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**Prospects for FDI Flows, TNC Strategies
and Policy Developments: 2004–2007**

**Global Investment Prospects Assessment (GIPA) Research Note 2:
Findings of second worldwide UNCTAD survey of
investment promotion agencies**

Executive summary

Investment promotion agencies (IPAs) worldwide are becoming increasingly optimistic regarding prospects for an increase in foreign direct investment (FDI) in the near term (2004–2005) as well as in the medium term (2006–2007). The likely recovery of FDI in 2004 is a key finding of UNCTAD's second annual survey of IPAs carried out in 2004. This result confirms the findings of a related survey of locational experts that UNCTAD carried out in cooperation with *Corporate Location* magazine. The results of that survey were published in April in document TD(XI)/BP/5. This year's IPA survey is the second of its kind, following a first edition in 2003, and yielded numerous interesting findings. For example, IPAs are optimistic about FDI prospects in the medium term (2006–2007), with 91 per cent of respondents believing that these will improve. Prospects are considered positive for almost all industries. Globally, the top-ranked industries in terms of prospects for FDI are hotels and restaurants, tourism, computers/information and communication technologies (ICT), and retail and wholesale – all in the services sector. The United States, Germany, the United Kingdom and France are viewed as the leading sources of FDI, followed by China and Japan. Production, logistics and other support services, as well as distribution and sales, are the foremost types of activities that IPAs expect transnational corporations to relocate abroad. Half of the responding IPAs expect FDI to enter through greenfield investments, while 27 per cent expect mergers and acquisitions to be the preferred mode of entry. On the policy side, IPAs are intensifying their efforts to attract FDI using targeting, in particular, and are not shying away from offering additional incentives.

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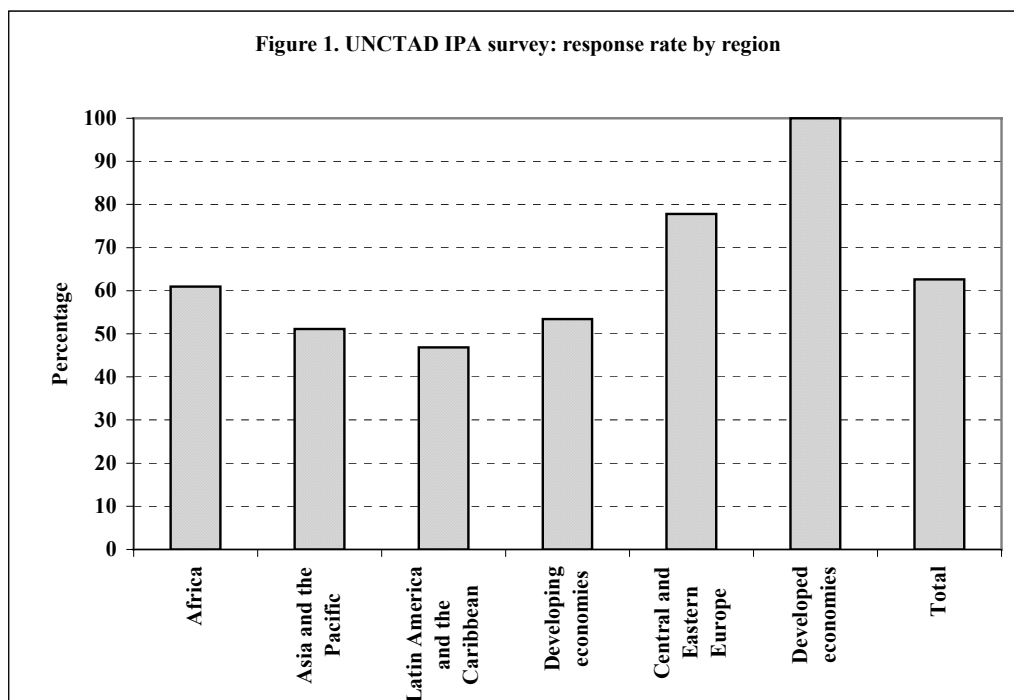
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UNCTAD would like to express its great appreciation to the respondents for their participation in the second IPA survey. Their kind cooperation and the valuable information they provided were indispensable for the assessment of FDI prospects.

Introduction

Global flows of foreign direct investment (FDI) remained stagnant in 2003 at \$653 billion after two consecutive declines – from \$1.4 trillion in 2000 to \$824 billion in 2001 and \$651 billion in 2002.¹ This sharp decline and ensuing stagnation raised several questions about FDI prospects in the short and medium term, as well as about the expected patterns by industry and region. The decline also prompted a number of policy responses by Governments seeking to counterbalance the global trend.

To address some of the questions and improve understanding of FDI prospects and related issues, UNCTAD conducted its second worldwide survey of 158 national investment promotion agencies (IPAs) during January–March 2004.² The overall response rate of the second survey was 63 per cent. The response rate for developed countries with IPAs was 100 per cent, while that for developing countries was 54 per cent (figure 1). IPAs can provide insights and a unique perspective on FDI trends and prospects, being at the forefront of countries' efforts to attract and facilitate such investments. As they respond in their day-to-day operations to foreign investors' inquiries and facilitate investors' locational exploratory missions and feasibility studies, they serve as important antennae for receiving signals relating to FDI flows and the location strategies of transnational corporations (TNCs).



Source: UNCTAD-DITE, Global Investment Prospects Assessment 2004.

For the first time, the findings of the 2004 survey of IPAs are complemented by and cross-checked against those of two other UNCTAD surveys carried out at the same time: a survey of the largest TNCs from developed and developing economies and the transition economies of Central and Eastern Europe (CEE); and a survey of international investment experts, who typically assist TNCs in their overseas location decisions. This note presents only the findings of the second annual survey of IPAs.

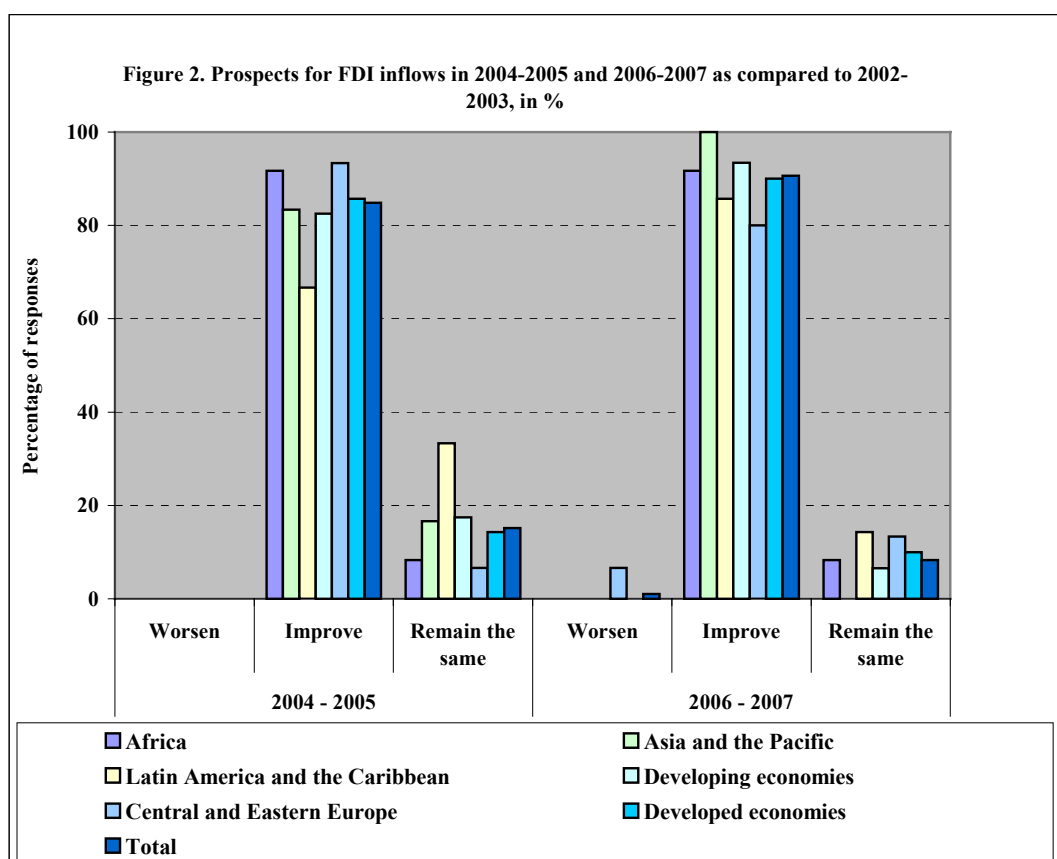
¹ For a comprehensive analysis of FDI trends, see UNCTAD, *World Investment Report 2003: FDI Policies for Development – National and International Perspectives*. Geneva and New York, United Nations, Sales no.: E.03.II.D.8. For an account of the most recent FDI developments, see UNCTAD press release, Global FDI Decline Bottoms Out In 2003, UNCTAD/PRESS/PR/2004/001, 12/01/04

² Some countries do not have national IPAs. They are, therefore, not covered by the survey.

Global prospects

Optimism prevails for short- and medium-term prospects for FDI, indicating a revival of future investment flows.

Given the severity of the recent downturn in FDI, the extent of optimism surrounding prospects for increased FDI in the short (2004–2005) and medium (2006–2007) term is striking (figure 2). A few survey findings stand out. In the short term, no IPA expects prospects to worsen, but in the medium term, 7 per cent of the CEE respondents do. Latin American and Caribbean IPAs are relatively less optimistic, with 67 per cent of respondents expecting an improvement in FDI in the short run, and 86 per cent in the medium term. Developed countries are slightly more optimistic about the medium term than the short term. Overall, respondents from developing economies are as optimistic as those from developed ones regarding FDI prospects in the medium term.

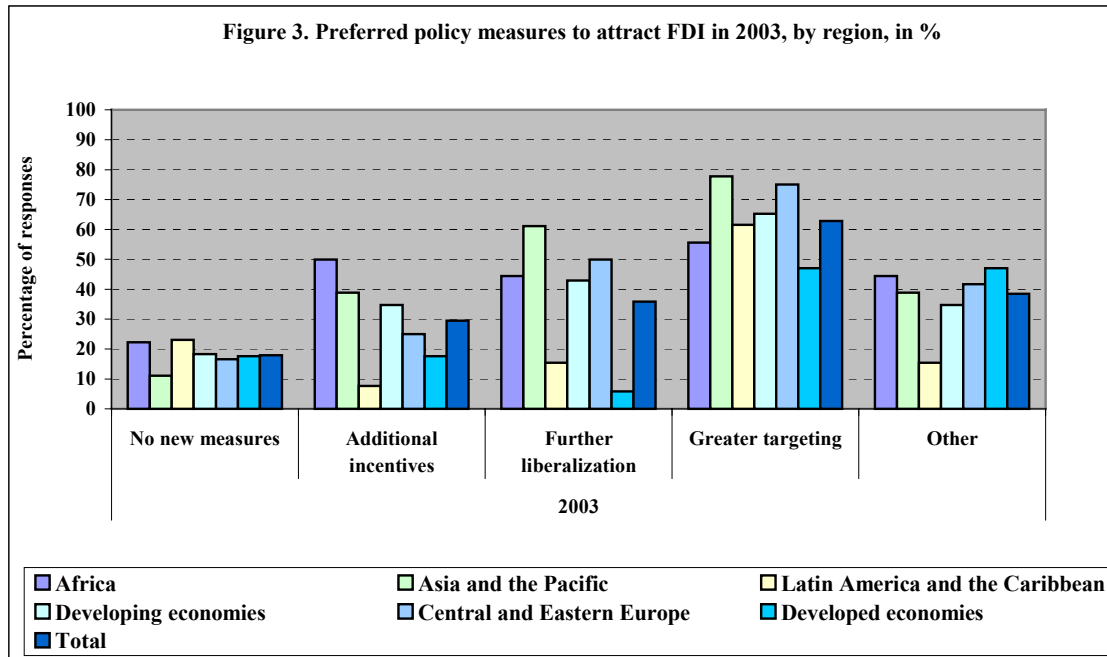


Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

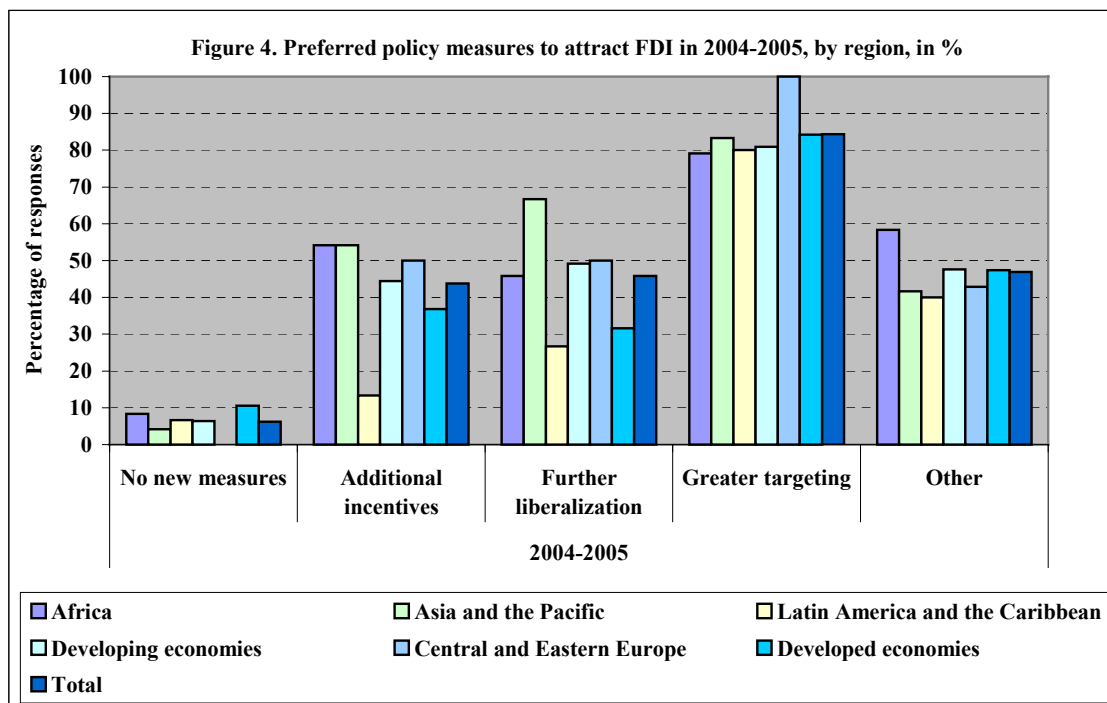
Competition for attracting FDI is becoming more intense, including through greater use of incentives and ongoing liberalization, as well as the use of targeting as an investment promotion instrument.

Despite expectations of improved FDI prospects in the short and medium term, competition among countries for FDI does not show signs of subsiding. If anything, it is becoming more intense, including through greater use of incentives and liberalization. This was evident in 2003, especially for IPAs in Africa, Asia and the Pacific, and Central and Eastern Europe. However, for most Latin American and Caribbean IPAs this trend is less evident; they used further liberalization and incentives less energetically than other regions to attract FDI. Developed countries also have low response rates concerning the use of policy instruments such as incentives and further liberalization. Investment

targeting, on the other hand, has become one of the most important tools for attracting FDI throughout the world, especially for IPAs in Asia and the Pacific, Central and Eastern Europe and Latin America and the Caribbean (figure 3). Overall, the use of targeting is expected to increase during the period 2004–2005 (figure 4).



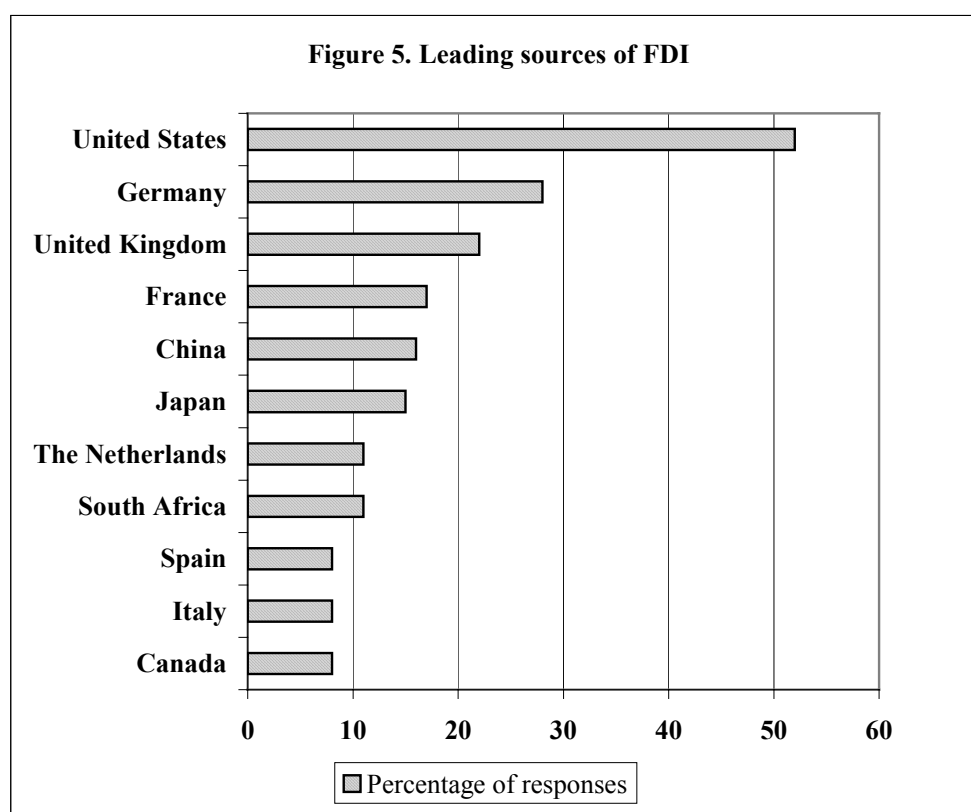
Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.



Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

China is now, for the first time, among the top five investing countries, but the United States is still expected to be the largest source country.

For the first time, a developing country, China, has made the list of the expected top five investing countries worldwide (2004–2005), replacing Japan, which traditionally has been a significant source country for FDI (figure 5).³ Many developing countries rank China second after the United States as an expected country of origin for FDI during the period. This may be because Chinese TNC ventures abroad so far have raised expectations on the part of developing-country IPAs as to the likelihood of attracting additional Chinese investment. The phenomenon is particularly significant because it underscores China's growing importance as regards FDI, not only as a host but also as a source country. However, in terms of the value of individual FDI projects, Chinese investment still tends to be smaller than that of traditional FDI home countries.



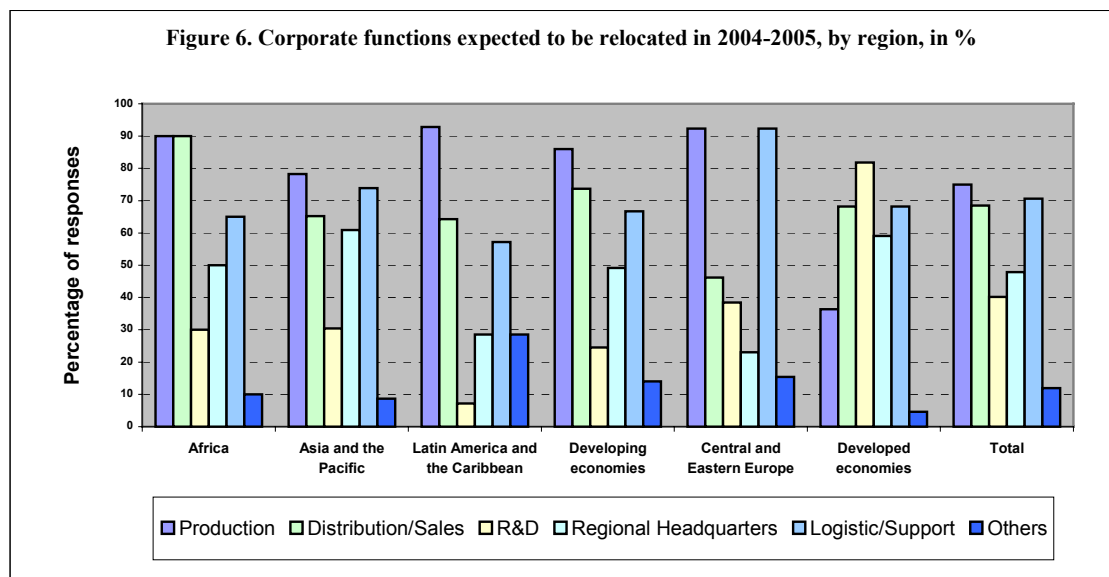
Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

Despite China's ascendancy, the United States remains the largest expected source country worldwide, both for developing and developed economies as distinct groups. In Central and Eastern Europe, it ranks second after Germany. Interestingly, a few smaller countries, such as South Africa and Spain, that are not typically identified as large foreign investors are on the list of the top 10 expected source countries, mainly because of their significance as home countries for specific regions.

³ For a comprehensive analysis of China's outward FDI, see UNCTAD's e-brief: China: an emerging outward investor, 4 December 2003, available at: http://r0.unctad.org/en/subsites/dite/fdistats_files/pdfs/China_ebrief.pdf

While logistics-related functions have gained ground globally, production functions dominate corporate activities located in developing countries. Activities related to research and development (R&D) are expected to remain highly concentrated in developed countries.

Three out of four of the responding IPAs expect more production activities to be located in developing countries during the period 2004–2005, thus underlining the importance of this more traditional type of functional concentration for developing countries (figure 6). However, this finding should not divert attention from the changes in the nature of production functions located abroad; there is increasing spatial specialization of international production, both regionally and globally. Latin America and the Caribbean stand out as the developing region where most countries expect an influx of production activities, according to 93 per cent of the respondents, followed by Africa (90 per cent of respondents) and Asia and the Pacific (78 per cent of respondents). The majority of respondents from developing countries also expected to benefit from the relocation of distribution- and sales-related activities (74%) as well as logistics and other support services (67%). These results are in line with those of other studies that show an increase in off-shoring of certain white-collar jobs from developed to selected developing countries.



Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

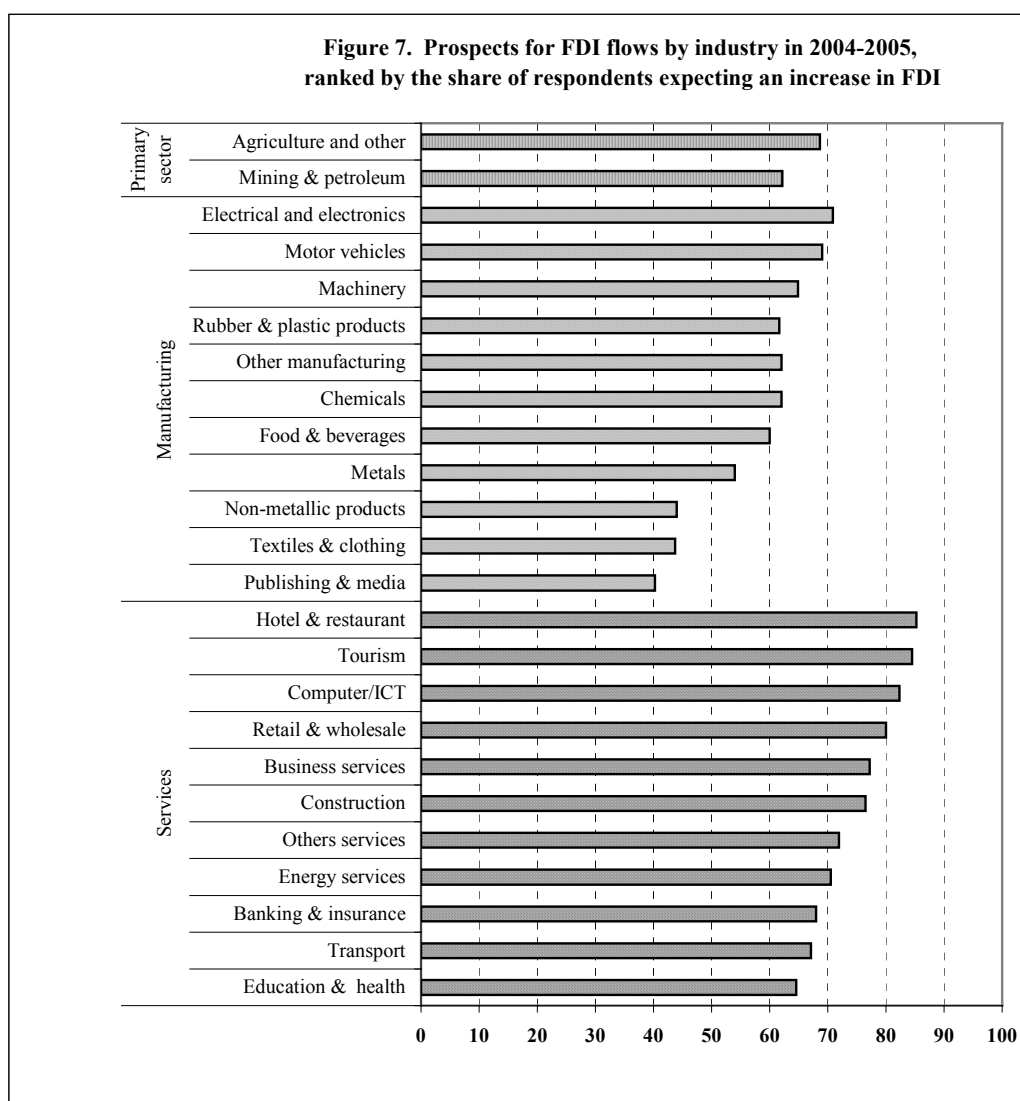
Developed countries have clearly shifted away from attracting production or manufacturing activity per se; instead, the majority of respondents from those countries expect logistics and other support services, distribution and sales, R&D and headquarters to be the principal functions located there.

Central and Eastern Europe stands out in the survey findings with regard to the location of international production by function, in that an exceptionally high percentage of respondents from the region (92 per cent) singled out production as well as logistics and other support services as activities they expect to be relocated there during 2004–2005. These figures suggest that the trend of relocation of production particularly from Western Europe to CEE countries is continuing as many of these join the European Union. Accession to the European Union of many Central and Eastern European countries has also increased the prospects for greater rationalization in functions other than production; hence the high scores not only for logistics and other support services, but also for distribution and sales. It is also noteworthy that 38 per cent of respondents mentioned Central and Eastern Europe as a location for R&D functions, compared with only 25 per cent for developing countries, a reflection of the region's technical expertise and level of education.

The Asia-Pacific region dominates both developing and developed countries as an expected location for regional headquarters of TNCs during 2004–2005, with 61 per cent of respondents expecting headquarters functions to be located there. Thus the well-established reputation of a handful of countries in Asia and the Pacific for offering environments friendly to headquarters-related services continues to pay off.

IPAs are much more optimistic about FDI prospects in services than in manufacturing or mining.

There is across-the-board optimism regarding FDI prospects in services compared with manufacturing and the primary sector. For most service industries, more than 70 per cent of all respondents expected better prospects for FDI compared with the situation in 2002 and 2003 (figure 7).



Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

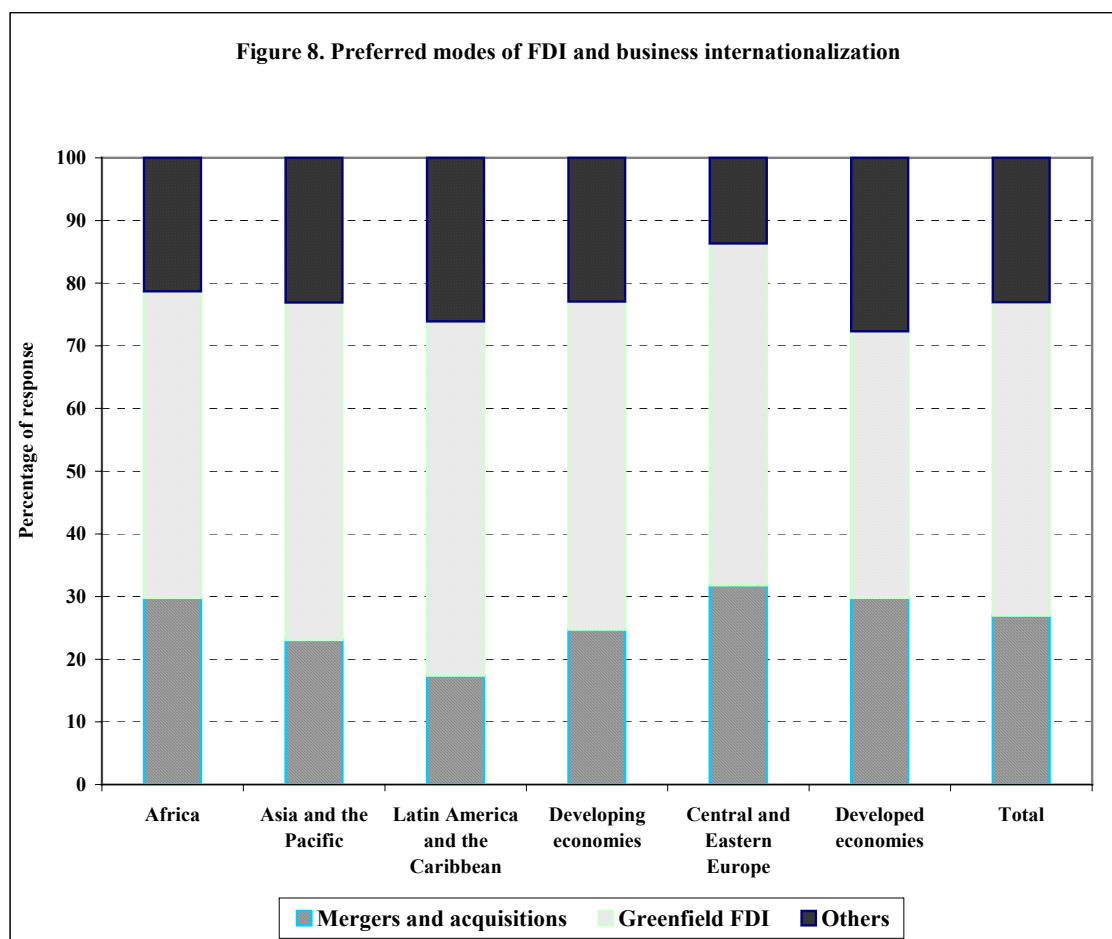
For many service industries (energy services, retail and wholesale, hotel and restaurant, transport, computer/ICT, business services and tourism), no IPA expected a worsening of FDI prospects during the period 2004–2005. For all service industries except banking and insurance, business services and

other services, respondents from developing countries were more optimistic regarding FDI prospects than those from developed countries.

The picture emerging from the survey for FDI prospects in the manufacturing sector was more mixed. No IPAs expected a worsening of FDI prospects in any industry except rubber and plastic products and “other” manufacturing. Overall, IPAs expressed significant optimism regarding FDI in electrical and electronic equipment, but in several industries (e.g. non-metallic products and metals, textiles and clothing, publishing and media) their optimism was more subdued than for most service industries.

Modes of investment are expected to follow traditional lines, greenfield FDI being dominant in the developing countries and mergers and acquisitions in the developed countries, but greenfield FDI is not far behind in the latter.

After the M&A boom of the 1990s, the preferred mode of expansion by TNCs is expected to continue reverting back to being predominantly greenfield in 2004–2005 (figure 8). This reflects the decline in M&As worldwide over the past few years following the M&A bust that started in 2001 and dampened prospects for a new wave of M&As of similar magnitude.



Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

In developing countries, as well as in Central and Eastern Europe, there is a pronounced expectation of greenfield investment projects being dominant, with 52 per cent and 55 per cent of respondents, respectively, expecting such investment. Expectations of M&As are much lower, at 32 per cent or less. In contrast, however, in the developed world the difference in expectations between greenfield

investment and M&As is smaller, the respective shares of respondents being 43 per cent and 30 per cent; the remaining 27 per cent envisage other modes of international expansion, including licensing.

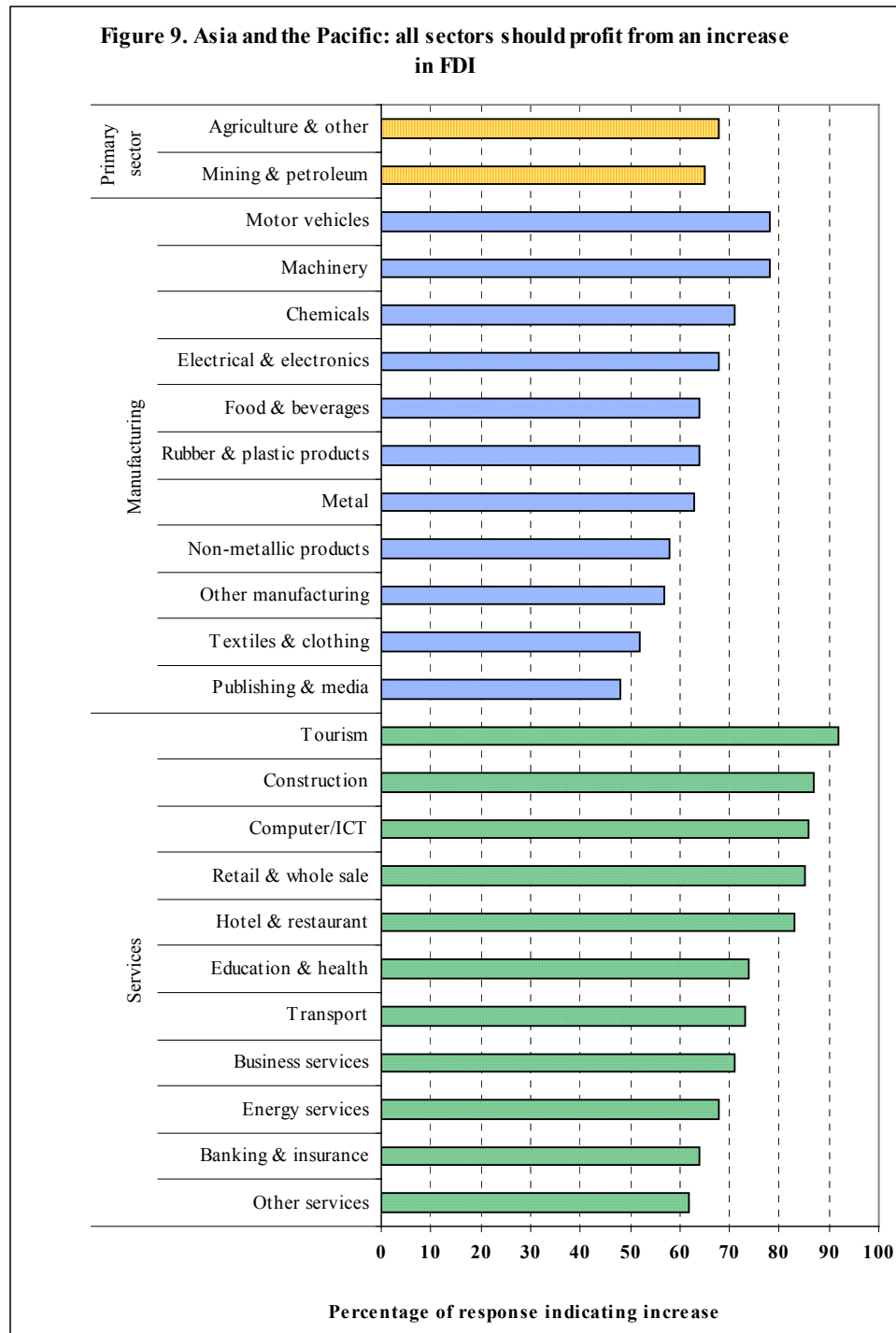
Regional prospects

Some findings of the second IPA survey are of particular importance for individual regions or groups of countries. These are highlighted below.

Asia and the Pacific

In contrast to the somewhat uncertain short-term FDI picture that emerged for Asia and the Pacific in last year's survey, the region now appears to have moved beyond the stagnating FDI flows that characterized 2003. Prospects for 2004–2005 are considered bright, with further improvement anticipated in the medium term (2006–2007) (figure 2). Machinery and equipment along with motor vehicles are the two manufacturing industries for which short-term FDI prospects are particularly positive. In the services sector there is considerable optimism for FDI in tourism, construction, and computers/ICT (figure 9). IPAs' response rate concerning expectations for location of regional headquarters, R&D and logistic/support services were the highest in Asia and the Pacific among all developing regions (figure 6). The United States and Japan were most frequently cited as the most important investors in the region. Finally, greenfield investment remains the preferred mode of entry for TNCs in the years to come.

Over 78 per cent of the IPA respondents from Asia and the Pacific indicated that they had intensified their investment promotion efforts by using targeting strategies, while 39 per cent resorted to additional incentives and 61 per cent used increasing liberalization to attract FDI (figure 3). Even more distinct than in any other developing region, greater FDI liberalization and targeting are reported to be the Asia-Pacific region's preferred instruments for attracting FDI in the medium term (figure 4).



Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

Latin America and the Caribbean

Prospects for FDI in Latin America and the Caribbean are also improving, according to respondents from this region, who expressed considerable optimism regarding increased FDI (86 per cent of respondents) in the medium term. However, it is noteworthy that these respondents were the least optimistic compared to those from other regions of the world – developed and developing – in the

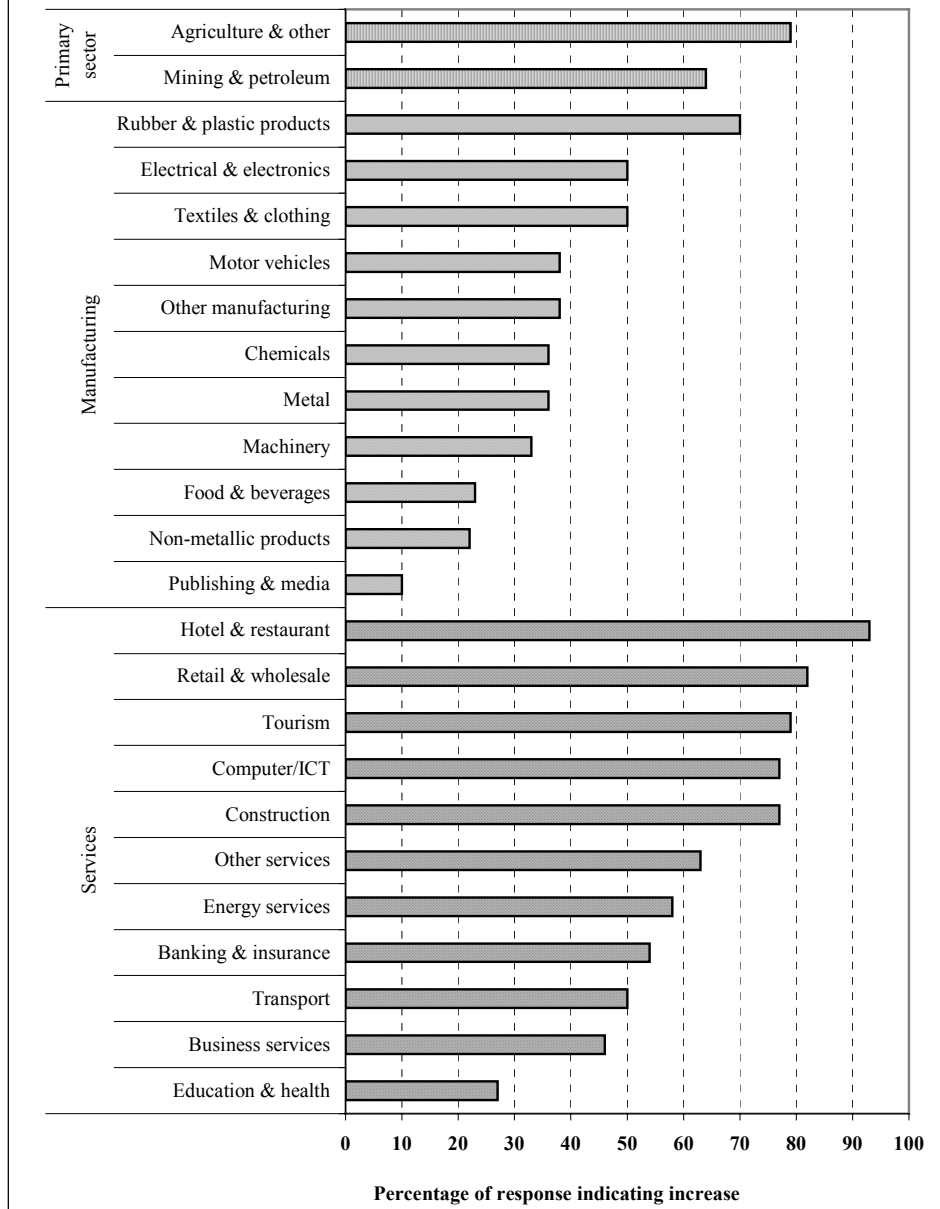
short term as regards improved FDI prospects. One third of the respondents expect prospects to remain unchanged in 2004 and 2005. As was mentioned earlier, expectations for the medium term are significantly better but still lag behind most other developing regions' expectations (figure 2). This picture reflects the economic difficulties that individual countries in the region continue to face, their disappointing FDI performance in 2002 and 2003, and the termination or slowing of many privatization programmes that have attracted FDI in the past. Again, the United States is expected to dominate the FDI picture in the region as the top source country, followed by Spain.

For the primary sector, agriculture is seen as the industry with the brightest FDI prospects. As for the secondary sector, no manufacturing industry stands out as having exceptionally bright prospects for FDI in 2004 and 2005, apart from rubber products. The percentage of respondents expecting prospects to remain unchanged or worsen generally exceeds that of respondents expecting an increase in FDI. There is typically greater optimism regarding FDI in the services sector, particularly hotels and restaurants, retail and wholesale trade, and tourism, followed by computer/ICT and construction (figure 10). More than in any other region, prospects for greenfield investment seem the brightest, with 56 per cent of the respondents expecting this to continue in 2004 and 2005 (figure 8). Provision of additional incentives is the least preferred instrument for attracting FDI compared to other developing regions, while a considerable increase in the use of investor targeting is expected during these two years. (62 per cent of respondents used greater targeting in 2003 to attract FDI, but 80 per cent said they expect to do so during the period 2004–2005.) (See figures 3 and 4.)

Africa

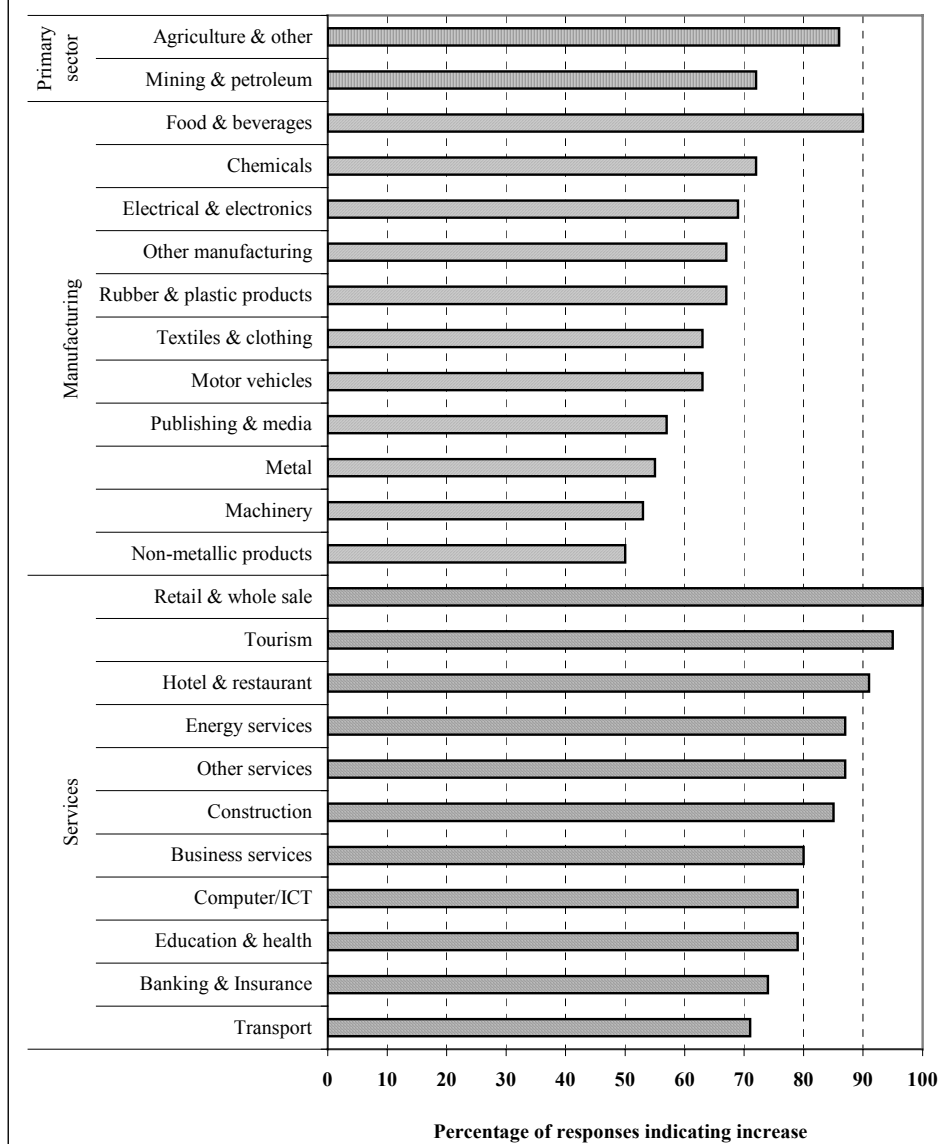
According to the survey, the outlook for Africa is particularly bright. There is significant optimism on the part of African IPAs both for the short and medium term (figure 2). Agriculture scored particularly high in terms of its prospects as a destination for FDI, as did food processing in the manufacturing sector. All services in Africa scored high in terms of FDI prospects, with 100 per cent of respondents expecting more FDI in the retail and wholesale sectors in 2004–2005, followed by tourism and hotels and restaurants (figure 11). South Africa and China are the most frequently mentioned as investors in the region for these years, surpassing countries that have – in value terms – traditionally been the most important investors (e.g. the United Kingdom and France). This implies that even if FDI from the former does not match the values of the traditional source countries, it might be more widespread and less focused on specific countries. Almost half of the respondents (49%) expect greenfield FDI to be the preferred mode of entry (figure 8). In 2003, African IPAs utilized incentives more than in any other developing region, while they lagged behind other developing regions in their use of greater targeting. Both these trends are expected to continue in 2004–2005, although the region should catch up as far as “targeting” is concerned (figures 3 and 4).

Figure 10. Latin America and the Caribbean: FDI growth will be in the services and primary sectors



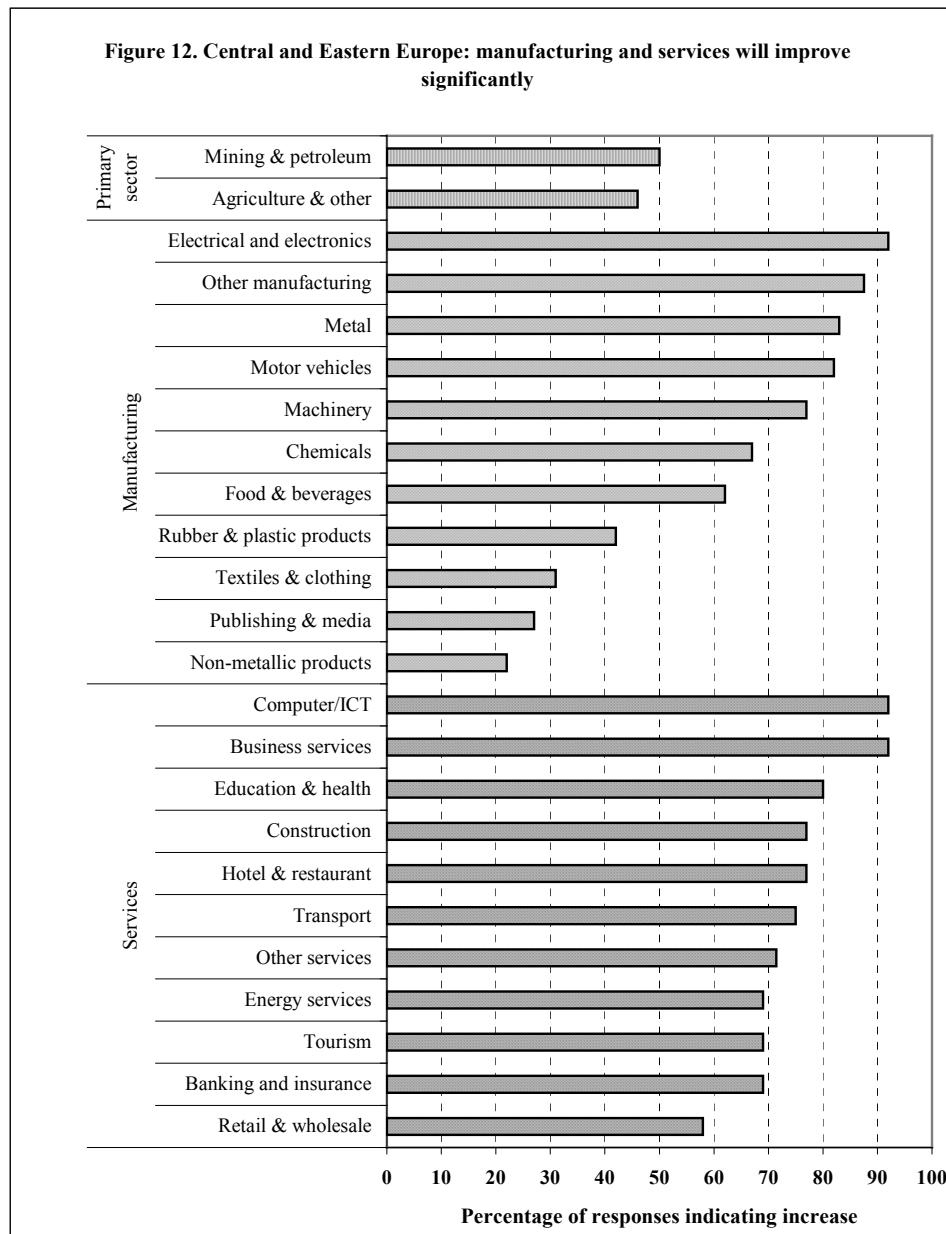
Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

Figure 11. Africa: high scores for all services in terms of FDI prospects



Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

Central and Eastern Europe

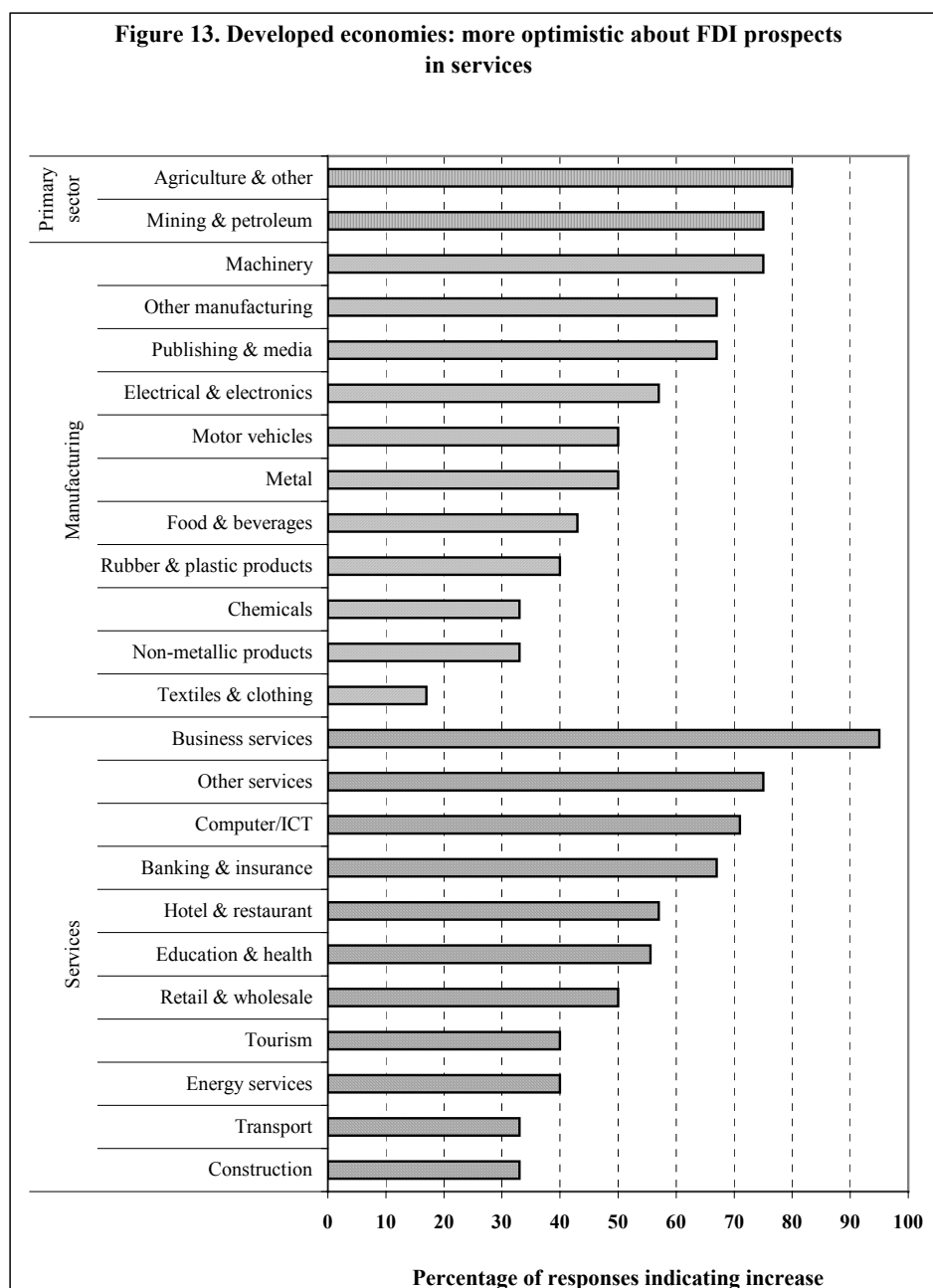


Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

The Central and Eastern European region is particularly optimistic regarding prospects for 2004–2005, but considerably less so for the medium term (2006–2007) (figure 2). This might stem from expectations that the accession of several CEE countries to the European Union will trigger an instant wave of FDI inflows into those countries that will later abate somewhat. Several manufacturing industries (electrical and electronic equipment, other manufacturing, metals and mineral products, motor vehicles, machinery and equipment) stand out, with significantly improved prospects in the short term. As in other regions, service industries score higher than manufacturing, especially business services, computer/ICT, education and health, construction and transport (figure 12). Following earlier trends, Germany and the United States are most often mentioned as the largest

investors in the region in the short term. Similar to the findings of the first IPA survey in 2003, greenfield investment is indicated as the dominant form of entry (figure 8). Liberalization and greater targeting were the principal instruments used in 2003 to attract FDI, and, while that trend is expected to continue in 2004 and 2005, greater use of incentives is also anticipated (figures 3 and 4).

Developed countries



Source: UNCTAD-DITE, *Global Investment Prospects Assessment 2004*.

The overall picture for developed countries as a group is as optimistic as for the rest of the world. In general, while optimism is on the rise regarding medium-term prospects for FDI, it is slightly less

strong than in other regions. In contrast to these findings for developed countries, the EU stands out as being particularly optimistic: all respondents from the region anticipate improved FDI prospects in 2004–2005.

The United States is expected to remain the top investor in the developed world, with Germany and the United Kingdom also ranking high. Investment promotion agencies are particularly optimistic about prospects for FDI in business services, computer/ICT, tourism, hotels and restaurants and banking and insurance in the services sector, while machinery and equipment, publishing and media as well as electrical and electronic equipment score high in the manufacturing sector (figure 13). M&As are expected to be more popular than greenfield FDI (figure 8). Greater targeting was the principal investment promotion instrument used for attracting FDI in 2003, and its importance is expected to increase considerably in 2004 and 2005 (figure 4).

Conclusion

In all the responses to the second annual IPA survey, there are signs of optimism and confidence in buoyant FDI performance in the coming years. IPAs in the developing world are especially positive regarding improved prospects in light of renewed economic growth worldwide. This suggests that IPAs not only believe the worst is over, but have actually become upbeat about prospects. Most likely, barring unforeseen adverse events, their expectations will be met as the world enters a new cycle of growth and prosperity. IPAs are using a combination of policy and investment promotion tools as part of their strategy to compete for and attract FDI, regardless of how they view future prospects. The findings of this survey make clear that, even where optimism prevails, tactics for attracting FDI continue to become more aggressive. The survey findings are complemented by two other UNCTAD surveys – of international investment location experts and TNCs – which provide interesting additional insights into future FDI trends.

UNCTAD's Global Investment Prospects Assessment (GIPA)

The Global Investment Prospects Assessment (GIPA) is designed to assess short- and medium-term prospects for FDI. It analyses predicted future patterns of FDI flows at the global, regional, national, and industry levels from the perspectives of global investors, host countries and international FDI experts. It also analyses evolving trends in the strategies of TNCs as well as FDI policies.

GIPA is designed to fill a research and policy analysis gap, equipping Governments and business alike with a critical instrument for proactive development of policies and strategies, as opposed to *post facto* assessment of foreign investment facts.

In addition to its own research and policy analysis, UNCTAD bases its assessments on the findings of three-part large-scale surveys:

- A worldwide survey of and follow-up interviews with the largest TNCs with headquarters in developed and developing countries and in Central and Eastern Europe.
- A worldwide survey of and follow-up interviews with international FDI experts who typically assist TNCs in their overseas location decisions (in collaboration with *Corporate Location* magazine).
- A worldwide survey of national investment promotion agencies regarding their perception of TNCs' investment strategies and of FDI prospects for their respective countries and regions.

These surveys complement each other and allow for direct comparisons the results obtained.

GIPA is managed by a team comprising:

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