University of International Business and Economics (UIBE), Beijing, China

Study Tour at UNCTAD’s Virtual Institute

FDI
Basic concepts and issues

29 September 2014
Kalman Kalotay
UNCTAD/DIAE
I. Basic concepts
II. Development impact
III. Policy issues
IV. Global FDI trends
I. Basic concepts
Definition of foreign direct investment

- Balance-of-payments concept
- Distinguish between portfolio and direct investment
  - Portfolio investment: short-term oriented capital flows; less than 10% of the equity or voting shares in a foreign company.
  - Direct investment: long-term relationship and a lasting interest and control of a foreign company.
FDI by motivation of investors

- **Natural resource-seeking**
  - Oil and gas extraction, mining, etc.

- **Market-seeking** (horizontal FDI)
  - Access a domestic or regional (EU, NAFTA, ASEAN) market

- **Efficiency-seeking** (vertical FDI)
  - Specialize and divide production in line with the comparative advantages of different locations; export-oriented FDI

- **Strategic-asset seeking** (primarily through M&As)
## Determinants of FDI I: Economic determinants

<table>
<thead>
<tr>
<th>Type of FDI</th>
<th>Key determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural resource-seeking FDI</td>
<td>Abundance of natural resources&lt;br&gt;Price movements&lt;br&gt;Access to skills</td>
</tr>
<tr>
<td>Market-seeking FDI (national or regional)</td>
<td>Market size and purchasing power&lt;br&gt;Market growth&lt;br&gt;Tradability of product/service&lt;br&gt;Need for local adaptation&lt;br&gt;Structure and openness of markets</td>
</tr>
<tr>
<td>Efficiency-seeking, export-oriented FDI</td>
<td>Quality and cost of human resources&lt;br&gt;Physical infrastructure (ports, roads, telecom, etc.)&lt;br&gt;Technical infrastructure&lt;br&gt;Trade costs&lt;br&gt;Quality of suppliers, clusters, etc.&lt;br&gt;Economic and political stability</td>
</tr>
<tr>
<td>Strategic asset-seeking FDI</td>
<td>Presence of firm-specific assets&lt;br&gt;Efficiency and transparency of financial markets</td>
</tr>
</tbody>
</table>
Determinants II: General policy framework

- Stability of the country
  - Economic stability
  - Political stability
  - Social stability
- Rule of the law
- Policies on the functioning and the structure of markets
  - Competition and M&A policies
  - Intellectual property policy
  - Anti-corruption policy
- Labour (employment) policy
- Environmental protection policy
- Tax policy
- Trade policy (tariffs and non-tariff barriers)
- Regional integration policies
Determinants III: Facilitation of FDI

- Rules regarding entry and operations of foreign investors
  - Openness to foreign investors (general and by sectors)
  - Registration rules and requirements for foreign investors
  - Licensing requirements
  - Construction permits
- Standards of treatment of foreign affiliates
- Rules on transfer of funds
- Rules on expropriation
- Access to dispute settlement
- Investment promotion services
- Investment incentives and performance requirements
- Rules on the employment of foreigners
- Social amenities (bilingual schools, quality of life, etc.)
- International investment agreements
II. Development impact
Potential benefits of FDI

- Capital and investment
- Technology transfer
- Skills upgrading
- Employment
- Linkages
- Exports
- Access to foreign markets or supplies
- Creation of new economic activities (especially in greenfield FDI)
- Fiscal revenue for the host Government (taxes)

- Higher productivity
- Potentially more environmentally friendly production
- Restructuring of existing firms or industries
- Increased competition
- Increased systemic competitiveness of the host economy

FDI: to be treated as a package of resources
But benefits are not automatic: 
The flipside of FDI

- Risk of high profit repatriation
- Enclave-type of activities, footloseness
- Trapping host countries in low value added (no automatic upgrading)
- High import contents
- Risk of regulatory problems in market seeking projects (especially in utilities)
- Crowding out of local firms due to unfair anti-competitive practices
- Low tax revenues due to too generous incentives (race to the bottom)
- Transfer pricing leading to tax evasion
- Environmental leakages (degradation)
- Reduction of labour standards (the problem of sweatshops)
- Potential loss of sovereignty
- Divestment in crisis
III. Policies
Liberalization and promotion and still dominate, but regulation is on the rise

National investment policy changes, 2000–2013
(Per cent of measures)
General vs. specific policies affecting FDI

**General policies**
- Monetary/fiscal policies
- Trade policies
- Exchange rate policies
- Technology policies
- Education policies
- Labour market policies
- Privatization policies
- Competition policies
- Intellectual property policies
- Environmental policies
- SME policies (see on Monday and Tuesday)
- Other policies

**Specific FDI policies**
- Investment liberalisation/restrictions
- Investment promotion
- Performance requirements
- Incentives
- Linkage promotion
Going beyond liberalization – some measures to consider

- Mandatory requirements on foreign affiliates
  - performance requirements (PRs)
- Encouraging foreign affiliates to act in desired ways
  - Incentives (sometimes tied to PRs)
- Upgrading local capabilities
  - absorptive capacity, SME capabilities, infrastructure, education and skills
- Ensuring proper functioning of markets
- Linkage promotion policies

- ... while considering the international limitations of autonomous policies
IV. Global FDI trends
Ups and downs in global FDI flows

(Billions of dollars)
Half of the 20 largest FDI recipients are developing or transition economies

(Billions of dollars)

- United States: 188
- China: 161
- Russian Federation: 124
- Hong Kong, China: 79
- Brazil: 77
- Singapore: 75
- Canada: 64
- Australia: 64
- Spain: 61
- Mexico: 62
- United Kingdom: 50
- India: 56
- Ireland: 39
- Luxembourg: 38
- Netherlands: 26
- Germany: 28
- China: 18
- Indonesia: 12
- Colombia: 10
- Italy: 17

UNCTAD
Developing and transition economies account for 39% of global outward FDI

Shares in global FDI outflows, by group of economies, 1999–2013
(Per cent)
30% of the 20 largest FDI sources are developing or transition economies

(Billions of dollars)
FDI inflows and outflows of China, 1999–2013
(Billions of dollars)