Foreign Direct Investment

Global trends, theoretical issues and policy implications for China

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Definition:
Foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity (firm or individual) in one economy (home economy) in an enterprise resident in another economy (host economy).

Three components:
- Equity capital
- Reinvested earnings
- Intra-company loans

Two major modes:
- Greenfield investment
- Cross-border mergers and acquisitions (M&As)
Statistics

- Major types of data:
  - FDI flows (inflows and outflows)
  - FDI stock (inward and outward FDI stock)

- Data on the operations of transnational corporations (TNCs)

- Statistical frameworks:
  - Balance of Payments (BOP): 10% threshold
  - International Investment Position (IIP)

- Main statistical guidelines:
  - IMF’s Balance of Payments Manual (BPM)
  - OECD’s Benchmark Definition of Foreign Direct Investment (BD4)

- Current version: BPM6, BD4
FDI inflows, global total and by group of economies, 1995 – 2012
(Billions of dollars)

Source: UNCTAD.
Relative size of global output, trade and FDI compared with the previous-crisis peak, 2011 (Per cent)

The previous peak = 100

Global output: +13%

Global trade: -23%

2008: Output and trade
2007: Foreign direct investment
Weak equity investment

FDI inflows to developed countries, by component, 2005-2011
(Billions of dollars)

Source: UNCTAD.
Top 20 investor economies, 2012
(Billions of dollars)

(x) = 2011 ranking
1 United States (1)
2 Japan (2)
3 China (6)
4 Hong Kong, China (4)
5 United Kingdom (3)
6 Germany (11)
7 Canada (12)
8 Russian Federation (7)
9 Switzerland (13)
10 British Virgin Islands (10)
11 France (8)
12 Sweden (17)
13 Republic of Korea (16)
14 Italy (9)
15 Mexico (28)
16 Singapore (18)
17 Chile (21)
18 Norway (19)
19 Ireland (167)
20 Luxembourg (30)

Source: UNCTAD.
Top 20 host economies, 2012
(Billions of dollars)

(x) = 2011 ranking

1 United States (1) 168
2 China (2) 121
3 Hong Kong, China (4) 75
4 Brazil (5) 65
5 British Virgin Islands (7) 65
6 United Kingdom (10) 62
7 Australia (6) 57
8 Singapore (8) 57
9 Russian Federation (9) 51
10 Canada (12) 45
11 Chile (17) 30
12 Ireland (32) 29
13 Luxembourg (18) 28
14 Spain (16) 28
15 India (14) 26
16 France (13) 25
17 Indonesia (21) 20
18 Colombia (28) 16
19 Kazakhstan (27) 14
20 Sweden (38) 14

Source: UNCTAD.
Internationalization of firms
- Export vs. FDI
- FDI vs. outsourcing

Motivations of FDI:
- Market-seeking
- Efficiency-seeking
- Natural resources-seeking
- Strategic assets-seeking

Strategies of FDI:
- Location selection
- Entry mode
- Entry timing, scale and sequencing

Performance implications
Various types of factors (economic, social, political ...) at different levels (global, regional, national, local, industrial, firm, project ...) affect TNCs’ investment decisions and therefore FDI flows.

Source: Liang (2012).
Dunning’s OLI paradigm

- **Ownership-specific advantages:**
  Ownership-specific advantages of a firm -- if exploited optimally -- can compensate for the additional costs of establishing production facilities in a foreign environment and can overcome the firm’s disadvantages vis-à-vis local firms (“liability of foreignness”).

- **Locational advantages:**
  The ownership-specific advantages of the firm should be combined with the locational advantages of a host country (e.g. large markets or lower costs of production factors).

- **Internalization advantages:**
  The firm finds greater benefits in exploiting both ownership-specific and locational advantages by internalization, i.e. through FDI, rather than arm’s-length transactions.
FDI has development implications for both host and home countries. The host country may see various broad types of impacts (economic, social, environmental ...), in different specific areas (finance, technology, employment, exports, BOP, fiscal income), at different levels (national, local, industrial ...), directly or indirectly (competition, demonstration, linkages, spillovers) realized. Factors determining these impacts can be specific to the country, industry, or company.

Figure V.1. Development implications of TNC participation in extractive industries: an analytical framework

An example
(from WIR07)
Both national policies and international investment agreements can be used to attract FDI, enhances its benefits and minimize the related risks and costs. Important issues include, for instance, investment promotion and facilitation, treatment, regulation, dispute settlement, competition, and technology and innovation. The FDI policy framework should be part of an overall development strategy, coherent with and supportive to other policies and institutions.

An example (from WIR05)
Rethinking FDI in China

Has the objectives of attracting FDI realized?

- Finance and investment
- Technology transfer and spillovers
- Domestic capacity development

Is the previous model sustainable?

- Negative economic effects
- Social implications
- Environmental impacts
- Problems related to processing trade

What is the way forward?

- Upgrading and moving up the value chain
- More emphasis on sustainability
- Balancing FDI and domestic capability
Thank you!

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