions of dollars)



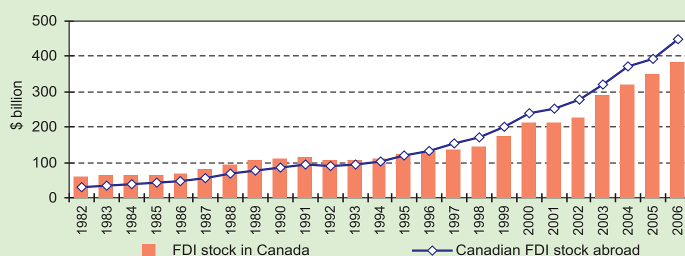
Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

[a] Ranked by the magnitude of FDI inflows in 2006.

Box II.10. Canada: using inward and outward FDI to internationalize

Canada is among the most attractive business locations in the world. The country was ranked first by the World Bank among its surveyed countries for ease of starting a business (World Bank, 2006). Moreover, in UNCTAD's Inward FDI Potential Index, it has been among the top five countries since 1990. At the end of 2006, the inward FDI stock of Canada amounted to $385 billion (box figure II.10.1) – a fourfold increase from its 1990 level.[a] Foreign affiliates accounted for around 45% of the country's exports and 30% of total business revenues in 2005.[b]

Box figure II.10.1. Canadian inward and outward FDI stocks, 1982-2006



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

The internationalization of the Canadian economy also continues through outward FDI. Canada ranks among the top 25 outward investor economies in UNCTAD's Outward FDI Performance Index. In contrast to FDI inflows, which have fluctuated heavily in recent years, annual outflows have been relatively stable: their stock has increased more than fivefold since 1990, to $449 billion in 2006 (box figure II.10.1).

The Canada-US Free Trade Agreement of 1988 and the North American Free Trade Agreement (NAFTA) of 1992 have encouraged Canadian FDI into the United States (MacDermott, 2007; Beaulieu et al., 2006), the prime target country for Canadian TNCs. During the period 2000-2006, 51% of Canadian outward FDI went to that country, compared to 19% to the EU. The leading investors abroad were firms in the finance and insurance industry, which accounted for 46% of total outflows, while those in the energy and metallic minerals industry accounted for 20%. In 2006, Canadian TNCs undertook several large acquisitions in the United States; for example, Goldcorp Inc. acquired Glamis Gold, a United States mining company, for $8.7 billion, and Brookfield, a Toronto-based real estate firm, together with Blackstone, the United States private equity group, bought Trizec Properties, a real estate investment trust company, for $2.9 billion (annex table A.I.3).

Further stimulus to outward FDI has come from the Government. Its international commercial policy recently has been paying more attention to outward FDI, a departure from its previous focus on trade and inward FDI (Beaulieu et al., 2006). In 2005, the Government acknowledged that the Canadian economy also benefits from outward investment as this contributes to competitiveness and increased R&D, and leads to technology transfers and spillovers to the Canadian economy.[c]

Source: UNCTAD.

[a] Compared to its potential, Canada had a lower Inward FDI Performance Index, ranking only 71st, but even this rank is much better than that of other developed countries such as the United States and the United Kingdom.

[b] Source: "Canada's international policy statement–a role of pride and influence in the world commerce", at: http://www.itcan-cican.gc.ca/ips/pdf/IPS-commerce-en.pdf.

[c] Ibid.

restructuring. In fact, 8 of the world's 10 largest cross-border M&As in 2006 took place within the EU. Intra-EU FDI in 2006 was responsible for an appreciable proportion of the inflows into EU member countries.

In the *EU-15*, inward FDI rose by 10%, to reach $492 billion in 2006. Lower flows to the United Kingdom, the Netherlands and Spain were more than offset by the increase in flows to Belgium, Germany, Italy and Luxembourg. FDI inflows into the *United Kingdom* fell by 28%, to $140 billion, largely reflecting a significant decrease in equity inflows (by 34%) and repayment of intra-company debt by foreign affiliates to their parent firms. Nevertheless, the country remained the largest FDI recipient in Europe in 2006, and the second largest worldwide. Several high-value cross-border acquisitions of United Kingdom firms took place, mainly in the telecommunications, transportation and chemical industries.[130] Inflows to *Sweden* amounted to $27 billion, the second largest amount since 1999, due to a significant increase in intra-company loans and equity inflows.

Inward FDI flows to the 12 countries forming the *European Monetary Union* (EMU) grew significantly in 2006, rising by 37% to $318 billion. Inflows to *Belgium* more than doubled to $72 billion, raising its total FDI stock to $603 billion, which was more than the country's GDP at the end of 2006. The continued presence in Belgium of TNC "coordination centres",[131] as well as new tax incentives that entered into force in January

2006, may have contributed to that increase. *France* recorded a small increase in inflows to $81 billion – representing a quarter of total inflows to the 12 EMU countries in 2006.

Inflows to *Germany* increased by 20%, to reach $43 billion in 2006, the bulk of which came from France, Denmark and the United States in that order. Among industries, banking and insurance received the largest share (32%) (Deutsche Bundesbank, 2007). *Italy's* inward FDI flows, still low compared to other European countries, doubled to $39 billion, due to large cross-border M&As in the banking sector. Inflows to *Luxembourg* rose substantially mainly due to the purchase of Arcelor by Mittal (Netherlands/United Kingdom) for $32 billion – the largest acquisition in 2006 (annex table A.I.3). After two consecutive years of negative inflows, as a result of repayment of loans by foreign affiliates to their parent firms, inward FDI flows to *Ireland* increased to $13 billion in 2006.

A few EMU-12 countries, namely Austria, Spain and the Netherlands, saw a decrease in FDI inflows in 2006. Inflows to *Spain* fell to $20 billion, the lowest level since 1999, largely reflecting decreased FDI in manufacturing, mainly due to competition from Eastern European and Asian countries. In the *Netherlands* inflows amounted to $4.4 billion in 2006, down from $41 billion in 2005, mostly due to the repayment of unusually high intra-company loans in 2005 by some United States and European affiliates.

FDI inflows to the *10 new EU member countries* (i.e. excluding the most recent accession countries of Bulgaria and Romania) retained their upward trend, totalling $39 billion, resulting mainly from a continued rise in reinvested earnings. *Poland* was the top recipient of that group, with record flows of $14 billion, as a result of increased investments not only from European investors, but also from Japanese companies such as Sharp, Bridgestone, Toyota and Toshiba. Germany and Italy (in that order) continued to be the leading sources of FDI to these countries.[132]

Among non-EU countries in Europe, *Switzerland* saw a recovery of FDI inflows in 2006, amounting to $25 billion, largely driven by record reinvested earnings of $14 billion. Its biotechnology and finance industries attracted the most foreign investments (Ernst and Young, 2006).[133]

In 2006, FDI inflows to *Japan* turned negative, falling to -$6.5 billion, following an already low inflow of $2.8 billion in 2005. Reinvested earnings of $2.3 billion could not compensate for the large negative equity inflows of $8.6 billion. Large disinvestments by Japanese affiliates of Vodafone and GM through their financial affiliates in the Netherlands, Canada and Hong Kong (China), in that order, were responsible for that decrease. In 2006, Japan's economic expansion was still hampered by deflationary pressures and low productivity growth in non-tradable goods and services (Moody's, 2007). The decline in FDI inflows made it impossible to achieve the ambitious target to double Japan's inward FDI stock by the end of 2006 (*WIR06*: 85). In *Australia,* after the large disinvestment of $35 billion in 2005, mainly due to the reincorporation of News Corp. (*WIR06*), inflows rose to $24 billion.

In 2006, cross-border M&As of developed-country firms increased by 20%, to $728 billion, the second largest annual increase so far, driven partly by private equity funds (chapter I). The rebound, in both number and value of deals, similar to that in 2005, was driven by economic expansion in the United States and the euro area, strong corporate profits, improved capacity utilization and rising stock markets in developed countries. Nearly 90% of M&As in developed countries were concluded by firms from other developed countries. Some developing-country TNCs were also involved in several mega M&A deals in developed countries in 2006 (annex table A.I.3). Altogether, developing-country firms invested up to $65 billion in acquisitions in developed countries – a 50% increase from the previous year.

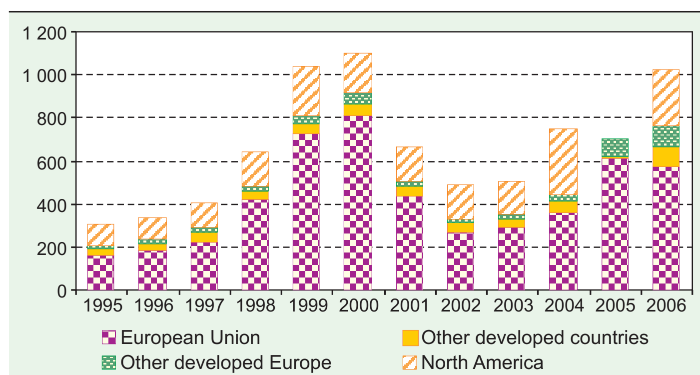
Like cross-border M&As, greenfield projects increased in all major subgroups/economies of developed countries to a total of 5,197 recorded projects in 2006 compared to 4,662 in 2005 (annex table A.I.1). While the EU had the largest combined number (3,844) as well as share (74%) of such projects in developed countries, the United States continued to be the single country with the largest number of projects – 723 in all. The number of greenfield projects in developed countries by firms from developing countries grew by 15% in 2006 to 405 projects.

b. Outward FDI increased sharply

Outflows from developed countries amounted to $1,023 billion, a growth of 45% (figure II.29). Developed countries continued to maintain their position as net outward investors, with outflows exceeding inflows by $165 billion. While there was a rebound of FDI outflows from the United States, more than half of total outflows from developed countries in 2006 were from the EU. Outflows from the 10 new EU members, although significantly higher than in 2005, continued to be modest compared to inflows ($12 billion, or 31% of FDI inflows).

A major reason for the upswing in FDI outflows was a rebound in outward FDI from the *United States,* the largest outward investor in 2006

Figure II.29. Developed countries: FDI outflows, 1995-2006
(Billions of dollars)



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

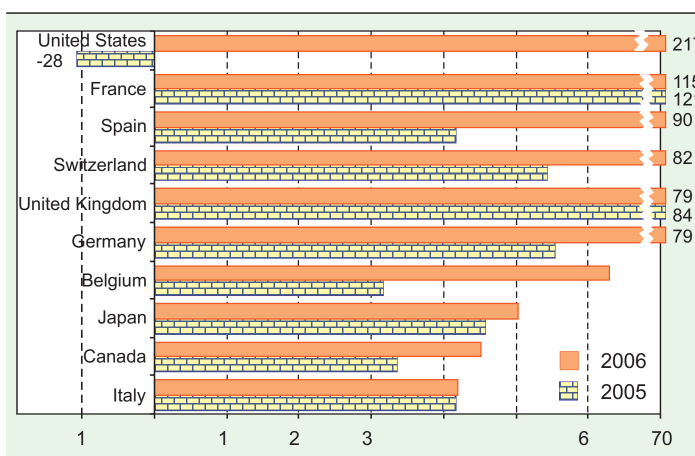
(figure II.30). After the negative outflows of FDI registered in 2005 due to the repatriation of profits induced by the one-off tax incentives provided by the American Jobs Creation Act (*WIR06*: 89), FDI flows from the United States jumped to $217 billion in 2006, while its FDI stock abroad rose to $2.4 trillion. Reinvested earnings ($201 billion) were the main FDI component in that increase. The EU was the region with the highest level of investments ($112 billion) by United States companies, followed by Asia and Latin America in that order. Manufacturing and financial firms were the major investors, accounting for $60 billion and $25 billion respectively (United States Bureau of Economic Analysis, 2007).

In 2006, FDI outflows from the *EU* countries fell slightly, to $572 million. Nevertheless, seven EU countries ranked among the top 10 developed source countries (figure II.30, table II.14). With outflows of $115 billion, slightly lower than those in 2005, *France* was the second largest source of FDI worldwide for the second year in a row. Companies in *Spain*, profiting from special incentives (*WIR06*: 89) and high growth in various sectors in their home economy (especially property, construction and banking), continued their rapid rate of outward expansion, resulting in record outflows of $90 billion. Of the three largest cross-border M&As in 2006, two originated from Spain (annex table A.I.3). Large overseas acquisitions by German companies, mainly in the United Kingdom and the United States, led to an increase of 43% in *Germany's* FDI outflows in 2006.

Other major sources of FDI from Europe were the Netherlands, Switzerland and the United Kingdom. FDI from *Switzerland* nearly doubled to $82 billion, also a new record. It took the form primarily of acquisitions in the United States and Canada, and mainly in finance and holding companies but also in the mining and chemical industries (Swiss National Bank, 2007). Outflows from the *United Kingdom* fell by 5% to $79 billion; nevertheless, its position as the world's second largest source country of FDI in terms of stock remained intact. Large United Kingdom companies in telecommunications and finance invested in developing countries, as illustrated by the acquisitions by the Vodafone group of firms in Turkey and South Africa and by HSBC of a bank in Panama.[134] FDI from *the Netherlands* amounted to $23 billion as a result of the acquisition of Arcelor (Luxembourg) by Mittal Steel (registered in the Netherlands).

In contrast to its declining inflows, *Japan's* FDI outflows increased further in 2006, by 10%, to reach a record $50 billion, the second highest since 1990. The depreciation of the yen did not deter outward FDI, while high corporate profitability of Japanese foreign affiliates enhanced reinvested earnings abroad to $16 billion, the largest ever. While the largest share of Japan's outward FDI flows went to Western Europe (36%), the second largest recipient was Asia (with 35%), overtaking North America (19%). The United States, however, was the single largest country recipient of Japanese FDI with $9 billion in investments, slightly lower than the $12 billion recorded in 2005, followed by the Netherlands, the United Kingdom[135] and China. Finally, outflows from *Israel* reached a record $14

Figure II.30. Developed countries: top 10 sources of FDI outflows, 2005-2006[a]
(Billions of dollars)



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

Table II.14. Developed countries: country distribution of FDI flows, by range,[a] 2006

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

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

[a] Countries are listed according to the magnitude of FDI.

billion because of large M&As such as the above-mentioned acquisition by Teva Pharma Inds Ltd of Ivax Corp (United States) (annex table A.I.3).

The countries among the *10 new EU members* with more than $1 billion in outward FDI were Poland, Hungary, the Czech Republic and Estonia.

2. Sectoral trends: services continued to dominate

Judging from information on cross-border M&As by sector in 2006, services continued to dominate FDI flows between developed countries. Manufacturing gained in importance in terms of both target and acquiring firms, while the importance of the primary sector declined compared to 2005 (table II.15).

In the *primary sector,* although the exceptionally large cross-border M&As in 2005 (such as the acquisition of Royal Dutch Petroleum by Shell Transport &Trading Co. cited in *WIR06*: 273) were not repeated in 2006, the volume of sales and purchases remained high. Cross-border M&As in mining alone, which accounts for the bulk of M&As in the primary sector, increased almost fivefold in terms of sales and more than sevenfold in terms of purchases (table II.15). High commodity prices as well as consolidation of the mining and quarrying industries (Part Two) were the main drivers of this trend. Nevertheless, because of the larger increase in the value of cross-border M&As in manufacturing and services, the share of the primary sector in total cross-border M&As declined.

Table II.15. Developed countries: cross-border M&As, by sector/industry, 2005-2006
(Million of dollars)

Sector/industry	Sales 2005	Sales 2006	Purchases 2005	Purchases 2006
Total industry	604 882	727 955	627 064	752 482
Primary	110 474	65 119	98 035	56 850
Mining, quarrying and petroleum	108 769	63 036	97 838	54 102
Mining and quarrying	11 035	50 492	4 858	36 903
Petroleum	97 735	12 544	92 980	17 199
Secondary	171 020	247 233	125 684	197 125
Food, beverages and tobacco	31 706	16 823	17 516	15 474
Textiles, clothing and leather	2 031	1 721	4 638	694
Woods and wood products	3 862	4 841	3 340	4 181
Printing, publishing and allied services	9 778	24 922	7 460	9 223
Oil, gas and petroleum refining	1 882	2 548	757	446
Chemicals and chemical products	53 017	54 162	36 574	36 642
Rubber and miscellaneous plastic products	2 421	7 244	1 336	5 715
Stone, clay, glass and concrete products	4 521	8 557	10 024	7 916
Metals and metal products	20 184	46 606	12 943	42 505
Machinery	4 235	16 520	5 117	21 422
Electrical and electronic equipment	12 687	37 750	10 195	33 760
Measuring, medical, photo equipment & clocks	13 438	8 748	6 424	10 193
Motor vehicles and other transport equipment	9 744	15 449	8 859	8 381
Services	323 388	415 602	403 309	498 507
Electricity, gas and water distribution	35 596	17 630	25 364	9 890
Construction firms	6 124	10 956	2 802	6 592
Trade	24 908	20 267	14 377	13 878
Hotels and restaurants	5 507	26 943	1 814	13 001
Transport, storage and communications	73 900	102 812	49 646	67 022
Telecommunications	47 141	58 151	29 896	59 325
Finance	63 927	92 055	253 322	333 967
Business activities	85 374	101 831	46 321	38 141
Health and social services	5 312	13 425	1 621	1 059
Community, social & personal service activities	21 050	25 439	6 734	10 061

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

Cross-border M&As in the *manufacturing sector* of developed countries rose by 45% in terms of sales and by 57% in terms of purchases, led by a significant increase in the metals and metal product, printing and publishing and electrical and electronic equipment industries. While M&As in chemicals and chemical products remained the same as in 2005, the main target in the manufacturing sector and the largest cross-border M&A deal in 2006 was the acquisition of Arcelor by Mittal (annex table A.I.3), which made the metal industry the largest recipient.

Services continued to be the main target and acquiring sector for cross-border M&As in developed countries. M&A activity was particularly intense in financial services, mainly

due to ongoing financial deregulation and restructuring. M&As also increased significantly in telecommunications[136] and tourism. In 2006, there was a significant increase in FDI in R&D activities, especially in the pharmaceutical and automotive industries (United Kingdom Department of Trade and Industry, 2006).[137] Apart from being a hub for some manufacturing activities, mainly the automotive industry (*WIR06*: 91), the group of 10 new EU-member countries is becoming attractive also for certain high value-added activities such as R&D.[138]

3. Policy developments

In 2006, many developed countries adopted policies that could directly or indirectly increase their attractiveness for FDI: of the 37 changes in their regulatory frameworks affecting FDI, 30 aimed at facilitating more FDI.[139] These policies included privatization and liberalization efforts, tax cuts and other monetary incentives, as well as promotion and marketing activities.

Privatization and liberalization. Most of the 10 new EU member States (that joined the EU in 2004) continued the process of privatization and opening up of their domestic economies to foreign investors in 2006, although at a slower pace. The Governments of Latvia and Malta, for instance, sold some State-owned assets. On the other hand, the new Government of Slovakia halted further privatizations of State-owned companies. In other EU countries, such as Austria, Portugal, France and Ireland, several large-scale privatizations were announced or completed.[140]

Further liberalization and opening up of some protected industries also took place. For example, the European Parliament approved the EU Directive on Services in the Internal Market in December 2006 (*WIR06*: 93), which is expected to stimulate FDI in this sector. In Australia, a new law was passed that allows more foreign investments and mergers in media: the earlier quantitative restrictions for FDI were eliminated, although investments in the industry would still require government approval. In Italy, the Minister for Economic Development announced a decree to start a programme of liberalization and increase competition in heavily protected services such as professional services, pharmacies, banks and taxis. In Greece, the Government opened its tourism industry to large-scale foreign investment. Japan relaxed its competition policy to facilitate the establishment of large-scale retailing operations.

Tax policy and other incentives. In 2006, several developed countries reformed their tax systems or cut their corporate tax rates to stimulate investment and attract foreign investors. In Austria, for example, new legislation abolished the Austrian non-resident capital gains tax for most foreign investors. The Czech Republic, Estonia, Greece and the Netherlands, introduced further cuts in their corporate tax rates. In Japan, foreign companies have been allowed to acquire Japanese firms through the exchange of shares since May 2007, which is expected to encourage cross-border M&As.[141] In Hungary, even though an additional business tax – called a solidarity tax – was introduced, the withholding tax for dividends paid to foreign corporations was abolished. And in Luxembourg, the dividend withholding tax rate was reduced from 20% to 15% and the income tax in Luxembourg City, where most of the holding and finance companies are located, was also reduced.

However, protectionist sentiment and various kinds of institutional barriers against foreign investment persist, and some are even on the rise again in several developed countries. In Austria, for example, the establishment of a private fund to protect Austrian companies from foreign takeovers is under discussion.[142] A report of the European Commission has concluded that the Community's corporate takeover rules of 2004 have failed to alleviate hostile takeovers (European Commission, 2006). At the same time, efforts are under way to reduce barriers to FDI. For example the European Commission tried to advise Spain to drop restrictions on the bid by the German energy group E.ON for Spanish power company Endesa (though eventually the German bid was withdrawn). In another case, the EU Advocate General in February 2007 backed the EU Commission's 2005 decision to take Germany to the European Court of Justice by claiming that the "Volkswagen Law" contravened EU rules on the free movement of capital (European Court of Justice, 2007).[143]

In the United States, although the continuing commitment to open up to investment and trade has been expressed on several occasions,[144] steps were taken to ensure that foreign investments do not jeopardize national security. Indeed, the Committee on Foreign Direct Investment in the United States (CFIUS) was reorganized for this purpose, and the time period for approval of foreign acquisitions will be extended, especially if the foreign investor is an enterprise that is partly or wholly-owned by a foreign government (*WIR06*).

4. Prospects: optimism for further growth in FDI

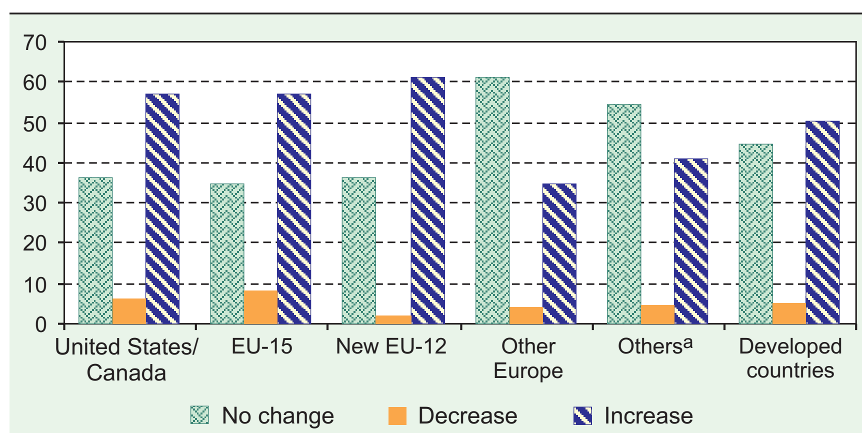
The medium-term prospects point to continued high levels of FDI flows to most developed countries, as many of the factors pushing

FDI flows upwards are expected to prevail for some time. Economic growth in developed countries seems set to remain robust in 2007 and 2008 (IMF, 2007a) and should continue to support corporate profits and upward movement of equity prices, stimulating further cross-border investments in those countries. While the pace of economic expansion in the United States has eased, it remains solid in the euro area and Japan. The OECD's leading indicators of economic performance in the first half of 2007 point to an upward trend in all the regions, with significant economic growth especially in South-East Asia (OECD, 2007). Increased FDI outflows can therefore be expected, especially to the developing countries. The EU's Directive on Services and the relaxation of some of the requirements of the United States' Sarbanes-Oxley Act[145] are expected to have a positive influence on FDI activity in 2007. The significant increase in cross-border M&As in developed countries (66% in value) in the first half of 2007, compared to the same period in 2006, is another indicator of higher FDI flows in 2007.

UNCTAD's *World Investment Prospects Survey* also indicates bright prospects for further growth in FDI flows in developed countries, with half of the TNCs surveyed anticipating an increase in FDI inflows into developed countries, and 44% expecting flows to remain the same (figure II.31). Growth of FDI inflows is likely to be the strongest in the United States, the United Kingdom, Poland and Germany (table I.14). Among developed countries as a whole, TNCs expressed greater optimism for FDI inflows to the new EU-12 members,[146] North America and the EU-15, in that order; while in other European and other developed countries (Japan, Australia and New Zealand) 41% of respondents expected FDI inflows to remain stable for the next three years. A number of other corporate surveys reflect optimism regarding business and FDI prospects.[147]

However several risks remain. Economic developments crucially depend on future oil prices and the unwinding of global current-account imbalances. The United States' deficits, asset price inflation, and a resulting increase in interest rates, present risks for the world economy. Although the considerable turbulence experienced by financial markets in early 2007 has calmed down, it is a reminder to investors and policymakers of potential financial market risks. The large increase in private equity buyouts in several countries and the accompanying transfer of risks to hedge funds has also increased the vulnerability of financial markets to various shocks (IMF, 2007a; and chapter I).

Figure II.31. FDI prospects in developed countries, 2007-2009: responses to UNCTAD survey
(Per cent of respondents)



Source: UNCTAD, 2007b.

[a] Australia, Japan and New Zealand.

Notes

1 At times this share has been higher, reaching more than 70% at the beginning of the decade.

2 Data on greenfield projects in this Chapter come from OCO Consulting, LOCOmonitor database (www.locomonitor.com).

3 Data on international reserves from the IMF's *International Financial Statistics*.

4 Based on 29 countries; *source*: IMF, *Balance of Payments Statistics*.

5 In addition to major oil producers such as Nigeria, Algeria, the Libyan Arab Jamahiriya, Angola and Sudan, mineral-producing countries such as Kenya, Mauritius, Lesotho, Swaziland, the United Republic of Tanzania, Uganda, and Zambia that had started to receive FDI in manufacturing, especially textile processing and export-oriented activities, also received larger inflows into resource exploration activities.

6 Zambia is the world's fourth largest copper producer, with most of the production undertaken by TNCs (chapter IV). See also "Zambian producers suffer as copper bonanza sends exchange rate soaring", *Financial Times*, 26 September 2006.

7 Under this Act, the United States Government has been offering trade preferences since 2000 to promote trade and investment in Africa. The expiration of this Act has been extended until 2015.

8 In 2005-2006, Lesotho witnessed an 8.3% contraction in manufacturing, which was strongly influenced by the removal of quotas after the expiry of the Multi Fibre Arrangement (MFA) on exports from low-cost Asian producers and the continued strength of the South African rand (Lesotho's mloti is pegged to the rand). *Source*: "Lesotho economy: Manufacturing sector performance to improve", *EIU Viewswire*, 28 June 2006. For Swaziland, see for instance, *Africa Renewal* (previously *Africa Recovery*), vol., 20, No. 1, April 2006: 18.

9 For example, France's Crédit Agricole acquired Egyptian American Bank (later renamed the new bank Crédit Agricole-Egypt) (*Source*: "Credit Agricole Egypt's Adrien Phares on his bank's acquisition of EAB", *Business Today*, 16 August 2006). In Nigeria, CNOOC (China) acquired NNPC OML-130 for $3 billion, and in Sudan, inflows surged partly as a result of the sale of MobiTel to MTC Kuwait for $1.33 billion.

10 This subregion comprises Algeria, Egypt, the Libyan Arab Jamahiriya, Morocco, Sudan and Tunisia.

11 The North African countries received FDI in the manufacturing sector from TNCs engaged in the production of cosmetics, water storage tanks, auto valves, irrigation pumps, minibus assembly lines, utility vehicles and pick-up trucks, paints, pharmaceuticals and chemical production. *Source*: PricewaterhouseCoopers (www.pwc.com).

12 *Source:* Central Bank of Egypt. For instance, pharmaceutical giant AstraZeneca invested in a plant to manufacture medicines (for cardiovascular disease, psychiatric disorders and cancer) in Egypt in 2006 ("AstraZeneca opens first manufacturing plant in the Middle East", in-Pharma Technologist.com (www.in-pharmatechnologist.com).

13 Tunisia sold 35% of Tunisie Telecom (TT) to a consortium comprising Dubai Technology and Media Free Zone, and Dubai Investment Group for $2.3 billion.

14 The subregion comprises Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Saint Helena, Senegal, Sierra Leone and Togo.

15 *Source*: "Ernie Els to design course in Cape Verde Islands", *Golf Today Travel,* 12 September 2006 (http://www.golftoday.co.uk/travel/press_releases/els_cape_verde.html).

16 The subregion comprises: Burundi, Cameroon, the Central African Republic, Chad, Congo, the Democratic Republic of the Congo, Equatorial Guinea, Gabon, Rwanda and Sao Tome and Principe.

17 Pecten is part of the Shell Group ("Pecten Cameroon Company", *MBendi*, 7 October 2006 (www.mbendi.com)).

18 The subregion comprises Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Seychelles, Somalia, Uganda and the United Republic of Tanzania.

19 The subregion comprises Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe.

20 *Sources*: "Vodafone raises South Africa stake to 50%", *Computer Business Review Online*, 7 December 2006 (http://www.cbronline.com/article_news.asp?guid=78E3F61D-8188-461D-BD07-458659500C6A); "India's Tata group acquiring 26 PCT stake in SAfrican telecom", *AFX News Limited*, 22 August 2006 (http://www.forbes.com/business/feeds/afx/2006/08/22/afx2963999.html); and "Dubai-led group gets Cape V&A for R7bn", *Business Day*, 9 October 2006. (http://www.businessday.co.za/articles/dailymailer.aspx?ID=BD4A275648).

21 See: www.unctad.org/fdistatistics for longer time series data.

22 *Source*: "South Africa: Scrambling for Africa", *AllAfrica*, 22 November 2006 (http://allafrica.com/stories/200607240385.html); "AngloGold in $58 million Russian mining alliance", *BusinessDay*, 7 April 2006; "SA firm wins new oil rights in Tanzania", *All Africa*, 2 May 2006 (www.allafrica.com); and "AngloGold in $58 million Russian mining alliance", *BusinessDay*, 7 April 2006.

23 Orascom (Egypt) bought a 19.3% stake in Hong Kong-based Hutchison; Telkom acquired part of Portugal Telecom, including its operations in several African countries such as Angola and Morocco; MTN bought into Lebanon's Investcom; Maroc Télécom acquired a majority stake in Burundi's Office national des telecommunications (Onatel); and Naguib Sawiris of Egypt purchased Wind Telecomuncazioni SpA of Italy.

24 Angola eased procedures for the entry of foreigners into the country; Kenya scrapped or simplified various types of operational licences, set up a Business Regulatory Reform Unit to bring standards up to international best practices and introduced a 24-hour service at the port of Mombasa and Mauritania eliminated various restrictions on foreign-exchange operations.

25 See endnote 69 in chapter I.

26 Under AGOA, Africa-based clothing exporters were able to import fabric from the cheapest available suppliers while still enjoying duty-free access to the United States market. When this concession expires in 2007, some of the foreign-owned clothing firms in eligible African countries may well decide to relocate elsewhere. In December 2006, the United States Congress passed AIIA under the AGOA to help avert the diversion of FDI and the loss of thousands of jobs in the region. The new Act supplements and extends the provisions of AGOA to help producers in sub-Saharan Africa better withstand greater competitive pressures from China following the expiry of MFA in 2005.

27 Includes China, Hong Kong (China), the Democratic People's Republic of Korea, the Republic of Korea, Macao (China), Mongolia and Taiwan Province of China.

28 FDI to financial service industries (mainly banking) declined from $12 billion in 2005 to $6 in 2006. Data on FDI in financial industries is reported by the Chinese Government based on data collected separately by China's three financial regulatory bodies: the banking, insurance and securities regulatory commissions. According to the China Banking Regulatory Commission, however, its data on foreign investments are not based on the standard balance-of-payments (BOP) definition of FDI (UNCTAD, 2007e).

29 There has been a worsening labour shortage in coastal provinces such as Guangdong. In response, minimum wage levels in several cities in the province have risen significantly in recent years. For example, the minimum wage increased by 17.4% in Shenzhen in 2006.

30 *Source*: Ministry of Commerce, Industry and Energy.

31 ASEAN members are: Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

32 The project is expected eventually to employ 3,000 workers and double Texas Instruments' production capacity ("Texas Instruments unveils $1 billion Philippines expansion", 3 May 2007, at: www.marketwatch.com).

33 Although wages in Viet Nam have been rising rapidly particularly after the minimum wage level was increased in early 2006, the wage rate is still attractive compared to that in China. The monthly wage rate (including all benefits) of the average worker in Viet Nam was about $90-$110 compared to $160-$190 in southern China in 2006 (JETRO, 2006: 88).

34 The subregion comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

35 This includes, for instance, the investment of $20 billion by Emaar Properties (United Arab Emirates) in real estate development in Islamabad and Karachi (see "Emaar unveils three real estate projects in Pakistan with total investment of AED 8.8 billion", at: http://www.emaar.com).

36 Largest M&As undertaken by Singaporean firms in developed countries include the PSA International-Peninsular & Oriental Steam Navigation (United Kingdom) deal ($6.4 billion) and the Temasek-Standard Chartered (United Kingdom) deal ($4.3 billion), though they are not recorded in 2006 (because payment was not made).

37 For example, see "A new wave of overseas investment has led to concerns of hollowing out", 30 October 2006 (www.Xinhuanet.com).

38 The objective of establishing these zones is to promote the internationalization of Chinese SMEs. The zones are established and run by Chinese enterprises, with financial support from the Chinese Government (*source*: Ministry of Commerce).

39 So far, the Central Foreign Exchange Management Centre, under the State Administration of Foreign Exchange (SAFE), has been the only government agency responsible for managing China's foreign exchanged reserves ($1 trillion by the end of 2006). Following the conventional approach to reserves management, which emphasizes security and liquidity, the agency has only invested in fixed-income securities such as United States Treasury Bonds. As highlighted in *WIR06* (box II.7), the Chinese Government has been considering alternative uses for its foreign currency reserves in view of the relatively low returns and high risks associated with the approach followed hitherto. Following a decision made by the State Council at the Central Financial Work Meeting in January 2007, the Chinese Government is establishing a Government Investment Corporation, which is expected to manage a possible $200 billion fund drawn from the pool of China's foreign currency reserves.

40 In 2005, Tata Steel acquired NatSteel (Singapore) for $486 million. In 2006, Tata Tea purchased a 30% stake in Energy Brands Inc. (United States) for a total acquisition price of $677 million, and Tata Coffee (a subsidiary of Tata Tea) acquired Eight O'Clock Coffee Company (United States) for $220 million.

41 India is now the second largest source of FDI inflows to London, accounting for 16% of total inflows.

42 For example, in terms of sales, Hongfujin Precision Industry (Shenzhen), a subsidiary of Hon Hai Precision Industry, has surpassed Motorola (China) in size, becoming the largest foreign affiliate in China, with about $15.7 billion in sales and $14.5 billion in exports in 2006 (Ministry of Commerce of China). In addition, the affiliates in China of Taiwan Province-based Quanta Computer and Inventec ranked number eight and nine, respectively, in the list of top foreign affiliates in China in 2006.

43 For example, China Huadian Corporation is cooperating with its local partner Perusahaan Listrik Negara on a $2 billion electricity project in Indonesia. Other agreements (worth $4 billion) in electricity and extractive industries were signed in October 2006 at a China-Indonesia energy forum in Shanghai.

44 For example, Royal Dutch Shell announced in July 2006 that it would invest in a $5 billion coal-to-liquids plant in Ningxia Province. Anglo American is considering a coal-mining and processing complex worth about $4 billion ("Anglo American shows China interest", *Financial Times*, 16 November 2006).

45 FDI in high-tech industries such as telecom equipment increased significantly in 2006 (according to data provided by the Ministry of Commerce).

46 *Source:* the Reserve Bank of India.

47 For example, Wal-Mart will cooperate with the local Bharti Enterprises to build hundreds of shops in the next five years ("Wal-Mart will enter the Indian retailing industry", *Financial Times*, 28 November 2006).

48 According to China's Ministry of Commerce (MOFCOM), Carrefour (France) had established 79 branches in China by the end of June 2006, with total sales reaching $15 billion in the first half of 2006 (http://mnc.people.com.cn/GB/54823/4929860.html). In February 2007, Wal-Mart acquired a 35% stake in Bounteous Company Ltd. (Taiwan Province of China), which operates Trust-Mart in mainland China (see "Wal-Mart expands in China through Trust-Mart stake", 27 February 2007, *MarketWatch*, at: www.marketwatch.com).

49 For example, Wal-Mart sold its 16 branches in the Republic of Korea to the local E-Mart in 2006. (Evan Ramstad, "South Korea's E-Mart is no Wal-Mart, which is why locals love it", *Wall Street Journal*, 10 August 2006).

50 For example, TCL had to write off much of its investment recently after it acquired Thomson (France) in 2004.

51 The applications for establishing branches in the United States by Chinese banks, such as Bank of China, China Construction Bank and Bank of Communications, have been denied several times by the United States authorities over the past decade. However, this may change after the Second China-United States Strategic Economic Dialogue in 2007, which reached the conclusion that any such applications should be examined based on the principle of national treatment (Mei Xinyu, "Chinese banks eyes overseas markets", 5 June 2007, at: www.FTChinese.com).

52 A priority objective indicated by both the Ministry of Commerce and the National Development and Reform Commission.

53 The new income tax rate will be 25%, but foreign affiliates can continue to enjoy previous tax rates (15% or 24% depending on location) during a five-year transition period.

54 The Indian National Security Commission has proposed to all economic departments of the Government that FDI from certain countries should be subject to approval and monitoring with regard to national security implications.

55 In 2006, the Ministry of Commerce and the National Development and Reform Commission introduced new rules on foreign takeovers in order to ensure a standard treatment for acquisitions and a screening based on antitrust and "national economic security" concerns. In July 2006, the Government introduced a regulation to restrict FDI in real estate in order to avoid overheating in China's real estate market.

56 Seven industries, including telecommunications, petroleum, defence, electricity, coal mining, civil aviation and ocean shipping, are considered to be of strategic importance, and thus to be controlled by the State.

57 For example, China announced plans to invest about $200 billion in its railway system over the next five years, and Viet Nam is planning a high-speed railway system.

58 First, poor infrastructure prevents the country from attracting efficiency-seeking FDI. Second, while the Government is making efforts to attract FDI projects, they are not necessarily welcomed by local communities.

59 Comprising Bahrain, the Islamic Republic of Iran, Iraq, Jordan, Kuwait, Lebanon, Oman, the Palestinian Territory, Qatar, Saudi Arabia, the Syrian Arab Republic, Turkey, the United Arab Emirates and Yemen.

60 Turkey was host to the largest cross-border M&A deal of the year in the region – the purchase of TELSIM Mobil Telekomunikasyon of Turkey by the United Kingdom's Vodafone Group for $4.6 billion (annex table A.I.3). There were an estimated 43 completed cross-border M&A sales in the country, compared with 23 in 2005 (annex table B.5).

61 Some 93 greenfield projects were recorded in Saudi Arabia, with over 10 in the construction sector (OCO Consulting, Locomonitor database, at:www.locomonitor.com).

62 Including the Islamic Republic of Iran, Iraq, Jordan, Lebanon, the Palestinian Territory, the Syrian Arab Republic and Yemen.

63 In principle, cross-border M&As should be part of FDI flows, but due to different methodologies in collecting these two sets

of data, figures do not match. For details on data differences between cross-border M&As and FDI flows, see *WIR00*.

64 *Source*: *Oxford Analytica*, 2 July 2007.

65 For example, ExxonMobil (United States), Royal Dutch Shell (United Kingdom/Netherlands) and Sasol (South Africa) have gas exploration projects in Qatar, and Royal Dutch Shell and Total (France) have them in Saudi Arabia.

66 In petroleum refining, the most significant cross-border acquisition in 2006 took place in Turkey, where OMV (Austria) took a 34% stake in the oil and gas firm Petrol Ofisi AS (Turkey) for $1.1 billion.

67 The motor vehicles and other transport equipment industry accounted for 13% of Turkey's total inward FDI stock in 2004, the second largest recipient industry after transport, storage and communications. This trend is continuing: in 2006, Doktas Docum Sanayi ve Ticaret, an automobile parts and components firm was acquired by Componenta Oyj (Finland) for $110 million.

68 Jordan Investment Board, *Investment Statistics 2006* (http://www.jordaninvestment.com).

69 Islamic finance, or the use and provision of finance in compliance with Islamic norms (based on the Shariah), operates on the principle of distribution of investment profits, rather than paying out and receiving interest for access to finance. Therefore, Islamic finance can take the form of direct investment rather than loan finance.

70 In June 2006, Umniah Mobile Communications, a major player in Jordan's highly competitive cellular market was bought by Batelco (Bahrain) for $415 million ("Batelco acquires Jordan mobile operator for $415 mln*", Khaleej Times*, 25 June 2006), and the Government of Jordan sold off its remaining 41.5% shares of Jordan Telecom to France Télécom for $183 million ("France Telecom acquires a majority interest in Jordan Telecom*", Financial Times*, 30 June 2006).

71 *Source*: UNCTAD, database on national laws and regulations.

72 The Central Bank of Bahrain has also enacted a Trust Law that specifies which investment products can be sold and invested in Bahrain (Bahrain Trust Law, *EIU Viewswire*, October 2006). As of 1 July 2006, licensing categories were defined by the type of regulated activity rather than the type of institution. Offshore banks, including investment banks, will now be covered by a "wholesale banking" licence ("Offshore Banking in Bahrain", *EIU Viewswire*, October 2006). For Saudi Arabia, see "Saudis to construct Euro 5.2 bn financial district in Riyadh", *Financial Times*, 10 May 2006 and for Qatar, see "Qatar Central Bank, 2006", *EIU Viewswire* (www.viewswire.com), 2006.

73 Non-Omani citizens will have the right to own residential property and land in "integrated tourism complexes". *Oman Tourism, EIU Viewswire*, March 2006.

74 The Qatar Government opened its market to foreign investment in the gas sector. There are several large projects under this initiative. For example, the Qatar Liquefied Gas Company Limited (Qatar Gas), a joint-venture company between Qatar Petroleum and ExxonMobil Corporation, has expanded its facilities at the Ras Laffan industrial city natural gas liquefaction plant in Qatar. Started in early 2005, the project investment has been estimated at $12 billion. Royal Dutch Shell is also investing in a Qatar gas plant to turn Qatari gas into super clean fuel, in a project worth up to $18 billion.

75 The law also consolidates existing legislation and introduces new, tighter provisions regarding transfer pricing and tax havens. Turkey Tax Law*, EIU Viewswire*, March 2006.

76 See, for example, "UAE mulls FDI reform", Khaleej Times, 22 December 2006; and "UAE Labour Law*", EIU Viewswire*, June 2006.

77 http://ec.europa.eu/trade/issues/bilateral/, accessed in March 2007.

78 The health-care sector is considered to be the industry with the highest growth potential, especially in the West Asian subregion (PricewaterhouseCoopers, 2007a), which could attract some FDI. In Jordan for instance, Kuwaiti investors are seeking government approval to launch a medical city near Amman at a cost of $3-5 billion.

79 In Kuwait, for example, legislation is expected to be passed in 2007, enabling Project Kuwait, a $7 billion plan to encourage foreign investment and development of oilfields in northern Kuwait, to start in the first half of 2008 (Salisu and Yagudin, 2007).

80 Oceania comprises American Samoa, Cook Islands, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, the Federated States of Micronesia, Nauru, New Caledonia, Niue, Norfolk Islands, Northern Mariana Islands, Palau, Papua New Guinea, Samoa, the Solomon Islands, Tokelau, Tonga, Tuvalu, Vanuatu, Wallis and Futuna Islands.

81 Their ranking according to the UNCTAD Inward FDI Performance Index, would be 94 and 136, respectively. However, the index for these economies is calculated separately from that of other economies; only Papua New Guinea is included in the index, which is limited to 141 economies for which the Inward FDI Potential Index is constructed (annex table A.I.6).

82 Following the agreement signed with China Metallurgical Construction Group Corporation in 2005 by the Government of Papua New Guinea, work has commenced at the joint Ramu Nickel-cobalt project in which the Chinese corporation holds 85% of equity.

83 The First Ministerial Meeting of the China-Pacific Island Countries Economic Development & Cooperation Forum took place in Fiji in 2006 with a view to promoting relations between China and the Pacific countries. China is establishing a loan-finance facility or an investment fund to enable qualified Chinese enterprises to invest in various Pacific island countries.

84 For example, in Fiji following a coup in December 2006, an initial decline in the number of tourist arrivals was observed, but the sector is showing signs of rapid recovery (EIU, 2007c). However, it is forecast that the long-run impacts of the coup will result in some 8% contraction in Fiji's real GDP (Narayan and Prasad, 2007). In the short term, FDI is expected to decline, although not nearly as much as the 33% decline in the aftermath of the 2000 coup. The interim Government has set up an inter-agency FDI taskforce to ensure that existing investment projects are implemented, but investors' confidence seems to recover only after a politically stable environment is re-established. In the Solomon Islands, after elections in April 2006, riots led to several business owners fleeing the capital. Tonga also witnessed violence, which led to the destruction of 80% of the capital's business district (EIU, 2007d).

85 Oil Search Ltd. was incorporated in Papua New Guinea in 1929 and is listed on the Australian Stock Exchange, with the Government of Papua New Guinea as the principal shareholder (of about 18%).

86 Bermuda is no longer included in this region, as it is now classified under developed countries.

87 For the Homeland Investment Act, see *WIR06*: 89.

88 Although this ratio must be interpreted with caution because data on FDI and M&As are not quite comparable (see *WIR00*), it is however a good barometer of the relative importance of M&As as a mode of FDI.

89 In 2006, the purchase by TNCs of local assets owned by foreign affiliates surged by 183 % while that of local assets owned by nationals decreased by 22 %. Both transactions are recorded as cross-border M&As (*source*: UNCTAD, cross-border M&As database (www.unctad.org/fdistatistics)).

90 Reinvested earnings are recorded both in the current account of the balance of payments (as being paid to the direct investor as investment income) and in the capital account (as being reinvested in the enterprise as FDI inflows).

91 Data on reinvested earnings in 2006 are available for Argentina, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Uruguay and Venezuela. These countries received 57% of the total inward FDI to South America in 2006.

92 *Source*: Central Bank of Costa Rica and Central Bank of the Dominican Republic.

93 Including offshore financial centres, outflows increased by 37%, to $49 billion.

94 *Source*: Central Bank of Brazil.

95 *Alexander's Gas & Oil Connections*, Vol. 10, No. 18, 28 September 2005*; América Economía.com,* Edición 342, 29 June 2007, and PDVSA (www.pdvsa.com).

96 *Business Latin America*, 22 January 2007 (London: EIU).

[97] *Business Latin America*, 29 January 2007 (London: EIU), *Business Latin America*, 30 October 2006 (London: EIU), and *Mercopress*, 8 March 2007 (www.mercopress.com).

[98] Banco de la República, Subgerencia de Estudios Económicos, at: www.banrep.gov.co/economia/flujos/flujoinv.xls.

[99] *Sources*: for Chile, Comisión Chilena del Cobre (Cochilco) (www.cochilco.cl) (the amount does not include investments in exploration and in routine maintenance); for Colombia, Banco de la República, *Subgerencia de Estudios Económicos*, at: www.banrep.gov.co/economia/flujos/flujoinv.xls; for Peru, *Proinversión*, 2007 and *Business Latin America*, 23 April 2007 (London: EIU); for Bolivia, *Business Latin America*, 15 January 2007 (London: EIU); for Guyana, *Business Latin America*, 30 October 2007 (London: EIU); for Suriname, *Business Latin America*, 31 July 2006 (London: EIU).

[100] *Sources: Business Latin America*, 18 September 2006, 14 August 2006 and 9 October 2006 (London: EIU); and www.thyssenkrupp-steel.com.

[101] In 2007 Nissan began using its Mexican operations to supply cars to 18 European countries. Volkswagen is another automaker that exports to Europe from its Mexican factory ("Horisly's space", *Automotive News*, 9 April 2007, at: http://horisly.blogspot.com/2007/04/nissan-to-supply-europe-from-mexico.html).

[102] ADEFA, *Press Release*, December 2006 and *Página 12*, 1 October 2006.

[103] Including FDI in automotive engines and other transportation equipments *(source*: Banco Central do Brasil).

[104] Fiat is proceeding with a $1.4 billion modernization plan for its operations in Brazil that will extend until 2008. General Motors has announced it might double its annual investment of $500 million by the end of the decade if GDP growth in Brazil improves. Ford has unveiled plans to invest $1 billion by 2011, and Volkswagen (Germany) intends to invest $1.2 billion by 2012 (*Business Latin America*, 22 January 2007 (London: EIU)). However, Volkswagen plans to phase out exports of its Fox model from Brazil to Europe, and will supply it at a lower cost from the Russian Federation (*Business Latin America*, 2 October 2006 (London: EIU)).

[105] Mexico's share in total apparel exports to the United States fell from 8.8% in 2005 to 7.4% in 2006, and that of DR-CAFTA countries from 14% to 12.5%. In contrast, the share of China, for example, increased from 22% to 25.9%, and that of Indonesia from 4.2% to 5.1%.

[106] Examples include the acquisition of Verizon's (United States) assets in the Dominican Republic by América Móvil for $2.1 billion, Telmex's acquisition of shares in Embratel (Brazil) for $809 million, and the acquisition of the Brazilian Tevecap (cable TV) by Telefónica for $467 billion.

[107] Verizon sold its assets in Venezuela to the State and its assets in the Dominican Republic to América Móvil (Mexico), while Telecom Italia sold its assets in Venezuela to the local group Cisneros.

[108] *Reuters América Latina*, 10 May 2007, and *Business Latin America*, 15 January 2007 (London: EIU).

[109] *Business Latin America*, 30 October 2006 and 29 January 2007 (London: EIU).

[110] *Clarín*, 9 January 2007 (www.clarin.com.ar), *Business Latin America*, 7 August 2005, 13 November 2006 and 25 December 2006 (London: EIU).

[111] *Business Latin America*, 25 December 2006 and 29 January 2007 (London: EIU).

[112] *Business Latin America*, 22 January 2007 and 27 November 2006 (London: EIU).

[113] The accord with China has already been implemented, but it does not include chapters on services and investments.

[114] The region is expected to achieve a GDP growth rate of 4.7% in 2007 (UNCTAD, 2007). Regarding prospects for commodity prices, see chapter III of this *WIR.*

[115] In addition to the sale of the local assets of AES and CMS (both United States companies) to the Government of Venezuela, CMS announced that it would sell its assets in Brazil, and Union Fenosa (Spain) announced plans to sell its assets in Nicaragua back to the State. In the telecom sector, Verizon (United States) agreed to sell its assets in Venezuela to the Government.

[116] *Source*: Central Bank of Brazil.

[117] Bulgaria and Romania which became new EU member States on 1 January 2007 are classified under South-East Europe and CIS in this Report. For more on geographical grouping, see *WIR06*, p 6.

[118] In 2006, the $4.7 billion purchase of Banca Comerciala Romana by the Austrian bank Erste Bank was the largest deal in the country so far (annex table A.I.3).

[119] For more on the rise of Russian TNCs, see Kalotay, 2007.

[120] *Source:* UNCTAD cross-border M&A database. Cross-border M&As of foreign affiliates in 2006 included the acquisition in Croatia by Société Générale (France) of HVB Splitska owned by Unicredito Italiano for $1.2 billion, and in Ukraine, the merger of the affiliate of OTP Bank (Hungary) with the affiliate of Raiffeisen Bank (Austria) for $833 million.

[121] In March 2006 the Government of the Russian Federation released a preliminary list of 39 industries deemed to be strategic, including energy and metals.

[122] In June 2007, TNK-BP, agreed to cede its controlling 62.9 % stake in the vast Siberian Kovytka gas field to Gazprom ("BP submits to Kremlin pressure and hands Kovytka to Gazprom" *Financial Times*, 23 June 2007).

[123] The sale of PetroKazakhstan to CNPC, a Chinese State-owned oil company (*WIR06*: 58) was allowed to go through only after CNPC agreed to sell a 33% stake in PetroKazakhstan to State-owned KazMunaiGaz.

[124] "Mining groups feel the heat in central Asia", *Financial Times*, 2 August 2006.

[125] However in some countries such as Romania the previous privatization deals were disputed (see Hunya, 2007 for the Petrom privatization-related dispute).

[126] In Serbia, for instance, a new Free Zone Law was enacted, while in Albania, in 2006, an initiative "Albania one Euro" was launched to attract foreign investors especially in energy generation. For more on this latter initiative, see: http://www.albinvest.gov.al/dokumenti.asp?id=304&menu=96.

[127] For example, in July 2007 the French oil company Total agreed to form a consortium with Gazprom to develop one of the world's largest natural gas deposits (see "Gazprom and Total strike a deal on gas", *International Herald Tribune*, 13 July 2007).

[128] In the survey, Romania and Bulgaria were not included as part of the South-East Europe and CIS region.

[129] For example, Teva Pharma Inds Ltd (Israel) bought Ivax Corp for $7.4 billion, and Novartis AG (Switzerland) acquired Chiron Corp. for $6.2 billion.

[130] For example, Telefonica (Spain) acquired O2 Plc for $31.7 billion, Ferrovial (Spain) bought a 14% stake in airports operator BAA for $21.8 billion, and Linde AG (Germany) acquired BOC Group Plc for $14.1 billion (annex table A.I.3).

[131] "Coordination centre" status is granted by Royal decree to very large industrial conglomerates which meet certain criteria. Multinational companies with coordination centre status, accounted for one third of Belgium's FDI inflows and 36% of its outward FDI in the period 1995-2005 (Piette, 2007). These conglomerates enjoy special fiscal advantages (e.g. although they pay normal Belgium corporate income tax rates of up to 33.99%, they are taxed on their trading profits at the rate of 4%-10% of their total "business expenses").

[132] For example, MOL (Hungary) sold a natural gas storage and wholesale trading business, to E.ON (Germany) for $1.3 billion, and the power generator, Slovenske Elektrarne (Slovenia), was taken over by Enel (Italy) for $1.1 billion (annex table A.I.3).

[133] For example the acquisition of Winthertur by AXA (France) "AXA buys Winterthur for Euro 7.9 billion" *Financial Times,* 15 June 2006.

[134] Vodafone bought TELSIM Mobil Telekomunikasyon in Turkey for $4.6 billion and VenFin Ltd. in South Africa for $2.9 billion; HSBC bank acquired Grupo Banistmo SA in Panama (annex table A.I.3).

[135] Major deals included the following: Japan Tobacco acquired Gallagher (United Kingdom) for $14.7 billion in what was not only the largest acquisition in the tobacco industry, but also the largest foreign takeover by a Japanese manufacturing company. The deal was recorded in 2007 ("Buying overseas: executives

discover that the developed world is their oyster", *Financial Times*, 13 March 2007). Toshiba bought Westinghouse Electric Co. (United States) for $5.4 billion, and Nippon Sheet Glass Co Ltd. acquired Pilkington PLC (United Kingdom) for $3 billion.

136 In 2006, two large acquisitions took place in telecommunications, that of the United Kingdom firm O2 PLC by Spain's Telefonica, and Lucent Technologies by France's Alcatel.

137 For instance, Ford (United States) announced that it would invest up to $1.8 billion over the next six years in its R&D projects in the United Kingdom, while Novartis (Switzerland) plans to create a research facility with 400 scientists in China ("Ford to invest £1 billion in UK R&D", *Financial Times,* 17 July 2006 and "Novartis in China R&D push", *Financial Times,* 3 November 2006).

138 For example, in 2006 Morgan Stanley opened a Business Services & Technology Centre in Budapest (Hungary) ("Eastern Europe becomes a centre of outsourcing", *The New York Times*, 19 April, 2007).

139 *Source*: UNCTAD, database on national laws and regulations.

140 The Austrian Government sold, through an initial public offering (IPO), a 49% stake in the previously 100% State-owned mail service provider, Österreichische Post, while in Portugal, the Government sold, through an IPO in October 2006, 25% of Galp Energia, a large State-owned oil and gas utility. The French Government announced the partial privatization of Gaz de France and the State-owned Aéroports de Paris, and, similarly, the Irish Government announced the offering of a major part of the State-owned national airline, Aer Lingus, to private investors.

141 This is further stimulated by a tax deferral, as shareholders of Japanese acquired firms receiving new shares do not necessarily pay the tax at the time of receipt of the shares. However, stock-swapping M&As by foreign companies are allowed only when their affiliates in Japan make deals on behalf of their parent firms.

142 "Business in Austria: not so welcome in Vienna", *The Economist*, 31 March 2007.

143 The so-called "Volkswagen Law" prevents mergers and investment in Volkswagen, the largest carmaker in the EU, as it caps voting rights and limits board seats at Volkswagen.

144 In addition to the Economic Report of the President, the Department of Commerce launched the *Invest in America* initiative in March 2007. This initiative will reach out to the international investment community, serving as ombudsman in Washington, DC, for the concerns of the international investment community, and will support state and local governments engaged in foreign investment promotion ("Commerce to launch new Federal Initiative to attract foreign investment", *Press Release* 7 March 2007, Department of Commerce, Washington, DC).

145 The Sarbanes-Oxley Act is a federal law in the United States which establishes new and enhanced standards for all United States public company boards, management and public accounting firms.

146 The new EU-12 group comprises the 10 members that joined the EU in 2004, plus Romania and Bulgaria that joined in 2007.

147 In the 10th Annual Global CEO Survey, 43% of the CEOs preferred Europe as their M&A destination, followed by Asia and then North America (PricewaterhouseCoopers, 2007a); a survey by Ernst and Young indicated that Western Europe maintained its lead as the most attractive global investment region with the United States second, and five countries in Europe figured among the global top 10, and Poland and the Czech Republic ranked 7th and 10th respectively (Ernst and Young, 2007).