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Global Fdi- Trends and Patterns

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ABSTRACT**:** *One of the striking features of the world economy has been the FDI flows which have grown steadily in volume and have outpaced the growth rate in world trade and outputs as increasing number of firms from developed as well as developing nations of the world seek to improve their locational portfolio of assets. The paper attempts to summarize the trends and patterns observed in global FDI flows during 1970-2012.*

KEY TERMS*: Foreign Direct investment, Global FDI, FDI flows, Trends*

I. INTRODUCTION

International Monetary Fund defines 'FDI' as an investment, which is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in management of the enterprise. In addition to equity participation, it also includes other non-equity forms of investment and control, such as, sub-contracting, management contract, turnkey agreement, franchising, licensing and product sharing. The striking feature of world economy in the recent decades has been the growth of FDI which has outpaced the growth in international trade and output. Increasing competition in the home country, improved means of communication and transportation and continuous economic liberalization in many economies are some of the factors driving international investment. In this context, the paper lays down the theoretical framework for FDI and outlines the major trends observed in global FDI flows during 1970 -2012. The paper is structured as follows. Section 2 is devoted to literature review. Section 3 discusses the trends and patterns of world FDI flows. Section 4 concludes.

II. REVIEW OF LITERATURE

The theory of capital movements was the earliest explanation for FDI, which was viewed as a part of portfolio investments (Iversen, 1935; Aliber, 1971). Initial contributions to the literature made by Hymer (1960) and Kindelberger, 1969 explained FDI as the means of transferring knowledge and other firm assets, both tangible and tacit, in order to organize production abroad. Firms choose hierarchies over arms length transaction to retain ownership and control over its unique proprietary assets. Vernon (1966) used the product life cycle concept to theorize that firms set up production facilities abroad for products that had already been standardized and matured in the home markets. The seminal works of Hymer(1976) and Kindelberger (1969) drew various contributions to the literature on FDI. R.H.Coase put forth the explanation of FDI from the Transaction cost perspective which views FDI as an organizational response to market imperfections. In similar vein, internalization theory explains FDI as response to the market failure for rent yielding resources and an attempt by the efficiency seeking firms to reduce transaction costs of cross border activity (Buckley and Casson 1976; Rugman 1981). From an organization learning perspective, March (1991) suggested that FDI is an outcome of the desire of firms to improve returns, present return or future returns. Dunning (1993) propounded Ownership, Location and Internalization (OLI) advantages based framework to explain firms' internationalization behaviour. Dunning's OLI framework bridged the idea of market power and transaction cost approach and explained FDI as an attempt to exploit ownership specific advantages in overseas market through the process of internalization.

These theoretical frameworks explained internationalization from asset exploiting perspective. The investment behaviour of firms from newly emerging economies that do not necessarily possess rent yielding assets can be explained from Asset Seeking Perspective (Makino et al, 2002). The asset augmenting or asset seeking perspective of FDI suggests that firms engage in FDI not only when they want to exploit its competitive advantages in a foreign market but also when they want to acquire complementary strategic assets possessed by firms in host countries, in order to enhance its international competitiveness. (Dunning 1995, 1998 and 2000). Building upon the asset seeking perspective,Mathews (2002) proposed that EMNCs represent instances of accelerated internationalization and use their latecomer position to their advantage through repeated applications of a process of 'linkage, leverage and learning'. They are not operating in a world where they seek to push monopolistic advantages as much as one where they seek to tap resources elsewhere and device appropriate strategies and organizational forms for doing so. Luo and Tung (2007) argue that emerging economy MNCs internationalize through a distinct process dubbed 'springboarding', designed to achieve the dual purpose of acquiring strategic resources abroad and reducing their institutional and market constraints at home.

III. GLOBAL FDI- TRENDS

The past 30 years has seen marked increase in FDI flows and stock. The world FDI stock increased phenomenally from US $ 698 billion in 1980 to US $ 23 trillion in 2012. The growth in FDI flows has indeed outpaced rate of growth in international trade. The trends in global FDI are discussed in three phases.

3.1 Phase I: 1970-1990 (North-North Phenomenon)

The average annual FDI flows during this period were recorded at about US$70 billion with developed countries accounting for almost three fourth of the world FDI inflows and 96% of world outflows. The first FDI boom took place in 1979-1981 triggered by the second oil crisis at the end of the 1970s. Global FDI outflows increased from US $ 39 billion in 1978 to US $63 billion in 1979 before falling back to US $ 27 billion in the year 1982. The short lived boom was led by major oil producing countries on the inward side. Saudi Arabia was the second largest FDI recipient after the United States during that period. After slowing down for the couple of years, FDI flows bounced back quickly in mid 1980. During the period 1983-1989, world FDI flows grew at an annual compounded growth rate of 28.9%, almost 4 times the rate of growth in world income and 3 times the rate of growth in world trade. The surge in FDI after 1985 was largely attributed to increase in investment flows among the industrialized nations. The G5 nations- France, West Germany, Japan, the United Kingdom and the United States accounted for almost 70% of global outflows and were recipient of about 57% of these flows. Nations classified as "developed market economies" by the United Nations were home to 93% of FDI flows and host to 81% of world FDI flows. Thus, developing countries received only 19% of total FDI during this period. Majority of such inflows were accounted for by small group of nations, namely, Mexico, Brazil and the Asian newly industrialized countries.

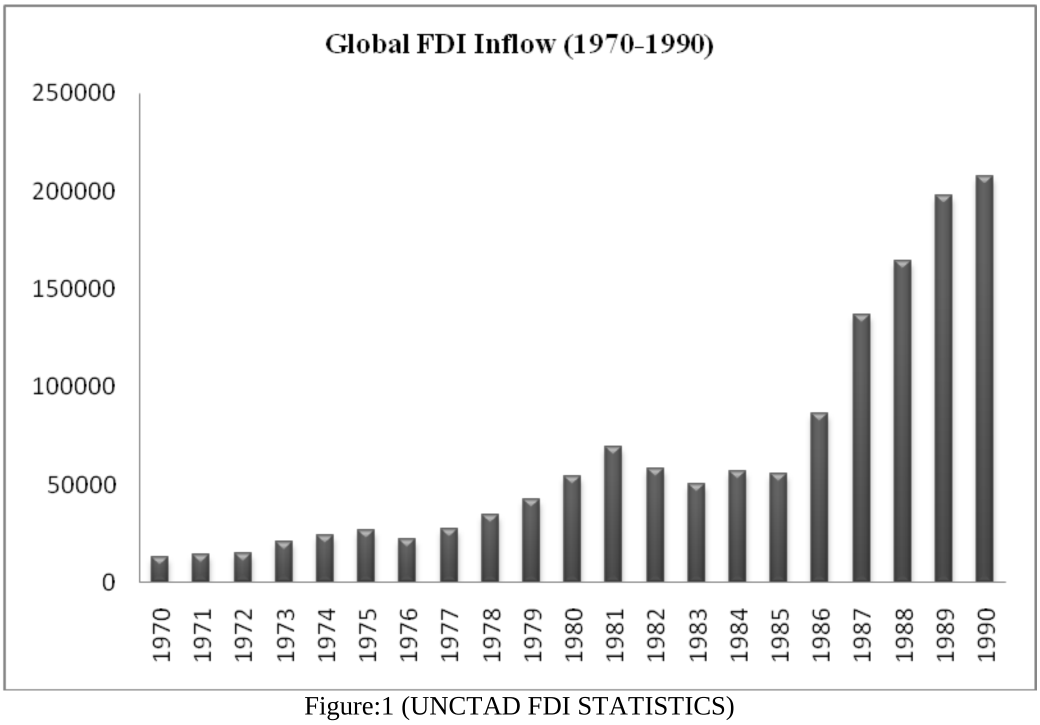
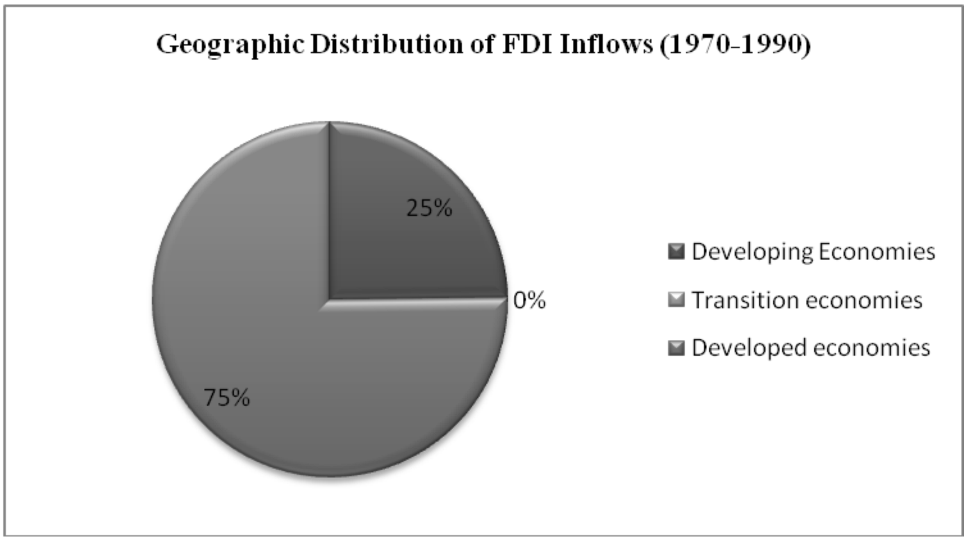


Figure:1 (UNCTAD FDI STATISTICS)



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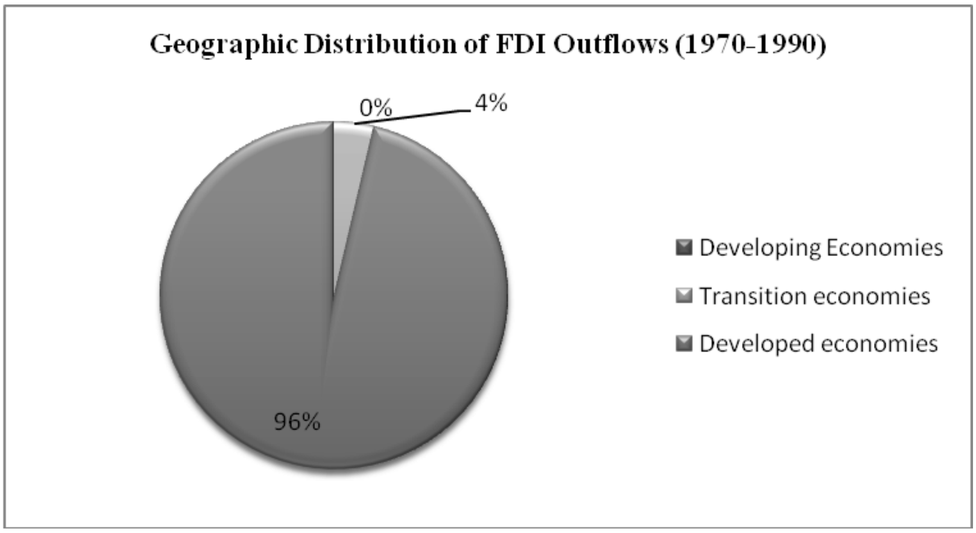

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3.2 Phase II: 1991-2000

World FDI flows during this period showed an upward trend with average FDI flows being recorded at US $519 billion.

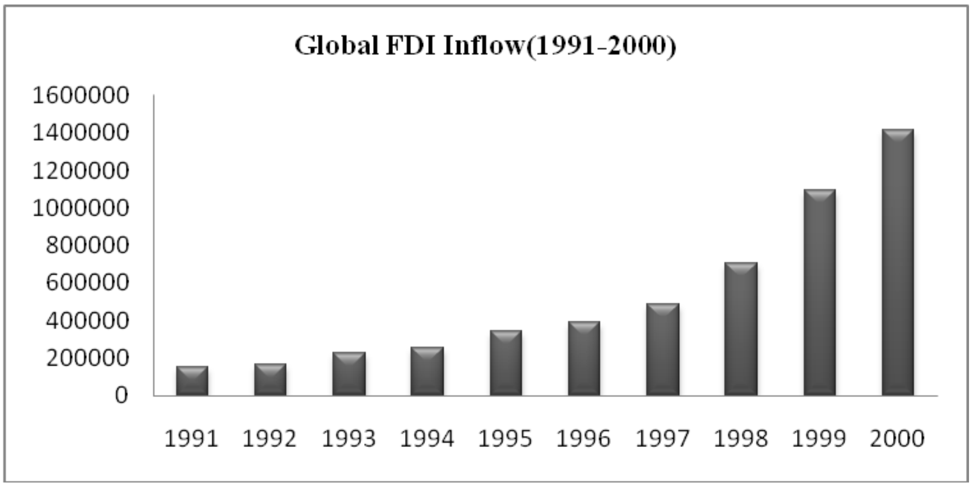
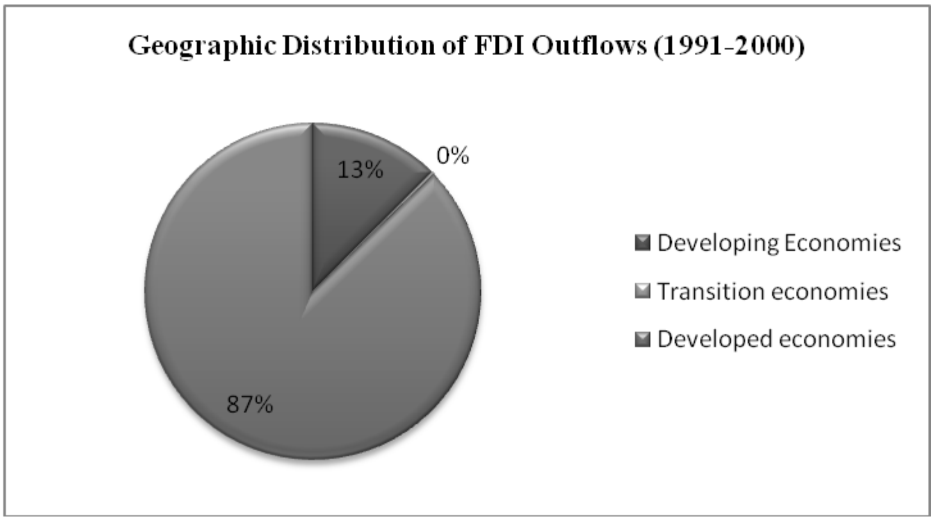


Figure: 4 (UNCTAD FDI STATISTICS)

This period saw increasing number of countries altering their investment regimes to make it favorable to Foreign Direct Investment. The number of countries making investment regime more liberal and conducive to foreign investment increased from 35 in 1991 to 63 in 1999. The changes in national FDI laws were complemented by the conclusion of new bilateral investment treaties (BITs), an increasing number between developing countries (WIR 2000). As a result the share of developing countries in global FDI inflows rose from 25% in phase I to 31% during 1991-2000 and its share in outflows increased from 4% to 13% during the same time period.



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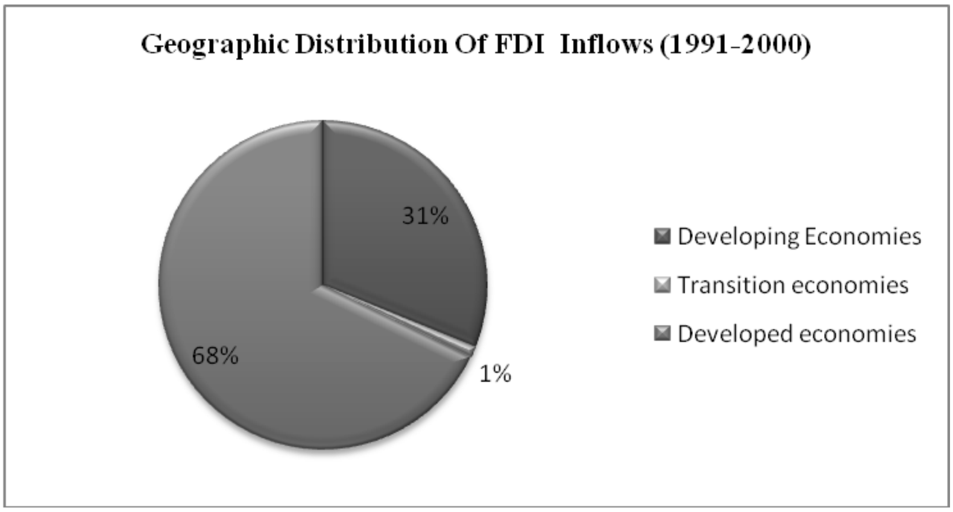

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A large chunk of FDI inflows in developing countries were directed towards China. As a result of liberalizing investment regime among other factors, China has become the largest FDI recipient country among the developing countries since 1992, accounting for almost a quarter of total inflows during 1991-2000. Global FDI flows set a new record post 1997 showing an average annual increase of 43% during 1998-2000. In 1998, world FDI outflows reached a record level of $ 690 billion and inflows of $706 billion. These levels were reached against the backdrop of numerous unfavorable economic conditions in the world economy such as Asian Financial Crisis, halting of high economic growth in East and South East Asia, economic recession in Japan and weak commodity and petroleum process impacting adversely the economies of East and South East Asia. However, this increase in FDI is accounted solely by the developed countries that experienced stable growth rate during the period and mainly because the effects of recession in Japan were compensated by increase in production in the United States and the European Union (UNCTAD 1999). After stagnating in 1998, FDI flows to developing countries have resumed their earlier growth trend. In 1999, developing countries received $208 billion in FDI, an increase of 16 per cent over 1998 and an all time high.

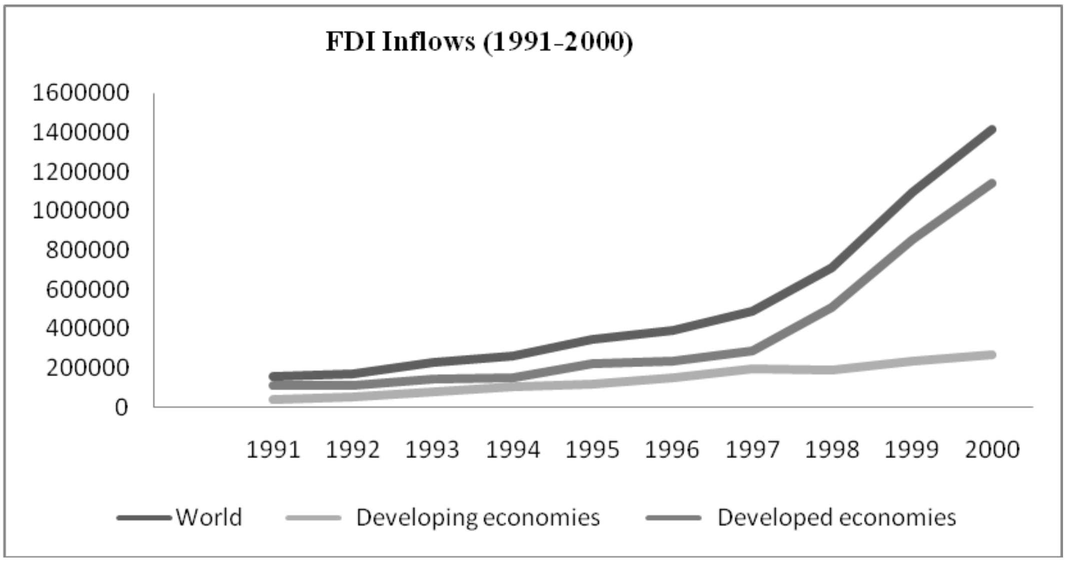


Figure: 7 (UNCTAD FDI STATISTICS)

3.3 Phase III: 2001 Onwards

The period 2001-2012 is associated with a considerable amount of variations in global FDI flows; the trend has been upward though. Annual average inflows during this period are recorded at about $1226 billion.

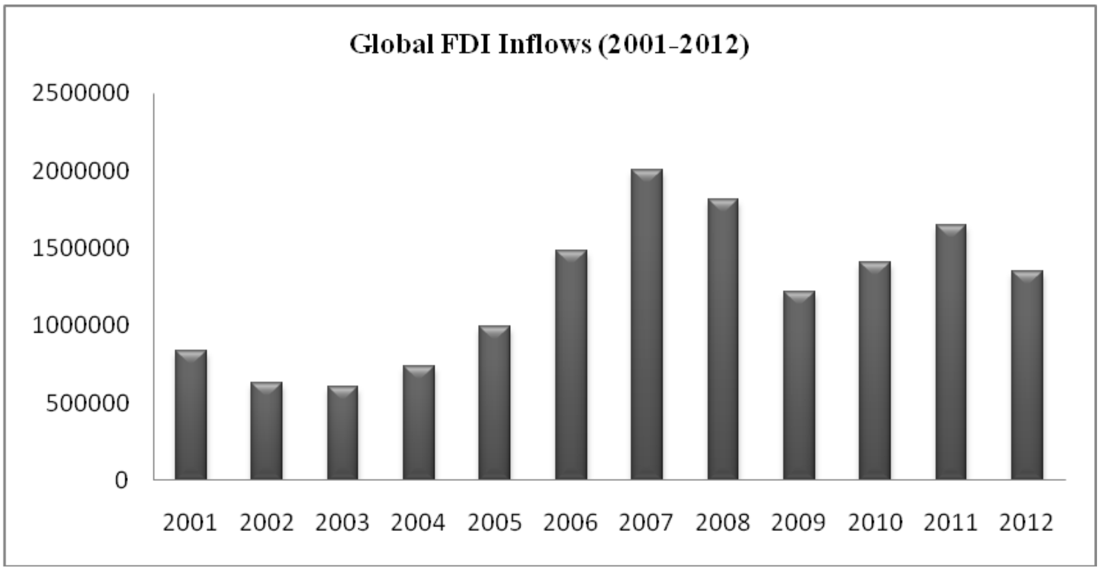
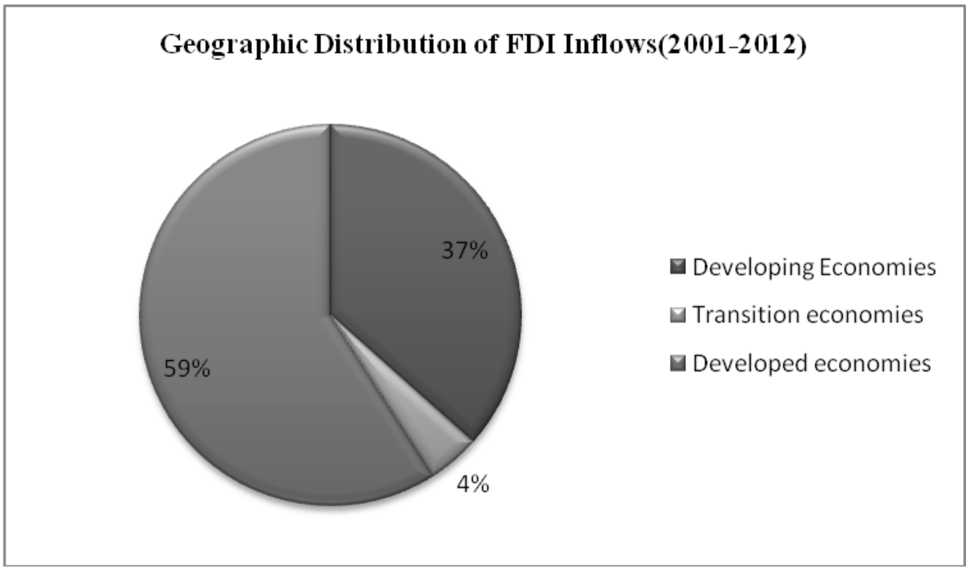


Figure 8 (UNCTAD FDI STATISTICS)

Continuing economic liberalization in the developing countries, slowdown in developed countries due to global financial crisis of 2008 and the recent euro zone crisis have resulted in the increase in share of developing countries in the global FDI flows. Developing countries on an average accounted for 37% of inflows and 18% of outflows up from 31% and 13% respectively during the last decade.



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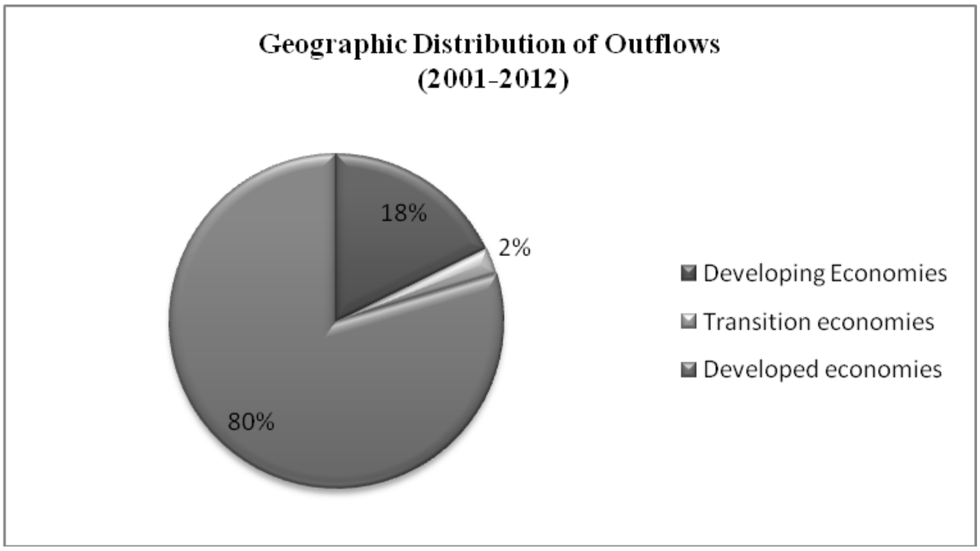

Figure 10 (UNCTAD FDI STATISTICS)

As compared to the year 2000, Global FDI flows declined sharply in 2001 with inflows falling by 51% and outflows by 55%. This steady decline in global FDI flows was led by decline in FDI flows to and from the developed nations of the world on account of slowdown in economic activity an major industrial economies. The slowdown in inflows was first of its kind and magnitude since 1991 and in outflows since 1992. Global FDI flows showed modest signs of recovery in the year 2004 after large declines in their values in 2001, 2002(13%) and 2003(12%). The recovery in FDI flows was accounted by recovery in developing countries. A number of developing countries in Asia, Africa and Latin America experienced strong economic growth and partly as a result received significantly higher FDI inflows. FDI flows reached its all time high in the year 2007 being recorded at about $2 trillion owing to high economic growth and strong economic performance in many parts of the world. However, international investments were severely affected by the financial and economic crisis that originated in US in mid 2007. After reaching the historic high of US $ 2272 billion in 2007, Global FDI outflow fell down to US $ 2005 billion in 2008. Investment remained numb in the following year and began to bottom out in the latter half of 2009. This was followed by modest recovery in first half of 2010. In 2011, global FDI outflows recorded an increase of 16% rising to US$ 1.7 trillion, surpassing the 2005-2007 pre crisis level for the first time. The strong recovery observed in 2011 could not last long and was followed by 17% decline in global FDI flows in the following year, owing to decline on outward FDI by developed countries. The decline in outward FDI by the developed countries is partly explained by deepening of sovereign debt crisis in the euro zone.

IV. CONCLUSION

The paper highlights the trend and patterns observed in Global FDIs which has been following an upward trend since 1970s. In initial years, global FDI outflows and inflows were majorly driven by the developed nations of the world indicating North-North phenomenon, where firms in advanced countries invested in other advanced industrialized countries. US had been the most preferred investment destination. However in the recent years and more particularly 2000 onwards share of developing countries in global FDI flows have increased at a commendable pace. Various macroeconomic events ranging from Asian Financial Crisis, Global Financial Crisis of 2008, euro zone crisis are responsible for the observed transformations in the FDI flows. The increased share of developing countries in the global outflows and inflows reflects the growing South-South phenomenon which can be expected to gain further momentum in the future.

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