DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS

TRENDS AND RECENT DEVELOPMENTS IN FOREIGN DIRECT INVESTMENT*

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I. Recent trends

A sharp decline in FDI within the OECD area…

Between 2000 and 2001, foreign direct investment (FDI) flows into and out of OECD countries recorded their largest drop in recent decades. Total inflows in the OECD area fell from US dollars (USD) 1.27 trillion to USD 566 billion, or a decline of around 56 per cent (Table 1). While firm data are not fully available for non-OECD countries, early indications suggest that their share of global FDI increased slightly in 2001, owing to a less sharp decline in inflows. On current estimates, the total 2001 outflows from OECD countries amounted to USD 593 billion, with the OECD area acting as a net exporter of USD 27 billion worth of FDI in 2001 as compared with USD 12 billion in 2000. (For a methodological description of the OECD foreign direct investment statistics, see Box 1.)

…affected countries differently…

The sharp decline in activity affected countries differently. The largest drops in inflows were seen in Germany and Belgium-Luxembourg (in both cases to the tune of about 80 per cent). This reflected historically large transactions in 2000 in connection with a few major cross-border corporate ownership changes. The traditionally largest players in direct investment -- United States and United Kingdom -- both saw declines in their FDI inflows that were broadly in line with OECD averages. FDI flows into Japan had picked up from a comparatively low level in 1999, but in 2001 they fell back somewhat. Among the large OECD economies, France and

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Italy bucked the trend and attracted increasing foreign direct investment inflows in 2001.

…and reduced the United States' role as a net importer of FDI.

While FDI outflows showed (not surprisingly) the same general trend as inflows, some country differences nevertheless bear mentioning. In particular, an earlier tendency for corporate cross-border consolidation to affect individual countries' FDI inflows and outflows in unison appears to have been weakened in 2001. Outflows from the United States, while lower than in 2000, nevertheless held up comparatively well and accounted for more than 21 per cent of OECD countries' total outward FDI in 2001. Germany's outflows of direct investment also did not drop much in 2001, returning the country to its pre-2000 role as a net exporter of FDI. Countries like the United Kingdom and Sweden, on the other hand, saw their outward FDI reduced by almost 85 per cent.

a) Making sense of the trends

The drop occurred from historically high levels…

When assessing the causes of the drop in international investment in 2001 it is essential to keep in mind the previous year's levels of FDI. The total amount of FDI in 2000 stood at an all-time historical high, at almost six times the levels recorded only five years earlier (Figure 1, Panel A). The decline between 2000 and 2001 essentially eliminated two thirds of the increase by reducing FDI flows to twice the level they had reached in the mid-1990s. In other words, the developments in 2001, rather than a seminal decline in international investment flows, appear to have marked a correction toward more sustainable levels, following what could arguably have been an "investment bubble" in 1999 and 2000.

…owing to a flurry of corporate takeovers in 1999 and 2000.

Most of the hike in FDI in 1999 and 2000 affected the largest OECD economies. It largely took the form of a growing number of mergers and acquisitions (M&As) in connection with a wave of global restructuring and repositioning among multinational enterprises. Stepped-up privatisation efforts by authorities also played a role, especially in the case of non-OECD countries. Moreover, specific data for M&A (discussed in more detail below) indicates that the increase in activity related to both the number of transactions and the average price paid for a given corporate acquisition (Figure 1, Panel B).

Table 1. Direct investment flows, OECD countries, 1998-2001

(billion US dollars)

	Inflows				Outflows			
	1998	1999	2000 p	2001 e	1998	1999	2000 p	2001 e
Australia	6.1	5.7	11.9	5.1	3.4	3.0	5.1	11.4
Austria	4.5	3.0	8.8	5.9	2.7	3.3	5.7	3.0
Belgium-Luxembourg	22.7	38.7	243.3	51.0	28.5	34.0	241.2	67.3
Canada	22.6	25.2	63.3	27.6	34.6	18.4	44.0	37.0
Czech Republic	3.7	6.3	5.0	4.9	0.1	0.1	0.0	0.1
Denmark	7.7	6.8	14.5	4.1	4.5	7.0	6.6	6.1
Finland	12.1	4.6	8.8	3.6	18.6	6.6	24.0	7.3
France	31.0	47.1	42.9	52.6	48.6	120.6	175.5	82.8
Germany	24.6	54.8	195.2	31.8	88.8	109.4	49.8	43.3
Greece	..	0.6	1.1	1.6	n.a.	0.5	2.1	0.6
Hungary	2.0	2.0	1.6	2.4	0.5	0.3	0.6	0.3
Iceland	0.1	0.1	0.2	0.2	0.1	0.1	0.4	0.3
Ireland	8.9	19.0	24.1	9.8	3.9	5.4	4.0	5.4
Italy	4.3	6.9	13.4	14.9	16.1	6.7	12.3	21.5
Japan	10.2	21.1	29.0	17.9	39.9	65.3	49.8	32.5
Korea	5.2	10.7	10.1	3.2	3.4	2.1	3.5	2.6
Mexico	11.9	12.5	14.7	24.7	..	..	..	3.7
Netherlands	37.9	31.9	54.3	55.6	38.8	41.5	72.0	44.4
New-Zealand	1.8	0.9	1.3	3.2	0.4	1.1	0.6	0.7
Norway	4.0	7.5	6.0	2.2	2.5	5.5	8.3	-1.0
Poland	6.4	7.3	9.3	6.8	0.3	0.0	0.0	0.1
Portugal	3.1	1.2	6.4	3.3	3.8	3.2	7.7	5.1
Slovak Republic	0.5	0.4	2.1	0.6	0.1	-0.4	0.0	0.1
Spain	11.8	15.8	37.5	21.8	18.9	42.1	54.7	27.8
Sweden	19.6	60.9	23.4	12.9	24.4	21.9	40.6	6.4
Switzerland	8.9	11.7	16.3	10.0	18.8	33.3	42.7	16.3
Turkey	1.0	0.8	1.7	3.3	0.4	0.7	1.0	0.6
United Kingdom	70.6	82.9	119.7	53.8	121.8	205.8	255.1	39.5
United States	179.0	289.5	307.7	130.8	142.6	188.9	178.3	127.8
TOTAL OECD	**522.6**	**775.6**	**1274.0**	**565.8**	**666.7**	**926.6**	**1285.6**	**593.1**

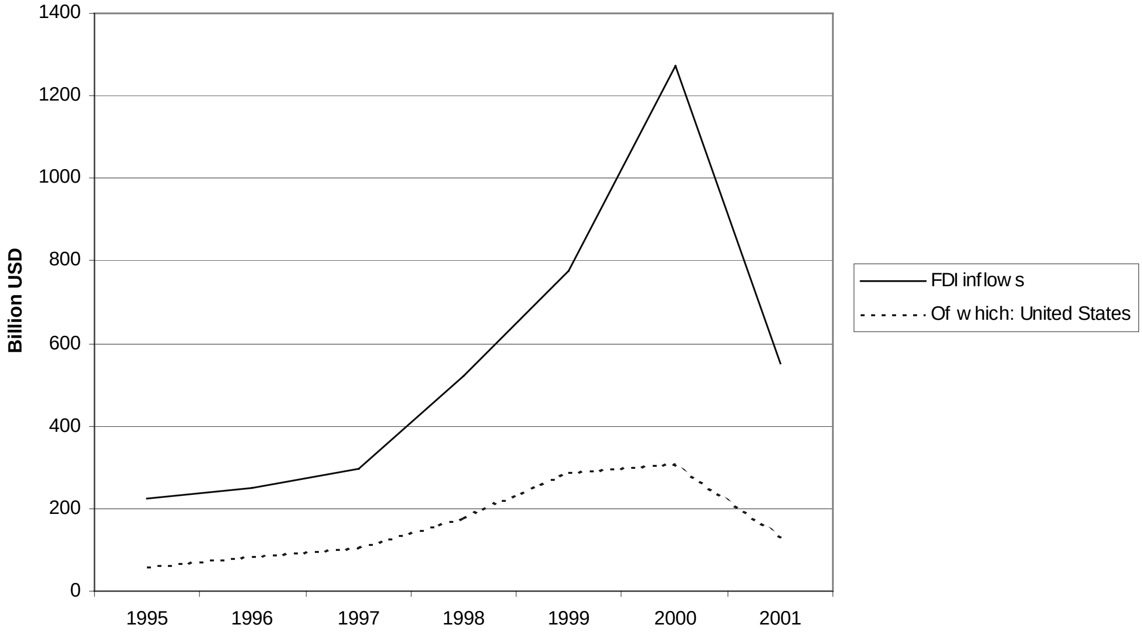
Note: Data are *converted* using the yearly average exchange rates.

Greece: *1999*-2001, source is IMF.
Korea and Netherlands: 2001, source is IMF.
Hungary: 1998, source is IMF.
Slovak Republic: Data include only equity capital. 2001 data cover Jan-Sep 2001.

Source: OECD International Direct Investment Database.

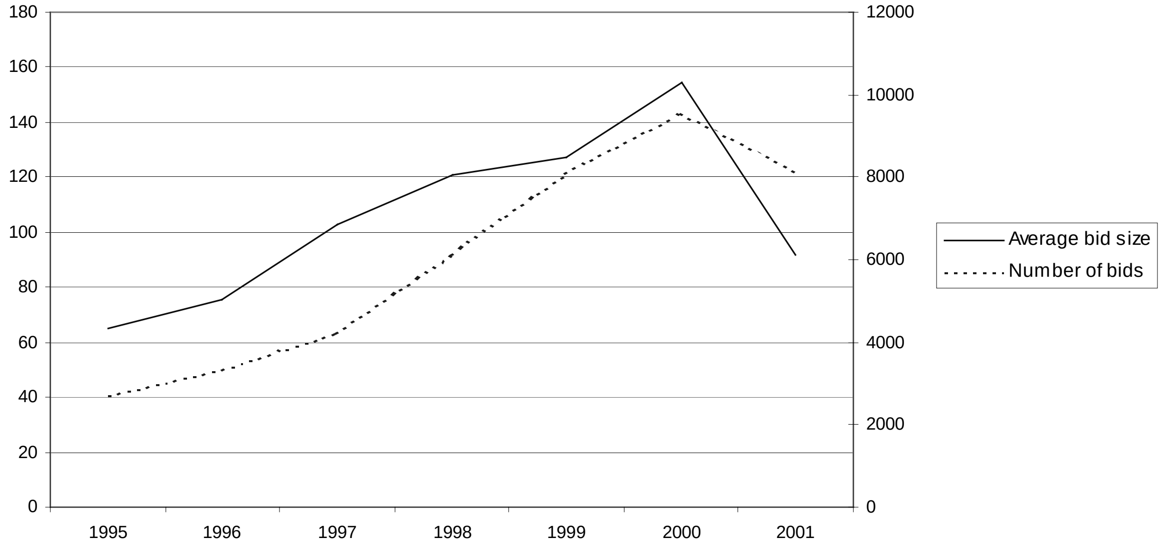
Figure 1. Behind the changes in FDI

Panel A. FDI inflows into OECD countries



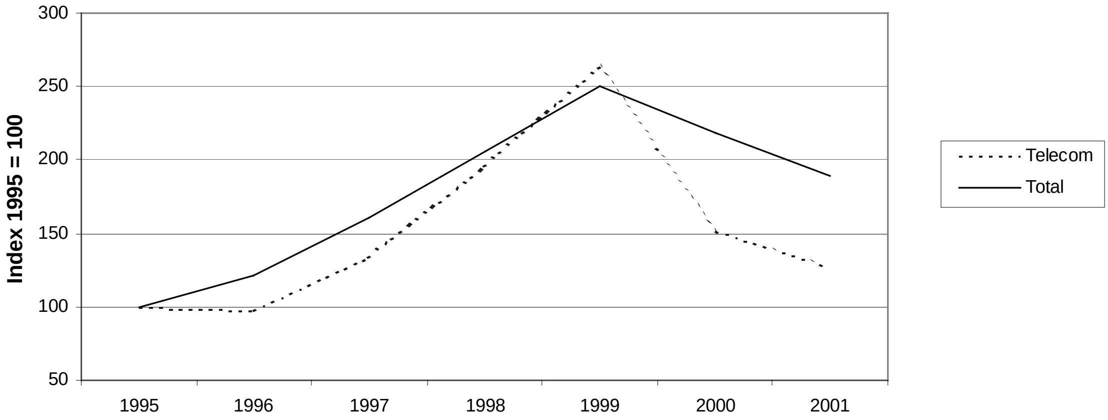
Source: OECD International Investment Statistics

Panel B. Global cross-border M&As: bids and bid sizes



Source: OECD International Investment Statistics

Panel C. US stock indices



Source: Thompson Financial

Panel D. Total privatisation proceeds in OECD countries

Source: OECD International Investment Statistics

Box 1: Foreign Direct Investment Statistics

Definitions and coverage

Direct investment: is a category of international investment made by a resident entity in one economy (direct investor) with the objective of establishing a lasting interest in an enterprise resident in an economy other than that of the investor (direct investment enterprise). "Lasting interest" implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the direct investment enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

Direct investment enterprise is an incorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power for an incorporated enterprise or an unincorporated enterprise in which a foreign investor has equivalent ownership. Ownership of 10 per cent of the ordinary shares or voting stock is the guideline for determining the existence of a direct investment relationship. An "effective voice in the management", as evidenced by an ownership of at least 10 per cent, implies that the direct investor is able to influence, or participate in, the management of an enterprise; absolute control by the foreign investor is not required. Direct investment enterprises are defined as entities that are either directly or indirectly owned by the direct investor and comprise:

– subsidiaries (an enterprise in which a non-resident investor owns more than 50 per cent);

– associates (an enterprise in which a non-resident investor owns between 10 and 50 per cent) and;

– branches (unincorporated enterprises wholly or jointly owned by a non-resident investor).

Voting stocks are equity/shares that give voting rights to the holder. These can either be "listed voting stocks" (that is, equity/shares that are listed on an official stock exchange), or "unlisted voting stock" (that is, equity/shares that are not listed on a official stock exchange.

Methodology

Other methodological guidelines for compiling FDI statistics are indicated in the OECD Benchmark Definition of Foreign Direct Investment, 3rd edition and the IMF Balance of Payments Manual, 5th edition.

Comparability

The comparability of FDI statistics across the OECD countries has improved notably although complementary efforts are planned to achieve further international consistency. A recent study by IMF and OECD, *Report on the Survey of Implementation of Methodological Standards for Direct Investment*, attempts to analyse the comparability of FDI statistics of OECD countries.

Source

OECD *International Investment Statistics Yearbook* provides detailed flow and stock statistics for inward and outward FDI based on the reports of the OECD countries. Further details can be obtained from the website www.oecd.org. The statistics used in the present article were complemented by IMF balance of payments statistics where OECD statistics were incomplete.

The stock market overvaluation of the past was a factor...

Except for the unlikely case where the latter solely indicates an increasing average size of takeover targets, part of the growth in FDI must hence be attributed to valuation changes -- i.e. to the very high equity prices of the late 1990s (Figure 1, Panel C). A second channel through which this has apparently affected international investment is the fact that it provided a boost to corporate sector liquidity by alleviating funding constraints on the part of listed enterprises. A further change to a similar effect was the development of deeper and more liquid markets for equity and corporate bonds within the euro-zone.

…as was a surge in utilities privatisation.

It would, however, be too simplistic to attribute the boom in FDI in the late 1990s solely to an equity price bubble. The causal relationships appear to have been more complex. For instance, a surge in privatisations in the mid- to late 1990s (Figure 1, Panel D) brought large amounts of new utilities stocks to the market, not least as regards the telecom sector. These shares soon became the object of optimistic pricing, and were traded across borders by investors. It would appear that it was the confluence of high prices, ebullient expectations and the presence of an active international investor community that acted as a spur to the mini-boom in FDI among the main OECD economies in 1999 and 2000. Conversely, the decline since then is influenced by equity price deflation, by the more sedate outlook for corporate profitability during the present cyclical slowdown and, particularly in the case of the United States, by a gradual loss of confidence in corporate financial reporting.

b) Mergers and acquisitions

M&A data for the first half of 2002…

An indication of FDI flows in the first half of 2002 can be derived from M&A data for this period. M&A is a particularly meaningful indicator of FDI into OECD member countries, insofar as virtually all cross-border direct investment in these economies (at least in value terms) takes the form of ownership changes in existing enterprises[1]. As for enterprises located in OECD countries' investment in non-Member countries, an increasing share of these capital transactions over the last ten years has taken the form of participation in privatisations, whereby FDI here too has become increasingly attuned with M&A flows. (For an overview of the M&A data definitions applied in this section, see Box 2.)

…indicate that the decline has continued, albeit at a reduced rate.

M&A inflows into OECD countries between January and early June 2002 amounted to just under USD 200 billion, following USD 636 billion in the whole of 2001 (Table 2). If the first months of 2002 are taken as representative, this indicates that M&A (and, by extension, FDI) inflows for the year as a whole were in the vicinity of USD 450 to 500 billion, or a further decline of as much as 25 per cent. Outflows in the first five months of the year were USD 185 billion (Table 3), which, on a whole-year basis, would seem to indicate an average decline of about 20 per cent. If borne out by the facts, this will reduce the 2002 FDI flows into and out of OECD countries to their lowest level since 1997. The hazards of using such extrapolations should, however, be kept in mind. FDI flows in the second half of 2002 could be influenced on the upside by a general pickup in economic activity in most OECD countries, and on the downside by the renewed bouts of weakness in equity prices that occurred during the early summer.

The decline in inflows into the United States appears particularly pronounced.

A few interesting observations may be drawn from a sharp change in country composition that took place up to the first half of 2002. Most notably, the US share of total OECD inflows declined from 30 per cent in 2001 to only 17 per cent in the first months of 2002. In fact, if the first half of 2002 is again taken as representative for the year as a whole, more than half the decline in total flows between 2001 and 2002 is attributable to the drop in M&A into the US economy. Conversely, the relative importance of the continental European economies appears to have grown with France and Germany receiving more than 20 per cent of all M&A inflows in the first half of 2002 -- up from 14 per cent in the whole of 2001. A whole range of smaller OECD countries likewise saw their share of overall M&A flows rise.

Table 2. Cross-border mergers and acquisitions, Inflows by country

(billion US dollars)

	1998	1999	2000	2001	Jan-12 Jun 2002
OECD	**617.4**	**879.6**	**1272.4**	**636.3**	**199.4**
Australia	12.8	29.2	19.2	17.6	5.6
Austria	4.4	0.2	2.7	10.3	0.1
Belgium-Luxembourg	65.4	37.9	12.5	18.9	16.0
Canada	18.3	31.2	139.3	50.9	14.4
Czech Republic	2.9	3.4	2.9	2.0	4.4
Denmark	9.6	6.5	14.1	1.5	1.3
Finland	22.7	4.9	5.0	4.3	2.7
France	38.5	29.3	50.8	27.5	14.8
Germany	20.1	63.8	293.2	60.8	25.4
Greece	3.8	7.1	1.4	1.3	0.0
Hungary	1.2	1.1	3.9	0.6	1.0
Iceland	0.0	0.1	0.0	0.0	0.0
Ireland	0.7	6.9	5.5	6.5	0.5
Italy	27.9	42.7	20.1	17.0	4.1
Japan	19.3	22.9	19.9	17.8	3.3
Korea	7.3	19.6	9.7	11.4	0.6
Mexico	3.5	1.2	25.4	16.3	3.9
Netherlands	28.4	45.8	40.0	16.1	11.0
New Zealand	2.6	4.8	4.4	3.3	0.3
Norway	1.5	6.2	10.2	5.3	0.4
Poland	2.8	7.3	10.4	3.5	0.5
Portugal	5.4	2.9	9.8	0.8	0.7
Slovakia	0.0	0.1	1.8	1.3	3.4
Spain	17.0	13.0	24.9	9.7	9.6
Sweden	14.0	58.7	29.0	12.8	3.9
Switzerland	16.4	19.0	28.4	17.4	5.9
Turkey	0.3	0.1	3.6	0.7	0.1
United Kingdom	80.5	147.6	214.8	112.7	30.9
United States	189.8	265.9	269.5	188.0	34.3
Selected other countries					
Israel	3.6	4.8	3.5	4.6	0.4
Hong Kong, China	3.7	9.5	15.1	13.8	0.4
China	4.5	10.2	45.2	5.4	1.5
Singapore	0.8	5.9	2.2	6.3	0.4
Brazil	31.1	11.1	34.4	9.6	2.9
Argentina	12.7	25.1	11.5	5.5	0.1
Chile	2.7	8.3	4.6	5.1	1.6

Source: Dealogic

Table 3. Cross-border mergers and acquisitions, Outflows by country

(billion US dollars)

	1998	1999	2000	2001	Jan-12 Jun 2002
OECD	**545.9**	**803.2**	**1115.8**	**573.3**	**185.2**
Australia	6.8	10.8	7.0	37.0	5.5
Austria	1.4	2.2	3.6	1.3	0.9
Belgium-Luxembourg	6.1	11.7	19.1	21.7	4.1
Canada	40.2	16.4	42.0	30.0	4.9
Czech Republic	0.0	0.0	0.0	0.0	0.1
Denmark	2.5	5.8	6.6	4.3	0.9
Finland	10.4	4.0	13.0	9.1	3.8
France	39.8	124.6	151.6	66.9	24.4
Germany	77.2	112.8	80.6	70.5	26.6
Greece	1.3	0.6	4.0	0.2	0.3
Hungary	0.1	0.0	0.4	0.0	0.0
Iceland	0.0	0.0	0.1	0.0	0.1
Ireland	3.6	3.6	4.8	1.8	0.4
Italy	13.1	14.7	19.7	21.8	3.1
Japan	8.1	21.6	22.7	21.8	1.9
Korea	0.1	0.1	1.6	0.1	0.0
Mexico	0.4	4.1	4.6	0.7	0.8
Netherlands	38.6	48.5	71.1	31.9	13.2
New Zealand	0.1	1.0	1.2	0.6	0.0
Norway	1.2	1.5	7.9	2.5	4.4
Poland	0.0	0.0	0.0	0.0	0.0
Portugal	4.7	2.4	5.4	1.7	0.9
Slovakia	0.0	0.0	0.0	0.0	0.0
Spain	17.0	34.7	60.3	8.5	5.2
Sweden	30.4	12.4	22.9	11.5	3.2
Switzerland	27.7	15.1	41.7	21.2	0.9
Turkey	0.1	0.6	0.0	0.0	0.0
United Kingdom	106.3	196.7	372.6	84.6	32.5
United States	108.8	157.2	151.2	123.4	47.1
Selected other countries:					
South Africa	3.4	6.5	4.3	2.1	0.85
Bermuda	11.8	38.0	10.4	16.4	1.3
China	2.0	0.7	1.4	1.4	0.5
Hong Kong, China	7.0	13.6	48.9	4.9	1.9
Singapore	0.6	5.0	14.5	16.2	0.9

Source: Dealogic

Box. 2 M&A Data: Sources and Definitions

The mergers and acquisitions data used in this article were made available for the purpose of this article by the global investment banking analysis company Dealogic on the basis of their M&A Global Database. The definitions applied to the data collection are the following:

Inclusion criteria:

1) Acquisitions, mergers and disposals. All transactions are included, of both public and private companies. Included are public offers; open market purchases; stock swaps; going-private deals; reverse takeovers; share placements; recapitalisations; and buy-outs.

2) Acquisitions of assets. Asset purchases are covered and include business divisions and operations; restaurants, pubs, hotels, casinos and other leisure industry assets; shopping centres; newspapers and periodicals; airports and ports; telephone, cellular and wireless licenses; pharmaceutical distribution rights; and hospitals, nursing homes and other medical care facilities.

3) Stake purchases. All stake purchases of 5 per cent or above in both public and private companies are covered wherever possible. The acquisition or disposal of lower stakes may also be included where the stake purchased or sold is considered to be of strategic importance.

4) Spin-offs, split-offs and equity carve-outs. Demergers including privatisations are covered.

5) Share buy-backs. Share buy-backs are included or excluded according to the following criteria. Public tender offers and buy-backs as divestments are covered; likewise buy-backs employed as a defensive technique are covered. Other buy-back programmes are included if they are for the repurchase of stakes greater than 10 per cent or, lastly, if the value of the programme is greater than USD 50 million.

6) Joint ventures. Strategically important joint ventures are covered. Transactions where existing assets or businesses are being acquired by, or merged into, a joint venture will be included. As a rule, the creation of new companies to pursue joint venture interests is not covered.

Exclusion criteria:

1) Alliances or agreements. Strategic alliances (not identified as joint ventures); distribution, contract and customer purchase agreements; and leases are not considered for inclusion. Likewise purchases by companies of products manufactured by another company are not considered.

2) Financial instruments. The following instruments are not included in the database: options, rights, warrants, debt instruments (e.g. subordinated notes), private placements other than private equity transactions, and loans. Placements of shares, whether primary or secondary, are not included unless they meet the criteria for divestments or privatisations.

3) Patents and copyrights.

4) Restructurings. Transactions considered as the merger of one company’s wholly owned subsidiaries are classified as a restructuring exercise, and as such are not included.

Additional information, as well as commercial access to Dealogic’s comprehensive databases, can be obtained from the website www.dealogic.com.

The patterns of outward investment changed little…

The geographic composition of M&A outflows, on the other hand, did not change much in the first half of 2002. The US share of total OECD outflows actually rose by a couple of percentage points to around 26 per cent, and consequently the United States became a net exporter of M&A for the first time in several years. With the United Kingdom accounting for another 18 per cent of the outflows, the two traditionally largest players in cross-border corporate ownership changes accounted for almost half of the outflows in the first half of the year.

…even toward countries expected to be touched by the Argentina crisis.

Finally, an important additional observation relates to countries outside the OECD area. Amid the financial crisis in Argentina it was widely expected that direct investors would shy away from South America in an act of "FDI contagion". However, so far there is little sign that this has happened. Table 2 indicates that while investment into Argentina has virtually ceased, the decline in cross-border M&A flows into neighbouring Brazil and Chile is not bigger than what would be expected given the world-wide slowdown in investment. On the other hand, some of the major hosts of foreign enterprises in East Asia appear to have attracted little inward investment in the first half of the year.

A sectoral shift from multimedia toward utilities.

The sectoral distribution of global cross-border M&A flows over the last 1 ½ years yields further insights. For instance, while the share of M&A of many of the "traditional" sectors is largely unaltered from 2001 to 2002 (indeed the primary sector and manufacturing were virtually unchanged at 9-10 per cent and 26 per cent respectively), an important shift took place within the service sector. While in 2001 financial services and information and multimedia enterprises were the target of 43 per cent of world wide M&A, their share of total flows was reduced to 26 per cent in the first half of 2002 (Figure 2). Conversely, the utilities and construction sector, which accounted for only a minor share of the flows in 2001, rose to almost a fourth in 2002 to date. The latter seems to reflect the fact that the utilities privatisations of recent years are still affecting the figures. However, with privatisation currently slowing down this probably implies that the present prominence of utilities in cross-border M&A transactions is a temporary phenomenon.

c) Individual M&As and transfers of ownership

Reviewing the largest international M&A transactions sheds important additional light on the national and, particularly, sectoral differences that emerged in 2001 and 2002.

1) Main transactions in 2001

The pre-eminence of US-UK flows became less pronounced in 2001…

The biggest individual cross-border transfers of ownership in 2001 were mostly transactions into and out of the world's largest economies, whereby a pre-eminence of cross-border M&As between US and UK companies that was visible in the international figures in 1999 and 2000 has now largely abated. Regarding the sectoral distribution, most of the largest M&As completed in 2001 targeted telecom companies, financial institutions and mining and mineral extraction companies.

…as investors principally targeted telecom companies…

The dominant sector by a wide margin was *telecom services*. By far the largest individual cross-border deal completed in 2001 was the acquisition of the US telephone network and digital television operator VoiceStream Wireless Corporation by Germany's Deutsche Telekom. The deal, valued at a total USD 24.6 billion, was financed by means of a combined tender offer and stock swap. Other telecom deals closed in 2001 were, in order of magnitude: the USD 11.2 billion spin-off of the UK mobile telecommunications operator mm02 to a group of international investors; the acquisition by British Telecom of a 45 per cent stake in Germany's Viag Interkom, at a price of USD 10.4 billion; the USD 9.8 billion increase of NTT DoCoMo of Japan's stake in the US operator AT&T Wireless Group to reach a total share of 16 per cent; the acquisition of Australia's Cable and Wireless Optus for USD 6.5 billion by Singapore Telecommunications; the USD 6.1 billion acquisition of Luxembourg's Bell by Pirelli of Italy; and the sale of 13.2 per cent of the shares in Orange of France to a group of international investors for USD 5.8 billion.

…followed by financial institutions…

Within the *financial sector*, the cross-border takeovers of one insurer and one bank were broadly in the same order of magnitude. The insurance group AXA of France assumed full ownership of its previously majority-owned US subsidiary AXA Financial by acquiring 40% of the company's shares at a price of USD 13.7 billion. Citigroup of the United States completed a USD 12.7 billion public offer for Grupo Financiero Banamex of Mexico. Other large deals affecting the financial sector included a USD 10.2 billion stock swap by which Tyco International of Bermuda gained control of the US service company CIT Group (the latter is active in financial as well as commercial and consumer services). Finally, Dao Heng Bank Group of Hong Kong, China was acquired for USD 5.8 billion by Singapore's DBS Group Holdings.

…and mining and mineral extraction companies.

The biggest transaction among *mining and mineral extraction companies* completed in 2001 was the USD 11.9 billion merger between Billiton of the United Kingdom and BHP of Australia to create the world's largest resources group. Another major deal was the privatisation of De Beers Consolidated Mines, which led to the purchase of 60.2 per cent of the company's equity by DB Investments of Luxembourg. The latter is a holding company owned jointly by Anglo American, Central Holdings and Debswana Diamond Company. The Canadian oil and gas producer Gulf Canada Resources was acquired by Conoco of the United States for USD 4.3 billion.

Outside the main sectors of operation, the largest cross-border transaction concluded in 2001 was the purchase of USD 17.3 billion worth of stock in the UK catering company Compass Group by existing shareholders.

2) 2002 so far

In the first half of 2002, the energy sector topped the list…

The *energy sector* figured prominently among the deals reached in the first half of 2002. The largest concluded transaction was the USD 5.6 billion takeover of the German integrated energy operator Veba Öl by BP of the United Kingdom. The UK oil and gas producer Enterprise Oil was acquired by Royal Dutch/Shell Group of the Netherlands for USD 5.0 billion, and Duke Energy Corporation of the United States bought the Canadian natural gas operator Westcoast Energy for USD 3.4 billion. Among the electricity generators and distributors, the United Kingdom's Innogy Holdings was taken over by RWE of Germany for USD 4.4 billion, and the UK National Grid Group acquired Niagara Mohawk Holdings of the United States for USD 3.0 billion.

…whereas activity in the telecom sector almost came to a halt.

The only major transaction in the *telecom sector* completed so far in 2002 was the USD 3.4 billion takeover of Germany's E-Plus Mobilfunk by Koninklijke KPN of the Netherlands. Large deals in other sectors included the acquisition for USD 6.6 billion of the French chemicals company Aventis CropScience by Bayer of Germany; the takeover of German tobacco manufacturer Reemtsma Cigarettenfabriken by the United Kingdom's Imperial Tobacco Group for USD 4.6 billion; and Kingfisher of the United Kingdom's acquisition of the French retail group Castorama Dubois Investissement for USD 4.3 billion.

3) Still to come

Several large transactions are still pending…

Several large M&As have been announced, but are still pending. The largest of them involved the medical company Roche Holding of Switzerland, which will pay an agreed USD 15.8 billion for 84.3 per cent of the US pharmaceutics developer Genentech.

…many of which are deferred takeovers of telecom companies…

The *telecom sector* accounts for some of the largest individual transactions among the pending M&As. Among the largest announced M&As is China Mobile of Hong Kong, China's USD 10.2 billion acquisition of the mainland Chinese mobile phone operator Anhui Mobile Communication. In a privatisation-related transaction Sonera Oyj of Finland is scheduled to be taken over by

Sweden's Telia for USD 9.0 billion.

…and other utilities.

*Utilitie*s other than telecoms also figure prominently on the list of future transactions. For instance, the electricity producer E.ON of Germany has agreed to acquire PowerGen of the United Kingdom for USD 7.3 billion; the US water provider American Water Works is set to be taken over by Germany's RWE for USD 4.7 billion; and Vivendi of France has announced that it will pay USD 3.0 billion for the UK water supplier Southern Water.

Finally, some deals in the *retail-oriented sectors* are awaiting completion. In a two-sided transaction P&O Princess Cruises of the United Kingdom will take over the US company Royal Caribbean Cruises for USD 3.0 billion, while itself being acquired by Carnival Corporation of the United States for USD 5.5 billion. South African Breweries (incorporated in the United Kingdom) will buy the US brewer Miller Brewing Company for USD 5.6 billion.

II. Longer-term trends in FDI

a) Economic indicators of foreign corporate presence

The economic impact of foreign corporate presence…

The extent of foreign corporate presence in a given economy is arguably best measured by the inward FDI stock. However, the total value of foreign-invested enterprises may not be the best measure of the economic impact of cross-border ownership. For instance, a ranking of countries according to inward FDI stocks generally places the most active international investors at the top (for FDI stock figures, see the Annexes), which hardly yields any new insights. FDI as a share of the host countries' domestic GDP, on the other hand, provides a rough indication of the relative economic importance of the foreign corporate presence across countries.

…appears to be greater in some of the small OECD economies than among the major recipients of FDI…

Figure 3 shows that the economies where foreign-owned enterprises are thought to be of greater importance tend to be the smaller ones, such as New Zealand, the Czech Republic and Denmark. However, G10 economies like Sweden, Switzerland, United Kingdom and Canada also have inward FDI positions relative to the domestic economy that are above average. Unsurprisingly, Japan comes out at the bottom, but even such a major recipient of FDI as the United States displays a rather low foreign corporate presence when measured relative to the overall share of the US economy.

…and by some measures it is growing in importance...

It is tempting to conclude from Figure 3 that the degree of globalisation has increased over the last decade. After all, inward FDI positions have increased relative to GDP between 1990 and 2000 in all countries for which data are available. However, it should be noted that the valuation of enterprises in most OECD countries also increased relative to GDP in the 1990s -- especially in those companies whose stocks were listed. In many cases, the relative increase in FDI stock can therefore be explained largely as the effect of a revaluation of corporate cross-border holdings.

…in non-OECD countries as well.

An interesting additional observation relates to the role of foreign corporate presence in many developing countries. As for example noted by the forthcoming publication *OECD (2002) Foreign Direct Investment for Development*, inward FDI positions relative to GDP in developing countries currently stand above world averages (Figure 4). In both Latin America and Asia, foreign corporate presence is, by this measure, more economically important than in North America and West Europe.

Foreign owned manufacturing companies account for an increasing share of production in many countries…

A different angle on the importance of foreign-owned enterprises was provided by *OECD (2001) Measuring Globalisation: The Role of Multinationals in OECD Economies* (an illustration from which is presented in Box 3). As shown in the box, the manufacturing production by foreign-owned enterprises in the United States was more than 40 per cent of total world production by foreign affiliates in the late 1990s. In addition, other figures indicate that the share of foreign affiliates' production in US manufacturing rose by 3 to 4 percentage points during the 1990s to reach a level just below 19 per cent. The EU countries taken together saw a similar increase during the period, and by 1998 close to 25 per cent of manufacturing production in the EU was undertaken by foreign-owned entities.

…but the same is not necessarily the case in the service sectors.

Once again, however, this does not necessarily mean that globalisation is on the rise. The increasing importance of foreign-owned enterprises in manufacturing concurred with a shift in economic activity toward service sectors in most OECD economies. Since the latter have a, still, lower share of foreign affiliates in economic activity in most OECD country, the effect has in many cases been to cushion or counterbalance the tendency toward larger overall dependence on foreign-owned enterprises.

Table 4. Cumulative FDI flows in OECD countries, 1992-2001

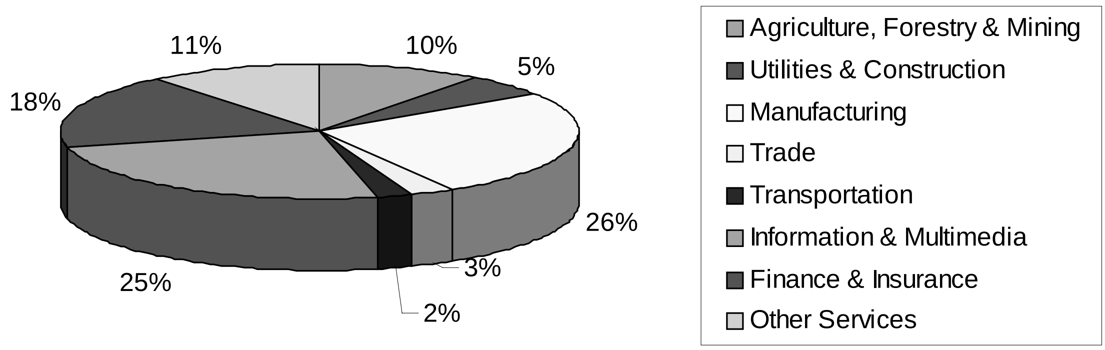
(billion US dollars)

Inflows		Outflows		Net Outflows	
United States	1 274.2	United States	1 145.5	United Kingdom	389.8
United Kingdom	444.4	United Kingdom	834.1	Japan	349.7
Belgium-Luxembourg	422.3	France	583.9	France	291.6
Germany	342.6	Germany	477.7	Germany	135.1
France	292.3	Japan	455.9	Switzerland	120.2
Netherlands	238.3	Belgium-Luxembourg	414.1	Netherlands	80.8
Canada	186.7	Netherlands	319.1	Italy	37.1
Sweden	157.4	Canada	200.2	Spain	36.7
Spain	138.6	Switzerland	182.8	Finland	35.6
Mexico	127.3	Spain	175.3	Canada	13.5
Japan	106.1	Sweden	130.3	Portugal	0.8
Australia	69.6	Italy	97.7	Iceland	0.3
Ireland	64.3	Finland	71.9	Norway	- 1.0
Switzerland	62.6	Australia	49.6	Slovak Republic	- 4.9
Italy	60.6	Denmark	41.5	Greece	- 6.2
Denmark	48.5	Norway	33.0	Denmark	- 7.0
Poland	47.2	Korea	25.7	Belgium-Luxembourg	- 8.3
Korea	38.5	Portugal	24.2	Turkey	- 8.4
Finland	36.3	Austria	23.9	Austria	- 12.0
Austria	35.9	Ireland	22.1	Korea	- 12.8
Norway	34.0	Mexico	3.7	New-Zealand	- 19.2
Czech Republic	26.8	Turkey	3.4	Hungary	- 19.9
Portugal	23.4	Greece	3.3	Australia	- 19.9
Hungary	22.1	New-Zealand	2.8	Czech Republic	- 26.0
New-Zealand	22.0	Hungary	2.2	Sweden	- 27.1
Turkey	11.8	Iceland	1.1	Ireland	- 42.2
Greece	9.4	Czech Republic	0.8	Poland	- 46.5
Slovak Republic	4.9	Poland	0.6	Mexico	- 123.6
Iceland	0.8	Slovak Republic	0.0	United States	- 242.6
TOTAL OECD	**4 323.9**	**TOTAL OECD**	**5 205.9**	**TOTAL OECD**	**882.0**

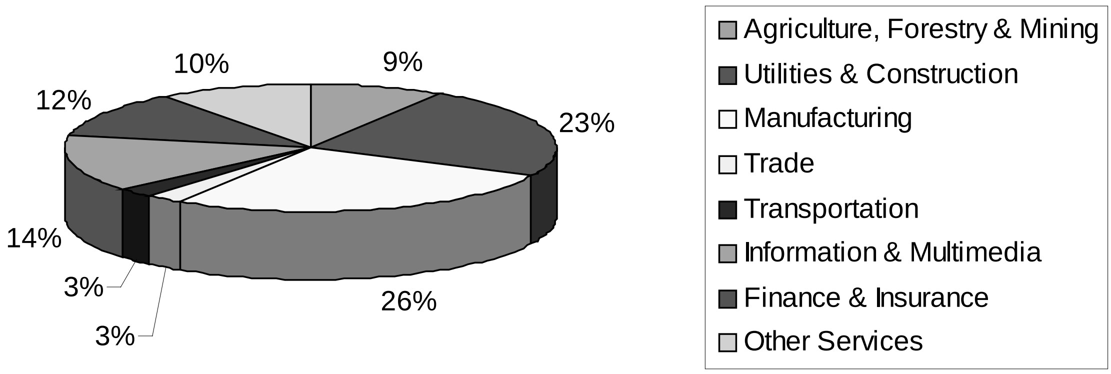
Source: OECD International Direct Investment Database.

Figure 2. M&A global flows (by recipient sector)

Panel A. 2001

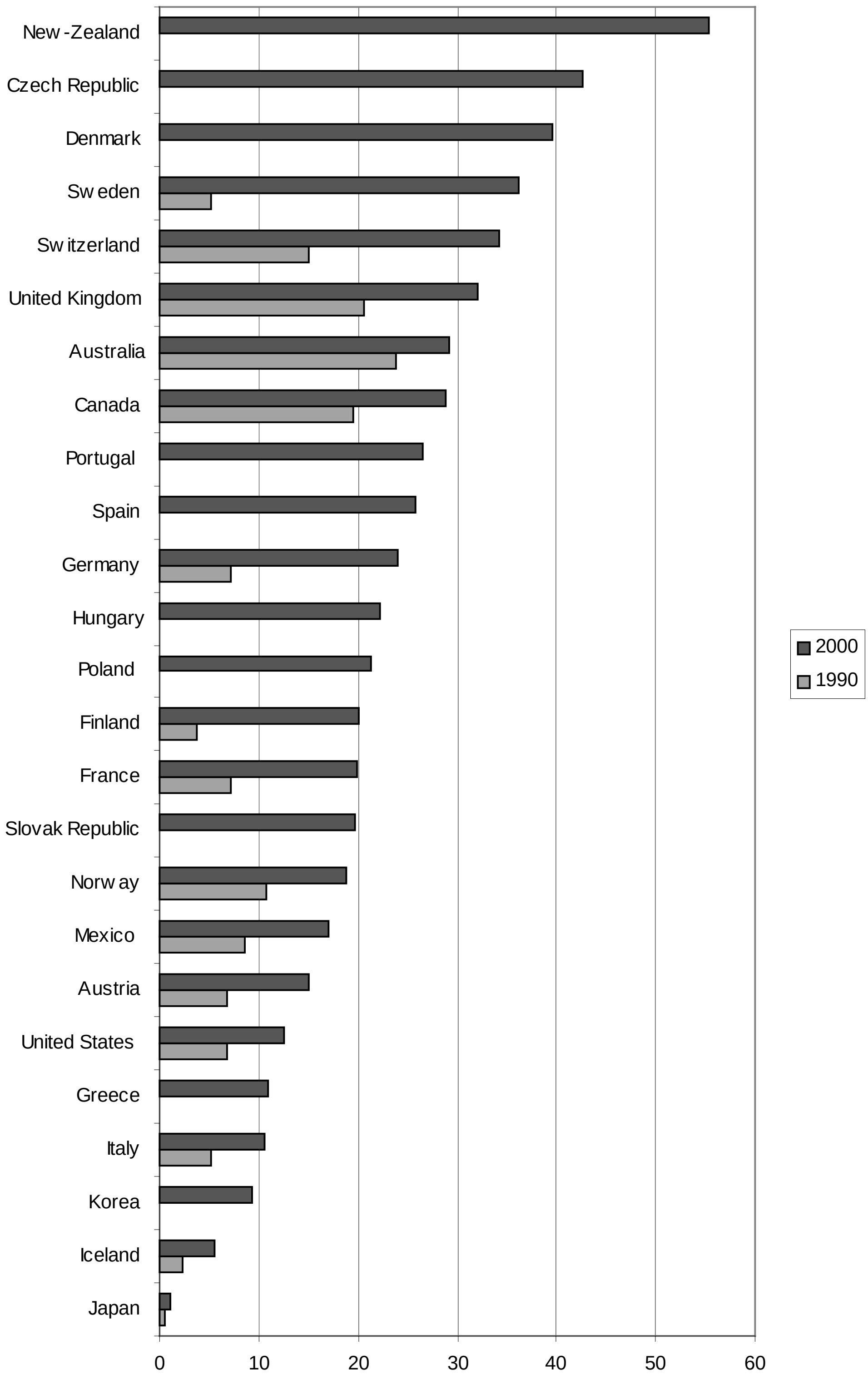


Panel B. January to early June 2002



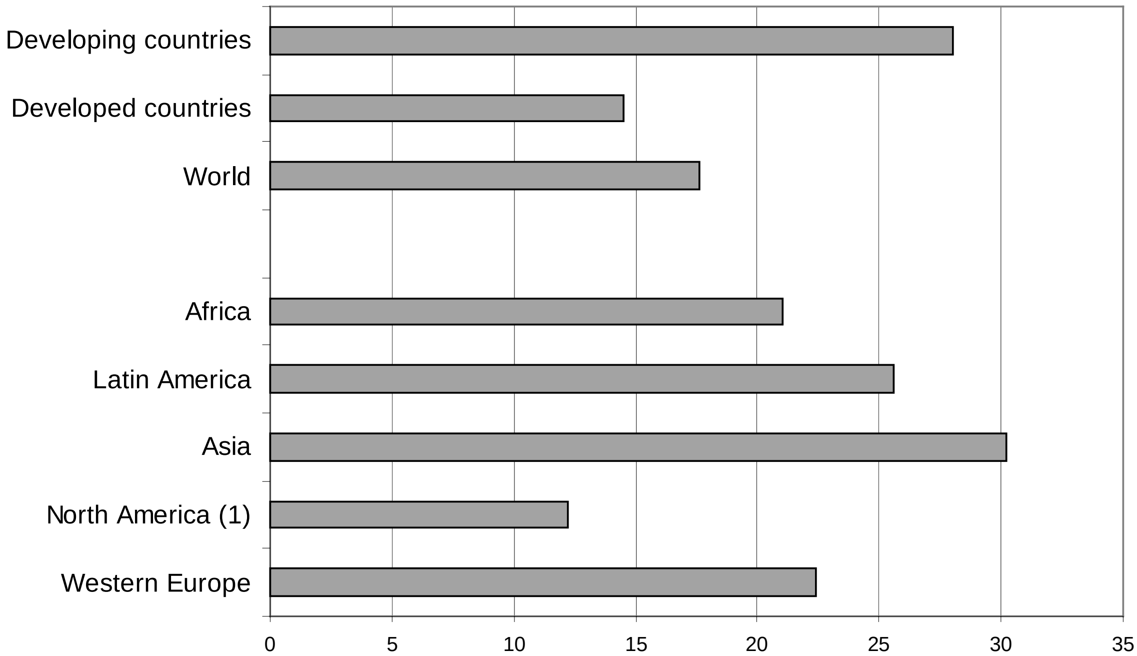
Source. Dealogic

Figure 3. Inward FDI Position (as share of domestic GDP)



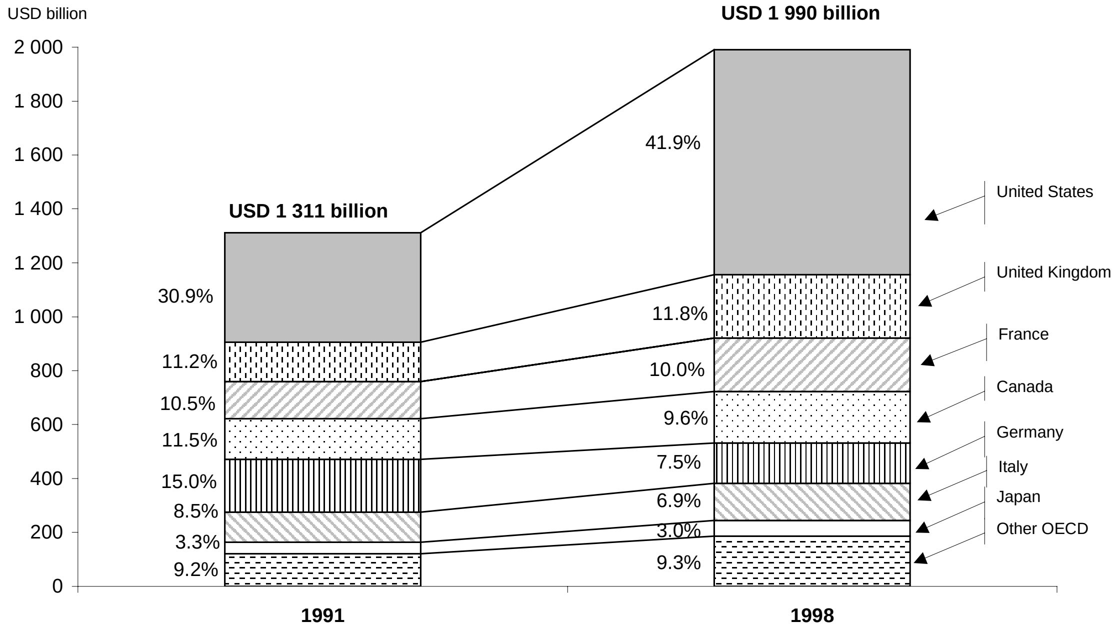
Source. OECD International Direct Investment Database.

Figure 4. Inward FDI Positions (per cent of GDP)



(1) Except Mexico
Source: OECD (2002), Foreign Direct Investment for Development (forthcoming).

Box 3. Trend in the share of foreign affiliates in manufacturing production (or turnover) in selected OECD countries



Source: OECD, Activities of Foreign Affiliates database.

– Between 1991 and 1998, the level of production of firms under foreign control (in absolute value) progressed in all the major countries, with the exception of Germany where it marked a decline.

– During the same period, the level of production of foreign firms doubled in the United States (from USD 405 to 883 billion), accounting thereafter for half of the production of these firms within the OECD area[1]. It should be noted that the US production accounts for 33 per cent of the total of the same countries.

– The United States and the United Kingdom are the only major countries in the OECD area where the level of production of firms under foreign control increased both in value and percentage terms.

– In Japan on the other hand, despite a significant increase in value (+ 38 per cent), the production under foreign control during the same period continued to represent only 3 per cent of the OECD total and 29 per cent of the OECD production[1].

b) FDI by sector

Traditionally, the United States is the main net recipient of FDI flows. Most of the money comes from Japan and a few European countries.

Taking a longer perspective, the most important source and recipient of foreign direct investment remains the United States, followed by the United Kingdom and some of the major continental European economies (Table 4). The net flows (arguably the most economically important long-term indicator) reveal that United Kingdom, Japan and France have acted as by far the most important net providers of direct investment over the last decade, and that the main beneficiary of these capital flows has been the United States. Moreover, it would appear that the group of countries that act as net FDI exporters is relatively narrow, whereas (apart from the United States) the net recipients are a wide group of smaller OECD and non-OECD economies. The latter countries each receive a relatively limited (but, in many cases, large relative to the size of their domestic economy) share of the total flows.

1) Services

The service sector has gained importance as a recipient of FDI…

One of the most prominent developments in international investment in the last decade relates to the increasingly prominent role of the service sector vis-à-vis the traditional industries[2]. In 2000, investments in the service sector stood at historically high levels, with inflows and outflows in OECD countries reaching USD 650 billion and USD 720 billion respectively. At close to 65 per cent of total FDI flows, this is the highest share ever accounted for by the service sector. In the early and mid-1990s, services generally hovered at around 50 per cent of total investment.

…partly reflecting the utilities privatisations in many OECD countries.

As indicated above, FDI flows in the service industries is influenced by privatisation trends. Many of the most significant recent privatisation operations around the globe included the sales of telecommunication companies, public utilities and financial enterprises, which were open to participation by non-resident investors. This development had an important impact on the size and absolute amounts of transactions to and from OECD countries in these sectors of activity. A large part of these FDI transactions, moreover, resulted from a few big M&A deals in the most capital intensive sectors

The US service sector is the OECD's largest recipient as well as investor…

During the period 1991 to 2000 (the last ten years for which detailed sectoral data are available) the United States took first position as both host and investing country in the services sector (Figure 5). This country alone accounted for more than 30 per cent of total OECD inflows and 20 per cent of the outflows. A major recipient of the direct investment into the US corporate sector has been the financial institutions. Throughout the decade, financial intermediation accounted, in average, for 40 per cent of all service-related FDI inflows.

…followed by the United Kingdom…

In second place, the United Kingdom accounted for 18 per cent of FDI outflows and around 15 per cent of inflows during the same period. UK service-related FDI flows have primarily concerned in- and outgoing investments in telecommunications and financial intermediation. Germany, in the past not necessarily a major player in service sector FDI, was lifted into third place among the recipients by one major foreign acquisition (Vodafone-Mannesmann).

…and a few other European countries that have seen major one-off takeovers in this sector.

At 12 per cent of total outflows France is in third place among the outward investors, owing largely to the proactive acquisition strategies of a couple of large enterprises in the entertainment and multimedia business. Other OECD economies that have been particularly active as investors or recipients of service-related FDI include Japan (investor country), Canada (recipient country) and the Netherlands (both).

2) Manufacturing

Manufacturing FDI flows have risen over the past decade, but less than in some other sectors.

FDI inflows to (and outflows toward) the manufacturing sectors of OECD countries accounted for more than 30 per cent of OECD FDI flows during the period from 1991 to 2000. In absolute numbers, the direct investment into manufacturing increased from around USD 34 billion 1991 to more than USD 270 billion in 1999, before receding somewhat in 2000. FDI outflows from OECD have shown a similar trend over the last decade, rising from USD 67 billion 1991 to more than USD 310 billion in 1999, but their subsequent drop in 2000 was far more abrupt than was the case with the inflows.

The importance of US manufacturing as a recipient has at times been staggering…

As in the service sector, the United States is by far the most important recipient of manufacturing sector FDI inflows. In fact, the dominance has been even more pronounced than in services, with 45 per cent of the overall OECD inflows between 1991 and 2000 going into the manufacturing industries of the United States (Figure 6, Panel A). Starting from a relatively modest share of around 20 per cent of global inflows at the beginning of the decade, the US manufacturing sector reached its peak as a recipient of foreign direct investment in 1998 with 65 per cent of total OECD flows. The most important receiving sub-sectors were petroleum, metal and mechanical products and machinery.

The manufacturing sector of the United Kingdom was the second most important recipient of FDI between 1991 and 2000 (with more than 9 per cent of the OECD total). The UK textile industries, which had received significant FDI inflows in the mid-1990s, seemed to regain the attention of foreign investors in 2000. Likewise, investments in petroleum industries and machinery increased notably toward the end of the period.

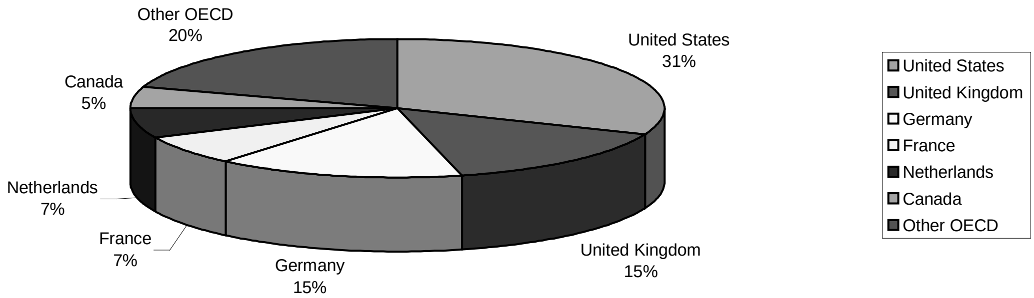
Other important host countries included Sweden, which, notwithstanding the limited size of its domestic economy, attracted 8 per cent of all manufacturing-related investment flows, France (at 5.5 per cent) and the Netherlands (at 5 per cent). At the end of the decade, petroleum industries in Sweden, the Netherlands and in France attracted large amounts of foreign capital. The latter country also recorded large investments into the food and beverages industry.

…whereas outflows from this sector have been more in line with other countries.

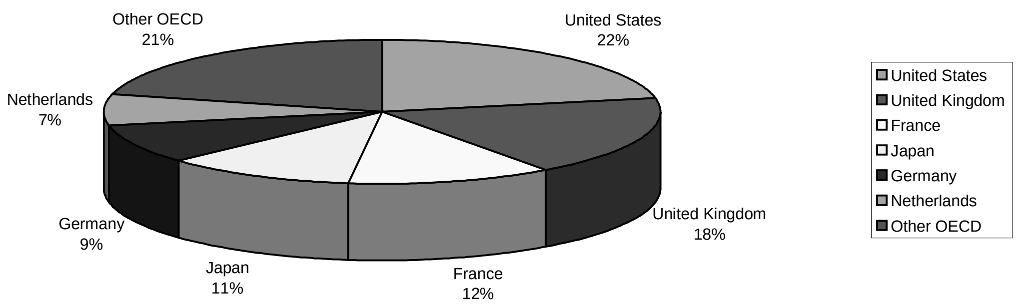
As regards FDI outflows, the share of United States enterprises has been much more moderate (Figure 6, Panel B). US investors mostly targeted machinery, petroleum and textiles. Unsurprisingly, some of the other active investors were found in countries with large current account surpluses -- e.g. Japan, which accounted for 13 per cent of total outflows toward the manufacturing sector, and France which accounted for 10 per cent -- but enterprises in the United Kingdom (16 per cent) and Germany (14 per cent) were even more active investors. Also, the large industrial companies of the Netherlands and Switzerland have given these countries a top role as manufacturing investors that might otherwise have been out of tune with their relatively limited economic weight.

Figure 5. FDI inflows into OECD countries, Service sectors, 1991-2000

Panel A. Inflows



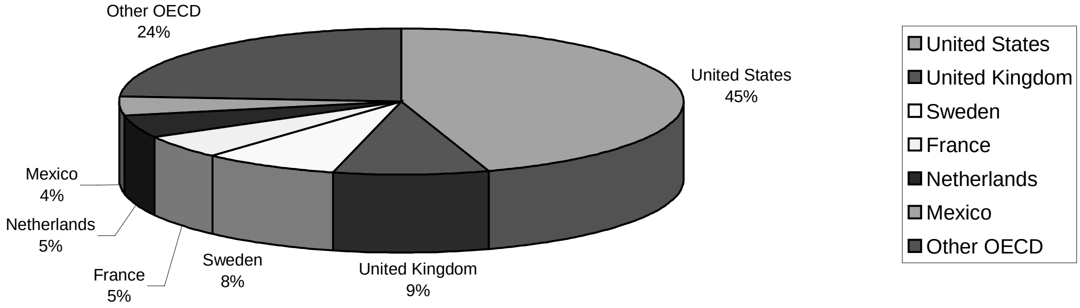
Panel B. Outflows



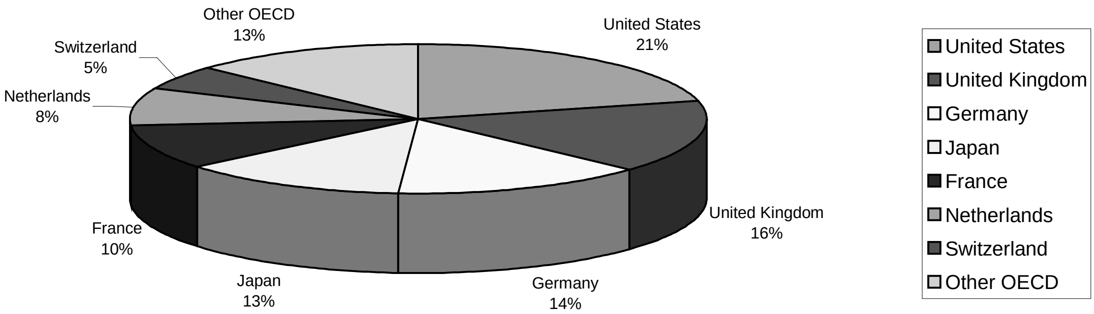
Source. OECD International Direct Investment Database.

Figure 6. FDI in OECD countries, Manufacturing, 1991-2000

Panel A. Inflows



Panel B. Outflows



Source. OECD International Direct Investment Database.

NOTES

1 . Foreign direct investment does, by definition, include mergers and acquisitions, greenfield investment, loans and similar capital transfers between related enterprises and reinvested earnings.

2. The service sector is here defined broadly to include: Electricity, gas and water; construction; trade and repairs; hotels and restaurants; transports and communication; financial activities, monetary institutions, and other financial institutions; insurance and activities auxiliary to insurance; other financial institutions and insurance activities; real estate and business activities; other services.