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WORLD INVESTMENT REPORT 2011

NON-EQUITY MODES OF INTERNATIONAL PRODUCTION AND DEVELOPMENT

UNITED NATIONS

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PREFACE

Global foreign direct investment (FDI) has not yet bounced back to pre-crisis levels, though some regions show better recovery than others. The reason is not financing constraints, but perceived risks and regulatory uncertainty in a fragile world economy.

The *World Investment Report 2011* forecasts that, barring any economic shocks, FDI flows will recover to pre-crisis levels over the next two years. The challenge for the development community is to make this anticipated investment have greater impact on our efforts to achieve the Millennium Development Goals.

In 2010 – for the first time – developing economies absorbed close to half of global FDI inflows. They also generated record levels of FDI outflows, much of it directed to other countries in the South. This further demonstrates the growing importance of developing economies to the world economy, and of South-South cooperation and investment for sustainable development.

Increasingly, transnational corporations are engaging with developing and transition economies through a broadening array of production and investment models, such as contract manufacturing and farming, service outsourcing, franchising and licensing. These relatively new phenomena present opportunities for developing and transition economies to deepen their integration into the rapidly evolving global economy, to strengthen the potential of their home-grown productive capacity, and to improve their international competitiveness.

Unlocking the full potential of these new developments will depend on wise policymaking and institution building by governments and international organizations. Entrepreneurs and businesses in developing and transition economies need frameworks in which they can benefit fully from integrated international production and trade. I commend this report, with its wealth of research and analysis, to policymakers and businesses pursuing development success in a fast-changing world.

BAN Ki-moon
Secretary-General of the United Nations

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ABBREVIATIONS

ASEAN	Association of South-East Asian Nations
BIT	bilateral investment treaty
BOO	build-own-operate
BOT	build-operate-transfer
CIS	Commonwealth of Independent States
COMESA	Common Market for Eastern and Southern Africa
CSR	corporate social responsibility
EAC	East African Community
EMS	electronics manufacturing services
FDI	foreign direct investment
GCC	Gulf Cooperation Council
GFCF	gross fixed capital formation
GHG	green house gas
IIA	international investment agreement
IP	intellectual property
IPA	investment promotion agency
IPO	initial public offering
ISDS	investor–state dispute settlement
IT-BPO	information technology and business process outsourcing
LDC	least developed country
LLDC	landlocked developing country
LNG	liquefied natural gas
M&As	mergers and acquisitions
MFN	most favoured nation
MSI	multi-stakeholder initiative
NEM	non-equity mode
NIE	newly industrializing economies
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
PPM	process and production method
PPP	public-private partnership
QIA	Qatar Investment Authority
R&D	research and development
ROCE	return on capital employed
RTAs	regional trade agreements
SADC	Southern African Development Community
SEZ	special economic zone
SIDS	small island developing States
SME	small and medium-sized enterprise
SOE	State-owned enterprise
SWF	sovereign wealth fund
TBT	technical barriers to trade
TNC	transnational corporation
TRIMs	trade-related investment measures
TRIPs	trade-related aspects of intellectual property rights
WIPS	*World Investment Prospects Survey*

KEY MESSAGES

FDI TRENDS AND PROSPECTS

Global foreign direct investment (FDI) flows rose moderately to $1.24 trillion in 2010, but were still 15 per cent below their pre-crisis average. This is in contrast to global industrial output and trade, which were back to pre-crisis levels. UNCTAD estimates that global FDI will recover to its pre-crisis level in 2011, increasing to $1.4–1.6 trillion, and approach its 2007 peak in 2013. This positive scenario holds, barring any unexpected global economic shocks that may arise from a number of risk factors still in play.

For the first time, developing and transition economies together attracted more than half of global FDI flows. Outward FDI from those economies also reached record highs, with most of their investment directed towards other countries in the South. In contrast, FDI inflows to developed countries continued to decline.

Some of the poorest regions continued to see declines in FDI flows. Flows to Africa, least developed countries, landlocked developing countries and small island developing States all fell, as did flows to South Asia. At the same time, major emerging regions, such as East and South-East Asia and Latin America experienced strong growth in FDI inflows.

International production is expanding, with foreign sales, employment and assets of transnational corporations (TNCs) all increasing. TNCs' production worldwide generated value-added of approximately $16 trillion in 2010, about a quarter of global GDP. Foreign affiliates of TNCs accounted for more than 10 per cent of global GDP and one-third of world exports.

State-owned TNCs are an important emerging source of FDI. There are at least 650 State-owned TNCs, with 8,500 foreign affiliates across the globe. While they represent less than 1 per cent of TNCs, their outward investment accounted for 11 per cent of global FDI in 2010. The ownership and governance of State-owned TNCs have raised concerns in some host countries regarding, among others, the level playing field and national security, with regulatory implications for the international expansion of these companies.

INVESTMENT POLICY TRENDS

Investment liberalization and promotion remained the dominant element of recent investment policies. Nevertheless, the risk of investment protectionism has increased as restrictive investment measures and administrative procedures have accumulated over the past years.

The regime of international investment agreements (IIAs) is at the crossroads. With close to 6,100 treaties, many ongoing negotiations and multiple dispute-settlement mechanisms, it has come close to a point where it is too big and complex to handle for governments and investors alike, yet remains inadequate to cover all possible bilateral investment relationships (which would require a further 14,100 bilateral treaties). The policy discourse about the future orientation of the IIA regime and its development impact is intensifying.

FDI policies interact increasingly with industrial policies, nationally and internationally. The challenge is to manage this interaction so that the two policies work together for development. Striking a balance between building stronger domestic productive capacity on the one hand and avoiding investment and trade protectionism on the other is key, as is enhancing international coordination and cooperation.

The investment policy landscape is influenced more and more by a myriad of voluntary corporate social responsibility (CSR) standards. Governments can maximize development benefits deriving from these standards through appropriate policies, such as harmonizing corporate reporting regulations, providing capacity-building programmes, and integrating CSR standards into international investment regimes.

NON-EQUITY MODES OF INTERNATIONAL PRODUCTION AND DEVELOPMENT

In today's world, policies aimed at improving the integration of developing economies into global value chains must look beyond FDI and trade. Policymakers need to consider non-equity modes (NEMs) of international production, such as contract manufacturing, services outsourcing, contract farming, franchising, licensing, management contracts, and other types of contractual relationship through which TNCs coordinate the activities of host country firms, without owning a stake in those firms.

Cross-border NEM activity worldwide is significant and particularly important in developing countries. It is estimated to have generated over $2 trillion of sales in 2009. Contract manufacturing and services outsourcing accounted for $1.1–1.3 trillion, franchising $330–350 billion, licensing $340–360 billion, and management contracts around $100 billion. In most cases, NEMs are growing more rapidly than the industries in which they operate.

NEMs can yield significant development benefits. They employ an estimated 14–16 million workers in developing countries. Their value added represents up to 15 per cent of GDP in some economies. Their exports account for 70–80 per cent of global exports in several industries. Overall, NEMs can support long-term industrial development by building productive capacity, including through technology dissemination and domestic enterprise development, and by helping developing countries gain access to global value chains.

NEMs also pose risks for developing countries. Employment in contract manufacturing can be highly cyclical and easily displaced. The value added contribution of NEMs can appear low if assessed in terms of the value captured out of the total global value chain. Concerns exist that TNCs may use NEMs to circumvent social and environmental standards. And to ensure success in long-term industrial development, developing countries need to mitigate the risk of remaining locked into low-value-added activities and becoming overly dependent on TNC-owned technologies and TNC-governed global value chains.

Policy matters. Maximizing development benefits from NEMs requires action in four areas. First, NEM policies need to be embedded in overall national development strategies, aligned with trade, investment and technology policies and addressing dependency risks. Second, governments need to support efforts to build domestic productive capacity to ensure the availability of attractive business partners that can qualify as actors in global value chains. Third, promotion and facilitation of NEMs requires a strong enabling legal and institutional framework, as well as the involvement of investment promotion agencies in attracting TNC partners. Finally, policies need to address the negative consequences and risks posed by NEMs by strengthening the bargaining power of local NEM partners, safeguarding competition, protecting labour rights and the environment.