World Investment in 2002

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The United Nations Conference on Trade and Development released its annual report on foreign direct investment, transnational corporations, and export competitiveness for the year 2002. The article highlights the report.

Foreign Direct Investment in 2001

A recent report by the United Nations Conference on Trade and Development (UNCTAD) shows that global flows of foreign direct investment (FDI) declined sharply in 2001 for the first time in a decade, following a record increase in 2000.[2] This was the result of the weakening of the world economy, particularly in the world's three largest economies–which all fell into recession–and a consequent drop in the value of cross-border mergers and acquisitions (M&As). The total value of cross-border M&As completed in 2001 ($594 billion) was only half that in 2000. The number of cross-border M&As also declined, from more than 7,800 in 2000 to some 6,000 in 2001, with the number of cross-border deals worth over $1.0 billion also falling from 175 to 133, and the total value of these large M&As falling from $866 billion to $378 billion.

According to the UNCTAD report, the decline in FDI was concentrated in developed economies, where FDI inflows shrank by 59 percent, compared to 14 percent in developing countries. Inflows to Central and Eastern Europe as a whole remained stable. Global inflows of FDI declined from a record $1,492 billion in 2000 to $735 billion in 2001, of which $503 billion went to developed economies, $205 billion to developing economies, and the remaining $27 billion to the transition economies of Central and Eastern Europe (CEE). The shares of developing countries and those of the CEE in global FDI inflows reached 28 percent and 4 percent respectively in 2001, compared to an average of 18 percent and 2 percent in the preceding two years. The 49 least developed countries (LDCs), as determined by the United Nations, remain marginal recipients with only 2 percent of all FDI to developing countries or 0.5 percent of the global total.

Both inflows and outflows fell sharply in developed countries in 2001 by more than half, to $581 billion and $503 billion respectively, after reaching a peak in 2000. The United States–despite the economic slowdown and the terrorist attacks of September 11, 2001–retained its position as the largest FDI recipient, although inflows more than halved, down to $124 billion. The United States, however, regained its position as the world's largest investor despite outflows of $114 billion that reflected a decline of 30 percent. Major partners both receiving and providing U.S. FDI inflows and outflows were the countries of the European Union (EU). However, the importance of North American Free Trade Agreement (NAFTA) countries as a recipient of U.S. FDI also increased, due partly to the acquisition of Banamex (Mexico) by Citigroup. Concerning inward FDI into the United States, cross-border M&A continued to be the primary mode of entry, led by the acquisition of VoiceStream Wireless Corp. by Deutsche Telekom for $29.4 billion, the largest cross-border M&As deal worldwide in 2001.

Inflows and outflows to and from the EU dropped in 2001 by about 60 percent, to $323 billion and $365 billion, respectively, mainly due to a decline in M&A-related FDI. FDI inflows to the United Kingdom–the main recipient in Western Europe–and Germany declined the most, while those to France, Greece, and Italy increased. FDI outflows comprised mainly cross-border M&As. France became the largest

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[2] This article is taken largely from material found in United Nations Conference on Trade and Development, "World Investment Report 2002: Transnational Corporations and Export Competitiveness – Overview," *World Investment Report 2002* (New York and Geneva, United Nations:2002); found at Internet address *http://www.unctad.org/WIR/pdfs/wir02ove_a4.en.pdf,* retrieved Oct. 1, 2002.

outward investor of the region, followed by Belgium and Luxembourg. Intra-regional flows accounted for an increased share of FDI in the EU. FDI outflows from Japan grew in 2001, while domestic investment and inward FDI declined, mainly due to the prolonged economic recession in that country. FDI flows to and from Australia and New Zealand, countries that have closer economic ties to the Asia-Pacific region, were less affected by developments in the United States than was Canada, where inflows fell by 60 percent.

For developing countries, FDI inflows fell from $238 billion in 2000 to $205 billion in 2001. The bulk of this decline was limited to a relatively small number of host countries. Argentina, Brazil, and Hong Kong experienced a decline in FDI inflows amounting to $57 billion. Africa remains a marginal recipient of FDI, even though FDI inflows rose from $9 billion in 2000 to more than $17 billion in 2001. The increase of $8 billion was largely due to a few large FDI projects, notably in South Africa and Morocco. Certain policy initiatives, notably the African Growth and Opportunity Act (AGOA) in the United States, have contributed to increased FDI in some countries that benefit from improved market access. Also sectoral composition of FDI inflows into the African continent is changing. While more than half of FDI flows went into the primary sector, particularly into oil and petroleum, FDI flows into service industries such as banking and finance, and transport, have become almost as important over the past two years, which the UNCTAD report notes suggests a gradual broadening of investment opportunities over time albeit at a slow pace.

FDI inflows to Asia and the Pacific fell from $134 billion in 2000 to $102 billion in 2001. Much of the decline was due to the drop in inflows to Hong Kong from a record level of $62 billion in 2000. The share of the Asia-Pacific region in world inflows rose from 9 percent in 2000 to nearly 14 percent in 2001. China regained its position as the largest FDI recipient in the region as well in the developing world as a whole. India, Kazakhstan, Singapore, and Turkey were significant recipients. The Association of the South-East Asian Nations (ASEAN) saw a fall in FDI levels in recent years. FDI inflows to ASEAN during 2000-2001 were only $12 billion per year which is about one third of the peak in 1996-1997.

FDI flows into Latin America and the Carribean declined for the second consecutive year, mainly because of a significant drop in FDI to Brazil, where the privatization process of the past few years has almost stopped; and to Argentina, where the economic and financial crisis has discouraged new investment. Mexico became the largest regional recipient with the acquisition of the bank Banamex by Citicorp for $12.5 billion. Outflows from Latin American economies remained modest and mainly directed at other countries in the region.

FDI in the 49 LDCs, although small in absolute terms, continued to make a contribution to local capital formation. As a percentage of total investment, FDI averaged 7 percent for the LDCs as a group during 1998-2000, compared to 13 percent for all other developing countries. Official development assistance (ODA) remains the largest component of external financial flows to LDCs. LDCs as a whole received $12.5 billion in bilateral and multilateral ODA in 2000 compared to $16.8 billion in 1990.

FDI inflows of $27 billion to the CEE countries and outflows of $4 billion from them in 2001, remain at levels comparable to those of 2000. FDI inflows increased in 14 of the region's 19 countries, and the region's share of world FDI inflows rose from 2 percent in 2000 to 3.7 percent in 2001. Five countries (Czech Republic, Hungary, Poland, Russia, and Slovakia) accounted for more than three quarters of the region's inflows in 2001. Outflows from the CEE countries declined somewhat in 2001, due to a slowdown in flows from Russia, which accounts for three-quarters of the outward FDI from the region.

Transnational Corporations and Export Competitiveness

Trends in International Production

UNCTAD's report also analyzed the role of transnational corporations (TNCs), export competitiveness, and trends in international production. The report notes that the role of TNCs in the globalizing world economy is increasing. International production continues to grow, as TNCs expand their role in the globalizing world economy. UNCTAD estimates suggest there are about 65,000 TNCs at the present time with about 850,000 foreign affiliates across the globe. In 2001, foreign affiliates accounted for about 54 million employees, compared to 24 million employees in 1990; their sales of almost $19 trillion were more than twice as high as world exports in 2001 (see table 1). Foreign affiliates now account for one tenth of world GDP and one third of world exports.

The expansion of international production is driven by a combination of factors that play out differently for different industries and for different countries. Three

Table 1
Selected indicators of FDI and international production, 2001

Item	Value at current prices	Annual growth rates
	Billion dollars	*Percent*
FDI inflows	735.0	–50.7
FDI outflows	621.0	–55.0
Sales of foreign affiliates	18517.0	9.2
Gross product of foreign affiliates	3495.0	8.3
Total assets of foreign affiliates	24952.0	9.9
Exports of foreign affiliates	2600.0	0.3
Employment of foreign affiliates (thousands)	53581.0	7.1
GDP in current prices	31900.0	2.0
Gross fixed capital formation	6680.0	—
Receipts from royalties and license fees	73.0	—
Exports of goods and non-factor services	7430.0	–5.4

Note.—Not included in this table are the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and the sales of parent firms themselves.Worldwide sales, gross product, total assets, exports and employment of foreign affiliates are estimated by extrapolating the worldwide data of foreign affiliates of TNCs from France, Germany, Italy, Japan, and the United States on the basis of the shares of those countries in worldwide outward FDI stocks.

Source: UNCTAD, *World Investment Report 2002*.

factors are the main drivers, according to the UNCTAD report. The first factor is policy liberalization–opening up national markets and allowing all kinds of FDI and non-equity arrangements. In 2001, 208 changes in FDI laws were made by 71 countries. More than 90 percent of these changes aimed at making the investment environment more favorable to inward FDI. In addition, as many as 97 countries were involved in the conclusion of 158 bilateral investment treaties, bringing the total of such treaties to 2,099 by the end of 2001. Similarly, 67 new double-taxation treaties were concluded. Moreover, the investment issue figured prominently at the Fourth WTO Ministerial Conference in Doha, Qatar, in November 2001. Part of the followup work involves a substantial effort to help developing countries evaluate better the implications for their development process of closer multilateral cooperation in the investment area.

The second factor is rapid technological change which, with its rising costs and risks, makes it imperative that firms tap world markets in order to spread these costs and risks over many markets and situations. Decreasing transportation and communication costs have made it economical to integrate distant operations and ship products and components across the globe in search of greater efficiency, with important implications for the export competitiveness of countries.

The third factor is increasing competition. Heightened competition compels firms to explore new ways of increasing their efficiency by trying to reduce costs and reaching out to new markets. As a result, international production has taken new forms, with new ownership, new contractual arrangements, and new activities that have been located in new sites.

TNCs and Export Competitiveness

The UNCTAD analysis of TNCs and their role in promoting export competitiveness suggests that improving export competitiveness helps countries develop, via: (a) increasing market share; (b) diversifying the export basket; (c) sustaining higher growth rates over time; (d) upgrading the technological and skill content of export activities; (e) expanding the economic base of domestic firms capable of competing internationally so that competitiveness becomes sustainable and is accompanied by rising incomes; (f) allowing countries to earn more foreign exchange and import goods, services, and technologies they need to raise productivity and living standards; (g) allowing countries to diversify away from dependence on a few primary commodity exports; (h) allowing countries to move up the skills and technology ladder, which is essential for increasing local value added and sustaining rising wages; and (i) permitting a greater realization of economies of scale and scope by offering larger and more diverse markets.

Improved export competitiveness can have significant consequences. In terms of market shares, only 20 economies together account for three quarters of the value of world trade. Developed countries–particularly the United States, Germany, and Japan–are major trading countries. However,

developing countries–such as China, Korea, Malaysia, Mexico, the Philippines, Taiwan, Thailand, Singapore, and economies in transition, such as Hungary—accounted for the largest gains in market share in 1985-2000. Each of the following six countries–China, Costa Rica, Hungary, Ireland, Korea, and Mexico–experienced not only a sharp increase in market share, but also a shift in their export profile, from non-dynamic to dynamic products, and from low technology to medium- and high-technology products. Dynamic products–such as electronics, automotive equipment, and apparel–promote technical skills and add greater value to products that are in greater demand in international markets. Asian winner countries gained market shares in all principal markets (Japanese, European, and North American), while those from other regions advanced mainly in a regional context. Western and Eastern European countries gained mainly in European markets, and countries in Latin America and the Caribbean have mainly gained in North American markets.

The UNCTAD report observed that access to key markets is a necessary but not sufficient condition for attracting export-oriented activities. Although multilateral trade liberalization has been a facilitating factor behind the emergence of international production systems, and the establishment of export-oriented activities abroad by TNCs, access to developed-country markets, especially for products of export interest to developing countries, needs to be further improved. In particular tariff peaks, tariff escalation and nontariff barriers in agriculture, textiles and clothing need to be addressed. Meanwhile, a rise in protectionism could effectively jeopardize the prospects of poor countries to fully exploit their comparative advantage. The growing use of trade measures such as antidumping, safeguards, and targeted subsidies in developed countries all give cause for concern, according to the report.