PART ONE

RECORD FLOWS IN 2007, BUT SET TO DECLINE

CHAPTER I

GLOBAL TRENDS

Globally, foreign direct investment (FDI) inflows continued to rise in 2007: at $1,833 billion, they reached a new record level, surpassing the previous peak of 2000. The financial and credit crisis, which began to affect several economies in late 2007, did not have a significant impact on the volume of FDI inflows that year, but it has added new uncertainties and risks to the world economy. This may have a dampening effect on global FDI in 2008-2009. At the same time, the global FDI market is in a state of flux, making it difficult to predict future flows with any precision.

This chapter examines recent trends in global FDI, cross-border mergers and acquisitions (M&As) and international production. Section A describes their changing geographical and industrial distribution, the relative positions of countries in terms of their transnationalization and inward FDI performance, and recent developments in FDI policies. Section B focuses on the impact of financial crisis that erupted in 2007 and on the depreciation of the dollar on FDI flows. Section C sheds new light on the rise of sovereign wealth funds as direct investors, and section D presents UNCTAD's latest ranking of the world's largest transnational corporations (TNCs). The final section discusses the prospects for FDI, drawing on an UNCTAD survey of 226 large TNCs.

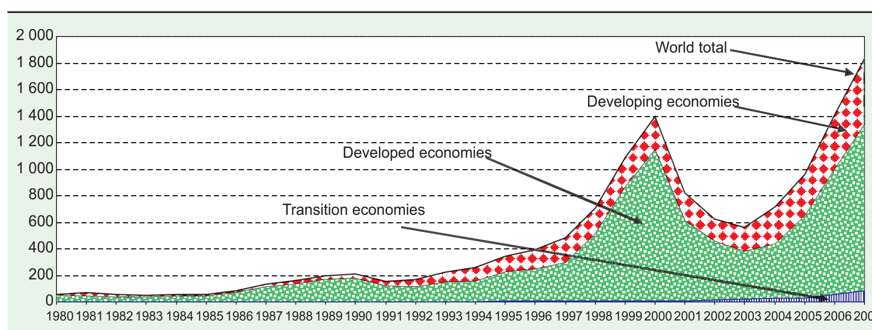
A. FDI and international production

1. Recent trends in FDI

a. Overall trends

Global FDI reached a new record high in 2007, reflecting the fourth consecutive year of growth. With inflows of $1,833 billion, the previous record set in 2000 was surpassed by some $400 billion (figure I.1). All the three major groups of economies – developed countries, developing countries and the transition economies of South-East Europe (SEE) and the Commonwealth of Independent States (CIS) – saw continued growth in FDI.

Figure I.1. FDI inflows: global and by groups of economies, 1980–2007
(Billions of dollars)



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

Since the *WIR* reports the value and growth of FDI flows in United States dollars, their numbers in 2007 could be considered inflated to some extent, due to the significant depreciation of the dollar against other major currencies.[1] Growth rates of dollar-denominated global FDI flows in 2007 diverge from those denominated in local currencies under the current exchange-rate realignment: if denominated in countries' own currencies, the average growth rate of global FDI flows would be 23% in 2006–2007, which is 7% lower than when flows are denominated in United States dollars (table I.1). In all regions and subregions except Central America, FDI inflows grew less in local-currency terms than in dollar terms. The difference was particularly pronounced in the euro zone in 2006–2007, given that the dollar hit a record low against the euro. A similar situation prevailed with respect to flows to South-East Asia, where many Asian currencies (e.g. Malaysian ringgit, Thai baht) appreciated considerably with respect to the dollar. That being said, estimates of global FDI flows in national currencies still point to an increase.

Table I.1. Growth rates of FDI flows denominated in (United States) dollars and in local currencies, 2006–2007
(Per cent)

Host economy	Growth rate of FDI flows denominated in dollars 2006	2007	Growth rate of FDI flows denominated in local currencies [a] 2006	2007
World	47.2	29.9	45.5	23.1
Developed economies	53.9	32.6	52.3	24.7
Europe	18.6	41.6	17.3	30.6
EU	12.8	43.0	11.5	31.6
Other developed Europe	421.5	19.9	430.1	14.4
North America	127.3	14.0	124.3	12.1
Developing economies	30.5	21.0	28.9	17.0
Africa	55.3	15.8	53.4	14.1
North Africa	89.2	-3.2	85.9	-5.7
Other Africa	31.2	35.3	30.4	34.4
Latin America	21.6	36.0	18.5	30.6
South America	-3.0	66.9	-7.8	54.9
Central America	1.8	26.6	0.0	27.2
Asia	29.9	17.0	28.9	13.1
West Asia	50.1	11.7	53.4	8.6
South, East and South-East Asia	24.8	18.6	22.6	14.5
East Asia	13.5	18.8	11.8	16.2
South Asia	112.4	18.8	117.5	11.1
South-East Asia	31.1	18.1	25.3	11.8
South-East Europe and CIS	84.6	50.3	78.9	42.2

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

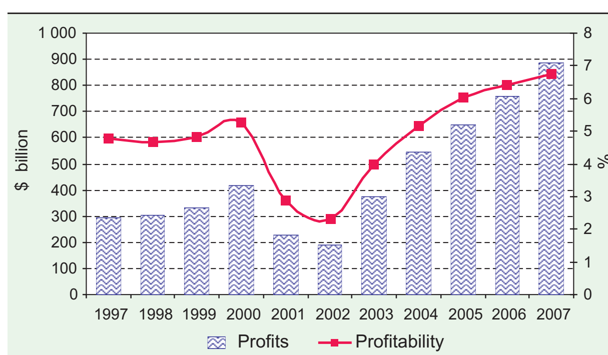
[a] Growth rates for world/region are weighted averages of country growth rates. The weight for each country is its share in the starting year in total FDI flows to the world/region denominated in dollars. Weighted growth rate for world/region is calculated using the following formula:

$$\frac{\sum_i weights_i * growth(x_i)}{\sum_i weights_i}$$

where the growth rate is calculated on the basis of FDI inflows denominated in local currencies.

The continued rise in FDI in 2007 largely reflected relatively high economic growth and strong economic performance in many parts of the world. Increased corporate profits of parent firms (figure I.2) provided funds to finance investment and reduced the impact of decreasing loans from the banks affected

Figure I.2. Profitability[a] and profit levels of TNCs, 1997–2007



Source: UNCTAD, based on data from Thomson One Banker.
[a] Profitability is calculated as the ratio of net income to total sales.

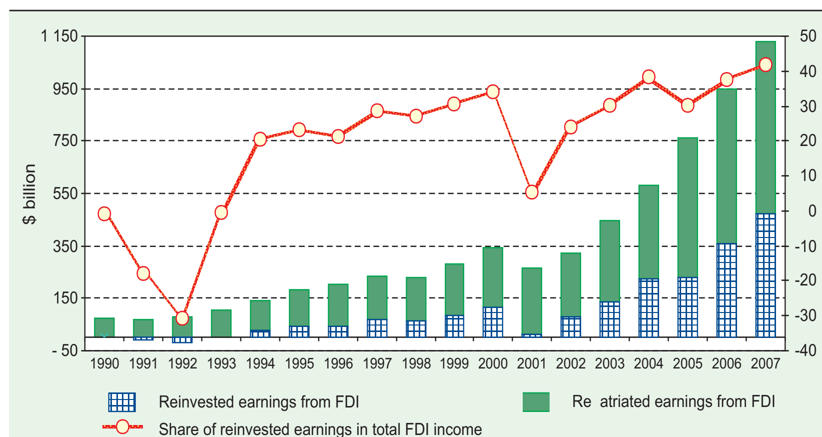
Note: The number of TNCs covered in this calculation is 989.

by the sub-prime credit crisis. In foreign affiliates, higher profits, amounting to over $1,100 billion in 2007 (figure I.3), contributed to higher reinvested earnings, which accounted for about 30% of total FDI flows in 2007 (figure I.4). These profits are increasingly generated in developing countries rather than in developed countries.[2]

The growth in FDI flows was also driven by cross-border M&A activity (figure I.5), which expanded in scope across countries and sectors. Its strong growth and a record number of mega deals (i.e. deals with a transaction value of over $1 billion) (table I.2) pushed the value of total cross-border M&As to a record $1,637 billion in 2007 (annex tables B.4 and B.6) – 21% higher than even the value in 2000 (figure I.5). The number of such transactions grew by 12% to 10,145 (annex tables B.5 and B.7). While the value of cross-border M&As does not exactly match the value of FDI flows, due to different data collection and reporting methodologies (*WIR00*), UNCTAD's revamping of its database and redefining of "cross-border" (box I.1) should improve the relevance of these data from an FDI perspective.

In addition, large TNCs in most industries remained in good financial health, reporting rising profits. In the financial industry, however, liquidity problems of several transnational banks spurred further consolidation, with participation by a number of sovereign wealth funds (SWFs). Meanwhile, the number of greenfield FDI projects decreased from 12,441 in 2006 to 11,703 in 2007 (annex tables A.I.1-A.I.2).[3]

Figure I.3. Worldwide income on FDI and reinvested earnings, 1990–2007

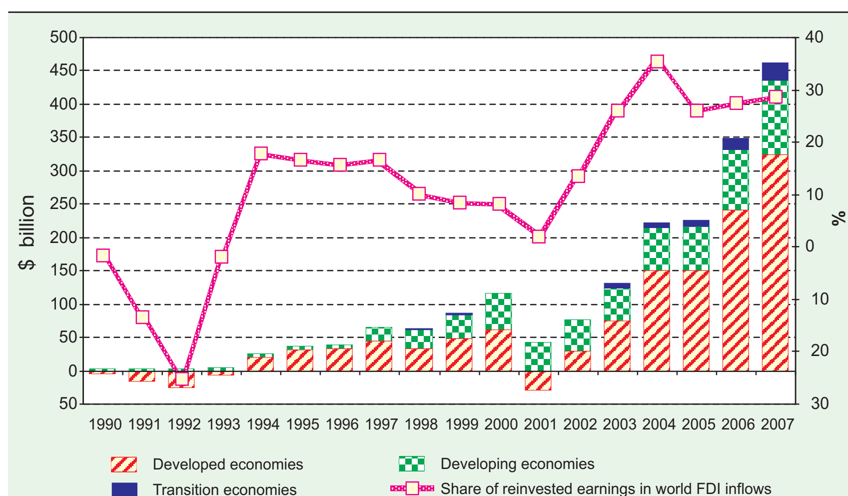


Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

Overall, the financial crisis that began in the second half of 2007 in the United States sub-prime mortgage market did not exert a visible dampening effect on global cross-border M&As that year. The largest deal in 2007, and the largest in banking history – the acquisition of ABN-AMRO Holding NV by the consortium of Royal Bank of Scotland, Fortis and Santander through RFS Holdings BV – took place in late 2007. This period also saw other major mega deals, including the second largest cross-border M&A, which was between Alcan (Canada) and Rio Tinto (United Kingdom) (annex table A.I.3).

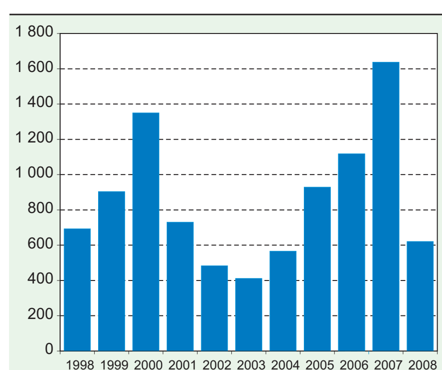
The growth of cross-border M&A activity in recent years, including 2007, was due to sustained strong economic growth in most regions of the world, high corporate profits and competitive pressures that motivated TNCs to strengthen their competitiveness by acquiring foreign firms. In addition, financing conditions for debt-financed M&As were relatively favourable. Despite a change in lending behaviour since mid-2007, caused by a general reassessment of credit risk, the growth of cross-border M&As in the second half of 2007 reached a peak of $879 billion. This was essentially due to the completion of large deals, many of which had begun earlier. More cautious lending behaviour of banks hampered M&A financing in the first half of 2008 (figure I.5), especially the financing of larger acquisitions, which plummeted to their lowest semi-annual level since the first half of 2006. The number of greenfield projects remained almost at the same level in the first quarter of 2008 as in the previous quarter.

Figure I.4. Reinvested earnings of TNCs: value and share in total FDI inflows, 1990–2007



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

Figure I.5. Value of cross-border M&As, 1998–2008
(Billions of dollars)



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

Note: Data for 2008 are only for the first half of the year.

However, the current crisis has led to a liquidity crisis in money and debt markets in many developed countries. This liquidity crisis has begun to depress the M&A business in 2008, especially leveraged buyout transactions (LBOs), which normally involve private equity funds. Indeed, the buyout activities by private equity funds, a major driver of cross-border M&As in recent years, are currently slowing down. This contrasts with the situation in

Table I.2. Cross-border M&As valued at over $1 billion, 1987–2008[a]

Year	Number of deals	Percentage of total	Value ($ billion)	Percentage of total
1987	19	1.6	39.1	40.1
1988	24	1.3	53.2	38.7
1989	31	1.1	68.2	40.8
1990	48	1.4	83.7	41.7
1991	13	0.3	31.5	27.0
1992	12	0.3	23.8	21.0
1993	18	0.5	37.7	30.5
1994	36	0.8	72.6	42.5
1995	44	0.8	97.1	41.9
1996	48	0.8	100.2	37.9
1997	73	1.1	146.2	39.4
1998	111	1.4	408.8	59.0
1999	137	1.5	578.4	64.0
2000	207	2.1	999.0	74.0
2001	137	1.7	451.0	61.7
2002	105	1.6	265.7	55.0
2003	78	1.2	184.2	44.8
2004	111	1.5	291.3	51.5
2005	182	2.1	569.4	61.3
2006	215	2.4	711.2	63.6
2007	300	3.0	1 161	70.9
Q1	*54*	*2.1*	*153.7*	*53.7*
Q2	*98*	*3.7*	*359.4*	*76.1*
Q3	*73*	*2.9*	*251.3*	*67.1*
Q4	*75*	*3.1*	*396.9*	*78.7*
2008 [a]	137	3.1	439.4	70.7
Q1	*77*	*3.3*	*259.7*	*73.8*
Q2	*60*	*2.9*	*179.7*	*66.6*

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

[a] First half only.

2007: cross-border M&As involving such funds almost doubled, to $461 billion – the highest share observed to date, accounting for over one quarter of the value of worldwide M&As (table I.3).

With the size of the funds growing, private equity investors have been buying larger, and also publicly listed, companies. Some factors have emerged that raise doubts about the sustainability of FDI activity by private equity funds (*WIR07*). These include a review of the favourable tax rates offered to private equity firms by authorities in some countries and the risks associated with the financial behaviour (e.g. high leverage) of such firms, particularly because of concerns about the availability and cost of credit in the aftermath of the sub-prime mortgage crisis. They also include an ongoing debate in some countries about possible regulation of private equity market participants.[4] An increased regulatory burden could cause the private equity industry to stay away or migrate to more lightly regulated jurisdictions.

Weakened private equity activity reduces the overall amount of FDI in host economies, as such equity can supplement investments by TNCs. In host developing countries, private equity can contribute to the development of a capital market and an equity culture. Such a culture is lacking in many developing-country markets where family-owned and State-owned businesses are dominant. The development of an equity culture can bring in additional capital and lower the cost of funds. From this point of view, the decrease in FDI by private equity funds in 2008 (table I.3) reduces the scope of development of equity markets. However, as long as this slowdown is due to the reduced availability of credit and its increased cost, rather than to tightened regulations, private equity funds are likely to rebound once the financial markets recover, and they should continue to be important direct investors.

Through its dampening effects on cross-border M&As, the decline of buyout transactions in the current financial market crisis is likely to have depressed FDI flows in the beginning of 2008.[5] It is difficult for private equity firms to obtain necessary loan commitments from banks for highly leveraged buyouts. While they raised a new record amount of funds totalling $543 billion in 2007 (Private Equity Intelligence, 2007), their fundraising in the latter half of 2007 declined by 19%, to $254 billion, compared to the first half of that year. However, the decline can be seen as a normalization or return to a more sound and much more sustainable situation (IMF, 2007; ECB, 2007), and a shift towards distressed debt and infrastructure funds from buyout funds. Several institutions had warned for some time that the credit standards for corporate credits, particularly for highly leveraged buyout loans, were too loose and could represent a danger for the financial system.

Table I.3. Cross-border M&As by private equity firms and hedge funds, 1987–2008 [a]
(Number of deals and value)

	Number of deals		Value	
Year	Number	Share in total (%)	$ billion	Share in total (%)
1987	158	13.5	13.4	13.7
1988	203	10.8	12.6	9.2
1989	292	10.7	26.2	15.7
1990	531	15.8	41.0	20.5
1991	648	16.6	28.1	24.0
1992	652	17.5	34.9	30.9
1993	707	17.8	45.3	36.7
1994	720	15.8	35.5	20.8
1995	722	13.1	33.6	14.5
1996	715	12.2	44.0	16.6
1997	782	11.6	55.4	14.9
1998	906	11.3	77.9	11.2
1999	1 147	12.7	86.9	9.6
2000	1 208	12.0	91.6	6.8
2001	1 125	13.9	87.8	12.0
2002	1 126	17.2	84.7	17.5
2003	1 296	19.6	109.9	26.7
2004	1 613	22.2	173.7	30.7
2005	1 707	19.9	211.0	22.7
2006	1 649	18.2	282.6	25.3
2007	1 813	17.9	461.0	28.2
Q1	*441*	*17.1*	*75.1*	*26.2*
Q2	*520*	*19.7*	*181.8*	*38.5*
Q3	*417*	*16.6*	*115.4*	*30.8*
Q4	*435*	*18.0*	*88.8*	*17.6*
2008 [a]	715	16.4	193.7	31.2
Q1	*338*	*16.8*	*131.5*	*37.4*
Q2	*327*	*15.9*	*62.2*	*23.1*

Source: UNCTAD cross-border M&As database.

[a] First half only.

Note: Private equity firms and hedge funds refer to acquirers whose industry is classified under "investors not elsewhere classified". This classification is based on that used by the Thomson Finance database on M&As.

Box I.1. Revision of the UNCTAD database on cross-border M&As

Starting with this year's *WIR*, data on cross-border M&As have been revised to cover all cases for which at least one of the four entities (immediate acquiring company, immediate target company, ultimate acquiring company and ultimate target company) is located in an economy other than that of the other entities. Previously, and including the data reported in *WIR07,* cross-border M&As were defined as those deals in which the target company was not located in the same country as the ultimate acquiring company. The data therefore excluded the following kinds of deals: (a) deals where the acquiring domestic company is located in the same country as the acquired foreign company (referred to as case 2 in annex table A.I.4); and (b) deals where the ultimate acquiring foreign company is located in the same country as the acquired domestic company (referred to as case 9). These cases were not considered "cross-border" in the M&A database, even if the economy of the ultimate target company was different from that of the ultimate acquiring company (case 2). (For a brief description of all 11 cases, see annex table A.I.4.) Indeed, there were many transactions categorized under case 2 in Latin America, and these have become an important element of the FDI trend in the region (see section on Latin America and the Caribbean in Chapter II).

International standards for reporting FDI data, as compiled for balance-of-payments purposes, recommend that data be compiled also on the basis of ultimate host and home economy in addition to those on the immediate basis (paragraph 346 of OECD's Benchmark Definition of FDI).[a] In reality, compilation based on immediate host and home economy is a common practice used in many countries. All transactions between the direct investor (parent firm) and the direct investment enterprise (foreign affiliate) are recorded as either assets or liabilities in balance-of-payments transactions. Following this recommendation, on the ultimate host/home country basis, although they are undertaken within the same economy, the deals under cases 2, 3, 7 and 8 in annex table A.I.4 should be reflected in FDI flow data.[b] In the UNCTAD cross-border M&A database, all transactions are now recorded on the basis of ultimate host (target) and acquiring (home) country. Thus, for example, a deal in which an Argentine domestic company acquired a foreign company operating in Argentina, in the new system this deal is recorded showing Argentina as the acquiring country, and the foreign country is the target country.

The data on cross-border M&As presented in this *WIR* are not strictly comparable to those presented in previous *WIRs*, as there are significant differences in the total number and value of the deals included under the old and new methodologies.

Source: UNCTAD.

[a] "FDI statistics should be compiled by immediate partner country using the debtor/creditor principle… (I)n addition, it is strongly encouraged that supplemental inward FDI position statistics be compiled on an ultimate investing country basis" (OECD, 2008a, paragraph 346).

[b] Value of deals under case 2 would be recorded as negative FDI inflows to the host economy (i.e. the economy where the acquired firm is located or from which the sale takes place), while those under cases 3 and 8 would be recorded as (positive). In case 7, as the ultimate host and home country is the same, the value of the deal would be recorded as both divestment and new investment in this economy, and, overall, the net impact on the level of FDI in the host/home country is null.

b. Geographical patterns

Virtually all the major geographical regions registered record inflows as well as outflows in 2007. However, higher growth rates of FDI inflows to developed countries than to developing countries reduced the share of developing countries in FDI inflows from 29% to 27% (annex table B.1). Regarding outflows, the share of developing countries also declined from 16% to 13%. By contrast, the share of economies in transition (i.e. South-East Europe and CIS) rose for both inflows and outflows.

(i) Developed countries

FDI inflows into developed countries grew once again in 2007, for the fourth consecutive year, to reach $1,248 billion – 33% more than in 2006 (figure I.6; annex table B.1). Flows to the United Kingdom, France and the Netherlands were particularly buoyant. The United States maintained its position as the largest FDI recipient country, while the European Union (EU) as a whole continued to be the largest host region within the developed-country group, attracting almost two thirds of total FDI inflows to the group in 2007. The increase in FDI inflows to developed countries reflected relatively strong economic growth in those countries in 2007. Continued robust corporate profits and rising equity prices further stimulated cross-border M&As, particularly in the first half of 2007.

Outflows from developed countries in 2007 grew even faster than their inflows. They increased by 56% to the unprecedented level of $1,692 billion, exceeding inflows by $445 billion. The continued upswing of outward FDI was mainly driven by greater financial resources from high corporate profits (figure I.2). While the United States maintained its position as the largest source of FDI in 2007, outflows from the EU countries nearly doubled, to $1,142 billion.

The various risks prevailing in the world economy are likely to influence FDI flows to and from developed countries in 2008. High and volatile commodity prices and food prices may cause inflationary pressures, and a further tightening of financial market conditions cannot be excluded. The growing probability of a recession in the United

States and uncertainties about its global repercussions may cause investors to adopt a more cautious attitude (see section E below). These considerations point to a dimming of FDI prospects in developed countries.

(ii) Developing countries

FDI inflows into developing countries rose by 21% (figure I.6), to reach a new record level of $500 billion (chapter II). Those to least developed countries (LDCs) alone reached $13 billion, a 4% increase over the previous year.

- In *Africa*, FDI inflows in 2007 rose to a historic high of $53 billion. The inflows were supported by a continuing boom in global commodity markets. Cross-border M&As in the extraction industries and related services continued to be a significant source of FDI, in addition to new inbound M&A deals in the banking industry. Nigeria, Egypt, South Africa and Morocco were the largest recipients (chapter II). These cases may illustrate a trend towards greater diversification of inflows in some countries, away from traditional sectors (e.g. oil, gas and other primary commodities).
- FDI inflows to *South, East and South-East Asia, and Oceania* maintained their upward trend in 2007, reaching a new high of $249 billion, an increase of 18% over 2006. They accounted for half of all FDI to developing economies. At the subregional level, there was a further shift towards South and South-East Asia, although China and Hong Kong (China) remained the two largest FDI destinations in the region.
- In *West Asia*, overall, inward FDI increased by 12% to $71 billion, sustaining a period of steady growth in inflows. Turkey and the oil-rich Gulf States continued to attract the most FDI, but geopolitical uncertainty in parts of the region affected overall FDI. Saudi Arabia became the largest host economy in the region, overtaking Turkey.
- FDI inflows into *Latin America and the Caribbean* increased by 36%, to a record level of $126 billion. Significant increases were recorded in the region's major economies, especially Brazil and Chile where inflows doubled. Contrasting with the experience of the 1990s, the strong FDI growth was driven mainly by greenfield investments (new investments and expansion) rather than cross-border M&As. This pattern was the result of strong regional economic growth and high corporate profits due to rising commodity prices. Natural-resource-based manufacturing accounted for a large proportion of inward FDI to Brazil, for example.

FDI outflows from the developing world remained high in 2007 at $253 billion.

- More *African* TNCs expanded their activities within and outside the region, driving FDI outflows from the region to $7 billion on average in the past two years.
- *South, East and South-East Asia and Oceania*, with FDI outflows of $150 billion in 2007, has become a significant source of FDI, particularly for other developing countries both within and outside the region.
- With the doubling of FDI outflows from *West Asia* to $44 billion, this region remains an important source of FDI, led by the countries of the Gulf Cooperation Council (GCC). SWFs based in the subregion have also accounted for a major proportion of FDI.

Figure I.6. FDI flows, by region, 2005–2007
(Billions of dollars)

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

- FDI outflows from *Latin America and the Caribbean* fell by 17% in 2007, to around $52 billion. This was due to the decline in outflows from Brazil to $7 billion following the exceptionally high level of $28 billion reached in 2006.[6]

(iii) South-East Europe and CIS

FDI inflows into the transition economies of South-East Europe and CIS increased significantly by 50% to reach a new record of $86 billion in 2007 – the seventh year of uninterrupted growth of FDI flows to the region. Inflows to the region's largest recipient, the Russian Federation, rose by 62% (annex table B.1). Interest in the Russian Federation as an FDI destination does not seem to have been greatly affected by the tightening of Russian regulations relating to strategic industries, including natural resources, or by disputes over environmental protection and extraction costs. Thus, overall, FDI inflows into the region remained buoyant.

FDI outflows from South-East Europe and CIS also rose to record levels in 2007, reaching $51 billion – more than twice as high as the previous year. FDI from the Russian Federation reached a new high in 2007 ($46 billion).

c. Sectoral patterns

In recent years there has been a significant increase in FDI flows to the primary sector, mainly the extractive industries, and a consequent increase in the share of that sector in global FDI flows and stock (*WIR07*: 22 and annex tables A.I.5-A.I.8). The primary sector's share in world FDI is now back to a level comparable to that of the late 1980s. The services sector still accounts for the largest share of global FDI stocks and flows, while the share of manufacturing has continued to decline.

In 2006, the primary sector's share of the estimated total world inward FDI stock stood at 8%, and the sector accounted for 13% of world FDI inflows in the period 2004–2006. There has been some recent levelling off of FDI flows to the primary sector, as indicated by FDI flow data as well as data on cross-border M&As and greenfield investment projects. The value of cross-border M&As in the sector declined from $156 billion in 2005 to $109 billion in 2006, and recovered only partially (to $110 billion) in 2007 (annex table B.6). The increase in FDI in the primary sector in 2007 was more evident in greenfield investments. Their number rose from 463 in 2005 to 490 in 2006 and 605 in 2007 (annex table A.I.2).

Manufacturing accounted for nearly one third of the estimated world inward FDI stock in 2006, but for only a quarter of world FDI inflows in the period 2004–2006 (annex tables A.I.5 and A.I.7). Its share in world inward FDI stock has fallen noticeably since 1990 – in both developed and developing economies – declining by more than 10 percentage points. In 2007, there was a significant upsurge of cross-border M&As in manufacturing, with cross-border M&A deals in that sector rising by over 86%, compared with increases of 1% and 36% in the primary and services sectors respectively (annex table B.6).

The services sector accounted for 62% of estimated world inward FDI stock in 2006, up from 49% in 1990 (annex table A.I.5). Nearly all of the major service groups have benefited from the shift of FDI towards services that began more than a quarter century ago. In the case of some services, such as trade and financial services, the increase began well before 1990, when they accounted for 12% and 20%, respectively, of total inward FDI stock globally. While trade, financial services and business activities continue to account for the lion's share of FDI in the sector, other services, including infrastructure, have begun to attract increasing shares of FDI since the 1990s. For example, the value of cross-border M&As worldwide in electricity, gas and water rose from $63 billion (about 6% of total sales) in 2006 to $130 billion (nearly 8% of the total) in 2007 (annex table B.6). The slow but steady increase in the share of infrastructure industries in FDI, including in developing countries, raises questions as to how FDI can contribute to development in general and to progress towards meeting the Millennium Development Goals (MDGs), in particular, through more and better infrastructure services for the poor. These issues are examined in Part Two of this report.

2. International production

Indicators of international production, such as sales, value added, assets, employment and exports of foreign affiliates, enable a better assessment of the impact of FDI (table I.4). They throw direct light on host-country production activity associated with FDI worldwide, and the importance of foreign affiliates in the world economy. Today, an estimated 79,000 TNCs control some 790,000 foreign affiliates around the world (annex table A.I.9). Their production continues to grow. For example, the value-added activity (gross product) of foreign affiliates worldwide accounted for 11% of global GDP in 2007. Sales amounted to $31 trillion, about one fifth of which represented exports, and the number of employees reached 82 million.

However, the above discussion at the global level conceals country differences in international production as measured by various indicators. This is why, as of 2007, the *World Investment Report* (*WIR)* started to analyse one specific indicator of international production: employment in foreign

affiliates. This variable was examined to show the direct impact of FDI on host economies. This year's *WIR* considers another variable frequently used to examine the level of international production: sales of foreign affiliates.

Country-level data show significant differences between countries in the relationship between sales of foreign affiliates and inward FDI stock as well as affiliates' output (table I.5). They also show a noticeable difference between the three sectors: the ratio of sales to inward stock is generally the lowest in the primary sector, and the highest in manufacturing, while that for the services sector falls in between. Sales are generally 5-6 times higher than value added, but there are differences by sector, with a given amount of sales corresponding to more value added in manufacturing than in services. In Latvia, Slovakia and Slovenia, for example, manufacturing generates more value added than in other countries, judging from data on value added per dollar of FDI stock (table I.5). Country and/or sectoral differences reflect the nature of the sales data, which include value added in production in the host country as well as the value of purchased inputs (imported as well as domestic suppliers). Thus the implications of an increase or decrease in sales for host and home countries may differ somewhat, depending on which of the factors mentioned are relevant. An analysis with regard to exports should be also examined in this context.

The UNCTAD Transnationalization Index of host economies, incorporating both FDI and international production indicators (value added and employment), measures the extent to which a host country's economy is transnationalized (figure I.7). The ranking has not changed much over the years, with Belgium, Hong Kong (China) and the former Yugoslav Republic of Macedonia being the most transnationalized of the developed, developing and transition economies, respectively, in 2005 (the most recent year for which data are available).

3. Indices of FDI performance and potential

Since *WIR02*, UNCTAD has provided indicators to measure the amount of FDI countries

Table I.4. Selected indicators of FDI and international production, 1982–2007

Item	Value at current prices ($ billion)				Annual growth rate (Per cent)						
	1982	1990	2006	2007	1986-1990	1991-1995	1996-2000	2004	2005	2006	2007
FDI inflows	58	207	1 411	1 833	23.6	22.1	39.9	27.9	33.6	47.2	29.9
FDI outflows	27	239	1 323	1 997	25.9	16.5	36.1	63.5	-4.3	50.2	50.9
FDI inward stock	789	1 941	12 470	15 211	15.1	8.6	16.1	17.3	6.2	22.5	22.0
FDI outward stock	579	1 785	12 756	15 602	18.1	10.6	17.2	16.4	3.9	20.4	22.3
Income on inward FDI	44	74	950	1 128	10.2	35.3	13.1	31.3	31.1	24.3	18.7
Income on outward FDI	46	120	1 038	1 220	18.7	20.2	10.2	42.4	27.4	17.1	17.5
Cross-border M&As [a]	..	200	1 118	1 637	26.6[b]	19.5	51.5	37.6	64.2	20.3	46.4
Sales of foreign affiliates	2 741	6 126	25 844[c]	31 197[c]	19.3	8.8	8.4	15.0	1.8[c]	22.2[c]	20.7[c]
Gross product of foreign affiliates	676	1 501	5 049[d]	6 029[d]	17.0	6.7	7.3	15.9	5.9[d]	21.2[d]	19.4[d]
Total assets of foreign affiliates	2 206	6 036	55 818[e]	68 716[e]	17.7	13.7	19.3	-1.0	20.6[e]	18.6[e]	23.1[e]
Export of foreign affiliates	688	1 523	4 950[f]	5 714[f]	21.7	8.4	3.9	21.2	12.8[f]	15.2[f]	15.4[f]
Employment of foreign affiliates (thousands)	21 524	25 103	70 003[g]	81 615[g]	5.3	5.5	11.5	3.7	4.9[g]	21.6[g]	16.6[g]
GDP (in current prices)	12 083	22 163	48 925	54 568[h]	9.4	5.9	1.3	12.6	8.3	8.3	11.5
Gross fixed capital formation	2 798	5 102	10 922	12 356	10.0	5.4	1.1	15.2	12.5	10.9	13.1
Royalties and licence fee receipts	9	29	142	164	21.1	14.6	8.1	23.7	10.6	10.5	15.4
Exports of goods and non-factor services	2 395	4 417	14 848	17 138	11.6	7.9	3.8	21.2	12.8	15.2	15.4

Source: UNCTAD, based on its FDI/TNC database (www.unctad.org/fdi statistics), UNCTAD, *GlobStat*, and IMF, *International Financial Statistics*, June 2008.

[a] Data are only available from 1987 onward.

[b] 1987-1990 only.

[c] Data for 2006 and 2007 are based on the following regression result of sales against inward FDI stock (in $ million) for the period 1980-2005: sales=1 484.6302+1.9534* inward FDI stock.

[d] Data for 2006 and 2007 are based on the following regression result of gross product against inward FDI stock (in $ million) for the period 1982-2005: gross product=591.8813+0.3574* inward FDI stock.

[e] Data for 2006 and 2007 are based on the following regression result of assets against inward FDI stock (in $ million) for the period 1980-2005: assets= -2 874.9859+4.7066* inward FDI stock.

[f] For 1995-1997, based on the regression result of exports of foreign affiliates against inward FDI stock (in $ million) for the period 1982-1994: exports=138.9912+0.6414*FDI inward stock. For 1998-2007, the share of exports of foreign affiliates in world exports in 1988 (33%) was applied to obtain the value.

[g] Based on the following regression result of employment (in thousands) against inward FDI stock (in $ million) for the period 1980-2005: employment=1 7164.7284+4.2372* inward FDI stock.

[h] Based on data from the IMF, *World Economic Outlook*, April 2008.

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

receive or invest abroad relative to the size of their economies (Inward FDI Performance Index and Outward FDI Performance Index respectively), and their potential to attract FDI flows (Inward FDI Potential Index).[7] In 2007, among the top 20 economies listed by the Performance Indices for both inward and outward FDI, relatively small countries continued to rank high (table I.6; annex table A.I.10). The trend has not changed significantly over the past few years. Notable changes include the move upwards of Cyprus, Egypt and the Republic of Moldova among the top 20 rankings for inward FDI performance, and Austria, Denmark and the United Kingdom for outward FDI performance.

The ranking of countries according to the UNCTAD Performance and Potential Indices yields the following matrix: front-runners (i.e. countries with high FDI potential and performance); above potential (i.e. countries with low FDI potential but strong performance); below potential (i.e. countries with high FDI potential but low performance); and under-performers (i.e. countries with both low FDI potential and performance). In 2006 (not 2007 because of data limitations for deriving the Potential Index), Oman, Saudi Arabia, Sweden and Tunisia joined the group of front-runners, and Nigeria, Peru and Togo joined the above-potential group (figure I.8).

4. New developments in FDI policies

a. Developments at the national level

Despite growing concerns and political debate over rising protectionism,[8] the overall policy trend continues to be towards greater openness towards FDI. UNCTAD's annual survey of changes in national laws and regulations that may influence the entry and operations of TNCs suggests that policymakers are continuing to seek ways of making the investment climate in their countries more attractive. In 2007, only 98 policy changes that affect FDI were identified by UNCTAD – the lowest number since 1992. The nature of the changes was similar to that observed over the past few years: 24 of the 98 changes were less favourable, most of which were related to extractive industries or reflected national security concerns; the remaining 74 changes were in the direction of making the host-country environment more favourable to FDI (table I.7).

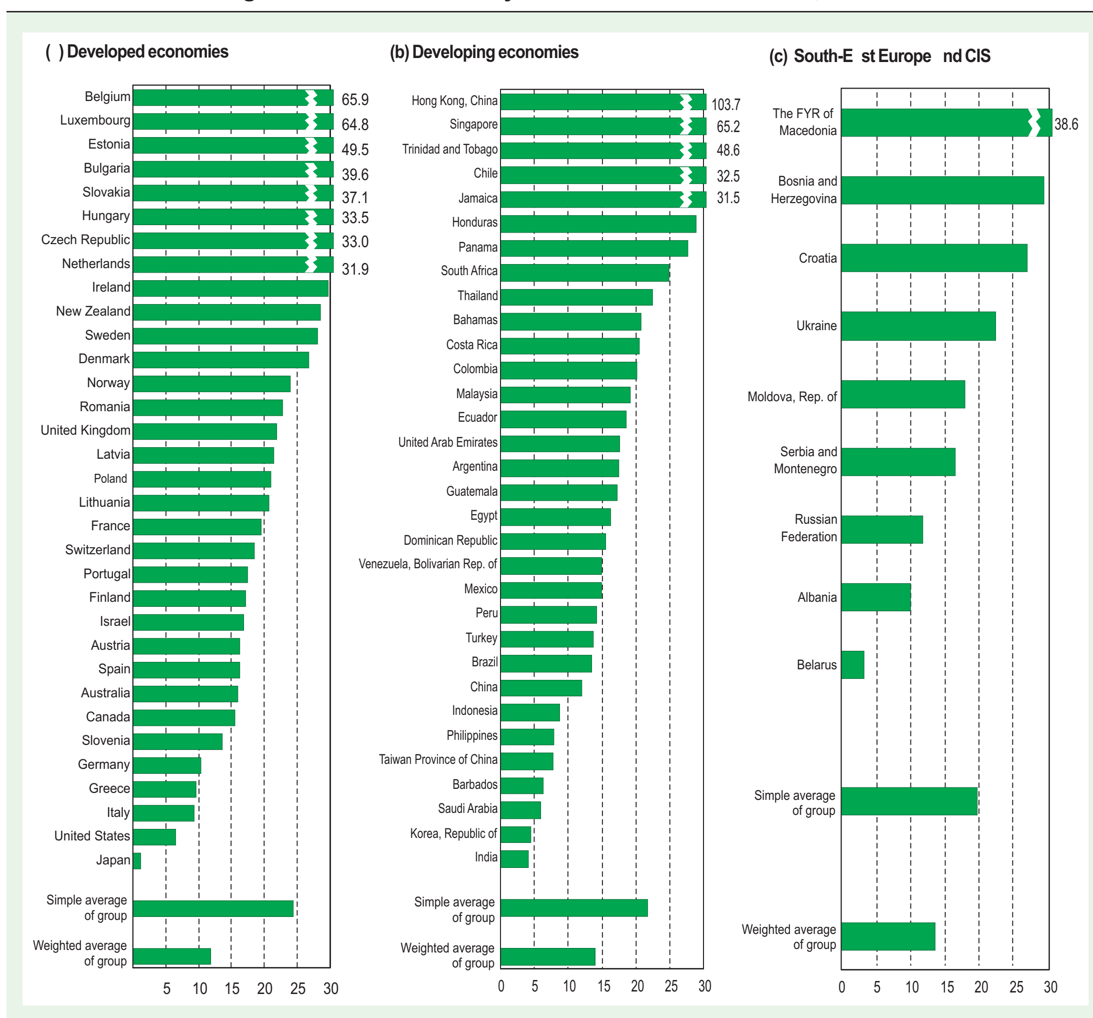
Many countries adopted new measures to attract FDI, such as offering various incentives or the establishment of special economic zones (SEZs). There was an ongoing trend to lower corporate income taxes in both developed and developing countries, and the number of countries with flat tax systems[9] continued to grow (table I.8). For example, while Iceland's corporate income tax rate has been cut steadily, from 50% in the late 1980s to the current level of 18%, in 2007 the country introduced a flat rate of

Table I.5. Sales and value added of foreign affiliates and inward FDI stock in host developing and former transition economies, most recent available year

Host economy	Year	Sector	Sales ($ million)	Value added ($ million)	Inward FDI stock ($ million)	Ratio of sales to inward FDI stock (in $)	Ratio of value added to inward FDI stock (in $)
Bulgaria	2004	Total	17 861	3 000	10 108	1.8	0.3
		Primary	..	..	156	..	..
		Manufacturing	8 593	1 387	2 611	3.3	0.5
		Services	9 269	1 613	7 263	1.3	0.2
China	2004	Total	698 718	..	245 467	2.8	..
		Primary	3 259	..	10 637	0.3	..
		Manufacturing	676 445	..	163 645	4.1	..
		Services	19 014	..	71 185	0.3	..
Czech Republic	2005	Total	112 535	22 347	60 662	1.9	0.4
		Primary	360	106	363	1.0	0.3
		Manufacturing	56 768	11 404	23 112	2.5	0.5
		Services	55 407	10 836	37 188	1.5	0.3
Estonia	2004	Total	8 362	1 789	10 064	0.8	0.2
		Primary	42	12	102	0.4	0.1
		Manufacturing	3 130	796	1 686	1.9	0.5
		Services	5 190	980	8 250	0.6	0.1
Hong Kong, China	2004	Total	232 772	45 760	453 060	0.5	0.1
		Manufacturing	9 362	2 051	8 836	1.1	0.2
		Services	223 399	43 707	435 890	0.5	0.1
Hungary	2005	Total	104 502	16 949	61 886	1.7	0.3
		Primary	..	45	271	..	0.2
		Manufacturing	56 583	11 525	22 847	2.5	0.5
		Services	47 919	5 379	31 116	1.5	0.2
Latvia	2004	Total	8 380	1 648	4 529	1.9	0.4
		Primary	..	..	97	..	..
		Manufacturing	1 402	420	534	2.6	0.8
		Services	6 978	1 228	3 382	2.1	0.4
Lithuania	2005	Total	14 008	2 444	8 211	1.7	0.3
		Primary	..	..	113	..	..
		Manufacturing	6 957	1 289	3 250	2.1	0.4
		Services	7 051	1 155	4 847	1.5	0.2
Romania	2005	Total	39 864	7 354	25 818	1.5	0.3
		Primary	..	..	1 890	..	..
		Manufacturing	17 999	3 427	9 638	1.9	0.4
		Services	21 865	3 926	14 106	1.6	0.3
Singapore	2002	Total	61 313	..	38 282	1.6	..
		Manufacturing	61 313	..	38 282	1.6	..
Slovakia	2005	Total	42 308	6 814	13 053	3.2	0.5
		Primary	..	..	138	..	..
		Manufacturing	26 719	4 605	5 235	5.1	0.9
		Services	15 589	2 209	7 680	2.0	0.3
Slovenia	2005	Total	14 954	1 735	7 055	2.1	0.2
		Primary	11	0	6	1.8	0.0
		Manufacturing	7 330	1 735	3 085	2.4	0.6
		Services	7 613	0	3 969	1.9	0.0

Source: UNCTAD, based on data from its FDI/TNC database (www.unctad.org/fdistatsitics) and data provided by Eurostat.

Figure I.7. Transnationality index[a] for host economies,[b] 2005



Source: UNCTAD estimates.

[a] Average of the four shares : FDI inflows as a percentage of gross fixed capital formation for the past three years 2003-2005; FDI inward stocks as a percentage of GDP in 2005; value added of foreign affiliates as a percentage of GDP in 2005; and employment of foreign affiliates as a percentage of total employment in 2005.

[b] Only the economies for which data for all of these four shares are available were selected. Data on value added were available only for Australia (2001), Austria (2003) Belarus (2002), Bulgaria, China (2003), Czech Republic, Estonia (2004), France, Hong Kong (China), Hungary, Italy (2004), Ireland (2001), Japan, Latvia (2004), Lithuania, Republic of Moldova, Netherlands (2004), Singapore (manufacturing only,2004), Portugal, Romania, Slovakia, Slovenia (2004), Spain, Sweden, and the United States. For Albania, the value added of foreign owned firms was estimated on the basis of the per capita inward FDI stocks and the corresponding ratio refers to 1999. For the other economies, data were estimated by applying the ratio of value added of United States affiliates to United States outward FDI stock to total inward FDI stock of the country. Data on employment were available only for Australia (2001), Austria (2003), Bulgaria, China (2004), Czech Republic, Estonia (2004), France (2003), Germany, Hungary, Hong Kong (China) (2004), Italy (2004), Ireland (2001), Japan, Latvia (2004), Lithuania, Luxembourg (2003), Netherlands (2004), Poland (2000), Portugal, Republic of Moldova (2004), Romania, Singapore (manufacturing only, 2004), Slovakia, Slovenia (2004), Spain, Sweden, Switzerland and the United States. For the remaining countries, data were estimated by applying the ratio of employment of Finnish, German, Japanese, Swedish, Swiss and United States affiliates to Finnish, German, Japanese, Swedish, Swiss and United States outward FDI stock to total inward FDI stock of the economy. Data for Ireland and the United States refer to majority-owned foreign affiliates only. Value added and employment ratios were taken from Eurostat for the following countries: Austria, Bulgaria, Czech Republic, Estonia, Finland, Hungary, Italy, Latvia, Lithuania, Netherlands, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.

10% on income from interest, dividends, capital gains and rents. Tax reductions were also implemented in Colombia (from 38.5% to 33%), Bulgaria (from 15% to 10%) and the former Yugoslav Republic of Macedonia (flat corporate income tax rate of 10%). Reduced corporate taxes are often justified by the need to stay competitive as locations for inward FDI.

Other countries introduced new promotional measures or improved their existing ones. In March 2007, for example, the United States Department of Commerce launched the Invest in America initiative, the first Federal-level plan to encourage foreign investment since the 1980s (chapter II.C).[10] Besides promoting the United States as an investment destination, it will serve as a contact point for international investors, and support State and municipal level efforts to attract inward FDI. Other countries, including Honduras, Peru and the Russian Federation, introduced special taxes and/or tariff regimes in SEZs and other zones. The overall trend towards providing more incentives to foreign investors was accompanied by continued liberalization of various economic activities, ranging from reinsurance services in Brazil to fixed-line telephony in Latvia.

As in 2006, the extractive industries represented the main exception to the liberalization

Table I.6. Top 20 rankings by Inward and Outward Performance Indices, 2006 and 2007 [a]

Inward FDI Performance Index ranking			Outward FDI Performance Index ranking		
Economy	**2006**	**2007**	**Economy**	**2006**	**2007**
Hong Kong, China	2	1	Luxembourg	3	1
Bulgaria	3	2	Iceland	1	2
Iceland	4	3	Hong Kong, China	2	3
Malta	5	4	Switzerland	4	4
Bahamas	8	5	Panama	5	5
Jordan	7	6	Belgium	7	6
Singapore	6	7	Netherlands	6	7
Estonia	9	8	Kuwait	12	8
Georgia	15	9	Bahrain	11	9
Lebanon	13	10	Singapore	8	10
Guyana	20	11	Ireland	9	11
Bahrain	12	12	Sweden	13	12
Belgium	10	13	Spain	14	13
Gambia	11	14	France	18	14
Panama	16	15	Estonia	17	15
Mongolia	19	16	United Kingdom	21	16
Tajikistan	18	17	Israel	15	17
Cyprus	24	18	Norway	16	18
Moldova, Republic of	27	19	Austria	23	19
Egypt	31	20	Denmark	33	20

Source: UNCTAD, annex table A.I.10.

[a] Countries are listed in the order of their 2007 rankings. Rankings based on indices derived using three-year moving averages of data on FDI flows and GDP for the three years immediately preceding the year in question including that year.

a review of all contracts relating to the exploitation of natural resources, ostensibly to ensure that licence terms were not being violated. As a result, foreign investors may face more onerous contract terms. However, to what extent these will deter prospective investors remains uncertain, given Kazakhstan's large oil resources and the high price of oil.

The nature and significance of other changes not favourable to FDI have varied. The most common reasons for countries' concerns over increased foreign ownership were related to national security, especially with regard to investments by SWFs and State-owned firms. For example, in the United States and the Russian Federation, stricter regulations were adopted concerning foreign investment projects with potential implications for national security. Reflecting the changing economic and political conditions in the world economy, the United States Government Accountability Office (GAO) reviewed this trend in a report covering 11 countries (box I.2) and concluded that "each country has changed or considered changing its foreign investment laws, policies, or processes in the last 4 years; many of the changes demonstrate an increased emphasis on national security concerns" (United States GAO, 2008: 3).

Figure I.8. Matrix of inward FDI performance and potential, 2006

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

Source: UNCTAD, based on annex table A.I.10.

trend (see *WIR07*). On the back of further increases in commodity prices, several natural-resource-exporting countries introduced new sectoral or ownership restrictions.[11] In Bolivia, the State-owned oil company, YPFB, reclaimed full control of two main oil refineries from Petrobras (Brazil). The Government also announced plans to increase taxes substantially on mining companies. Ecuador similarly raised the State's share of the profits gained in the hydrocarbons sector. Meanwhile, the Government of the Bolivarian Republic of Venezuela took control of a number of oil projects, including the Cerro Project, resulting in the filing of new claims by the foreign investor, ExxonMobil (United States).[12] While this trend was the most prominent in Latin America (*WIR07* and chapter II of this report), it was also evident elsewhere. In Kazakhstan, for example, the Government announced

The growing role of SWFs as overseas investors has triggered much policy discussion (section C). Germany has been actively working with the EU to establish rules for those funds at the European level. The main concern among some developed countries appears to be that the funds may buy stakes in strategic industries to gain access to and knowledge of latest

Table I.7. National regulatory changes, 1992–2007

Item	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Number of countries that introduced change	43	56	49	63	66	76	60	65	70	71	72	82	103	92	91	58
Number of regulatory changes	77	100	110	112	114	150	145	139	150	207	246	242	270	203	177	98
More favourable	77	99	108	106	98	134	136	130	147	193	234	218	234	162	142	74
Less favourable	0	1	2	6	16	16	9	9	3	14	12	24	36	41	35	24

Source: UNCTAD database on national laws and regulations.

technology (box I.2). In addition to the above national security concerns, resistance to investment in 2007 was also a response to planned takeovers of "national champions", as illustrated by the failed bid by E.ON (Germany) for the national utility company, Endesa (Spain).

Developed countries accounted for 36 of the identified regulatory changes (26 of which were in Europe), while in developing and transition economies, there were 15 identified changes in Africa, 14 in South, East and South-East Asia, 10 in Latin America and the Caribbean, 8 in West Asia, 8 in CIS and 7 in South-East Europe. A relatively high proportion of the observed regulatory changes were "less favourable" in Latin America and the Caribbean. This mainly reflected regulatory amendments (discussed above) for the extractive industries (figure I.9). Notable regional differences remain. FDI policy changes at the regional level are described in more detail in the respective regional trend sections in chapter II of this *WIR*.

Table I.8. Countries with a flat tax, 2007
(Percentage tax rate)

Economy	Individual	Corporate
Estonia	22	24
Georgia	12	20
Hong Kong (China)	16	17.5
Iceland	36	18
Kyrgyzstan	10	10
Latvia	25	15
Lithuania	27	15
Mongolia	10	25
Romania	16	16
Russian Federation	13	24
Slovakia	19	19
The FYR of Macedonia	12	10
Ukraine	15	25

Source: UNCTAD, based on Mitchell, 2007.

b. Developments at the international level

In 2007, the universe of international investment agreements (IIAs) continued to expand, with a marked variation among regions. Fewer bilateral investment treaties (BITs), double taxation treaties (DTTs) and other international agreements that include investment provisions were concluded than in previous years, particularly BITs.

(i) Bilateral investment treaties

In 2007, 44 new BITs were signed, bringing the total number of agreements to 2,608. The number of countries now parties to such agreements has reached 179 following the BIT concluded by Montenegro (its first BIT ever as an independent State) with the Netherlands (figure I.10).

Asian countries were the most active, concluding 29 new BITs. This confirms a sustained high level of commitment from policymakers in this region for closer economic integration and investment

Box I.2. FDI and national security: report of the United States Government Accountability Office

In February 2008, the United States Government Accountability Office (GAO) published a report that reviews the foreign investment regimes of 10 other countries.[a] The aim was to identify the mechanisms and criteria which countries use to balance the benefits of foreign investment with national security concerns, and to compare them with the United States.

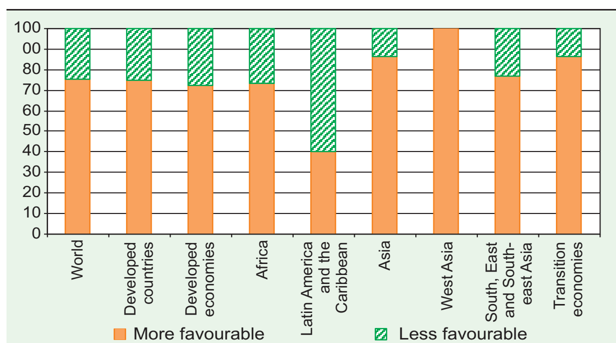
The GAO report concluded that all the countries reviewed had enacted laws and instituted policies regulating foreign investment, many to address national security concerns. However, each of the 11 countries had its own concept of national security that influenced what investments may be restricted. Restrictions ranged from requiring approval of investments in a narrowly defined defence sector, to broad restrictions based on economic security and cultural policy. In addition, some countries have recently made changes to their laws and policies to identify national security more explicitly as an area of concern, following some controversial investments. The report also noted that several countries had introduced lists of strategic sectors that required government review and approval.

Eight countries use a formal process to review transactions; only the Netherlands and the United Arab Emirates do not have a formal review process. The Netherlands, however, restricts entry into certain sectors such as public utilities, and the United Arab Emirates limits ownership in all sectors. During the formal review process, national security is a primary factor or one of several factors considered. All countries were reported to share concerns about a core set of issues, including, for example, the defence industrial base, and, more recently, investment in the energy sector and investment by State-owned enterprises and SWFs. Most countries have established time frames for the review and placed conditions on transactions prior to approval. For example, a country may have national citizenship requirements for company board members. Most countries' reviews are mandatory if the investment reaches a certain size, or if the buyer would achieve a controlling or blocking share in the acquired company. Five countries (France, Germany, India, Japan and the Russian Federation) allow decisions to be appealed through administrative means or in court. In addition to the formal mechanisms, there are unofficial factors that may influence investment in each of the 11 countries. For example, in some countries an informal pre-approval by the government may be needed for sensitive transactions.

Source: UNCTAD, based on United States GAO, 2008.

[a] The countries were Canada, China, France, Germany, India, Japan, the Netherlands, the Russian Federation, the United Arab Emirates and the United Kingdom.

Figure I.9. Regulatory changes, by nature and region, 2007
(Per cent)



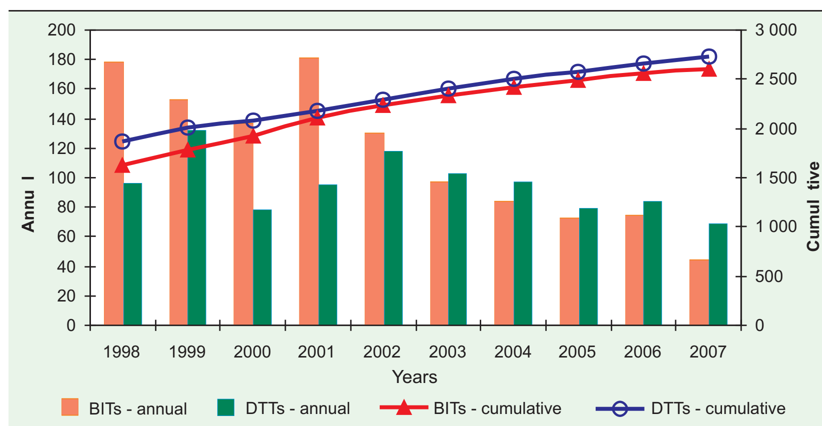
Source: UNCTAD database on national laws and regulations.

protection and liberalization. China, Oman and Qatar concluded the largest number of new agreements, with five BITs each in 2007. Asia and Oceania are now party to 41% of all BITs. *Developed countries* were involved in 25 of the new BITs and continue to figure prominently among the top 10 signatories of BITs (figure I.11). At the end of 2007, developed countries were involved in 60% of all BITs. Countries in *South-East Europe and CIS* signed 11 new BITs. With a total of 581 BITs concluded by end 2007, countries in this region were parties to 22% of all BITs. Countries in *Africa* concluded 11 new BITs in 2007. The least active region was *Latin America and the Caribbean* with only 4 new BITs. Noteworthy in this regard is that some countries of the region have withdrawn from the ICSID Convention (Bolivia), announced that consent to ICSID arbitration is no longer available for certain categories of disputes (Ecuador) or are considering such moves (Nicaragua, Bolivarian Republic of Venezuela) (Gaillard, 2008). Some countries in the region are also denouncing or renegotiating existing BITs.

With regard to developing countries, of the 44 new BITs signed in 2007, 13 were between developing countries, thus adding to the trend of enhanced South-South economic cooperation. South-South agreements now represent more than 27% of the total number of BITs (figure I.12). China alone accounts for a large share of these South-South agreements. In 2007, it concluded four new BITs with other developing countries. About 60% of the Chinese BITs concluded from 2002 to 2007 were with other developing countries, mainly in Africa.[13]

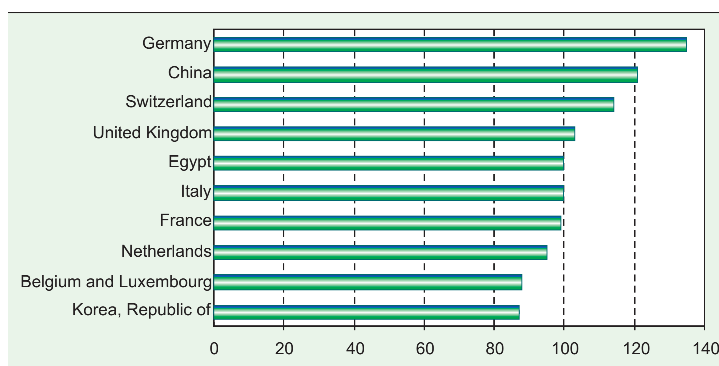
At the same time, a growing number of BITs are being renegotiated. In fact, as many as 10 of the 44 (23%) BITs signed in 2007 replaced earlier treaties. This brought the total number of renegotiated BITs to 121 at the end of 2007. To date, Germany has renegotiated the largest number of BITs (16), followed by China (15), Morocco (12) and Egypt (11). This number may rise, as many BITs are becoming relatively old, and more countries are revising their model BITs to reflect new concerns related, for example, to environmental and social issues, and the host country's right to regulate.[14] Environmental considerations are also featuring in negotiations of new BITs (e.g. one under way between Canada and China).[15] Furthermore, a growing number of recent agreements mark a step towards a better balancing of the rights of foreign investors, on the one hand, and respect for legitimate public concerns on the other.

Figure I.10. Number of BITs and DTTs concluded, annual and cumulative, 1998–2007



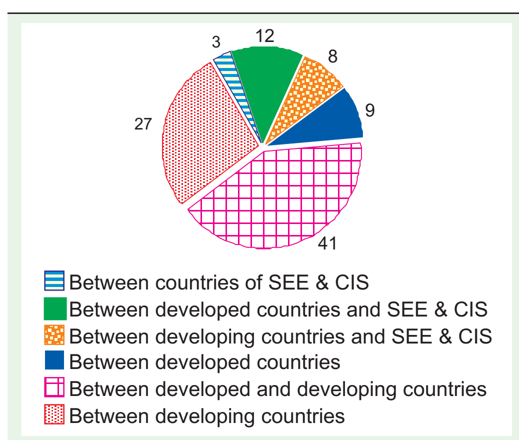
Source: UNCTAD (www.unctad.org/iia).

Figure I.11. Top 10 signatories of BITs by end 2007



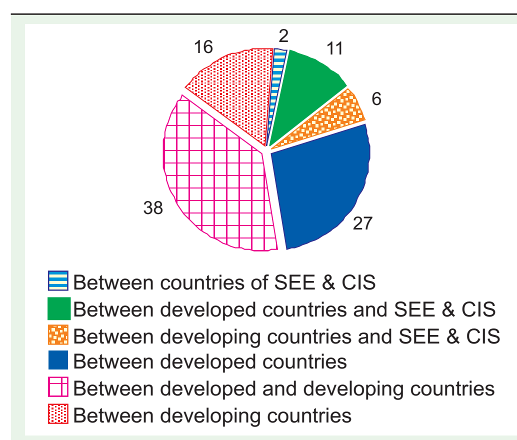
Source: UNCTAD (www.unctad.org/iia).

Figure I.12. Total number of BITs concluded at the end of 2007, by country group
(Per cent)



Source: UNCTAD (www.unctad.org/iia).

Figure I.13. Total number of DTTs concluded at the end of 2007, by country group
(Per cent)



Source: UNCTAD (www.unctad.org/iia).

(ii) Double taxation treaties

In 2007, 69 new double taxation treaties (DTTs) were concluded, bringing the total to 2,730 treaties (figure I.10). Developed countries are parties to 52 of them, and 17 of the new DTTs were between developed countries only. Belgium-Luxembourg was the most active with 7 new DTTs, followed by the United Kingdom and the United States (5 each). Developing countries were involved in 36 of the new DTTs, led by Saudi Arabia (5 new DTTs). Eight of the treaties signed in 2007 were among developing countries only. Those between developed and developing countries still account for the largest share (38%) of all the DTTs (figure I.13).

(iii) International investment agreements other than BITs and DTTs

During 2007, 12 IIAs other than BITs and DTTs were concluded, bringing the total of such agreements to 254.[16] Asian economies were among the most active (chapter II). In addition, at least 70 new IIAs other than BITs and DTTs were under negotiation at the end of 2007, involving 108 countries.

Most of the agreements concluded in 2007 establish binding obligations on the contracting parties concerning the admission and protection of foreign investment, in addition to a framework on investment promotion and cooperation. The scope of the protection commitments in the new free trade agreements (FTAs) is comparable to that found in BITs, including with regard to dispute settlement.

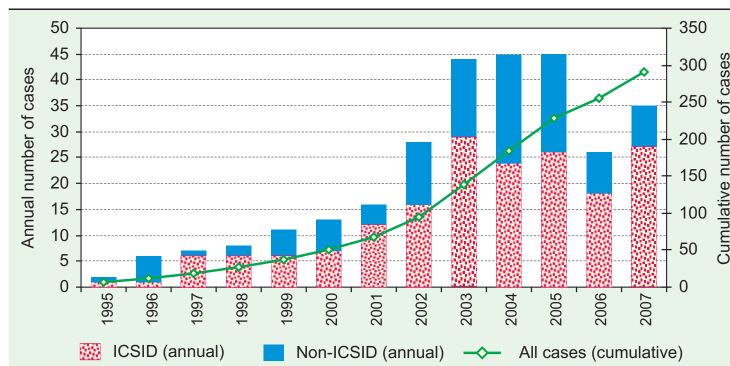
(iv) Investor-State dispute settlement

In parallel with the expanding universe of IIAs with investor protection provisions, the number of investor-State disputes has continued to rise. The cumulative number of known treaty-based cases had reached 288 at the end of 2007 (UNCTAD, 2008a) (figure I.14).[17] In 2007, at least 35 new treaty-based investor-State cases were filed, 27 of which were with the International Centre for Settlement of Investment Disputes (ICSID).[18] While this was a marked increase over 2006, when 26 cases were reported, it is below the peaks reached in 2003–2005. Since ICSID is the only arbitration facility to maintain a public registry, the real number of actual treaty-based cases is likely to be higher.

The rise in disputes has affected many countries to date. In fact, at least 73 governments – 45 of them in developing countries, 16 in developed countries and 12 in South-East Europe and CIS – were involved in investment treaty arbitration by end 2007. Argentina tops the list with 46 claims lodged against it, 44 of which relate at least in part to Argentina's financial crisis in the early 2000s. In 2007, four new cases were brought against that country. Mexico has the second largest number of known claims (18), followed by the Czech Republic (14), Canada and the United States (12 cases each). Six countries faced arbitration proceedings for the first time in 2007: Armenia, Bosnia and Herzegovina, Costa Rica, Guatemala, Nigeria and South Africa.

As many as 90% of known disputes were initiated by firms headquartered in developed countries. The large majority of cases were initiated on the grounds of violating a BIT provision (78%), followed by provisions under the North American Free Trade Agreement (NAFTA) (14%) and the Energy Charter Treaty (6%). In 2007, the first two cases were initiated on the grounds of alleged violations of the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR). A little

Figure I.14. Number of known investor-State arbitrations, annual and cumulative, 1995–2007



Source: UNCTAD (www.unctad.org/iia).

less than half of the disputes (39%) were related to the services sector, including electricity distribution, telecommunications, debt instruments and water services (chapter V). All primary sector cases related to mining and oil and gas exploration activities.

Tribunals rendered at least 28 awards in 2007, 24 of which were in the public domain. Of all the cases terminated by the end of 2007, 41 awards were rendered in favour of the State, 39 in favour of the investor and 42 were settled amicably;[19] 155 cases were still pending.

(v) Implications of recent developments

A number of features characterize IIA negotiating activity and international investment disputes in 2007. First, the shift in treaty-making activity from BITs towards FTAs and other economic integration treaties that combine trade and investment liberalization appears to be continuing. Second, the most intensive treaty-making activity took place in Asia, reflecting the strong economic performance of the region. Third, there is a relatively robust trend towards the renegotiation of existing IIAs and replacing them with more sophisticated agreements. Fourth, the surge in investor-State disputes continues and involves a growing number of countries, a broad variety of IIA provisions, and in some cases significant amounts of damages awarded. As a result, a few countries are considering or have already decided to terminate their membership in ICSID.

All these developments contribute to rendering the existing IIA universe more complex and more difficult to manage for capacity-constrained developing countries. Thus, seeking to ensure that the IIA universe remains manageable for all countries is becoming an increasingly challenging task. In this respect, reinforcing the development dimension of IIAs to take proper account of developing countries' IIA-related concerns remains a key issue.

One topic that has received more attention lately relates to the question of *arbitration-avoiding strategies for developing countries*. Surprisingly, alternative methods of dispute resolution (ADR) seem hardly ever to be used in investment matters, although they are available under international instruments, such as the ICSID Convention and the UNCITRAL Conciliation Rules.[20] It would be worthwhile considering giving a more prominent role to ADR – such as mediation and conciliation – in future IIAs. Mediation and conciliation could have several advantages over international arbitration. If successful, it might be cheaper, faster, and more protective of the relationship between the foreign investor and the host country – all important aspects for developing countries.

Further, IIAs currently might not be living up to their full potential in *promoting inward investment*. They focus on investment protection, with investment promotion primarily perceived as a side-effect of the former. Only a small minority of existing IIAs actually include *specific* provisions on investment promotion, such as measures to improve the overall policy framework for foreign investment, increase transparency and exchange information on investment opportunities, organize joint investment fairs, grant financial or fiscal incentives to investors or provide for an institutional mechanism that monitors the actual success of promotion efforts (UNCTAD, 2008c). It may be worthwhile to give more consideration to the issue of investment promotion in IIAs.

In the absence of global investment rules, countries continue to conclude investment treaties on a bilateral and regional basis, thereby further perpetuating and accentuating the existing IIA patchwork with its inherent complexities, inconsistencies and overlaps, and its uneven consideration for development concerns. It is in light of this development that, at the *UNCTAD XII Conference* held in Accra in April 2008, member States reiterated that UNCTAD should continue to help developing countries participate in the debate on IIAs, focusing on their development dimension and examining their effects. More specifically, UNCTAD was called upon to provide policy analysis and capacity-building in relation to the negotiation and implementation of current and future bilateral and regional investment agreements, management of investor-State disputes, alternative means of dispute settlement, the approach to investment promotion and the effects of IIAs.

B. Current financial and monetary developments and FDI

The sub-prime mortgage crisis that erupted in the United States in 2007, which caused property prices to plunge and a slowdown in the United States economy, has had worldwide repercussions. World economic growth in 2007 was relatively strong, but the effects of the crisis had begun to take their toll by mid-2008, and forecasts for 2008 have been revised downwards pointing considerably lower growth rates (e.g. IMF, 2008b). So far, the impact of the crisis on FDI flows has been mixed. The credit crisis in the United States has accentuated the depreciation of the dollar which in turn has stimulated FDI flows into the United States from countries with appreciating currencies (Europe and developing Asia).

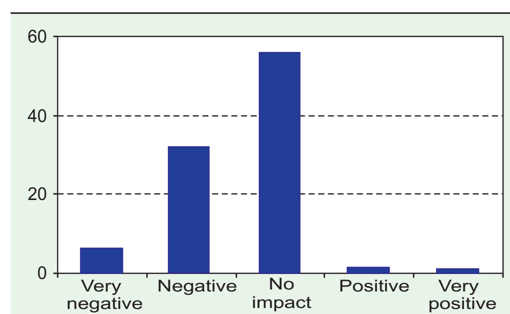
1. The current financial crisis and FDI flows

The problems related to sub-prime mortgage lending and their fallout in the United States since the latter half of 2007 have disrupted financial markets, with broad impacts on the United States economy as a whole. The resultant liquidity problems have extended to some European countries as well.[21] These, along with long-term effects in terms of difficulties and higher costs of obtaining credit, are also affecting FDI flows. Such effects can be discerned at the micro (or firm) as well as macroeconomic levels.

At the firm level, given that in developed countries FDI is mostly in the form of M&As, it is mainly the direct impact of the crisis on cross-border M&As that is affecting FDI flows. The degree of the impact depends on the extent to which the sub-prime fallout affects lending to the corporate sector and other foreign investors (e.g. private equity funds). In most sectors, TNCs have ample liquidity to finance their investments, as shown by the high corporate profits reported, at least until 2007 (figure I.2). In the UNCTAD 2008 survey of large TNCs, about one third of respondents envisaged negative impacts on FDI flows in the short term, but about half of them suggested no impacts (figure I.15).

At the macroeconomic level, the economies of developed countries could be affected by the slowdown of the United States economy and its subsequent impact on the most important financial centres, affecting bank liquidity and credit supply. It has led to a decline in issuance of corporate bonds, while credit available for investment has fallen not only in the United States, but also in several European countries. Both FDI inflows and outflows

Figure I.15. Impact of financial instability on FDI flows 2008–2010
(Per cent of responses to the UNCTAD survey)



Source: UNCTAD, 2008b.

Note: The survey question was: To what extent have your actual FDI and short-term investment plans been affected by the financial instability following the sub-prime loan market crisis?

to and from these countries may therefore slow down. The question is whether such effects are also being experienced in developing economies, in particular those where there is strong and growing demand for FDI. The fact that economic growth of these economies has remained resilient suggests that this may not be the case. Overall, both microeconomic and macroeconomic impacts that might affect the capacity and willingness of firms to invest abroad were limited, at least in 2007.

To date, the financial crisis has mainly affected North American and European commercial and investment banks, whereas the negative effects on the Asian financial system have been fairly limited. Asian banks, and especially Chinese banks, have gained strength recently. In both 2006 and 2007 three Chinese banks (ICBC, CCB and Bank of China) were among the top seven banks in the world in terms of the value of their market capitalization.[22] In contrast, many banks in developed countries had to bear substantial losses in the market value of their equity.[23] The turmoil in financial markets and the problems faced by several banks has started a new process of consolidation in the banking sector through M&As. Banks that were able to ride out the crisis without suffering large losses are seeing an opportunity for (cheap) investment in banks that were severely hit, and the equity prices of which fell sharply, by 40% to 60%. Chinese banks have started to acquire larger stakes in the banking and other financial industries of developed countries. Minsheng acquired a 20% stake in the United Commercial Bank in the United States for $200 million, while China's Citic Bank invested $1 billion for a 6% stake in Bear Stearns (United States). However, SWFs have played the most active role in recent M&As in the banking sector (though mainly in the form of portfolio investment), as discussed below.

2. Influence of the falling dollar on FDI decisions

In 2007, the exchange rates of the major currencies of developed countries continued their trend that started at the beginning of this decade. The United States dollar, in particular, further depreciated against the euro and the pound sterling (figure I.16). From 2000 to 2007 the United States dollar lost 33% of its nominal value against the euro and 24% against the pound sterling.[24] Large exchange rate changes have taken place in the past five years between the currencies of the United States, Japan and the EU. However, the effects of exchange rate changes on aggregate FDI flows are not straightforward.[25] The UNCTAD survey revealed that more than one third of TNC respondents reported negative impacts, while 58% of TNCs said there had been either a positive impact or no impact from dollar deprecation (figure I.17).

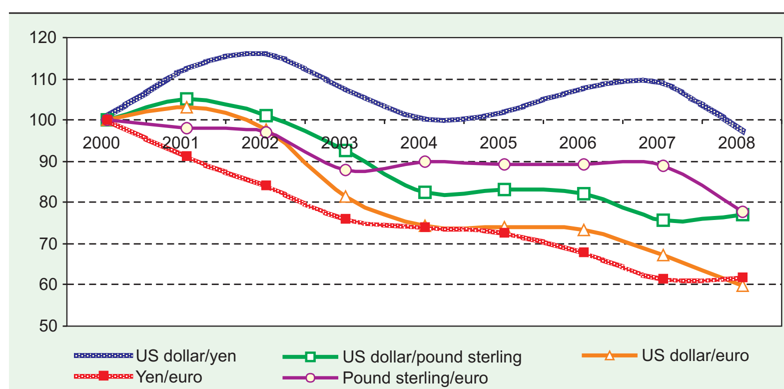
While it is difficult to isolate the effects of exchange rate changes from the effects of other determinants on FDI flows, there are some discernible cases of European firms that increased their FDI in the United States in reaction to the appreciating euro (box I.3). As already noted, FDI inflows into the United States have increased considerably in the past four years, from a low of $53 billion in 2003 to $233 billion in 2007. The bulk of the inflows – around 60% – originated from EU countries. The increase in investments in the United States by European companies in reaction to the falling United States dollar can be explained by two factors.[26] First, the sharp appreciation of the euro and the pound sterling increased the relative wealth of investors from Europe and reduced their investment costs in the United States, which have to be paid largely in United States dollars. Second, European companies suffer if they are highly exposed to exchange rate risks stemming from exports to the dollar zone, when costs are fixed to the euro. Revenues of European firms from sales in the United States have shrunk as a result of the sharp depreciation of the United States dollar against the euro and the pound sterling.

Examples abound: several European carmakers like BMW, Fiat and Volkswagen are following a strategy of building new production facilities or expanding existing plants in the United States to create a natural hedge against a sharp appreciation of the euro. BMW plans to increase United States production by more than 70%,[27] and in January 2008, the German carmaker, Volkswagen, announced plans to produce engines and transmission systems in North America and to establish an assembly plant in the United States in order to reduce its exposure to changes in the United States dollar exchange rate. The plant is set to produce 250,000 cars in 2008.[28]

Similar plans exist in other industries as well. The French manufacturer, Alstom, announced plans in December 2007 to build a $200 million plant in the United States to reduce the impact of the low dollar on its margins.[29] In November 2007, the chief executive of EADS, the European aircraft maker, indicated that EADS would have to move more production to dollar-zone economies.[30]

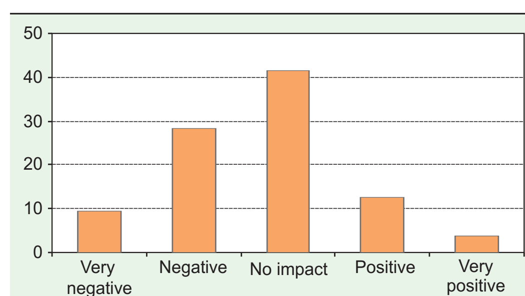
In contrast, in 2008 Porsche decided not to move production to the United States as it has already hedged its dollar exposure until 2013.[31] Porsche is the European carmaker most exposed to dollar-

Figure I.16. Nominal bilateral exchange rate changes of selected currencies, 2000–2008 [a]
(2000=100)



Source: UNCTAD, based on OECD, *Economic Outlook*, No. 83, June 2008.
[a] 2008 data are projections by OECD.
Note: A falling curve indicates a depreciation of the exchange rate of the first mentioned currency against the second currency.

Figure I.17. Impact of depreciation of the United States dollar on global FDI flows for 2008–2010
(Per cent of responses to the UNCTAD survey)



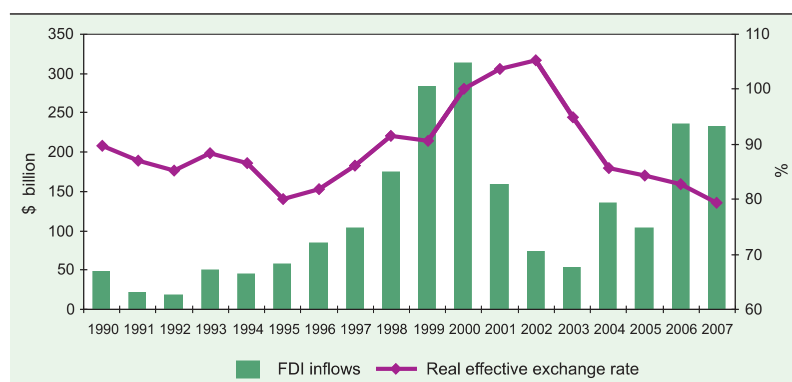
Source: UNCTAD, 2008b.
Note: The survey question was: To what extent have your actual FDI and short-term investment plans been affected by the depreciation of United States dollar?

euro exchange rate changes, as NAFTA countries account for around 40% of its total sales (Eiteman, Stonehill and Moffett, 2007) and the company has no manufacturing or assembly bases in the NAFTA region.

Increasing investments in the United States by European companies also partly reflect a reallocation of production within their networks of production units. For example, exports by foreign affiliates in the United States to Mexico grew by more than 40% between 2002 and 2005,[32] reflecting increased intra-firm flows of exports from foreign companies in the United States to Mexico (in the context of NAFTA).

The effects of the current depreciation of the dollar on FDI inflows into the United States (figure I.18) are similar to those that occurred in the second half of the 1980s. At that time also inflows into the United States sharply increased in reaction to the strong devaluation of the United States dollar against the yen and several European currencies (Froot and Stein, 1991; Klein and Rosengren, 1994). An empirical test on this relationship also shows a similar result (box I.3).

Figure I.18. FDI inflows to the United States and the real effective exchange rate, 1990–2007



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and IMF's *International Financial Statistics*, June 2008 (for data on exchange rate).

Note: Real effective exchange rate is based on relative normalized unit labour costs.

The fact that TNCs can raise funds in the capital markets in host countries or in international capital markets suggests that they may avoid effects from currency change movements. As some TNCs are also skilful in using derivatives (such as futures, forwards, options and swaps) to hedge against exchange rate changes, FDI flows into tax havens (e.g. Caribbean island economies) and special purpose entities are increasing for this purpose. The current depreciation of the dollar has stimulated this type of FDI as well. For example, FDI flows to tax havens in the Caribbean more than trebled in 2006, and continued to be high in 2007 (annex table B.1).

C. FDI by sovereign wealth funds

A growing number of individual and institutional investors invest in collective investment institutions (e.g. hedge funds, private equity funds), which have become direct investors by acquiring 10% or more of equity, with voting power, in enterprises abroad. These institutions are incorporated investment companies or unincorporated undertakings, and in most cases private. However, sovereign wealth funds (SWFs) have also begun to expand abroad as a result of a rapid accumulation of reserves in recent years.

1. Characteristics of SWFs

Various governments have created special investment funds to hold foreign assets for long-term purposes. In recent years, a number of these SWFs have emerged as direct investors. There is no universally agreed-upon definition of such funds, but their original objective was wealth preservation (box I.4). Their objectives vary, but their investment strategies tend to be quite different from those of traditional TNCs and private equity funds.

A comparison of SWFs with private equity funds shows several differences (box I.5). Not only is the volume of SWFs about nine times larger than that of private equity funds, they are also growing more rapidly due largely to fast increasing trade surpluses and foreign exchange reserves. The size of these funds (or assets under management) is estimated to be about $5 trillion today[33] (annex table A.I.11), compared to $500 billion in 1990. With the further rise in oil prices and other commodities, SWFs are continuing to accumulate foreign exchange reserves. There are some 70 such funds in 44 countries with assets ranging from $20 million (Sao Tome and Principe) to more than $500 billion (United Arab Emirates) (annex table A.I.11). However, their holdings are concentrated in China, Hong Kong (China), Kuwait, Norway, the Russian Federation, Saudi Arabia, Singapore and the United Arab Emirates (figure I.19).

2. Investment patterns

Despite their larger size, FDI by SWFs was only $10 billion in 2007 (figure I.20), accounting for a mere 0.2% of their total assets and only 0.6% of total FDI

Box I.3. Dollar depreciation and FDI flows to the United States: recent empirical findings

To test empirically the hypothesis that the depreciation of the United States dollar has been accompanied by an increase in FDI flows to the United States – a similar situation as was found in the 1980s – a model developed by Froot and Stein (1991) is used here. FDI flows as a dependent variable take into account the host country market size (GDP). Thus the dependent variable is FDI inflows over GDP, which is postulated to be a function of the real exchange rate and a time trend.[a] The investment behaviour of other forms of capital inflows, such as foreign official flows and foreign portfolio investments in United States treasuries or corporate bonds, is compared with that of FDI inflows. Given that the euro was introduced in 1999, the period for this exercise is limited to 1999–2007.

There are several noteworthy features of the estimates reported in box table I.3.1. First, FDI inflows in the United States are statistically negatively correlated with the value of the dollar. Second, the coefficient of real exchange rate is higher for FDI inflows than for portfolio flows (corporate stocks and bonds) and other capital flows, and is statistically significant. This implies that FDI inflows are more responsive than portfolio investments to dollar depreciation. The econometric result, that FDI inflows are statistically correlated with the value of the dollar, may support the wealth-effect argument with respect to the FDI-exchange rate relationship and intra-firm reallocation of production for the period in question, as discussed in the text.

Box table I.3.1. Regression of changes in foreign assets in the United States on the value of the dollar, quarterly data, 1999–2007

Form of gross capital inflows into the United States	Coefficients on		DW	R^2 (adjusted)	DF
	log (REER)	T			
Total foreign capital flows	-3.1 (1.98)	-0.0 (0.01)	2.1	0.2	33
Foreign official flows	0.1 (2.64)	0.1 (0.02)***	1.6	0.5	31
Foreign private flows	-4.0 (2.33)*	-0.0 (0.02)	2.1	0.1	33
FDI flows	-6.7 (2.23)***	-0.1 (0.02)***	2.1	0.3	30
United States corporate stocks and bonds	-2.3 (1.49)*	-0.0 (0.01)	1.4	0.0	32

Source: UNCTAD estimates, based on data from UNCTAD (for FDI flows); United States Bureau of Economic Analysis (for other capital flows and GDP) and JP Morgan for the real effective exchange rate.

Note: The following model $\log(Y_t) = \alpha_1 + \alpha_2 * \log(REER) + \alpha_3 * T_t$ is estimated, with OLS and standard errors calculated to allow for conditional heteroscedasticity (White, 1980) in the regression residuals. Standard errors are in parenthesis and *, **, *** represent statistical significance at the 10%, 5% and 1% levels, respectively. REER is the JP Morgan index for real effective exchange rate - a rise in the index indicates a real appreciation of the dollar. T is time trend. Dependent variable Y_t is expressed as a per cent of United States GDP in logarithm value. DW is Durbin-Watson statistic and DF is the degree of freedom.

Source: UNCTAD.

[a] There are many other variables influencing FDI flows (*WIR99*), but the purpose is simply to discern the impact of exchange rate levels on FDI.

flows. By comparison, private equity funds, although much smaller in size, invested more than $460 billion in FDI that year. Most of the SWFs invested heavily in low-yield government bonds in the United States and Europe. While they are increasingly investing in stocks and higher yielding assets, their acquisitions normally constitute ownership shares of less than 10%, which is the threshold for an investment to be classified as FDI. Nevertheless, growth of FDI by SWFs during the period 2005–2007, the majority originating in the United Arab Emirates, was dramatic. Of the $39 billion of FDI invested by SWFs during the past two decades, as much as $31 billion was committed in the past three years. From 1990 to 2004, average annual cross-border M&A outflows by SWFs amounted to only $0.5 billion (figure I.20). The number of cross-border M&A deals by SWFs increased from only 1 in 1987 to 20 in 2005, and 30 in 2007 (figure I.20).

FDI by SWFs has been geographically and sectorally concentrated. About three quarters of their investments were in developed countries, mainly, the United Kingdom, the United States and Germany (figure I.21), and 73% were in the services sector at end 2007 (figure I.22). Developing countries (notably in Asia) received $10.5 billion, or 27% of the total, but there was very limited SWF activity in Africa and Latin America. A specific feature of these investments has been their high concentration in business services (24% of the total), with much less going to the primary and manufacturing sectors and financial services. But, there were some important exceptions. For example, in 2005 IPIC (United Arab Emirates) acquired

Box I.4. What are SWFs?

SWFs are government investment vehicles that are funded by the accumulation of foreign exchange assets and managed separately from the official reserves of the monetary authorities. They usually have a higher risk tolerance and higher expected returns than traditional official reserves managed by the monetary authorities. They aim at systematic professional portfolio management to generate a sustainable future income stream. Their portfolio investment includes bonds, equities and alternative asset classes.

SWFs are not a new phenomenon. They have existed since the 1950s, especially in countries that were rich in natural resources (particularly oil), but had largely gone unnoticed until the middle of the present decade. Two of the largest of these funds, Kuwait Investment Authority and Temasek Holdings of Singapore, were founded in 1953 and 1974 respectively. In recent years, the assets of SWFs have grown considerably, reflecting the rapidly growing current-account surpluses of many developing countries and the accompanying accumulation of foreign exchange reserves.

Some examples of SWFs are the Abu Dhabi Investment Authority, China Investment Corporation, Kuwait Investment Authority, GPFG Norway and GIC fund from Singapore. Recently, the Libyan Arab Jamahiriya launched a fund as well (annex table A.I.11). Equivalent to 2% of the total global value of traded securities,[a] SWFs are becoming aggressive investment vehicles. Some of them take on management stakes, such as Singapore's Temasek, Qatar's Investment Authority, Abu Dhabi Mudabala, Dubai International Capital and Istithmar – the latter two of which are the investment vehicles of the Dubai Government. However, the distinction among different funds is not clear. Certain funds are prohibited by law from acquiring a large equity share such as FDI (e.g. Norwegian funds whose investments in equity stakes are limited to a maximum of 5%). Some governments also have stabilization funds, the only purpose of which is to stabilize revenues from commodity exports, and they do not usually engage in the purchase of shares.

Since SWFs hold more financial resources than private equity or hedge funds, they could have a significant influence on financial markets worldwide.

Source: UNCTAD.

[a] "The invasion of the sovereign wealth funds", *The Economist*, 17 January 2008.

Box I.5. How are SWFs different from private equity funds?

Both SWFs and private equity firms have become increasingly important players in global investment activities. They have diversified the investor base and contributed to a better environment for managing risks and absorbing shocks during crises. They can play a complementary role to TNCs as important sources of much-needed investment in the developing world. Potentially, this could have a positive impact in helping to reduce disparities in the global economy. Taken as a whole, the activities of SWFs are also increasing the stake of developing countries in the global economy.

Both SWFs and private equity funds have generated significant benefits through their investments, but they have also given rise to some important concerns. Significant challenges at both the systemic and national levels relate largely to regulatory issues and the need to strengthen transparency and oversight without undermining the benefits that these institutions generate. This requires policy development at both national and multilateral levels (see section C.3 below).

There are some major differences between SWFs and private equity funds (box table I.5.1 for details):

- Unlike private equity funds, SWFs are controlled directly by the home country government.
- SWFs can hold stakes for a longer period than private equity funds.
- Non-economic rationale sometimes combines with economic motivations in investment decisions by SWFs.

These differences manifest themselves in the investment strategies of SWFs.

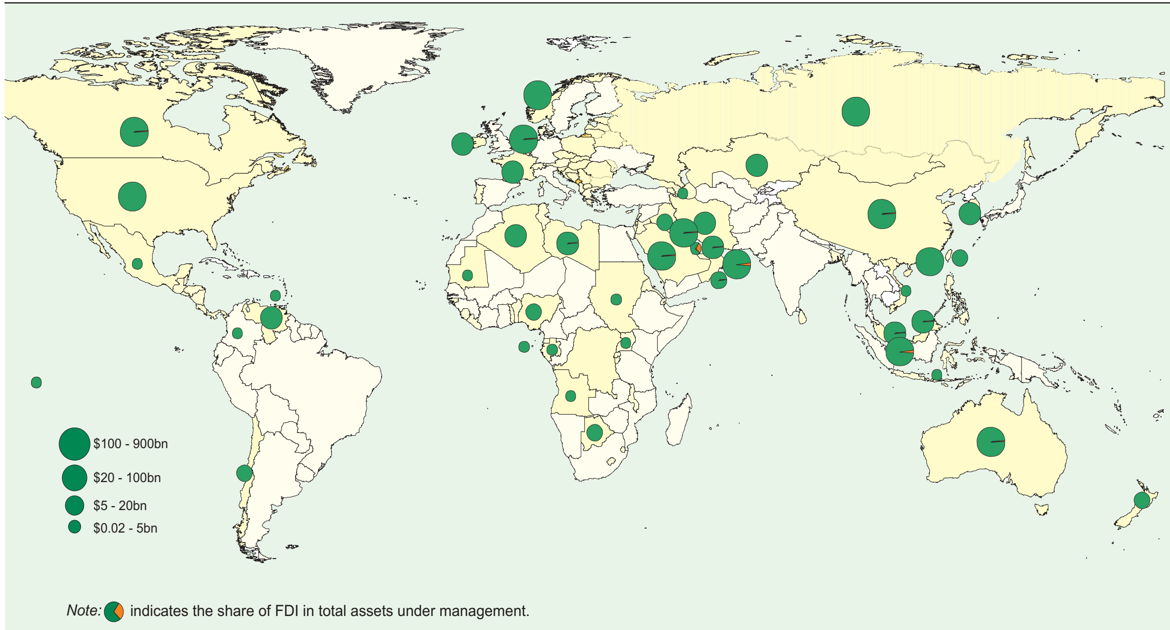
Box table I.5.1. Comparison between SWFs and private equity funds, 2007

Item	SWFs	Private equity funds
Volume	$5,000 billion	$540 billion
FDI	$10 billion	$460 billion [a]
Main source economies of FDI	United Arab Emirates, Norway, Saudi Arabia, Kuwait, Singapore, China, Hong Kong (China) and Russian Federation	United States, United Kingdom
Largest funds involving FDI	Istithmar PJSC (United Arab Emirates), Dubai Investment Group, Temasek Holdings(Pte)Ltd (Singapore), GIC (Singapore)	KKR, Blackstone, Permira, Fortress, Bain Capital, Carlyle (United States)
Investment strategy	Shifting from passive to active investors. Have tended to hold investment-grade, short-term, liquid sovereign assets in the major currencies, particularly United States treasury securities, but are now becoming strategic investors, with a preference for equities. Also investing in bonds, real estate, hedge funds, private equity and commodities. Still limited involvement in FDI. Concentrated in developed countries.	Shorter time frame (exit within 5-8 years) than public companies and traditional TNCs, but play a more active role in the management of invested companies than SWFs. At the same time, inclined to look for options that offer quick returns, akin to those of portfolio investors. Buy larger and also publicly listed companies, but also invest in venture capital. Undertake FDI through buyouts. FDI is expanding in developing countries.

Source. UNCTAD.

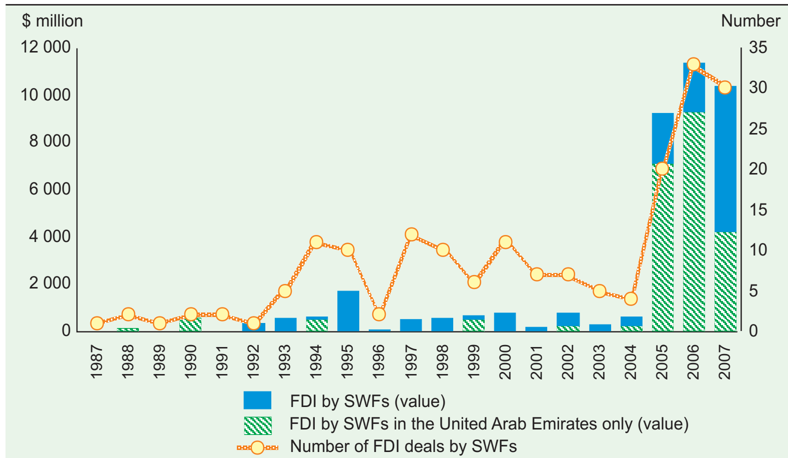
[a] Cross-border M&As only.

Figure I.19. Major FDI locations of sovereign wealth funds, 2007



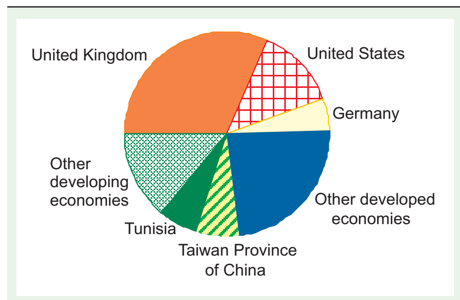
Source: UNCTAD, based on annex table A.I.11.

Figure I.20. FDI flows[a] by sovereign wealth funds, 1987–2007



Source: UNCTAD cross-border M&A database (www.unctad.org/fdistatistics).
[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.

Figure I.21. FDI[a] by SWFs, by main host groups and top five host economies, end 2007[b]
(Per cent)



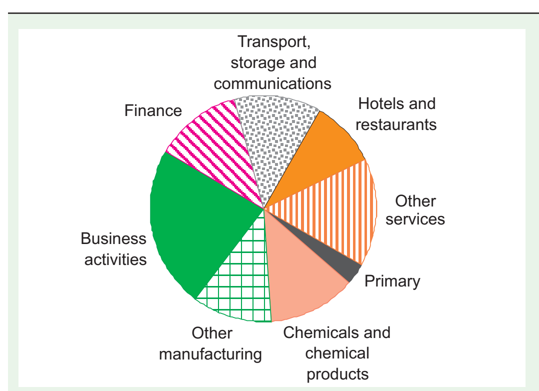
Source: UNCTAD, based on annex table A.I.13.
[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.
[b] Cumulative investments (M&As) between 1987 and 2007.

Kuokwang Petrochemical Co Ltd (Taiwan Province of China) for $2.4 billion (table I.9). In financial services, Temasek Holdings of Singapore acquired a 12% stake in the British bank Standard Chartered. In other industries, FDI by SWFs includes investments in telecommunications (in Tunisia), and plastics (e.g. Denmark, Germany).

In portfolio investment, in which SWFs are more active, there are a number of significant investments. In the manufacturing sector, for example, the Kuwait Investment Authority (KIA) is the largest single investor in Germany's Daimler Benz, though its share is quite small.[34] In 2007, however, the most active investments took place in the financial services of developed countries, due to the financial market crisis and the associated liquidity needs of numerous banks in the United States and the EU. In the latter half of 2007, three of the largest financial services companies in the United States, Citigroup, Merril Lynch and Morgan Stanley, actively sought new investors and fresh capital. Sharply falling stock prices made these investments relatively cheap for SWFs:

- China Investment Company (CIC) invested $5 billion in Morgan Stanley;
- Abu Dhabi Investment Authority acquired a $7.5 billion stake in Citigroup;

Figure I.22. FDI[a] by SWFs, by main target sectors and top five target industries, end 2007 [b]
(Per cent)



Source: UNCTAD, based on annex table A.I.14.

[a] Cross-border M&As only. Greenfield investments by SWFs are assumed to be extremely limited.

[b] Cumulative investments (M&As) between 1987 and 2007.

- KIC (Republic of Korea), together with Kuwait Investment Authority, invested $5.4 billion for an equity capital stake in Merril Lynch; and
- The Government of Singapore Investment Corporation (GIC) acquired a $9.8 billion stake in the Swiss bank UBS.

Apart from these spectacular investments in the financial sector, SWFs acquired significant stakes in private equity funds and hedge funds in 2007. This is a new strategy of SWFs, which still shy away from larger or complete takeovers of TNCs in other production activities, as they lack the expertise to manage such TNCs. For example, CIC acquired a 9.9% stake in Blackstone (United States), one of the biggest private equity companies. Mubadala Fund of Abu Dhabi invested in Carlyle (United States), the Abu Dhabi Investment Authority acquired a 9% stake in Apollo (United States) and Dubai International Capital bought a 10% stake in Och-Ziff, a hedge fund in the United States. The growing investments of SWFs in private equity and hedge funds could signal an increasing number of joint deals in the future. SWFs are additional and emerging sources of funds for private equity firms as bank loans decline because of the financial crisis.

In sum, the recent behaviour of SWFs has been motivated by various market trends and changes in global economic fundamentals, and by the structural weaknesses in the global financial architecture. Recent investments by SWFs in the financial sector may have exerted a stabilizing effect on financial

Table I.9. Twenty selected large FDI cases by sovereign wealth funds, 1995–2007

Year	Value ($ million)	Acquired company	Host economy	Industry of the acquired company	Acquiring SWF or entity established by SWFs	Home economy	Acquired share (%)
2005	2 359	Kuokwang Petrochemical Co Ltd	Taiwan Province of China	Industrial organic chemicals, nec	International Petroleum Investment Co (IPIC)	United Arab Emirates	20
2006	2 313	Tunisie-Telecoms	Tunisia	Telephone communications, except radiotelephone	Investment Corporation of Dubai	United Arab Emirates	35
2005	1 691	Borealis A/S	Denmark	Plastics materials and synthetic resins	Abu Dhabi Investment Authority	United Arab Emirates	50
2005	1 495	Tussauds Group Ltd	United Kingdom	Amusement and recreation services	Dubai International Capital LLC	United Arab Emirates	100
2006	1 270	Travelodge Hotels Ltd	United Kingdom	Hotels and motels	Dubai International Capital LLC	United Arab Emirates	100
2006	1 241	Doncasters PLC	United Kingdom	Aircraft parts,equipment	Dubai International Capital LLC	United Arab Emirates	100
2005	1 222	CSX World Terminals LLC	United States	Marine cargo handling	Dubai Ports International	United Arab Emirates	100
2006	1 200	280 Park Ave,New York,NY	United States	Operators of non-residential buildings	Istithmar PJSC	United Arab Emirates	100
2007	1 160	Mauser AG	Germany	Plastic foam products	Dubai International Capital LLC	United Arab Emirates	100
1995	1 135	Mediaset SpA(Fininvest)	Italy	Television broadcasting stations	Investor group	Saudi Arabia	18
2006	1 030	Merry Hill	United Kingdom	Operators of non-residential buildings	Queensland Investment Corp	Australia	50
2007	954	Chapterhouse Holdings Ltd	United Kingdom	Real estate investment trusts	GIC Real Estate Pte Ltd	Singapore	100
2007	942	Barneys New York Inc	United States	Men's and boys' clothing and accessory stores	Istithmar PJSC	United Arab Emirates	100
2007	862	Hawks Town Corp	Japan	Department stores	Government of Singapore Investment Corp Pte Ltd (GIC)	Singapore	100
2007	821	Capital Shopping Centres PLC	United Kingdom	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	40
2007	621	Bank Muscat	Oman	Banks	Dubai Financial LLC	United Arab Emirates	15
2007	612	WestQuay Shopping Center	United Kingdom	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	50
2007	596	Westfield Parramatta	Australia	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	50
2005	594	Bluewater Shopping Centre	United Kingdom	Operators of non-residential buildings	GIC Real Estate Pte Ltd	Singapore	18
2006	594	Adelphi	United Kingdom	Operators of non-residential buildings	Istithmar PJSC	United Arab Emirates	100

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics). For those cases ranked between 21 and 50, see annex table A.I.12.

markets, as they seem to have contributed to restoring the capital base of hard-hit banks. However, in many developed countries public and political statements indicate mixed reactions to FDI by SWFs, especially funds from emerging economies as discussed below.

3. Growing concerns about SWFs

Increasing investments of SWFs in the banking industry in 2006–2007 have been generally welcomed in view of their stabilizing effect on financial markets. But they have also aroused some negative public sentiment in several developed countries, provoking new fears of protectionism and policy moves to change legislation on FDI. In particular, concerns by developed as well as developing countries that SWFs could gain control of infrastructure and other strategic industries (e.g. energy, national defence, oil, gas and electricity supply, and other sensitive activities such as sea ports and airports) have led some governments to tighten regulations (or propose such changes) relating to investments by SWFs.

First, it has been argued that since SWFs could pose a threat to national security, governments should erect barriers against these investors. But most States already reserve the right to refuse M&As for national security reasons, even if, overall, they are very open to foreign investors (see *WIR06*: 225f.).[35] National security exceptions mainly relate to economic activities in the military and other strategic sectors. A prominent example is the United States Exon-Florio provision which allows the blocking of an acquisition by a foreign entity if national security is endangered (United States GAO, 2008). In Japan,[36] Germany,[37] France,[38] the United Kingdom[39] and many other countries, the legal framework similarly allows the restriction or withdrawal of a foreign investment for national safety and security reasons.

Opponents of FDI by SWFs further argue that the funds might invest in companies that were privatized in recent years and that the improvements in their efficiency from such privatizations may be rolled back as a result of SWF investment. In addition, some are sceptical about investments by SWFs from countries that lack a free market or respect for human rights and sound environmental standards. However, it should be pointed out that SWFs have to conform to national and international labour and environmental standards, and that if there is a high degree of competition in the market, SWFs have no monopoly power to control or exploit that market.

Also criticized is the lack of transparency of SWFs which, with the exception of the Norwegian (box I.6)[40] and Canadian SWFs, and, recently, Kuwaiti SWFs, do not disclose their asset portfolios and investment decisions (Truman, 2007; IMF, 2008a). Despite their potentially strong impact on the market, SWFs have little accountability to regulators, shareholders or voters, and there are limited data on their investment strategies, portfolio composition and the average annual returns on assets.

On the other hand, the changing investment strategy of SWFs may imply considerable opportunities as well. For example, they recycle the huge dollar inflows of the countries concerned, thereby contributing to the financing needs of the deficit countries, and therefore to stabilization of the global financial system, by injecting more capital. The passive investments of SWFs in dollar-denominated fixed assets in the past were connected with low returns; today their governments are seeking higher returns on their investments. Enhancing transparency and accountability of SWFs is important. If such conditions were to be met, there would be little reason to treat SWFs less favourably than other fund management companies, private equity groups or hedge funds.

Several initiatives are already under way to establish principles and guidelines relating to FDI by SWFs. At the multilateral level, the IMF has been called upon to develop guidelines for SWFs and has created, with some member States, the International Working Group of Sovereign Wealth Funds to agree on a common set of voluntary principles and practices for SWFs; the European Commission (EC) is exploring plans for an EU-wide law to monitor SWFs; and the OECD is developing guidelines for recipient countries. Ministers of OECD countries, at the Council at Ministerial Level on 5 June 2008, endorsed the following policy principles for countries receiving SWF investments:

> “Recipient countries should not erect protectionist barriers to foreign investment.
>
> Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
>
> Where such national security concerns do arise, investment safeguards by recipient countries should be: transparent and predictable, proportional to clearly-identified national security risks, and subject to accountability in their application” (“OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies”, Meeting of the Council at Ministerial Level, 4-5 June 2008, C/MIN(2008)8/FINAL).

At the SWF level, the Abu Dhabi Investment Authority (ADIA), GIC and Norges Bank Investment

Box I.6. Norwegian Government Pension Fund: a "gold standard" for governance of SWFs

The Norwegian Government Pension Fund (NGPF) is considered the "gold standard" for good practice in governance arrangements and operational guidelines that address concerns regarding the accountability and transparency of SWFs. Funds are transferred to the NGPF from the earnings from petroleum. The Norges Bank Investment Management (NBIM) was established in 1998 as a separate department within Norges Bank to manage the pension fund.

The NGPF governance structure seeks to achieve: (i) accountability, through a clear division of responsibilities and a system of checks and balances; (ii) transparency, by providing open information on performance, risks, costs and investments; and (iii) professionalism, by delegating all investment decisions to professionals.

On accountability, the Ministry of Finance decides strategic asset allocation, defines the benchmark portfolio, sets the limit for deviations from the benchmark, identifies companies to be excluded from the investment target, and reports to Parliament. The Norges Bank is responsible for cost-effective transactions and market exposure, active management to achieve "excess" returns (the difference between the return on the Fund and the return on the benchmark), risk management and reporting, and corporate governance, and it advises the Ministry of Finance on investment strategy.

On transparency, NBIM reports on performance, risks and costs on a quarterly basis. These quarterly reports are published on its website and are supported by a quarterly press conference. In addition, an annual report is published listing all investments.

The NBIM's main tasks, as the professional fund manager, are: cost-effective market exposure, creating "excess" returns against the benchmark through proactive management, safeguarding long-term financial interests through corporate governance (as a minority shareholder in invested companies), and risk management, control and reporting. Its strategy for creating "excess" returns involves taking many small positions rather than a few large ones, with the greatest possible independence in position-taking, and diversifying into well-defined strategies. It also emphasizes a high degree of specialization in both internal and external management, and focuses on keeping costs related to trading and portfolio management low.

Source: UNCTAD, based on the NGPF's website at: www.norges.bank.no.

Management (NBIM) are working with the IMF to develop a code of conduct for their activities. Singapore's Temasek Holdings has stated that it will avoid investing in "iconic" companies in developed markets. Clear procedures and guidelines by governments, identifying which industries are regarded as strategically important, should be established to make the investment environment more predictable. Such guidelines will have important implications for the regulatory and legal frameworks of host countries.

D. The largest TNCs

This section looks at the foreign activities of the largest TNCs in 2006. The 100 largest non-financial TNCs worldwide and the 100 largest TNCs from developing economies are ranked by foreign assets. The purpose is not to look at their size per se, but at their internationalization, which is different from other rankings where size in terms of total assets, income or market capitalization, are the determining criteria for ranking.[41] Finally, this section also includes an analysis of the 50 largest financial TNCs worldwide ranked by the Geographical Spread Index (GSI).

The largest TNCs play a major role in international production, both in developed and developing economies. Over the past three years, on average they accounted for 10%, 16% and 12%, respectively, of the estimated foreign assets, sales and employment of all TNCs in the world. At the same time, the rapid increase in FDI in the past decade has been accompanied by a structural change in its sectoral composition towards services, notably telecommunications, electricity and water services. The current UNCTAD lists of largest TNCs include many that are involved in infrastructure development, but this has not always been the case (box I.7). The wave of liberalization and privatization in the late 1980s and throughout the 1990s, especially in the key infrastructure industries, had a particularly marked effect on the internationalization of these services. These industries, which had been mostly State-owned enterprises or nationalized companies subject to tough restrictions and prohibitions on foreign ownership, were also the fastest to become internationalized after privatization and liberalization opened them up to foreign participation, largely through FDI and strategic alliances.

1. The world's top 100 TNCs

Overall, the rankings in the first half of the top 100 list in the past decade have remained relatively stable: General Electric (United States) heads the list with more than 8% of the total foreign assets of the top 100 companies – almost three times as much

Box I.7. Infrastructure TNCs in the top 100 TNCs

In 2006, the world's 100 largest TNCs included eight utility companies and eight telecoms companies, seven of which were headquartered in the EU and are ranked in the first quartile of the top listed companies. Most of these TNCs were not among the top 100 prior to 1998 (box table I.7.1). The industry composition of the top 100 reveals that in 1996 there were only one utility company and five telecoms companies and by 1998 there were three utility companies and six telecoms companies.

Box table. I.7.1. Largest TNCs in infrastructure industries:[a] ranks in 2006 and in the year of entry

TNC	Country	Industry	2006 rank	Year of entry into top 100	Rank
Vodafone	United Kingdom	Telecoms	7	2000	1[b]
EDF	France	Electricity	9	2001	30
Telefonica	Spain	Telecoms	11	1998	52
E.ON	Germany	Electricity	12	2000	23
Deutsche Telekom	Germany	Telecoms	13	2002	56
France Telecom	France	Telecoms	15	2002	9
Suez	France	Water	19	1998	13
RWE	Germany	Electricity	22	1998	66

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] Excluding diversified TNCs.

[b] Following the merger with AirTouch Communications in 1999, Vodafone became the world's largest TNCs ranked by foreign assets.

Source: UNCTAD.

as the second-ranked British Petroleum (United Kingdom). The top 10, with about $1.7 trillion in foreign assets, or more than 32% of the total foreign assets of the top 100, include four petroleum and two motor vehicle companies, two infrastructure companies, one company in the electrical/electronic equipment industry and one retail company. These 10 companies also account for 29% of all foreign sales, but for only 15% of all foreign employment of the 100 largest TNCs, although the retail company Wal-Mart is the world's largest foreign employer.

Table I.10. Snapshot of the world's 100 largest TNCs, 2005–2006

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

Variable	2005	2006	Percentage change
Assets			
Foreign	4 732	5 245	10.8
Total	8 683	9 239	6.4
Share of foreign in total (%)	54	57	2.3[a]
Sales			
Foreign	3 742	4 078	9.0
Total	6 623	7 088	7.0
Share of foreign in total (%)	56	58	1.0[a]
Employment			
Foreign	8 025	8 582	6.9
Total	15 107	15 388	1.9
Share of foreign in total (%)	53	56	2.7[a]

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] In percentage points.

While a number of new companies from the services sector entered the higher rankings in the list during the decade, some companies in the more traditionally important industries remained among the top. In the petroleum industry, Shell and Exxon, which were number one and two respectively 15 years ago, are still among the top ranked largest TNCs. In 1993, General Electric which was ranked fifth, and motor-vehicle companies such as Toyota and Ford which ranked sixth and seventh respectively, even improved their rankings in 2006.

In 2006, there were few changes in the top 100, with only 10 new entries originating from 8 different countries. By origin, 85 of the companies had their headquarters in the Triad (the EU, Japan and the United States), the United States dominating the list with 21 entries. Of the top 100 firms, 72 came from five countries: the United States, France, Germany, the United Kingdom and Japan, in that order. The number of firms from developing economies in the top 100, which had increased to seven in 2005, fell to six in 2006, but they represented a wide range of activities and diverse origins (two from the Republic of Korea, and one each from Hong Kong (China), Malaysia, Mexico and Singapore).

The activities of the largest TNCs increased significantly, with foreign sales and foreign employment increasing at almost 9% and 7% respectively, faster than that of their domestic activities (table I.10). The ratio of foreign activities to total activities increased again in 2006.

Six industries dominated the list of the largest TNCs. Motor vehicles (13) and petroleum (10) represented more than half of the companies in the first quartile. Electrical/electronic equipment (nine), utilities (eight), telecoms (eight) and pharmaceuticals (seven) followed. These six industries accounted for 55% of the 100 largest TNCs. Metals and non-metallic products, chemical products, retail and wholesale trade, and food and beverages accounted for another 23%.

While the ranking used in UNCTAD's list of the largest TNCs is based on foreign assets, ranking the companies by foreign sales or by foreign employment would give a different picture. If ranked by sales, petroleum TNCs would occupy the top five positions in the list and five automobile manufacturers would be in the top ten. The largest TNC in terms of foreign sales (ExxonMobil) is 10 times larger than the firm ranked 59, based on foreign sales. Ranking the companies by foreign employment gives yet another picture, with two retail companies and two food and beverage companies in the top five positions. The largest retail TNC in terms of foreign employment is 10 times larger than the firm ranked 55 based on foreign employment.

Another aspect of foreign operations is the geographical spread or the number of host countries for foreign affiliates. On average, the largest TNCs have affiliates in 41 foreign countries. The ranking by the number of host countries for foreign affiliates results in a much more diversified list of home countries and industries (table I.11). Deutsche Post (Germany) leads, followed by the Royal Dutch Shell Group. There is a wide range of home countries and activities in this list, which indicates that the form and extent of international diversification differs widely among firms.

Table I.11. Top 15 TNCs, ranked by number of host economies of their affiliates

Company	Home country	Number of host economies [a]
Deutsche Post AG	Germany	111
Royal Dutch/Shell Group	Netherlands, United Kingdom	98
Nestlé SA	Switzerland	96
Siemens AG	Germany	89
BASF AG	Germany	88
Procter & Gamble	United States	75
GlaxoSmithKline	United Kingdom	74
Linde	Germany	72
Bayer AG	Germany	71
Philips Electronics	Netherlands	68
Total	France	66
IBM	United States	66
WPP Group PLC	United Kingdom	64
Roche Group	Switzerland	62
Novartis	Switzerland	62

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] Majority-owned foreign affiliates only.

The preferred locations for foreign affiliates of the top 100 TNCs, measured in terms of location intensity, which takes into account the home country of the TNCs,[42] are the United Kingdom and the United States (figure I.23). The top four positions are similar to those in 2005. China ranks sixth, ahead of France and Canada. Among developing economies other than China, Brazil, Mexico and Singapore rank among the top 20 preferred locations.

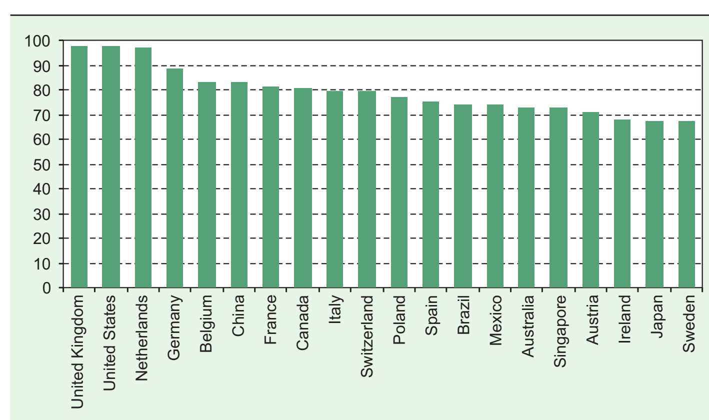
How transnational are the largest TNCs? The degree of international involvement of firms can be analysed from a number of perspectives: their operations, stakeholders and the spatial organization of management. Given the range of perspectives and dimensions that can be considered for each, the degree of transnationality of a TNC cannot be fully captured by a single, synthetic measure. UNCTAD's Transnationality Index (TNI)[43] is a composite of three ratios: foreign assets to total assets, foreign sales to total sales, and foreign employment to total employment. The conceptual framework underlying this index helps to assess the degree to which the activities and interests of companies are embedded in their home country and abroad (UNCTAD, 2007a).

In 2006, the average TNI for the largest TNCs increased by one point value, but it is worth noting that this average value is highly dependent on the companies represented in the top 100. Nevertheless, over the past 15 years the average value has increased by 14 points, with ups and downs not necessarily in phase with the FDI cycle (figure I.24). The home countries and industries of the top companies ranked by TNI are extremely diverse (annex table A.I.15).

It is also important to look at the differences in TNI between the leading TNCs from the major home countries. The value is higher than average for TNCs from France and the United Kingdom, and it is lower than average for TNCs from Germany, Japan and the United States (table I.12).

One aspect of transnationality from the operations perspective, which is not included in the TNI measure, is the intensity of foreign operations according to the number of foreign affiliates. The geographic spread of a company's operations and interests is captured by the number of foreign affiliates and the number of host countries in which a company

Figure I.23. Location intensity of the 20 most preferred host economies, 2007



Source: UNCTAD, based on Dun & Bradstreet, *Who Owns Whom Database.*

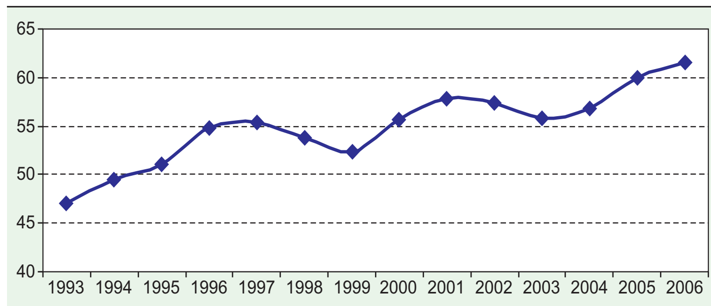
Table I.12. Comparison of TNI values by country, 2005, 2006
(TNI values and number of entries)

Country	Average TNI [a] 2005	Average TNI [a] 2006	Number of entries 2006
Top 100 TNCs	**59.9**	**61.6**	**100**
from:			
United States	52.8	57.8	22
France	62.4	63.8	15
Germany	52.6	54.8	14
United Kingdom	72.5	72.8	13
Japan	48.7	52.1	0.9

Source: UNCTAD/Erasmus University database on largest TNCs.

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

Figure I.24. TNI values of the top 100 TNCs, 1993–2006



Source: UNCTAD/Erasmus University database on largest TNCs.

Table I.13. II values of selected industries, 2005, 2006

Industry	Average II[a] 2006	2005
Motor vehicles	63.4	62.1
Electrical/electronics	74.1	76.2
Petroleum	55.8	60.5
Pharmaceuticals	80.1	81.9
Telecommunications	73.9	71.6
Utilities	71.4	53.1
All industries	70.1	69.5

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] II, the "Internationalization Index", is calculated as the number of foreign affiliates divided the number of all affiliates.

has established its affiliates. The Internationalization Index (II) – the ratio of a TNC's foreign to total affiliates – shows that on average more than 70% of the affiliates of the world's largest TNCs are located abroad (annex table A.1.15). However, there is wide discrepancy between the IIs for TNCs in the different major industries in the top 100: the II for companies in the pharmaceutical, telecommunications, and electrical and electronics industries is much higher than that for companies in the motor vehicle or petroleum industries (table I.13). This signifies that their operations are spread over many more countries, even though FDI may be less important relative to their total assets.

2. The top 100 TNCs from developing economies

In 2006, the foreign assets of the 100 largest TNCs from developing countries amounted to $570 billion. The 10 largest TNCs in the world accounted for almost half of the foreign assets of the top 100. With foreign assets of $71 billion, Hutchison Whampoa (Hong Kong, China) remained in the lead, accounting for as much as 12% of the total foreign assets of the top 100. Petronas (Malaysia), Samsung Electronics (Republic of Korea), Cemex (Mexico), Hyundai Motor (Republic of Korea) and Singtel (Singapore), ranked in that order, also figured among the world's 100 largest non-financial companies.

The top five firms from developing economies in 2006 were already listed among the top 20 on the list of the largest TNCs from developing economies 10 years ago. All TNCs in the top 50 positions have more or less maintained their rankings for the past few years. Overall, the composition of the top 100 has remained relatively stable, at least in the first half of the list, with one exception (a telecoms company from Kuwait). The top 100 TNCs from developing economies operate in a broader range of industries than their counterparts from developed economies, and companies from the electrical/electronic and computer industries still dominate the list with 20 entries. They are followed by TNCs in telecoms (9), petroleum (8) and food and beverages (8).

The regions and countries of origin of the top 100 TNCs from developing economies have changed little over the past 10 years: 76 TNCs are from South, East and South-East Asia, 10 are from Latin America, 11 from Africa, and, for the first time, three new TNCs in the infrastructure industries are from West Asia (Turkey and Kuwait). By economy, Hong Kong (China) and Taiwan Province of China dominate the list with 26 and 16 TNCs respectively. Singapore and China have maintained their relative lead with 11 and 9 companies respectively. South Africa (10), Mexico (6) and Malaysia (6) are the other important home countries for TNCs from developing countries.

In 2006, the foreign assets, foreign sales and foreign employment of the largest 100 increased by 21%, 27% and 12% respectively, compared to the previous year (table I.14). But relatively speaking, their foreign operations, as reflected in the ratio of the foreign component to the total, remained fairly stable compared to 2005, with only small increases.

Table I.14. Snapshot of the world's 100 largest TNCs from developing economies, 2005, 2006
(Billions of dollars, thousands of employees and per cent)

Variable	2005	2006	Percentage change
Assets			
Foreign	471	571	21.3
Total	1 441	1 694	17.6
Share of foreign in total (%)	33	34	1.0[a]
Sales			
Foreign	477	605	26.9
Total	1 102	1 304	18.3
Share of foreign in total (%)	43	46	3.2[a]
Employment			
Foreign	1 920	2 151	12.0
Total	4 884	5 246	7.4
Share of foreign in total (%)	39	41	1.7[a]

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] In percentage points.

Compared to the largest TNCs worldwide, developing-economy TNCs have affiliates in a smaller number of foreign affiliates – only 9 on average. Cemex (Mexico) is present in the largest number of host countries, followed by three companies in electrical/electronics (table I.15). The most preferred locations for the foreign affiliates of the top developing-economy TNCs are the United Kingdom and the United States, as is the case for the largest TNCs worldwide, but China is the third most-preferred location, ahead of Germany, Hong Kong (China), the Netherlands and Brazil.

While a firm like Cemex is truly diversified geographically, with activities in Asia, West Asia, Europe and Latin America, most companies have a more regional focus: Mexican companies tend to have more activities in Latin America and Asian companies in Asia. With the exception of Sappi (South Africa) none of these TNCs in the top 15 have foreign affiliates in African countries.

How transnational are TNCs from developing economies compared to their counterparts from developed countries? The average TNI is higher for the world's 100 largest TNCs, but the gap between the two is closing (UNCTAD, 2007a). In 2006, the average TNI value for the largest TNCs from developing economies increased by three points. This TNI value is larger for companies in Asia than in other developing regions (table I.16). The home countries and industries of the top companies ranked by TNI are highly diversified (annex table A.1.16).

The degree of transnationality is also affected by the extent to which TNCs are expanding their foreign activities in various locations. The Internationalization Index (II), the ratio of a TNC's foreign to total affiliates, shows that, on average, more than 50% of the affiliates of the largest TNCs from developing economies are located abroad, a much lower value than for TNC from developed countries. However, there is wide discrepancy among industries. For TNCs from developing economies, the II of firms in the electrical and electronics and computer industries is very similar to that of their counterparts from developed countries (table I.16).

Table I.15. Top 15 TNCs from developing economies ranked by the number of host economies of their affiliates, 2007

Corporation	Home economy	Number of host economies
Cemex	Mexico	35
Samsung Electronics Co.	Republic of Korea	32
Flextronics International	Singapore	30
LG Corporation	Republic of Korea	24
Singtel	Singapore	24
Acer	Taiwan Prov. of China	23
Neptune Orient Lines	Singapore	20
Hutchinson Whampoa	Hong Kong, China	15
Lenovo Group	China	15
Grupo Bimbo SA	Mexico	14
Orient Overseas International	Hong Kong, China	14
Hon Hai Precision Industries	Taiwan Prov. of China	12
America Movil	Mexico	12
Sappi	South Africa	12
Kia Motors	Republic of Korea	11

Source: UNCTAD/Erasmus University database on largest TNCs.

Table I.16. Transnationality of the largest TNCs from developing economies: TNI and II, by region, 2006

Top 100 TNCs from developing economies	Average TNI[a]		Average II[b]	
Region/economy	TNI	No. of companies	II	No. of companies
of which:				
Africa (South Africa)	45.0	11	47.7	11
South-East Asia	52.3	20	40.4	17
East Asia	58.6	56	56.3	55
West Asia	56.5	3	92.5	1
Latin America and the Caribbean	40.1	10	39.6	10
Total	**53.9**	**100**	**50.8**	**94**

Source: UNCTAD/Erasmus University database on largest TNCs.

[a] For definition of TNI, see table I.12.
[b] For definition of II, see table I.13.

3. Profitability of the largest TNCs

A ratio widely used to evaluate a company's operational efficiency is the return on sales (ROS), also known as a firm's operational profit margin. It is calculated as the ratio of net income (before interest and taxes) to total sales, and provides insight into how much profit is generated per dollar of sales. For firms for which data were available, ROS was calculated, as an average value over the two years 2005–2006.

A comparison by industries suggests that the top TNCs in the pharmaceutical industry have higher returns, on average, than those in all other industries, and they are three points higher than those in the telecoms industry, which ranks second (table I.18). As seen in a previous section, the average II for the top TNCs in this industry is also the highest. At the bottom of the ROS ranking are the largest TNCs from the motor vehicles industry and retail and wholesale trade (table I.18).

The question of whether and how the internationalization of activities affects the performance of a firm is one of the issues most examined in research on strategic management and international business. The importance of international diversification stems from the fact that it represents a growth strategy that has a major potential impact on a firm's performance. The numerous studies – more than 100 investigations in all – that have examined the diversification-performance relationship in the manufacturing sector, have yielded conflicting results (Contractor, 2007; Glaum and Oesterle, 2007; Hennart, 2007). On average, global trends that point in the direction of

Table I.17. Transnationality of the largest TNCs from developing economies: TNI and II, by major industries, 2006

Industry	TNCs from developing economies	
	TNI	II
Motor vehicles	28.7	54.9
Electrical/electronics	64.0	61.4
Petroleum	27.0	20.1
Telecommunications	41.4	55.2
Metals and metal products	46.9	24.4
Food and beverages	61.3	42.4
Transport and storage	62.3	66.6
Computers and related activities	55.6	72.3
Construction	38.2	33.1
Machinery and equipment	50.0	67.7
All industries	**53.9**	**50.8**

Source: UNCTAD/Erasmus University database on largest TNCs.

more foreign activities and more internationalization obscure the fact that the form and pace of insertion in the world economy differs widely across industries and home countries of firms.

4. The world's top 50 financial TNCs

In response to foreign market opportunities created as a result of deregulation and globalization, many financial firms have increased their FDI and acquired other companies. This is partly because they believe that only very large players will have the cost advantages necessary to remain competitive in their home markets.[44] In addition, they see geographical diversification as an advantage in reducing the volatility of risks. They also view market power as giving them the necessary financial strength to be able to conform to the new Basel II agreement, which is designed to establish minimum levels of capital for internationally active banks.

Table I.18. Average return on sales of major industries, 2005–2006

Industry	ROS	Number of entries
Pharmaceuticals	16.1	7
Telecommunications	13.2	6
Food & beverages	12.9	6
Electricity, gas and water	10.6	9
Petroleum	8.3	7
Electric/electronics	6.5	7
Motor vehicles	4.4	9
Retail and wholesale trade	4.4	6
All industries	**10.8**	**85**

Source: UNCTAD/Erasmus University database on largest TNCs.

In the mid-1990s, M&A activity in financial services was dominated by domestic deals in the United States, driven by changes in the regulatory framework.[45] By the early 2000s, cross-border M&As involving European firms accounted for a large share of all cross-border activities in the industry. Over the past five years, the largest deals, of over $10 billion, have been concluded mainly among European banks. Since 2001, M&A deals in the financial sector have been on the rise, in both number and value (table I.19). European banks are also expanding rapidly into South and Eastern Europe and the Balkans (box I.8).

Table I.19. M&A deals of over $1.5 billion in the financial sector, 2001–2007

Year	Number of deals	Total value
2007	13	140
2006	13	65
2005	8	44
2004	5	34
2003	3	19
2001–2002	3	21

Source: UNCTAD cross-border M&A database.

During the last quarter of 2007, many banks, mortgage lenders, investment funds and hedge funds suffered significant losses as a result of defaults on mortgage or devaluation of mortgage assets in the United States. By the end of 2007, banks announced $60 billion worth of losses, as many of the mortgage bonds backed by sub-prime mortgages had fallen in value. As of April 2008, financial institutions had suffered sub-prime-related losses or write-downs exceeding $245 billion. Two banks – Northern Rock (United Kingdom) and Bear Stearns (United States) – were effectively rescued by their governments.[46] Many institutions escaped bankruptcy with merger deals. Banks also sought and received additional capital from SWFs: an estimated $69 billion has been invested by these entities in large financial institutions over the past year (section C).

Large groups continue to dominate world financial services, not only in terms of total assets but also in terms of the number of countries in which they operate. The 50 largest financial TNCs in terms of total assets in 2006 are ranked by UNCTAD's Geographical Spread Index (GSI), since data on foreign assets, foreign sales and foreign employment are not available for all groups of financial service TNCs (annex table A.I.17). This index is significantly higher for the largest financial groups and for firms from Switzerland, due to the small size of the home country market in the case of the latter.

In 2006, Citigroup (United States) was the top-ranked financial TNC and was more internationalized than any other group in terms of the number of host economies of its affiliates. Overall, European groups dominated the list of the world's top 50 financial TNCs with 34 entries, compared to 9 from the United States, 4 from Japan and 3 from Canada. Japanese banks, after increasing in size through domestic M&As, have gradually regained their positions in the international financial markets from which they had almost completely withdrawn in the 1990s. Despite M&A activity, the ranking of these groups has remained relatively stable: all groups except two were already ranked in the top 50 last year. However, the purchase of ABN AMRO in 2007 by a consortium of three of the largest financial groups will certainly have a strong impact on future rankings.

Information on the location of foreign affiliates suggests that the most preferred host country for the largest financial TNCs remains the United Kingdom followed by the United States (figure I.25). China is ranked third, while three other developing countries, Singapore, Brazil and Mexico, are also among the top 20 preferred locations. Among the new EU member countries, Poland confirmed its importance as a major location for financial activity in Europe, with increased FDI by European financial groups (including, in 2006, by Fortis and Eurobank from Greece).

E. Prospects

After four years of high GDP growth, a slowdown is expected in 2008 due to the financial and credit crises which are now affecting a number of countries worldwide (e.g. IMF, 2008b). High levels of energy and food prices may aggravate this situation. Economic growth in developing countries could compensate for weaker growth in high-income countries. Although economic growth in developing economies is projected to decline, from 7.8% in 2007

Box I.8. Banking in the Balkans[a]

The creation of a viable and sound financial system in South-East European (SEE) countries has been a fundamental aspect of their transition to a market economy. At the beginning of the 1990s, much of the banking industry in the SEE countries and Turkey remained underdeveloped. The implementation of a reform process improved the banking industry in all the transition countries. In general, the reform process consisted of the establishment of a two-tier system, a new regulatory system conforming with BIS standards, allowing the entry of foreign banks, and the privatization of State-owned banks, which was a crucial element in the effective transition of these countries' banking systems to market-oriented ones.

Substantial inflows of FDI, accompanied by a stable business environment and sound macroeconomic policies, have made investments in the banking industry even more attractive. Over the past few years, the level of financial intermediation has increased significantly in the Balkans due partly to substantial investment by foreign banks, which have acquired local banks through privatizations or M&As. During the period 2006–2007, there were six large M&A deals in the financial industry in this region (box table I.8.1).

Box table I.8.1. Largest cross-border M&A deals in the financial sector in the Balkans, 2006–2007

Year	Acquiring firm	Home country	Target firm	Country	Value ($ billion)
2006	National Bank of Greece	Greece	Finansbank	Turkey	5.0
2006	Erste Bank	Austria	Banca Commerciala Romania	Romania	4.7
2007	Citigroup	United States	Akbank	Turkey	3.1
2006	Credit Agricole	France	Emporiki Bank	Greece	2.7
2007	ING Group	Netherlands	Oyak Bank	Turkey	2.7
2006	Dexia	Belgium	DenizBank FS	Turkey	2.4

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

Austrian and Greek banks are taking the lead in investment in banking in the Balkans, though the expansion of French and Italian banks into these countries is also noteworthy. In addition, Greek banks are extending their reach into neighbouring countries of SEE, which are growing twice as fast as the Greek domestic market. By 2005, Greek banks had spent an estimated $1 billion buying bank assets in the Balkans.[b] In the past three years the number of acquisitions has accelerated, with the five largest Greek banks, National Bank of Greece, Alpha Bank, Eurobank, ATEbank and Piraeus Bank, stepping up their commercial and retail banking investments. Notable acquisitions have been by the National Bank of Greece (NBG) in Turkey (Finansbank), Serbia (Vojvodjanska Banka), Romania (Banca Romaneasca) and Bulgaria; by Eurobank in Turkey (Tekfenbank) and Bulgaria (DZI Bank and Postbanka); by Alpha Bank in Serbia (Jubanka); by ATEbank in Serbia (AIK Banka) and Romania (Mindbank); and by Piraeus Bank in Serbia (Atlas Banka) and Bulgaria (Eurobank). At the same time, NBG is pulling out of Western Europe by closing uncompetitive branches in Frankfurt, Paris and Amsterdam.

But the Greek banks are not alone. Other European banks have also moved in. Bank Austria Creditanstalt (a unit of Germany's HypoVereinsbank), Austria's Raiffeisen, and Italy's Unicredito and Banca Intesa are particularly active in the subregion. At the same time, Crédit Agricole and Société Générale, from France, have acquired Greek banks. Among the largest deals, Erste Bank (Austria) acquired Banca Commercial Romania for $4.7 billion and Dexia (Belgium) acquired Denizbank FS (Turkey) for $2.4 billion.

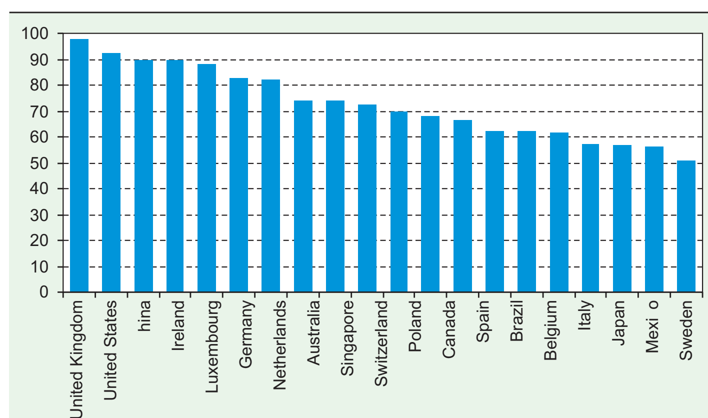
In the new EU accession countries, Bulgaria and Romania, foreign banks have moved rapidly to take dominant positions. In Bulgaria 83% of the banks are controlled by foreign owners. In Romania, Austrian banks are leading (23%), followed by Greek banks (10%) and Italian banks (7%). Romania may offer the best prospects for FDI by foreign banks since, although it is the second largest market in Central and Eastern Europe, it has the least developed banking system.

Source: UNCTAD.

[a] The Association of Balkans Chambers (Albania, Bosnia and Herzegovina, Bulgaria, Cyprus, Greece, Montenegro, Romania, Serbia, the former Yugoslav Republic of Macedonia and Turkey) covers 14.3% of the area of the European continent and 25.3% of its population.

[b] *Business Week*, 20 June 2005.

Figure I.25. Location intensity of the top 20 preferred host countries for financial TNCs, 2007



Source: UNCTAD, based on Dun & Bradstreet, *Who Owns Whom database*.

to 6.5% in 2008, it remains well above the average of recent decades (World Bank, 2008a).

Corporate profits are declining[47] and syndicated bank loans to firms during the first half of 2008 nearly halved over the same period of 2007.[48] Corporate survey findings are pessimistic as regards economic prospects. According to the latest *McKinsey Global Survey of Business Executives* (McKinsey, 2008a), a large majority of executives around the world expect a slowdown in the United States to have a negative impact on their national economies, and nearly 90% report at least a moderate link between their economies and the United States economy. CEO respondents to the *11th Annual Global CEO Survey* carried out by Pricewaterhouse Coopers (2008a) fear a global economic downturn, but continue to recognize the strategic importance of overseas expansion. The survey clearly shows that the impact of the recent global credit crunch and the heightened risk of recession are affecting business confidence. A.T. Kearney's survey also shows that investors are concerned about the economic health of the United States (A.T. Kearney, 2008a).

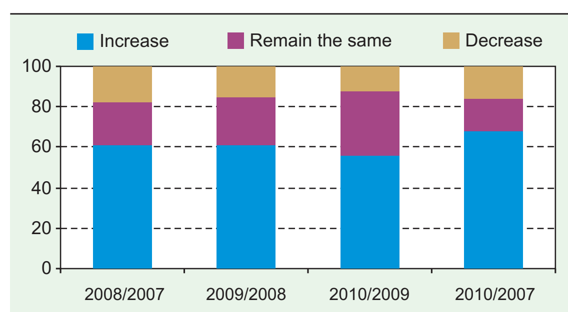
The financial crises could worsen the existing global external imbalances, trigger exchange rate fluctuations, lead to rising interest rates and high and volatile commodity prices, and build inflationary pressure. All of these possible developments pose risks that may also affect global FDI flows.

Will FDI decline in 2008-2009? Based on 75 countries for which data on FDI flows for the first quarter of 2008 were available, annualized FDI flows for the whole of 2008 are estimated to be some $1,600 billion, about 10% less than in 2007. The data on cross-border M&As for the first half of 2008 also show a fall of 29%, compared to the second half of 2007 (figure I.5). However, so far the downswing in FDI flows or cross-border M&As has been much less acute than that of 2001 (figures I.1 and I.5). Some sources point to a fall in FDI flows in 2008 in developed countries (OECD, 2008b), though expectations regarding flows in emerging economies are still upbeat (Institute of International Finance (IIF), 2008a). UNCTAD's *World Investment Prospects Survey 2008–2010*[49] points to lower optimism than that expressed in the previous survey (UNCTAD, 2007b), though it suggests a rising trend in the medium term (figure I.26).[50]

In terms of preferred regions and country groups for FDI, East, South and South-East Asia remains the most preferred region, followed by the EU-15, North America, and the new EU-12 (countries that joined the EU in 2004 and 2007). China is the most preferred investment location, according to the UNCTAD survey, followed by India, the United States, the Russian Federation and Brazil (table I.20). Viet Nam remains in sixth place because of the availability of skilled and cheap labour and its being the second fastest growing economy in the world behind only China. A.T. Kearney's 2007 FDI Confidence Index shows the same top three countries. In Europe taken alone, the United Kingdom is the most attractive location, followed by France, according to a survey by Ernst & Young (2008a). The JBIC survey of Japanese manufacturing TNCs found that China again ranked at the top, although the number of firms planning to expand production in the country continued to decline (JBIC, 2008). As for long-term prospects, the survey showed for the first time India replacing China as the most promising country for business operations of Japanese TNCs.

Looking at prospects by sector, FDI in natural resources is expected to pick up further. High demand for natural resources, partly caused by China's growing economy, and the opening up of new, potentially profitable opportunities in the primary

Figure I.26. Prospects for global FDI flows over the next three years
(Per cent of responses to the UNCTAD survey)



Source: UNCTAD, 2008b.

sector (e.g. gas and oil in Algeria) will attract more FDI into that sector. FDI in commodity-dependent emerging countries is expected to rise more than other emerging countries (IIF, 2008a). Current high food prices may also affect investment decisions in agriculture and related industries.

In conclusion, while the global outlook for international expansion of TNC operations still looks positive, particularly in developing countries, a lower level of optimism and more prudence are expressed by TNCs in their investment expenditure plans than in 2007.

Table I.20. UNCTAD Survey 2008–2010: the most attractive locations for FDI in the next three years (Responses and comparison with the 2007–2009 survey responses)

Economies	2007-2009 survey	Economies	2008-2010 survey
China	56	China	55
India	45	India	41
United States	38	United States	33
Russian Federation	23	Russian Federation	28
Brazil	14	Brazil	22
Viet Nam	13	Viet Nam	12
United Kingdom	10	Germany	9
Australia	10	Indonesia	8
Germany	7	Australia	7
Mexico	7	Canada	6
Poland	7	Mexico	6
		United Kingdom	6

Source: UNCTAD, 2008b.

Notes

1 For example, if the growth rate of FDI inflows is calculated on the basis of euro-denominated FDI inflows for 2007, it would be 19%.

2 For example, at the company level, Toyota, one of the most profitable TNCs in the world, now earns more than half of its profits in developing countries, up from only 17% in 2004 (*Nikkei*, 6 February 2008).

3 Based on the number of projects from the Locomonitor database (www.locomonitor.com). However, data for the value of such projects were not available. This database includes new FDI projects and expansions of existing projects, both announced and realized. Due to lack of data on the value of most projects, only trends based on the number of investment cases can be examined. This database provides data only from 2003 onwards.

4 In the United Kingdom, for example, Sir David Walker, a prominent banker and former regulator, was commissioned to develop a voluntary code of conduct for private equity firms. In November 2007, he recommended that large businesses acquired by private equity should adopt similar regulatory standards to those of listed companies.

5 Data for FDI inflows in major host countries in the beginning of 2008 showed a decline for Canada, France, Germany, Italy, the Netherlands, Switzerland and the United States (see section E).

6 This included the acquisition in 2006 of Inco (Canada) by CVRD of Brazil for $17 billion, which represented the largest investment by a Brazilian company ever.

7 The *UNCTAD Inward FDI Performance Index* is a measure of the extent to which a host country receives inward FDI relative to its economic size. It is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. The *UNCTAD Outward FDI Performance Index* is calculated in the same way as the Inward FDI Performance Index: it is the share of a country's outward FDI in global FDI outflows as a ratio of its share in world GDP. The *UNCTAD Inward FDI Potential Index* is based on 12 economic and structural variables measured by their respective scores on a range of 0–1 (raw data available on: www.unctad.org/wir). It is the unweighted average of scores on the following variables: GDP per capita, rate of growth of real GDP, share of exports in GDP, telecoms infrastructure (average no. of telephone lines per 100 inhabitants, and mobile phones per 100 inhabitants), commercial energy use per capita, share of R&D expenditures in gross national income, share of tertiary level students in the population, country risk, exports of natural resources as a percentage of the world total, imports of parts and components of electronics and automobiles as a percentage of the world total, exports of services as a percentage of the world total, and inward FDI stock as a percentage of the world total. For the methodology for building the index, see *WIR02*: 34–36.

8 See, for example, *Economist Intelligence Unit* (EIU, 2007) and work by the OECD on preventing investment protectionism, at: www.oecd.org.

9 A flat tax system refers to a system that taxes everyone at the same rate, regardless of their income bracket.

10 See: www.trade.gov/investamerica/.

11 Altogether six policy changes relating to the extractive industries were identified in the survey in the following four countries: Bolivia, Ecuador, Kazakhstan and the Bolivarian Republic of Venezuela.

12 ICSID (International Centre for Settlement of Investment Disputes) case ARB/07/27, "Mobil Corporation and others v. Bolivarian Republic of Venezuela".

13 Nine of the 16 BITs China signed from 2003 to 2007 were concluded with African countries: Benin, Djibouti, Equatorial Guinea, Guinea, Madagascar, Namibia, Seychelles, Tunisia and Uganda.

14 Norway, for example, is finalizing a new model BIT that includes, *inter alia*, the promotion of transparency in economic cooperation between the parties, and emphasizes the protection of health, safety, the environment and international labour rights. It also stresses the importance of corporate social responsibility and reaffirms the parties' commitment to democracy, the rule of law, human rights and fundamental freedoms.

15 For more details, see Foreign Affairs and International Trade Canada, 2005.

16 These agreements include, for example, closer economic partnership agreements, regional economic integration agreements or framework agreements on economic cooperation.

17 These disputes were filed with ICSID (or the ICSID Additional Facility) (182), under the United Nations Commission on International Trade Law (UNCITRAL) (78), the Stockholm Chamber of Commerce (15), the International Chamber of Commerce (5), and ad-hoc arbitration (5). Another case was filed with the Cairo Regional Centre for International Commercial Arbitration, one was administered by the Permanent Court of Arbitration, and for one case the exact venue was unknown at the time of writing.

18 This number does not include cases that are exclusively based on investment contracts (State contracts) and cases where a party has so far only signalled its intention to submit a claim to arbitration, but has not yet commenced the arbitration (notice of intent). If the latter cases are submitted to arbitration, the number of pending cases will increase. All data concerning investor-State dispute settlement (ISDS) cases are based on UNCTAD's online ISDS database at www.unctad.org/iia.

19 For 11 cases that were decided, the decision is not in the public domain.

20 For ICSID Rules of Procedure for Conciliation Proceedings (Conciliation Rules), see http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp. For the UNCITRAL Conciliation Rules, see http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1980Conciliation_rules.html.

21 Examples include bailed out banks in Germany (IKB, Sachsen LB), a bank run in the United Kingdom (Northern Rock) and massive losses by some of the largest banks (e.g. UBS of Switzerland).

[22] "Global 500", *Financial Times*, 29 June 2007 and 28/29 June 2008.

[23] For example, the MSCI (Morgan Stanley Capital International) bank index plummeted by nearly 20% in 2007.

[24] In real effective terms, the United States dollar depreciated by 28%, whereas the euro and the pound sterling appreciated by 26% and 16% respectively.

[25] Empirical studies of the effects of exchange rate changes on FDI flows show conflicting results, depending on the specific assumptions of the underlying economic models, and the structural characteristics of the home and host economies. It is therefore difficult to generalize about the effects of exchange rate changes on FDI flows (Russ, 2007). Indeed, foreign firms did not seem to take advantage of the low exchange rate of the Japanese yen during the 1990s and early 2000s. Record FDI inflows to Japan in 2007 were mainly due to large-scale investments in the financial sector, motivated by strategic considerations other than foreign exchange movements (see section on developed countries in chapter II).

[26] It is difficult to determine to what extent exchange rate changes have influenced recent FDI decisions. In recent years, European TNCs have invested heavily within the euro zone as well as in the EU accession countries, as the creation of the euro and greater economic integration in the EU have promoted a concentration of economic activity (*WIR07*). Therefore, increased intra-EU FDI flows to some extent have been at the expense of FDI outflows to other regions and countries, such as the United States.

[27] "The declining dollar – how the companies are coping", *CFO Magazine*, 1 February 2008.

[28] "Volkswagen plans production in North America", *Reuters*, 22 January 2008 (http://www.reuters.com/article/ousiv/idUSL2665653620080126), and *Nikkei*, 31 May 2008.

[29] "The declining dollar – how the companies are coping", *CFO Magazine*, 1 February 2008.

[30] "Low dollar threatens the life of Airbus", *Financial Times*, 22 November 2007.

[31] "Porsche denies U.S. Cayenne production", *Automotive News*, 15 May 2008 (www.autonews.com).

[32] Data from United States Bureau of Economic Analysis (www.bea.gov).

[33] These UNCTAD estimates are based on information from Edwin Truman, Peterson Institute for International Economics, JPMorgan Research, Sovereign Wealth Fund Institute and Global Insight. Other agencies report different estimates. For example, JPMorgan estimated $3–3.7 trillion in 2007, and it is expected to reach $5–9.3 trillion in 2012 (Fernandez and Eschweiler, 2008).

[34] KIA has had an equity capital stake in Daimler Benz since 1974. This share accounted for 6.9% of the total stock value in 2007.

[35] For example, Thyssen-Krupp, a German steel company, had to buy back shares from the Islamic Republic of Iran to cut its stake to under 5% in 2003, down from the 25% which the Government of the Islamic Republic of Iran had acquired in the predecessor company, Krupp, in 1976 when the firm was nearly bankrupt.

[36] The Government of Japan requires foreign companies to notify the Government 30 days in advance of plans to purchase 10% or more equity in Japanese high-tech companies.

[37] In Germany, a lively debate in 2007 on whether the activities of foreign SWFs should be restricted or controlled led to a proposed change in the German Foreign Trade and Payments Act in 2008. A new paragraph is planned to protect public order and the safety of Germany. FDI from countries outside the EU with an equity capital stake of 25% or more now has to be approved by the German Government (Germany, Bundesministerium für Wirtschaft und Technologie, 2008). The German industry federation, BDI, has repeatedly warned against economic patriotism and supports for a continuing high degree of openness to FDI inflows by the German corporate sector ("Investitionsfreiheit bewahren", *BDI*, 15 August 2007, http://www.bdi.eu/dokumente/positionspapier_investitionsfreiheit_bdi_432584.pdf.

[38] In France, for example, President Sarkozy promised to protect French managers from "extremely aggressive" sovereign wealth funds (*Economist*, 17 January 2008:1).

[39] The Government of the United Kingdom can restrict foreign investments in specific companies that it considers important to national security through government ownership of majority shares of these companies (United States GAO, 2008).

[40] According to its disclosure, NGPF has invested 40% of its assets in more than 3,500 equity capital stakes worldwide. None of these investments is larger than 5% of the total value of outstanding stocks of the target companies, and therefore none can be counted as FDI (Norges Bank Investment Management, 2007).

[41] For example in November 2007, PetroChina, first to hit $1,000 billion in value, became the world's largest company, ahead of ExxonMobil and General Electric. The capitalization of PetroChina is much lower in June 2008 but still ranked second according to the Global 500 ranking (*Financial Times*, 28/29 June 2008). However, this firm is not included in the list of the largest TNCs from developing economies in terms of foreign assets. Neither is Microsoft – ranked fifth – listed in the world's largest TNCs by foreign assets.

[42] Location intensity is defined as the total number of TNCs having at least one affiliate in the host country, divided by 100, minus the number of TNCs from this country listed in the top 100 (*WIR06*: 34).

[43] UNCTAD's TNI was introduced in 1995 as a response to the academic debate on the ways to measure transnationality.

[44] According to Vander Vennet (1994 and 2002), the market power motive can better characterize EU banks because they are organized as a system of national oligopolies.

[45] The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which in June 1995 allowed nationwide inter-State banking through holding company banks, and the Gramm-Leach-Bliley Act of 1999, which allowed cross-industry mergers between commercial banks and other financial institutions.

[46] Northern Rock (United Kingdom) was nationalized by the Government of the United Kingdom and the United States Federal Reserve orchestrated the rescue takeover of the investment bank Bear Stearns by rival firm JP Morgan Chase.

[47] For example, earnings of S&P 500 companies have been declining since the last quarter of 2007 (*source*: Standard & Poor's Index Service).

[48] According to Dealogic the syndicated loans worldwide in the first half of 2008 were $1.5 trillion, the lowest level in the past four years (*Nikkei*, 7 July 2008).

[49] This survey of some of the largest TNCs is conducted worldwide on an annual basis. It was undertaken from March to June 2008 using a sample of 3,000 companies chosen from among 8,000 TNCs. Simultaneously, an ad hoc group of international location experts has been set up to provide a more qualitative and global analysis on medium-term business opportunities, risks and uncertainties affecting international investment. The results of its analysis are included in a separate survey report (UNCTAD, 2008b).

[50] An average of 63% of the companies surveyed expressed optimism regarding FDI prospects for the period 2008–2010 (figure I.26), and 59% expected an increase in FDI flows in 2008.