International Journal of Emerging and Transition Economies
Vol. 5, No. 1-2, 2012, 47- 56

GLOBAL FOREIGN DIRECT INVESTMENT FLOWS AND THE ECONOMIC CRISIS

Artur Klimek*

ABSTRACT

This paper has been devoted to analyzing the implications of the economic crisis, which was triggered by the mortgage credit defaults in the United States in the summer 2007, on the flows of foreign direct investment (FDI) in the world. The issue has not been broadly studied in the economic literature and the sufficient explanation has not been delivered yet. The problem is essential due to the significant influence of the crises on reshaping the global architecture. The distinctive feature of this paper is focusing on the rising power of emerging economies as new sources of FDI in the distressed world economy. Main numerical analysis was conducted using preliminary data on FDI in year 2009 and beginning of year 2010.

Keywords: *Foreign Direct Investment, Financial Crisis, Emerging Countries*

GLOBAL FOREIGN DIRECT INVESTMENT FLOWS AND THE ECONOMIC CRISIS

INTRODUCTION

The decision about foreign engagement in a form of foreign direct investment (FDI) is one of the most crucial for managers due to the risk incurred by establishing foreign operations. An economic crisis can significantly increase costs of financing new projects. Especially when the expansion of a company is financed by debt. We could notice that the cost of money for many multinational corporations (MNE) increased considerably in the peak of the latest crisis. The problem of financing new investments means also constraints in the availability of credits. In the end of year 2008 and throughout year 2009, due to the widespread risk, banks preferred to keep a safe level of cash in order to meet unexpected losses. The same problem occurred in the stock market. When sources of money dry prices on

* Wroclaw University of Economics, Wrocław, Poland, E-mail: artur.klimek@ue.wroc.pl

stock exchanges are falling sharply and it is extremely difficult to place new issue of shares in the market and accumulate the needed capital. The time of crisis means that also enterprises focus on improving liquidity and decrease investment. In such circumstances the fixed costs of establishing new affiliate abroad are rising.

Companies undertake overseas investments motivated by four general factors: resource seeking, market seeking, efficiency seeking and strategic assets seeking (Dunning, 1998). These objectives are particularly important during the economic downturn. Finding new markets or increasing the stake in existing markets can be very difficult in times when the investment and consumption are plummeting. The prospective markets are losing their attractiveness and the period of repaying the investment is increasing.

Nonetheless, the crisis can be perceived as an excellent opportunity by many firms. Firstly, when home market is declining many firms are looking for overseas locations that may be growing at the moment. Even if the world economy is highly interrelated and many processes are of a global type, some countries still have different economic cycles. The most distinguished example is China. In year 2009, when most of the major economies contracted rapidly, Chinese rate of GDP growth was almost 9 per cent and with excellent perspectives for year 2010. The same situation, but in a smaller scale took place in Europe, where Poland developed of over 1 per cent, whilst most of its trading partners decreased significantly. Therefore the exploitation of foreign market opportunities is even more important in the downturn, that in the prosperity in the world economy.

The second reason for making investment projects abroad, in the time of economic contraction in the global economy, is to increase the competitiveness of a firm by locating production in low-cost countries. During the crisis time buyers are more concerned about prices of products and will not accept any unjustified costs. Companies are also trying to boost sales by decreasing the prices.

Another thing that may positively affect the increase of FDI flows is the changing role of developing countries in the world economy. As it was mentioned earlier, Chinese economy grew significantly in year 2009. It means that firms from the country are abundant with capital and try to exploit the problems of indebt companies from developed countries. One of the examples is the sales of Volvo to Chinese carmaker Geely in the end of March 2010 (Reed & Ward, 2010). Volvo reported loses for over last ten years, but the reason of purchasing the company by the Chinese producer was to gain a premium brand name and technology.

There were also other examples of improvement in FDI levels during the economic downturn. The positive development of FDI during the Asian crisis in the late 1990s was observed for South Korean enterprises (Winters, 2007). The results of author's analysis confirmed that the outward FDI from this country remained at a relatively stable level and many companies continued investments even though the overwhelming crises.

The main aim of the paper is to analyse changes in the global flows of FDI caused by the latest economic crises. The author will scrutinise the impact on the two main groups of countries: developed and developing economies. The analysis will be conducted using the newest available sources of data. Comparison may be somewhat diminished due to the fact that the recent data on FDI are delivered by particular countries for different periods. Nevertheless, it is important to analyse the data even of the shortcomings.

The paper was divided into three principle parts. First part covers the situation in FDI before the crisis. Part two contains analysis of FDI flows during the crises. Third part is devoted to the directions of the future development of the FDI.

DEVELOPMENT OF FDI BEFORE THE CRISIS

As the overseas expansion in the form of FDI may be very risky and incurs high fixed costs, it develops predominantly during the phase of prosperity. It is confirmed by investment flows during last twenty years (figure 1). Years 2000 and 2007 were periods of thriving development of the global economy. Firms perceived the time as a perfect opportunity for further development abroad. However, the rising values of FDI flows were indirectly caused by the rising prices of assets. The prices increased the values of cross-border mergers and acquisitions (M&A), which are the predominant mode of FDI. It basically meant that corporations acquiring foreign assets had to pay very high prices for them.

After the record periods of years 2000 and 2007 came crises that highly negatively affected the flows of FDI. But if we separate FDI flows of highly developed and less developed countries, we notice that actually only advanced economies were distressed. It is clearly noticeable in year 2008 when firms developed economies cut their FDI sharply, but emerging countries' firms increased their share of total FDI and intensified foreign activities.

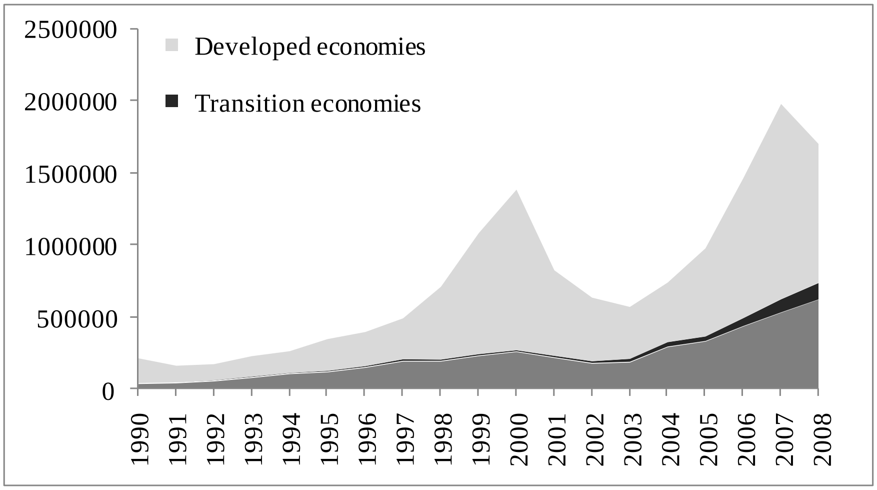

Figure 1: FDI inflows by group of economies [in mil. USD]

Source: Own elaboration based on UNCTAD data.

It is worth highlighting that for the last twenty years flows of FDI have developed much faster comparing to the flows of international trade. This confirms that corporations were primarily focused on the capital expansion, not the trade. Naturally, we need to remember about the role of MNC in the international trade. Largest corporations create the bulk of traded goods and services over the borders.

INVESTMENT FLOWS DURING THE CRISIS

The situation in 2008 and beginning of 2009 was deteriorating steadily. It points that there is still a possible deterioration in coming quarters (figure 2). This is caused by the fact that enterprises need some time to prepare new projects of foreign expansion and to gather resources necessary in the overseas activities.

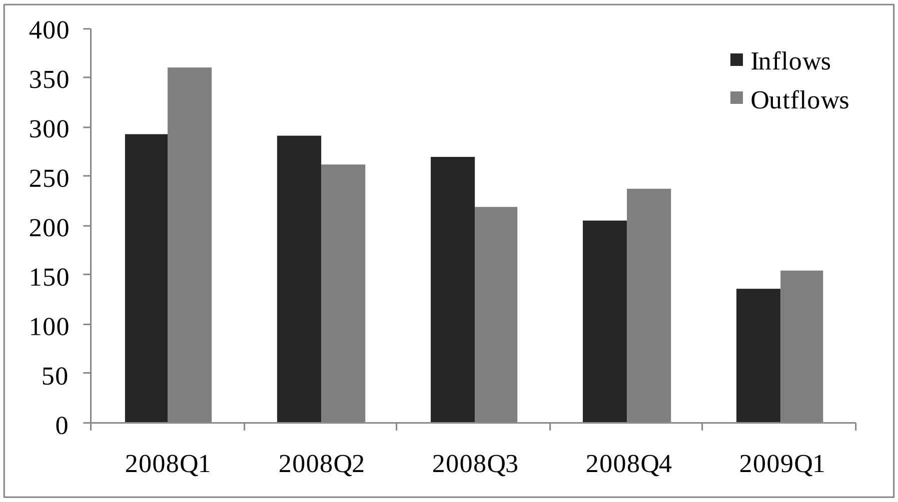

Figure 2: Global inflows and outflows of FDI quarterly [in bn USD]

Source: Own elaboration based on UNCTAD data.

Besides avoiding new investment project abroad, some firms make divestments and run restructuring plans (UNCTAD, 2009). The aim of such activities is to cut costs, to reduce overestimated capacity and to reduce the level of debts in the company.

The influence of the crisis depends on the mode of FDI. Significant reduction in the number of new cross-border M&A transactions took place due to problems with financing large deals and halt of some privatisation projects by the governments. On the other hand, the number of new greenfield investments grew in year 2008 comparing to year 2007 (UNCTAD, 2009). This can be explained by looking for new ways of improving operations, but more significantly because the projects are of longer time span and they cannot be terminated immediately.

Nevertheless, the reduction of the investment flows is not equal among firms originating in various economies. Corporations from China have been much more active than their European counterparts in the overseas expansion during the crisis (Klimek, 2010). China as a foreign investor must be perceived in a separate way comparing to developed countries. One of the important issues is the role of Chinese government both in creating incentives and direct activities (Brown, 2009). Especially, if we take into consideration the activity of China Investment Corporation – one of the largest sovereign wealth funds in the world. China's overseas activities comprise also seeking the natural-resources in order to meet vast needs of the fast developing economy (Buckley, 2007).

FUTURE PERSPECTIVES

In author's opinion the globalisation processes cannot be reversed even by the most severe economic disasters. The crises may influence changes in the composition of FDI flows and some industries may be negatively affected. Comprehensive analysis of the situation in the coming years was provided by United Nation Conference on Trade and Development (UNCTAD), which delivers results of surveys among large companies in the world. Some of the outcomes may be particularly interesting in the light of this article.

The most important is the prospect of future development of FDI. As it was expected the number of respondents positively assessing the situation is rising over time and only small fraction of the managers expects worsening the situation (table 1). The outlook is the worst in the short term and improving in years 2010 and 2011. The flows of FDI are expected to grow simultaneously with the level of development of the global economy.

Table 1: FDI growth prospects compared with 2008 [% of respondents]

Year	Increase	Remain the Same	Decrease
2009	22	20	58
2010	33	26	41
2011	50	31	19

Source: *World Investment Prospect Survey 2009-2011*, 2009.

Moreover the position of fast developing countries, described as the BRIC countries, is increasing. Among six best destinations of FDI are China, India, Brazil and Russian Federation (UNCTAD, 2009a). This confirms the movement of the gravity centre to the emerging countries.

SITUATION IN SELECTED COUNTRIES

Most of the FDI analyses, especially the ones coping with recent situation, is based on the aggregated data. In order to enrich the analysis, the author employed the latest data on the FDI flows in selected countries. Observing the flows of FDI in the United States we can conclude that both outward and inward investment decreased significantly due to the crisis (figure 3). Comparing years 2007 and 2009 we can see that the values almost halved in the period. The unexpected situation in outward FDI happened in year 2005 when large amount of capital in form of FDI was withdrawn from some European countries.

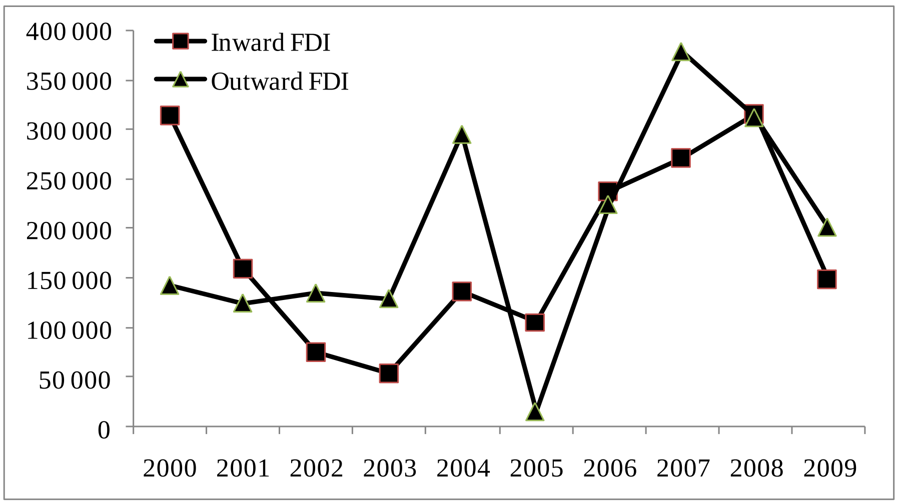

Figure 3: Outward and inward FDI in United States between 2000 and 2009 [in mil. USD]

Source: own elaboration based on U.S. Bureau of Economic Analysis data.

The value of Chinese investment in the period of five years 2003 and 2008 had a very clear trend (figure 4). Higher dynamics is observed in the outflows of FDI from this country. This can be viewed as a confirmation of strength of the Chinese economy. Firms from this country have more resources than their counterparts in developed countries.

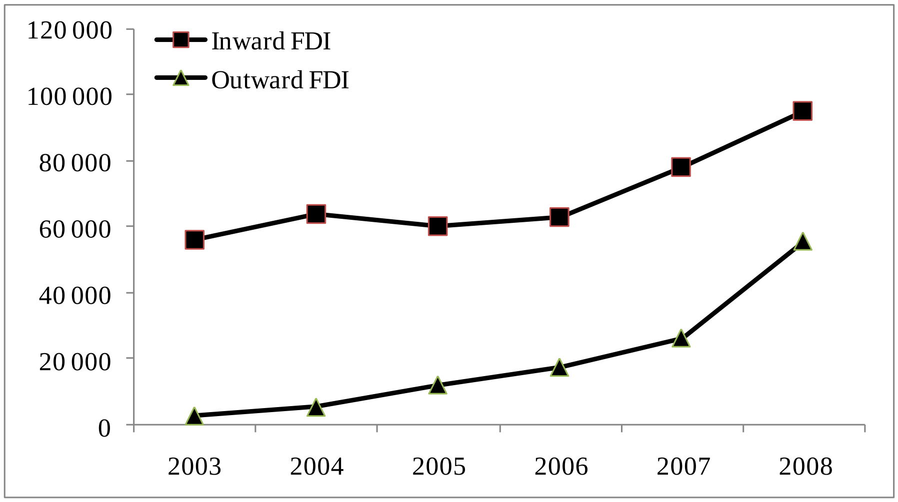

Figure 4: Outward and inward FDI in China between 2003 and 2008 [in mil. USD]

Source: own elaboration based on Ministry of Commerce of People's Republic of China data.

Newly revealed data on Chinese inward FDI in the first quarter of year 2010 confirm that 5.459 new foreign investment projects were approved by the authorities (up by 19.87% year on year) and the utilization of inward foreign investment reached USD 23.443 bn, which is up by 7.65% year on year (MOFCOM, 2010).

The situation is not consistent in all developing countries. In year 2009 comparing to year the inflows of FDI to India decreased from USD 33.034 billion to USD 27.098 billion, that is 18% less (Ministry of Commerce and Industry of India, 2010). Even if the flows were denominated in Indian currency the decrease was of 6%. When we compare the situation in January 2009 with the same period in year 2010 we can still see the decrease from USD 2.339 bn to USD 2.042 bn (Ministry of Commerce and Industry of India, 2010a).

SUMMARY

The economic crisis significantly affected the capital flows in the form of FDI in the world. There is a direct relationship between the volume of FDI and rate of change of GDP. Business firms expand both domestically and internationally if prospects of future development are optimistic.

Obviously, the growth rate of an economy is not a solitary factor influencing the flows of capital in this form. Monetary, fiscal, and trade policies of governments are factors underpinning the future development of economies and in the end of the day they are exhibited by the GDP rate of change.

During the current economic crisis possibilities of financing are scarcer and the cost of capital is rising for many firms. Due to this facts, numerous companies and industries had to recalculate and redesign foreign operations. But the crisis has not challenged all participants of FDI flows in the same way. We could notice the appearance of enterprises and institutions that gained during the crises (e.g. rising activities of sovereign wealth funds).

One of the main conclusions coming out of the analysis is the decoupling of FDI flows of less developed countries from the flows of the advanced economies. Foreign activities of enterprises from highly developed countries are more prone to the changes in the global economic situation. The investment projects are closely linked with the stage of business cycle. On the other hand, the developing economies steadily increase their overseas activities, even in an unfavourable period of global economy. The emerging countries were also less affected when it comes to the inflows of FDI. China or India lost only small fraction comparing to the pre-crises level. More important for the mentioned economies is the prospect of future FDI flows – according to surveys they will be top destinations in coming years.

Additionally, the developing countries use their extensive money reserves to support the activities of national enterprises abroad and to meet the political aspirations. It is also worth highlighting the significance of investment projects from developing countries located in other countries of the similar level of development. In such circumstances the role of advanced economies is decreasing. One of the examples is massive Chinese investments in natural resources industries in Africa. However, the continent is not the most important for Chinese firms, which rather locate their investments in other Asian countries.

Taking it all into consideration we can conclude that the latest economic crisis was a catalyst of the changes in the world economy. The looming period highlighted some of the structural problems of global

architecture, but also allowed new participants to mark their positions and aspirations.

REFERENCES

Assessing the impact of the current financial and economic crisis on global FDI flows. (2009). United Nations Conference on Trade and Development, New York and Geneva.

Brown, K. (2009), Chinese Overseas Investment and the Global Economic Crisis. Harvard Asia Quarterly, 12, 1, 25-34.

Buckley, P. J., et.al. (2007). The determinants of Chinese outward foreign direct investment. Journal of International Business Studies, 38, 4, 499-518.

Dunning, J. H. (1998). Location and Multinational Enterprise: A Neglected Factor? Journal of International Business Studies, 29, 1, 45-66.

Fact Sheet on Foreign Direct Investment. (February 2010). Department of Industrial Policy and Promotion, Ministry of Commerce and Industry of India.

Fact Sheet on Foreign Direct Investment. (April 2010a). Department of Industrial Policy and Promotion, Ministry of Commerce and Industry of India.

Klimek, A. (2010). Bilateral flows of foreign direct investment between China and European Union. In B. Skulska (Ed.), Asia - Europe. Partnership or Rivalry? Prace Naukowe Uniwersytetu Ekonomicznego we Wrocławiu, forthcoming.

News Release of National Assimilation of FDI From January to March 2010. (April 2010). Investment Promotion Agency of MOFCOM, People Republic of China.

Reed, J. & Ward, A., Geely seals deal to buy Volvo from Ford. Retrieved April 27, 2010 from the World Wide Web: http://www.ft.com.

Statistical Bulletin of China's Outward Foreign Direct Investment 2008. (2009). Ministry of Commerce of People's Republic of China.

Winters, M. S. (2007). Market Assess or Efficient Production: Why Did South Korean Outward Direct Investment Persist After the Crisis. Asian Business & Management, 6, 265-284.

World Investment Prospect Survey 2009-2011. (2009a). United Nations Conference on Trade and Development (UNCTAD), New York and Geneva.

World Investment Report 2009: Transnational Corporations, Agricultural Production and Development (2009). United Nations Conference on Trade and Development (UNCTAD), New York and Geneva.