UNITED NATIONS

TD

United Nations Conference on Trade and Development

Distr.
GENERAL

TD/B/COM.2/77
1 February 2007

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Commission on Investment, Technology and
Related Financial Issues
Eleventh session
Geneva, 8–14 March 2007
Item 3 of the provisional agenda

THE EMERGING LANDSCAPE OF FOREIGN DIRECT INVESTMENT: SOME SALIENT ISSUES

Note prepared by the UNCTAD secretariat[*]

Executive summary

Amid the recent widespread expansion of global foreign direct investment, a number of developments reflect a significant change in the FDI landscape. One of the most noteworthy is the rise of developing country TNCs as significant investors. This phenomenon reflects deep-rooted changes in the international economy, particularly since developing countries are taking an increasing share of global production, trade and investment. Some key issues raised by this phenomenon, in particular its implication for South–South cooperation and policy, are examined in section II of this note. Another important development in the pattern of FDI over the past few years, partly related to the rise of developing country TNCs, has been the rapid growth in FDI in natural resources and related industries. This has happened because of a great demand for raw materials (especially arising from increased demand from fast-growing emerging economies), as well as an opening up of new potentially profitable opportunities in the primary sector. This phenomenon represents an important opportunity for resource-rich developing countries, including least developed countries, and is discussed in section III.

[*] This document was submitted on the above-mentioned date as a result of processing delays.

GE.07-50152

CONTENTS

	Page
Introduction	3
I. The global FDI environment	3
II. Outward FDI from developing countries	5
A. Trends	5
B. Drivers, impact and policies	7
1. Impact on host countries	8
2. Impact on home countries	9
3. Policies on outward FDI from developing countries	9
III. FDI in extractive industries	10
A. Trends	10
B. Issues	11
References	14
Annex table	15

INTRODUCTION

1. The UNCTAD secretariat has prepared this note to help identify policy issues for discussion by the Commission on Investment, Technology and Related Financial Issues at its eleventh session.

2. The Commission's deliberations are taking place at a time of increasing and sustained foreign direct investment (FDI) flows to and from both developed and developing countries (section I). Furthermore, important deep-rooted evolutionary changes are occurring in FDI patterns and activities of transnational corporations (TNCs), leading to the emergence of a new FDI landscape. One of the most important aspects of these changes is the rise of developing and transition economy TNCs as significant players on the world stage. This phenomenon, examined in the *World Investment Report 2006: FDI from Developing and Transition Economies — Implications for Development,* reflects structural changes in the international economy, which lead to developing countries taking an increasing share of global production, trade and investment. The increase in FDI by developing country TNCs seems set to continue, resulting in their assuming a greater role in the world economy. This critical development, in particular its implication for South–South cooperation and policy, is examined in section II of this note.

3. Another crucial change in the pattern of FDI, partly related to the rise of developing country TNCs, has been the rapid expansion and proliferation of FDI in natural resources and related industries. Among other factors, a great demand for natural resources (especially arising from the energy and raw materials needs of fast-growing emerging economies, as well as the opening up of new potentially profitable opportunities in the primary sector) will most likely attract significant further FDI in extractive industries, especially in developing countries. Given the vital nature of the primary sector for many developing countries, FDI in extractive industries raises a number of issues regarding its development impact and policy implications. The topic is thus a significant item on many national and international policy agendas, and is discussed in section III. The discussion builds on deliberations at the Expert Meeting on FDI in Natural Resources, which was held in Geneva from 20 to 22 November 2006.

I. THE GLOBAL FDI ENVIRONMENT

4. UNCTAD's preliminary estimates indicate that FDI inflows in 2006 reached $1.2 trillion in 2006 (see annex table), up substantially from $916 billion in 2005 and approaching the $1.4 trillion peak of 2000. Inward FDI continues to grow in all subregions and reflects an ongoing boom in cross-border mergers and acquisitions (M&As), partly fuelled by funds deriving from commodity price increases. The expansion of FDI for a third year in a row also reflects high growth rates across the world as a whole.

5. Two thirds of FDI flows in 2006, at $800 billion, were to developed countries (up from three fifths in 2005). This represents an exceptional 48 per cent estimated increase over the $542 billion flows into developed countries in 2005. Part of this reflects the revival of the United States as destination for FDI. In 2005, that country did not figure among the top 10 recipient countries, but in 2006 it returned to its customary number 1 position (pushing the United Kingdom into the number 2 position) with FDI flows of $177 billion. The European Union, with FDI inflows of $549 billion, remains the largest host region. Although over 90

per cent of all inflows into developed countries originated in other developed countries, investments by developed country TNCs are increasing in scale and scope (see section II).

6. FDI flows into developing countries in 2006 rose by a more modest, but significant, 10 per cent to $368 billion. After the record increases of 2005, this moderation in the pace of increase in FDI inflows was expected. However, there was some variability across developing regions.

7. FDI in *Africa* — at $39 billion a new record, and increasingly in the extractive sector — recorded a 25 per cent increase over the $31 billion in 2005. Buoyant demand for commodities continues to attract FDI by both developed and developing country TNCs, especially in the oil and gas industry. Cross-border M&As in the extraction and related service industries in the region in the first half of 2006 were three times more than those in the same period in 2005. However, the regional FDI picture varies across sectors, countries and subregions. Most of the inflows are concentrated in the West, North and Central African subregions. Inflows remain low in low-income economies that lack natural resources.

8. High oil prices, strong GDP growth rates and further liberalization also led to a substantial increase — 23 per cent — in 2006 FDI flows to *West Asia*, reaching a total of $43 billion. Turkey and oil-rich Gulf States continued to attract most FDI inflows in spite of geopolitical uncertainty in parts of the region. Energy-related manufacturing and services were the industries most affected.

9. Compared with West Asia and Africa, FDI in *South, East and South-East Asia* increased at a lower — but substantial — rate of 13 per cent during 2005 to reach $187 billion in 2006. TNCs' investments in high-tech industries are growing rapidly. China, Hong Kong (China) and Singapore retained their positions as the three largest recipients of FDI in the region. India surpassed the Republic of Korea to become the fourth largest recipient. Outward FDI from the region surged, with newer investors such as China and India joining major existing Asian source economies, such as Malaysia, Singapore and Taiwan Province of China.

10. In the case of *Latin America and the Caribbean* preliminary results actually indicate a small fall in FDI inflows to $99 billion in 2006. Mexico and Brazil remained the largest recipient countries, with inflows virtually unchanged in the former and increasing by 6 per cent in the latter. FDI inflows into Chile increased by 48 per cent in 2006, owing to the continued rise in reinvested earnings that resulted notably from windfall profits in mining. FDI inflows into Colombia and Argentina decreased by 52 per cent and 30 per cent respectively, as a result of a decline in cross-border M&As. Among other factors, the possibility of regulatory changes and of their extension to more countries may have given rise to uncertainty among investors in the primary sector, resulting in a decrease in FDI inflows.

11. The fastest rate of growth in FDI flows was in those to *South-East Europe and the Commonwealth of Independent States*, where FDI inflows grew by 55 per cent over the previous year to $62 billion in 2006, the sixth year of uninterrupted growth of FDI in the region. These flows were concentrated in three countries — the Russian Federation, Ukraine and Romania — and in a few industries, principally those linked to natural resources. Inflows into the region's largest host country, the Russian Federation, almost doubled (see annex table). FDI is likely to remain particularly buoyant in countries that joined the EU on 1 January 2007 (Bulgaria and Romania). FDI prospects for the Russian Federation may, however, be affected by the tightening of its natural resource regulations and disputes about

environmental protection and extraction costs that emerged in 2006 (e.g. with respect to two major oil development projects in Sakhalin island).

12. In general, trends in policies and legislation related to FDI continue to be supportive of inward FDI in both developed and developing countries, but there is a discernible shift in the balance towards a more restrictive approach. For example, in 2000 there were 150 national regulatory changes recorded by UNCTAD, of which 147 were broadly "favourable" to FDI and 3 which were "less favourable" or restrictive. In 2005, however, there were 164 "favourable" changes (down from a high point of 234 in 2004) and 41 "less favourable" (up from 36 in 2004). Of course, the increase in the degree of restriction on FDI and foreign TNCs needs to be seen in perspective: not only do "favourable" changes (at least nominally) still outnumber "less favourable" ones, but they also represent the lion's share of cumulative regulatory changes since the 1980s. And the less favourable changes have been mainly confined to a small number of countries or specific economic sectors. For example, Bolivia, Chad, Chile, the Russian Federation and Venezuela all introduced measures in 2006 to either increase the State's control over national natural resources or gain a greater share of the value added. There have also been fierce debates about foreign control of "strategic" national assets in developed countries, as well as developing ones, with cross-border M&As triggering intense political discussions in countries such as France, Italy, Spain and the United States in 2006. Acquisitions of developed country firms by TNCs from developing countries such as China, the United Arab Emirates (particularly Dubai) and India were among the emerging trends sparking off such discussions; and although no regulatory changes may be forthcoming after each national debate, such debates may nevertheless create an atmosphere impacting negatively on decisions regarding M&As.

13. There are other factors that may affect FDI flows in 2007 and beyond, in addition to changes in regulations and the investment climate World economic growth in 2007 is projected to slow down moderately.[*] Continuing global external imbalances, sharp exchange rate fluctuations, rising interest rates, a build-up of inflationary pressures, and high and volatile commodity prices all pose risks that may hinder growth, and — in consequence — impact on the scale of FDI.

II. OUTWARD FDI FROM DEVELOPING COUNTRIES

A. Trends

14. Although developed country TNCs account for the bulk of global FDI, different data sources confirm the growing and significant international presence of firms — both private and State-owned — from developing and transition economies. Their outward expansion through FDI provides development opportunities for the home economies concerned, as well as the developing countries in which they invest. This phenomenon is eliciting mixed reactions from recipient countries in different parts of the world. Some welcome the increased FDI from those economies as a new source of capital and knowledge, while for others it also represents new competition. The increase in FDI from developing and transition economies was the topic of the *World Investment Report 2006.*

15. A small number of source economies are responsible for a large share of those FDI outflows, but companies from an increasing number of countries see the need to explore

---

[*] United Nations. *World Economic Situation and Prospects.* New York and Geneva, 2007.

investment opportunities abroad in order to defend or build a competitive position. Global FDI from developing and transition economies reached $133 billion in 2005, representing about 17 per cent of world outward flows. This figure includes offshore financial centres. Excluding those, the total outflow was $120 billion — the highest level ever recorded. The value of the stock of FDI from developing and transition economies was estimated at $1.4 trillion in 2005, or 13 per cent of the world total. As recently as 1990, only six developing and transition economies had reported outward FDI stocks of more than $5 billion; by 2005, that threshold had been exceeded by 25 developing and transition economies.

16. Data on cross-border M&As, greenfield investments and expansion projects, as well as statistics related to the number of parent companies based outside the developed world, confirm the growing significance of TNCs from developing and transition economies. Between 1987 and 2005, their share of global cross-border M&As rose from 4 per cent to 13 per cent in value terms, and from 5 per cent to 17 per cent in terms of the number of deals concluded. Their share of all recorded greenfield and expansion projects exceeded 15 per cent in 2005, and the total number of parent TNCs based in Brazil, China, Hong Kong (China), India and the Republic of Korea has multiplied considerably over the past decade.

17. Sectorally, the largest share of FDI from developing and transition economies has been in tertiary activities, notably business, financial, trade-related and infrastructural services. However, significant FDI has also been reported in manufacturing (e.g. electronics) and, more recently, in the primary sector (oil exploration and mining). Data on cross-border M&As confirm the dominance of services, which constituted 63 per cent, by value, of M&As undertaken in 2005 by companies based in developing and transition economies. By industry, the highest shares that year were recorded for transport, storage and communications, mining, financial services, and food and beverages.

18. The geographical composition of FDI from developing and transition economies has changed over time, the most notable long-term development being the steady growth of developing Asia, including West Asia,[†] as a source of FDI. Its share in the total stock of FDI from developing and transition economies stood at 23 per cent in 1980, rising to 46 per cent by 1990 and to 62 per cent in 2005. Conversely, the share of Latin America and the Caribbean in the outward FDI stock fell from 67 per cent in 1980 to 25 per cent in 2005. The top five home economies accounted for two thirds of the stock of FDI from developing and transition economies, and the top 10 for 83 per cent. In 2005, the largest outward FDI stock among developing and transition economies was in Hong Kong (China), the British Virgin Islands, the Russian Federation, Singapore and Taiwan Province of China.

19. A sizeable proportion of FDI originates from offshore financial centres. The British Virgin Islands are by far the largest such source, with an outward FDI stock in 2005 estimated at almost $123 billion. From a statistical point of view, trans-shipping FDI via offshore financial centres makes it difficult to estimate the real size of outward FDI from specific economies and by specific companies. In some years, flows from those centres were particularly large. However, since 2000, their outward FDI has declined considerably and now amounts to about one tenth of the total flows of FDI from developing and transition economies.

[†] Historically, East and South-East Asian economies have been the largest source of FDI from developing Asia, but recently South and West Asia have increased in significance. For example, FDI from West Asia is being led by cash-rich countries, such as the United Arab Emirates, which are strengthening their ties with other Asian economies such as China and India, as well as in Africa.

20. The emergence of new sources of FDI may be of particular relevance to low-income host countries. TNCs from developing and transition economies have become important investors in many LDCs. Developing countries with the greatest dependence on FDI from developing and transition economies (and for which data are available) include China, Kyrgyzstan, Paraguay and Thailand, and LDCs such as Bangladesh, Ethiopia, the Lao People's Democratic Republic, Myanmar and the United Republic of Tanzania. Indeed, FDI from developing countries accounts for well over 40 per cent of the total inward FDI of a number of LDCs. For example, in Africa, South Africa is a particularly important source of FDI; it accounts for more than 50 per cent of all FDI inflows into Botswana, the Democratic Republic of the Congo, Lesotho, Malawi and Swaziland. Moreover, the level of FDI inflows from developing and transition economies into many LDCs may well be understated in official FDI data, as a significant proportion of such investment goes to their informal sector, which is not included in government statistics.

21. UNCTAD estimates show that *South–South* FDI has expanded very rapidly over the past 15 years. Total outflows from developing and transition economies (excluding offshore financial centres) increased from about $4 billion in 1985 to $61 billion in 2004; most of those outflows were destined for other developing or transition economies. In fact, FDI among those economies increased from $2 billion in 1985 to $60 billion in 2004. These data include FDI from transition economies, but since these account for a very small proportion of transactions, these figures can also be used as a proxy for the size of South–South FDI.

B. Drivers, impact and policies

22. The increase in the number and diversity of developing country TNCs over the past decade is largely due to the continuing impact of globalization on developing countries and their economies. The dynamics are complex, but within them the combination of competition and opportunity — interwoven with liberalization policies across developing and developed regions — is particularly important. As developing economies become more open to international competition, their firms are increasingly forced to compete with TNCs from other countries, both domestically and in foreign markets, and outward FDI can be an important component of their strategies. This competition, in turn, can impel them to improve their operations, and it encourages the development of firm-specific competitive advantages, resulting in enhanced capabilities to compete in foreign markets.

23. Four key types of push and pull factors, and two associated developments, help explain the drive for internationalization by developing country TNCs. First, market-related factors appear to be strong forces that push developing country TNCs out of their home countries or pull them into host countries. Secondly, rising costs of production in the home economy, especially labour costs, are a particular concern for TNCs from East and South-East Asian countries such as Malaysia, the Republic of Korea and Singapore, as well as Mauritius (which has labour-intensive, export-oriented industries, such as garments). Thirdly, competitive pressures on developing country firms are pushing them to expand overseas. These pressures include competition from low-cost producers, particularly efficient East and South-East Asian manufacturers. Fourthly, home and host government policies influence outward FDI decisions.

24. In addition to the above-mentioned factors, there are two major developments driving developing country TNCs abroad. First, the rapid growth of many large developing countries — foremost among these being China and India — is causing them concern about running short of key resources and inputs for their economic expansion. This is reflected in strategic

and political motives underlying FDI by some of their TNCs, especially in natural resources. Secondly, there has been an attitudinal or behavioural change among these TNCs, which increasingly realize that they are operating in a global economy, which forces them to develop an international vision. These two developments, together with push and pull factors — especially the threat of global competition in the home economy and increased overseas opportunities arising from liberalization — add empirical weight to the idea that there is a structural shift towards earlier and greater FDI by developing country TNCs.

1. Impact on host countries

25. For developing host economies, FDI from other developing countries provides a broader range of potential sources of capital, technology and management skills to tap. For low-income developing countries, this can be of particular importance. As indicated above, in a number of LDCs developing country FDI accounts for a large share of total FDI inflows. To the extent that firms from developing countries invest appreciable amounts in other developing countries, that investment provides an important additional channel for further South–South economic cooperation.

26. Because the motivations and competitive strengths of developing country TNCs and the locational advantages sought by those firms diverge in several respects from those of TNCs from developed countries, their impact on host developing economies may provide certain advantages over the impact of FDI from developed countries. For example, the technology and business model of developing country TNCs are often closer to those used by firms in host developing countries, and this suggests a greater likelihood of beneficial linkages with host country firms and technology absorption. Also, developing country TNCs tend to use greenfield investments more than M&As as a mode of entry into a host country — that is, they establish new facilities as opposed to acquiring existing ones by purchasing a local company. This applies especially to investment in developing countries. Thus, their investments are more likely to have an immediate effect in improving production capacity in developing countries.

27. Employment generation is an important issue for developing countries, especially LDCs. Inasmuch as developing country TNCs are more oriented towards labour-intensive industries than their developed country counterparts, among other factors, they can play an important role in this connection in the economies of the South. Empirical evidence reported in the *World Investment Report 2006* indicated that in 15 African countries surveyed developing country TNCs on average created relatively more jobs per unit in manufacturing industries. They were also more likely to use unskilled workers, which is also an important consideration for many host countries. Although the evidence is still limited, the role of developing country TNCs in job creation in other developing countries is also important. In China a half of the 23.5 million workers employed by foreign affiliates in 2003 were associated with developing country TNCs; the equivalent share is over 40 per cent in Indonesia. Of course, employment generation has to be balanced against other issues, including the level of technology associated with foreign affiliates.

28. But South–South FDI — like all FDI — can also give rise to concerns. One is that foreign TNCs might come to dominate the local market. Another is that some host countries might feel concerned about the widespread presence of too many firms from a single home country.

2. Impact on home countries

29. Outward FDI from developing countries can also contribute, directly and indirectly, to a home economy. Arguably, the most important potential gain for home countries from outward FDI is the improved competitiveness and performance of the firms and industries involved. Such gains may translate into broader benefits and enhanced competitiveness for the home country as a whole, contributing to industrial transformation and upgrading of value-added activities, improved export performance, higher national income and better employment opportunities. Improved competitiveness of outward-investing TNCs can be transmitted to other firms and economic agents in home countries through various channels, including via linkages with, and spillovers to, local firms, competitive effects on local business, and linkages and interactions with institutions such as universities and research centres. In sum, the more embedded the outward-investing TNCs are, the greater will be the expected benefits for the home economy.

30. At the same time, outward FDI may pose risks for the home economy: it can lead to reduced domestic investment, hollowing out of parts of the economy and a loss of jobs. As always, the beneficial impacts have to be weighed against possible costs.

3. Policies on outward FDI from developing countries

31. From a home country perspective, an increasing number of developing and transition economies are dismantling barriers to outward FDI. While some form of capital control is often still in place to mitigate the risk of capital flight or financial instability, restrictions are mostly aimed at limiting international capital flows other than FDI. Only a handful of developing countries retain outright bans on outward FDI. Countries are increasingly recognizing the potential benefits of outward FDI. A number of Governments, especially in developing Asia, are even actively encouraging their firms to invest abroad, using a variety of supportive measures to that end. Such measures include the provision of information, matchmaking services, and financial or fiscal incentives, as well as insurance coverage for overseas investment.

32. There is no one-size-fits-all policy that can be recommended for addressing outward FDI. Every home country has to adopt and implement policies that are appropriate to its specific situation. Whether a country will benefit by moving from "passive liberalization" to "active promotion" of outward FDI depends on many factors, including the capabilities of its enterprise sector and investing companies' links with the rest of the economy. Nevertheless, for those countries that decide to encourage their firms to invest abroad, it is advisable to situate policies dealing specifically with outward FDI within a broader policy framework aimed at promoting competitiveness.

33. The scope for “South–South” FDI has led many developing host countries to adopt specific strategies to attract such investment. The establishment of the "G-NEXID" network by UNCTAD is also of relevance in this context, as it will allow the sharing of experiences among export-import (EXIM) banks from developing countries.

34. There are also policy implications for host countries. A key question is what developing host countries can do to leverage fully the expansion of FDI from the South. For example, the scope for “South–South” FDI has led many developing host countries to adopt specific strategies to attract such investment. However, some stakeholders are less enthusiastic about the rise of new investors. Several cross-border M&As by TNCs with links

to their Governments have generated national security concerns, and others have spurred fears of job cuts. Countries need to be careful in their use of legislation aimed at protecting national security interests, keeping in mind the risk of fuelling possible retaliation and protectionism.

35. Beyond the national level of policymaking, the interest among developing and transition economies in international investment agreements may also be affected. Increased FDI from those economies is likely to generate growing demand from the business community in the emerging home countries for greater protection of their overseas investments. As a consequence, the focus of developing country Governments may shift from emphasis on inward investment promotion to protection of outward FDI. This may influence the substantive content of future treaties as well as give rise to calls for the renegotiation of existing treaties.

36. Finally, issues of corporate social responsibility (CSR) are likely to become more important as companies in developing and transition economies expand abroad. Discussions related to CSR have traditionally revolved around developed country TNCs and their behaviour in developing countries. The managements of latecomer TNCs from developing countries will be similarly exposed to those issues.

37. The emergence of new sources of FDI requires attention from policymakers in countries at all levels of development. There is hence a need for increased awareness and understanding of the factors driving FDI from developing countries, and of its potential impacts in host and home countries, with a view to maximizing the benefits that countries can derive from this phenomenon. There is considerable scope for a further sharing of experience among policymakers from developing and transition economies, particularly from the perspective of South–South cooperation. In this context, the Commission may wish to consider further the issues raised above regarding developing country FDI and its impacts, and determine which merit further consideration. As part of these considerations, some attention might be given to how a dialogue involving both developing and developed countries could be initiated in order to increase awareness and understanding of the factors driving developing country FDI and its potential impacts; to determine how "South–South" investment cooperation between host and home countries might be utilized to help enhance the prospects of cross-border investments to the mutual development benefits of both sides of the equation; and to identify which mechanisms could be put in place or augmented to help strengthen this cooperation. UNCTAD could contribute to the above processes by continuing its research into, and analysis of, this evolving phenomenon, the results of which it could make available or disseminate through reports, case studies, and meetings and other international forums.

III. FDI IN EXTRACTIVE INDUSTRIES

A. Trends

38. Although TNC activity in the extractive industries once represented the largest share of global FDI, its relative importance has fallen steadily since the 1950s, reaching about 5 per cent of total FDI at the start of this decade, against 32 per cent and 63 per cent respectively

for the manufacturing and services sectors (UNCTAD, 2006).[‡] At the same time, there was also a shift away from developing to developed countries in terms of the concentration of investments, triggered partly by nationalizations in the South between 1950 and the 1970s, and partly by new discoveries of oil and other raw materials.

39. Since the late 1980s FDI in the primary sector in developing countries has recovered for various reasons. Some developing countries privatized State-owned assets via sales to foreign investors and/or opened up to greenfield FDI. Others have started to exploit their oil and mineral riches by actively encouraging participation by TNCs carrying out FDI. Perhaps most important, the burgeoning raw material needs of rapidly growing resource-poor large developing countries such as China and India have resulted in the rise of developing country TNCs whose primary objective is to secure resources for their home economies. Many of these are targeting natural-resource-rich developing countries, including LDCs, in Africa, Latin America and elsewhere.

40. Until the 1970s, FDI in extractive industries was mainly undertaken by major TNCs from a few developed countries. The situation is dramatically different today, with the emergence of developing countries as significant investors. In some industries, for example oil and gas, these developing country TNCs are primarily State-owned enterprises (SOEs). Of the 25 leading oil and gas companies in 2003, seven companies were developed country TNCs, while 15 were SOEs from developing countries or the Russian Federation, and three had minority State ownership — Petrobras (Brazil), ENI (Italy) and Lukoil (Russian Federation) (UNCTAD, 2006). National oil companies have increasingly gained control over exploration and extraction during the past three decades and now control some 82 per cent of all known oil reserves. In metal mining, developed country TNCs remain dominant, although firms from Latin America, the Russian Federation, China and India are increasingly expanding overseas. For example, of the 25 leading mining companies, ranked by their share of world mining production, developed country TNCs dominate the list with 16 entries. Seven companies are from developing countries and the remaining two are Russian.

41. As a result of the above factors, there has been some shift of mining and oil FDI back towards developing countries. Many countries in Africa and in Latin America and the Caribbean have abundant supplies of oil, gas and various minerals. West Asia has an abundance of oil and gas, although most countries in other Asian regions are less endowed in this regard. Countries in West Asia are generally closed to FDI in oil, while many countries in Latin America and Africa opened up to FDI in extractive industries only during the 1990s. In 2004 and 2005, the record levels of FDI inflows into Africa continued to be oriented towards natural resources, particularly in the petroleum industry.[§] In 2005, the 10 largest FDI recipient countries in Africa were rich in oil or metal minerals; and in Latin America, most economies with significant natural resources saw increases in FDI in primary industries.

B. Issues

42. The role of TNCs in extractive industries raises a number of issues as regards their impact on host developing economies, as well as the policy implications and responses. The

[‡] In absolute terms, of course, primary sector FDI has continued to grow, especially since 1970 — it increased by 400 per cent during the 1970s, by 350 per cent during the 1980s and by 400 per cent over the period 1990–2003.

[§] In 2004, the share of this industry exceeded 60 per cent of total inflows into Angola, Egypt, Equatorial Guinea and Nigeria. It has also accounted for the largest share of FDI in Algeria, the Libyan Arab Jamahiriya and Sudan in recent years.

issue of impact and others relating to FDI in extractive industries were the subject of an UNCTAD Expert Meeting held from 20 to 22 November 2006.

43. The experience of resource-rich developing countries indicates that this wealth can be a mixed blessing. With few exceptions,[**] most mineral- and oil-abundant economies have performed worse in terms of growth and poverty reduction than resource-poor ones. Some resource-rich countries are poorer today than they were 20 to 30 years ago. Bearing in mind this so-called resource curse (and the evidence is mixed), the impact of FDI on host developing countries needs to be considered in the broader context of the role of extractive industries in development and poverty reduction.

44. A number of factors determine whether Governments utilize foreign TNCs to exploit their natural resources. Perhaps most important is the fact that TNCs have access to finance, technology and expertise. Constructing a pipeline, developing an oil deposit or establishing new mining facilities can cost billions of dollars.[††] Few developing countries, especially LDCs, can easily raise the amount of capital or possess other resources, including skills and technology, needed for such investments. Private investors with the requisite resources, especially TNCs, are therefore natural partners for Governments. However, the latter are also eager to reap maximum benefits from their natural resources, and the sharing of revenue between investors and the State is thus a central issue in extractive industries.

45. Countries aim to derive other benefits — in addition to government revenues and foreign exchange earnings — by involving foreign companies. These include employment generation, the creation of local linkages and infrastructural development. However, it must be borne in mind that the general nature of the contemporary primary sector compared with, say, the secondary sector may influence how these benefits are achieved. For example, in order to be profitable, many projects in extractive industries are very capital-intensive, which means that Governments need to focus on indirect jobs through backward and forward linkages as a primary route to employment generation. Furthermore, there are concerns that potential economic gains from the extraction of resources may be outweighed by adverse environmental or social costs. Other concerns related to the industry include the depletion of non-renewable resources, corruption and widening income inequalities. Although many of these concerns are associated with the sector rather than with the ownership of investments per se, in circumstances where the bulk of the investment is carried out by TNCs the foreign ownership of assets and activities cannot but be an issue.

46. Recognizing the timeliness of examining the FDI in extractive industries, the Expert Meeting held from 20 to 22 November 2006 discussed a number of key issues. Among these issues, three can be spelled out: (a) how countries can maximize the benefits from the current commodity boom, including through inward FDI; (b) government's longer-term perspective in order to benefit from FDI in extractive industries; and (c) furthering South–South cooperation. The current commodity boom, though different from earlier ones (for example, increases in raw material prices have not caused a recession in developed countries) and potentially long-lasting, will come to an end. It therefore behoves developing country

[**] Often cited successes among developing countries include Botswana, Chile, Malaysia and South Africa.

[††] For example, in the United Republic of Tanzania, increasing exports of gold to some $700 million in 2005 (from $120 million in 2000), required investment of $1.3 billion (*Mining Journal Online*); developing oil deposits in the Orinoco Belt in Venezuela cost $17 billion (*International Herald Tribune*, 1 June 2006); and in Azerbaijan, the recently opened Baku–Tbilisi–Ceyhan pipeline cost $3.9 billion (*The Economist*, 19 August 2006).

Governments benefiting from the boom — Governments in, for example, Africa, Latin America and the Caribbean and elsewhere, which are receiving record amounts of FDI — to treat it as a catalyst in furthering development, both directly through projects for infrastructure, investment, establishing productive capabilities and so forth, and indirectly through the creation of stabilization funds for future use.

47. Planning for the long term is essential — especially with respect to a country's natural resources, which should be perceived as a strategic asset. This requires investment in the sector to be conducted in the context of the country's full economic development agenda, including a balancing of present and future exploitation to meet this agenda. This has implications for ensuring good-quality governance at the national level, the establishment of relevant policies, and the enactment and implementation of regulations and agreements, including international investment agreements and contracts and codes. At the present time national Governments are in a relatively strong position, and regulations and agreements are being reviewed in many countries. However, in order to take full advantage of such reviews, countries need to possess relevant high-quality technical and administrative skills. These can be lacking, especially in LDCs, and consequently it is difficult to negotiate beneficial agreements with TNCs, and even more so to reap benefits from the implementation of such agreements.

48. Finally, the rise of developing country TNCs is both a marker for a major change in the world economy (for example, it was remarked that demand for oil and many minerals in Asia is now higher than in North America, and this in itself will have further consequences because of their use in infrastructure and heavy industries) and an opportunity for consequential South–South cooperation, especially because developing country FDI in extractive industries is growing rapidly. However, as developing country TNCs join developed country ones in investing in the South, this should not obviate the need to properly assess the overall cost-benefit calculus pertaining to FDI in extractive industries. In consequence, developing country TNCs will increasingly come under the spotlight, for example in terms of their governance and corporate responsibility.

49. A number of recommendations emerged from the deliberations at the above-mentioned Expert Meeting relating to Governments, the private sector and the international community as a whole (TD/B/COM.2/EM.20/2). There is a need for more technical assistance to developing countries aimed at improving their regulatory frameworks (including mining codes) and institutional capabilities to benefit more from FDI in extractive industries, and at strengthening their ability to negotiate with TNCs. There is also a need to undertake further policy analyses on ways to encourage industrialization and diversification based on resource extraction, as well as on mining taxation schemes. It is indicated in the recommendations that developing countries need to develop their institutional capabilities, for example their geographical survey data, in order to strengthen their bargaining positions, and that countries and companies involved in extractive industries should be encouraged to sign up to the Extractive Industries Transparency Initiative. Finally, the scope for South–South collaboration in the establishing of development-friendly policies and institutions regulating the involvement of TNCs in extractive industries should be further explored.

50. Against this background, and with a view to establishing priorities, the Commission may wish to discuss further the issues raised above regarding TNC activities in extractive industries, including the South–South perspective, as well as the recommendations and ways and means of implementing them. In the context of current work on this topic at UNCTAD,

including the forthcoming *World Investment Report 2007: FDI in Extractive Industries,* the Commission's discussion might also include the role that UNCTAD could play in supporting international cooperation in this area by contributing to a better understanding of priority issues and through technical assistance activities aimed at strengthening the capabilities of developing countries to deal and work with TNCs and their affiliates.

References

UNCTAD (2006). *TNCs, Extractive Industries and Development.* TD/B/COM.2/E.20/2.

Annex table. FDI inflows, by host region and major host economy, 2004–2006
(Billions of dollars)

Host region/economy	2004	2005	2006 [a]	Growth rate (%)
World	**710.8**	**916.3**	**1 230.4**	**34.3**
Developed economies	**396.1**	**542.3**	**800.7**	**47.7**
Europe	217.7	433.6	589.8	36.0
European Union	213.7	421.9	549.0	30.1
EU-15	*185.2*	*387.9*	*510.7*	*31.7*
France	31.4	63.6	88.4	39.0
Germany	- 15.1	32.7	8.1	- 75.1
Italy	16.8	20.0	30.0	50.2
United Kingdom	56.2	164.5	169.8	3.2
10 new EU member States	*28.5*	*34.0*	*38.4*	*12.8*
Czech Republic	5.0	11.0	5.4	- 50.8
Hungary	4.7	6.7	6.2	- 7.3
Poland	12.9	7.7	16.2	109.9
United States	122.4	99.4	177.3	78.2
Japan	7.8	2.8	- 8.2	- 395.5
Developing economies	**275.0**	**334.3**	**367.7**	**10.0**
Africa	17.2	30.7	38.8	26.5
Egypt	2.2	5.4	5.3	- 1.9
Morocco	1.1	2.9	2.3	- 20.9
Nigeria	2.1	3.4	5.4	60.0
South Africa	0.8	6.4	3.7	- 42.7
Latin America and the Caribbean	100.5	103.7	99.0	- 4.5
Argentina	4.3	4.7	3.3	- 29.5
Brazil	18.1	15.1	16.0	5.9
Chile	7.2	6.7	9.9	48.4
Colombia	3.1	10.2	4.9	- 52.0
Mexico	22.3	18.9	18.9	0.0
Asia and Oceania	157.3	200.0	229.9	15.0
West Asia	18.6	34.5	43.3	25.5
Turkey	2.8	9.7	17.1	76.3
South, East and South-East Asia	138.0	165.1	186.7	13.1
China	60.6	72.4	70.0	- 3.3
Hong Kong (China)	34.0	35.9	41.4	15.4
India	5.5	6.6	9.5	44.4
Indonesia	1.9	5.3	2.0	- 62.9
Republic of Korea	7.7	7.2	1.9	-73.6
Malaysia	4.6	4.0	3.9	- 1.6
Singapore	14.8	20.1	31.9	58.8
Thailand	1.4	3.7	7.9	114.7
South-East Europe and CIS	**39.6**	**39.7**	**62.0**	**56.2**
Russian Federation	15.4	14.6	28.4	94.6
Romania	6.5	6.4	8.6	34.1
Kazakhstan	4.1	1.7	6.5	275.5

Source: UNCTAD.
[a] Preliminary estimates.
Notes: World FDI inflows are projected on the basis of 76 economies for which data are available for part of 2006, as of 7 November 2006. Data are estimated by annualizing their available data — in most cases the first two quarters of 2006. The proportion of inflows into those economies in total inflows into their respective region or subregion in 2005 is used to extrapolate the 2006 data.

* * * * * * * *