

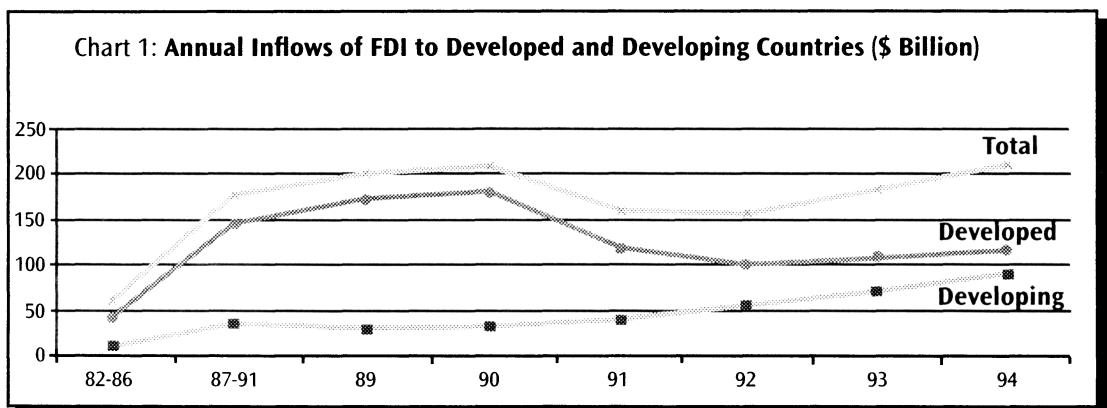
## Global Trends in FDI

The current decade is witnessing the growing significance of foreign investments in the world economy and a rapid liberalisation in policies in developing countries towards trade and investment. Multinational enterprises (defined as all firms with overseas investments, regardless of size, spread or share of equity) account for ever increasing shares of world output, trade and technology. In 1991, it is estimated that MNEs and their affiliates generated total sales of \$4.8 trillion and intra-firm trade of \$1.5 trillion. This can be compared to total world trade in goods and services of \$4.5 trillion, including intra-firm trade (\$3 trillion excluding it).<sup>2</sup> The stock of FDI continues to grow faster than world GDP, domestic investment and trade.<sup>3</sup> This is true of developing countries as a group – FDI flows into the developing world grew at 4 percentage points faster than their exports of goods and services in 1986-90, and at 21 percentage points faster in 1991.<sup>4</sup>

In terms of overall trends, one of the most significant recent features of FDI is the rapid and sustained rise in flows to the developing world.<sup>5</sup> After a period of relative stagnation in the wake of the debt crisis and the ensuing recession up to

the mid-1980s (in 1980-85 FDI to developing countries actually declined by 4% per annum), investment in the developing world revived strongly. Over the latter part of the 1980s, it rose by 17% per annum, with a further acceleration after 1990. According to the forthcoming World Investment Report 1995, total FDI to developing countries reached a record figure of \$85 billion in 1994, an increase of 21.4% over the previous year. This rise followed increases (in current dollars) of 37% in 1992-93, 32% in 1991-92 and 25% in 1990-91. The value of inflows to developing countries rose by 166% in the first 4 years of the decade, a period when FDI to the developed world declined by 34%. The distribution of investment flows between the developed, developing and formerly socialist countries are shown in Chart 1.

FDI flows to different regions of the developing world during 1985-1992 are shown in Table 1. The rise of investment interest in developing countries is striking not only because of the large sums involved but also because it reverses a decline in their share of total flows. This share had declined from the earlier peak of around



one-third in the 1970s to one-quarter by 1980. It fell further to 16% in 1986-90, a period when FDI in the developed world rose rapidly (23% per annum). In the 1990s, by contrast, there has been a sharp decline of inflows into the developed countries. In 1991, FDI in the OECD countries fell by 31%, and in 1992 by a further 16%. In the subsequent two years flows have revived, by 7% in 1993 and 9% in 1993, both lagging behind the rise in developing countries.

As a consequence, the share of developing countries reached its former peak of 33% in 1992, and went on to reach 36% in 1993 and 41% in 1994. In current dollars, the value of FDI in the developing world was equal to that of inflows into the developed world in 1986. If present trends continue, direct foreign investment in the developing world may exceed that in the developed world in a few years. However, this depends very much on how flows are distributed as economic activity revives in the latter: FDI flows tend to be highly volatile in the short term and are very sensitive to business cycles in the major OECD countries. What is clear is that there are major structural shifts under way in the pattern of production (and trade) in favour of certain developing countries that should lead to a continued shift in investments towards the developing world.

Given the nature of the phenomenon, with sharp cyclical movements and sensitivity to political and economic changes, it is difficult to forecast long-term FDI flows with any degree of precision or confidence. Nevertheless, many attempts are made to model and predict such flows. An econometric forecasting exercise by UNCTAD (1993.b) is worth reporting.<sup>7</sup> This exercise suggests that, assuming continued liberalisation and reasonable rates of economic growth (5-6% per annum for the developing world as a whole), FDI in the developing world would equal that in the developed world by 2020 – rather longer than a simple extrapolation of current trends suggests.

According to UNCTAD (1993.b), each

### Box 1: A Long-Term Projection of FDI

The UN Transnational Corporations and Management Division used a single-equation regression model for FDI inflows during 1972-88.<sup>6</sup> FDI inflows were explained by lagged GNP, GNP growth, domestic investment-GNP ratio, exchange rate and variability of the exchange rate. Region-specific variables were added for Latin America (trade as proportion of GNP and level of debt) and Africa (dummy for sudden jumps in FDI). 0

Three forecasts were made, based on: (a) extrapolations of growth rates for 1972-86, (b) UN projections from Project Link, and (c) IMF and World Bank projections for average growth rates. The projected annual growth rates of inward FDI, in constant 1990 dollars, for 1989-95 were as follows:

Regions	a	b	c
Asia	11.3	11.6	11.8
L. America 1	7.9	15.6	12.2
Africa	6.3	16.3	16.1

The projections b and c, based on model Link and IMF/WB assumptions about GNP growth, suggest that Asia would have slower growth rates of FDI than Latin America or Africa. However, some of these expectations are clearly not borne out either by subsequent growth or by FDI performance. Well over half the period covered by the analysis has now elapsed, and East Asia has continued to outperform other regions. In addition, its competitiveness has risen faster. Africa in particular has failed to respond to policy reforms, and FDI has continued to bypass most of the continent. Moreover, expectations of continued liberalisation may not be well founded for all developing countries.

**Table 1: Aggregate FDI inflows to Developing Countries, 1985-92**  
(US \$ million and %)

	1985	1986	1987	1988
All developing countries	11,526.7	11,647.2	13,909.3	21,994.3
of which Commonwealth	1,786.8	1,227.2	2,093.8	2,316.3
percent	15.5	10.5	15.1	10.5
Low-income countries	4,107.2	3,898.6	4,978.6	6,113.9
of which Commonwealth	851.0	458.4	1,147.1	1,039.8
percent	20.7	11.8	23.0	17.0
Lower-middle income	3,357.5	2,647.9	3,041.4	4,881.3
of which Commonwealth	823.4	645.5	716.3	1,025.6
percent	24.5	24.4	23.6	21.0
Upper-middle income	4,062.0	5,100.7	5,889.3	10,999.2
of which Commonwealth	112.4	123.4	230.4	250.9
percent	2.8	2.4	3.9	2.3
<b>Memo items:</b>				
Hong Kong	—	996.0	3,298.0	2,675.0
Singapore	1,047.0	1,710.0	2,836.0	3,655.0
Sub-Saharan Africa	876.6	671.4	1,351.8	1,226.2
percent of total LDCs	7.6	5.8	9.7	5.6
of which Commonwealth	616.6	226.5	972.1	655.9
percent of region	70.3	33.7	71.9	53.5
East Asia and Pacific	3,183.5	3,872.8	5,200.6	8,553.7
percent of total LDCs	27.6	33.3	37.4	38.9
of which Commonwealth	783.7	580.8	537.4	887.2
percent of region	24.6	15.0	10.3	10.4
Europe and Central Asia	854.0	871.9	1,295.4	2,238.8
percent of total LDCs	7.4	7.5	9.3	10.2
of which Commonwealth	317.2	350.5	377.8	521.7
percent of region	37.1	40.2	29.2	23.3
Middle East and N Africa	2,206.4	2,212.0	(93.7)	1,456.3
percent of total LDCs	19.1	19.0	(0.7)	6.6
of which Commonwealth	—	—	—	—
percent of region	—	—	—	—
South Asia	317.2	350.5	377.8	521.7
percent of total LDCs	2.8	3.0	2.7	2.4
of which Commonwealth	317.2	350.5	377.8	521.7
percent of region	100.0	100.0	100.0	100.0
L. America, Caribbean	4,089.0	3,668.6	5,777.5	7,997.6
percent of total LDCs	35.5	31.5	41.5	36.4
of which Commonwealth	52.0	47.4	187.2	210.8
percent of region	1.3	1.3	3.2	2.6
<b>Total NICs</b>	<b>1,281.0</b>	<b>3,467.0</b>	<b>7,450.0</b>	<b>8,160.0</b>

1989	1990	1991	1992
25,813.5	28,915.1	37,370.0	45,721.8
5,274.6	4,411.1	6,000.6	6,124.4
20.4	15.3	16.1	13.4
8,249.2	6,756.8	7,469.1	14,972.4
2,762.8	1,320.8	1,175.3	1,460.8
33.5	19.5	15.7	9.8
7,140.9	7,988.8	11,699.9	12,985.5
2,136.2	2,725.4	4,569.8	4,403.0
29.9	34.1	39.1	33.9
10,423.5	14,169.5	18,201.0	17,764.0
375.6	364.9	255.5	260.7
3.6	2.6	1.4	1.5
1,076.0	783.0	—	—
2,773.0	5,263.0	4,325.0	5,635.0
2,664.7	866.1	1,525.5	1,481.9
10.3	3.0	4.1	3.2
2,348.5	1,082.8	816.8	1,073.4
88.1	125.0	53.5	72.4
10,678.3	12,038.3	14,918.2	20,831.2
41.4	41.6	39.9	45.6
1,886.2	2,358.6	4,110.0	4,119.2
17.7	19.6	27.6	19.8
3,471.7	4,644.6	6,842.0	7,240.0
13.4	16.1	18.3	15.8
584.3	395.6	532.4	523.0
16.8	8.5	7.8	7.2
1,331.7	3,172.2	1,000.1	1,353.2
5.2	11.0	2.7	3.0
—	—	—	—
—	—	—	—
584.3	395.6	532.4	523.0
2.3	1.4	1.4	1.1
584.3	395.6	532.4	523.0
100.0	100.0	100.0	100.0
7,082.8	7,798.3	12,551.8	14,292.4
27.4	27.0	33.6	31.3
403.8	528.5	541.5	408.8
5.7	6.8	4.3	2.9
<b>6,211.0</b>	<b>8,091.0</b>	<b>6,712.0</b>	<b>7,064.0</b>

group would reach an FDI figure (in constant 1990 dollars) of \$400 billion in 2020, when foreign investments would account for 6% of total investments in the developing world and 7% in the developed countries (up from 3% and 4% respectively in 1990). These forecasts are based on simplifying assumptions about future policy reforms, growth, capital-output ratios, exchange rates and the response of FDI to these. They ignore issues of competitiveness and shifts in industrial location between regions and countries, and seem unduly optimistic about FDI in Africa. The main features of the analysis are reported in Box 1, which also notes the drawbacks of these projections.

As far as the composition of FDI is concerned, the longer-term trend for the decline in the share of the primary sector was reversed in the 1980s.<sup>8</sup> Driven by investments in petroleum and mining, the share of the FDI stock in the primary sector in developing countries, which had fallen to 21 percent in 1975, rose to 24 percent in 1985, thereafter declining to 22 percent in 1990. The share of manufacturing in the stock of developing country FDI fell steadily over this period, from 56 percent in 1975 to 49 percent in 1990. Within manufacturing, however, the higher technology and skill activities gained in the developing world while resource- and labour-intensive activities declined in significance. This shift has been particularly marked in the NIEs of East Asia, where investors moved rapidly out of labour-intensive into capital- and technology-intensive activities.

The emerging pattern of FDI reflects the pace and nature of technological progress, and affects the direction of FDI flows, benefiting host countries that had a relatively good base of technical and managerial skills, well-developed infrastructures and supporting systems of local suppliers and subcontractors.<sup>9</sup> These changes in FDI by the OECD countries were accompanied by the rapid growth of “developing country multinational enterprises” from the more industrialised developing countries. These started with the

relocation of simple, labour-intensive industries from the NIEs to low wage countries, but soon moved into more complex activities and into a large range of host countries, including developed ones. The pioneering developing country multinational enterprises have now been joined by a variety of investors from a large number of other developing countries, operating overseas in tourism, finance, trade, real estate and other primary sectors apart from manufacturing (see below).

Over the long term, FDI in services has gained at the expense of manufacturing in global investment flows. This reflects the pattern of structural change, technological changes in services and related infrastructure, changes in corporate strategies and the liberalisation of many service sectors. Established industrial multinational enterprises have moved into service activities, and a host of traditionally home-bound service firms have set up affiliates in important markets overseas. Banking and finance have spearheaded the growth of service FDI, followed by insurance, transport, telecommunications, tourism, construction, advertising, retailing and information technology. The growth of service FDI is particularly marked in the developed world. Take the major overseas investors, for instance: 51% of the USA's overseas investment in 1992 was in services, compared to 41% in 1985; for the UK, 46% and 35%, for Japan, 66% and 52%, for France 46% and 47% and for Germany, 56% and 53%.<sup>10</sup> However, there are signs that service FDI in some developing countries has also risen as a result of recent policy liberalisation. This is particularly marked in Latin America, where much of the revival of foreign investment inflows has been in banking, telecommunications, hotels, retailing and similar activities. Privatisation has also played a very important role in FDI in Latin America (and Eastern Europe), far more so than other developing regions. This will be taken up at more length below.

In Asia, the bulk of FDI still concentrates on

manufacturing, testifying to the faster development of the industrial sector, better export performance and greater industrial and technological capabilities built up there. This difference in investment patterns deserves more interest than it seems to have received, since it may have differing implications for the development of the two regions. To the extent that the growth of manufactured exports and industrial competitiveness is of special significance to long-term growth and structural change, the pattern of FDI seems to bode better for Asia than for Latin America. However, this interesting issue goes beyond the scope of this paper, and will not be explored here.

The recent growth of FDI has witnessed the continued growth of a variety of 'new forms' of foreign investment.<sup>11</sup> These new forms involve contractual and ownership relationships in which the foreign investor does not hold the majority equity share. In some cases, the relationship may not involve any equity at all, and its duration may be limited to a one-off transaction. Apart from minority joint ventures, new forms of FDI include licensing agreements, management and marketing contracts, franchising, turnkey projects, subcontracting and OEM (original equipment manufacture) arrangements, and BOO and BOT (build-own-operate and build-operate-transfer) contracts for utilities and infrastructure projects. Most of these forms are not new, of course, but their significance has continued to grow as buyers or host countries have become more capable, smaller investors have entered the international arena, governments have sought to encourage domestic ownership of assets, and competing sources of technology and skills have emerged in maturing technologies.

In contrast, BOT and BOO are genuinely new forms of investment (in most cases the projects are handled jointly by local consortiums and by foreign technology suppliers and financiers) in developed as well as developing countries. Their spread has been boosted by the urge of many governments to privatise public

enterprises, improve the functioning of utilities, improve the environment for private enterprise, raise the large volumes of finance involved while reducing pressures on the official budget.<sup>12</sup> Some developing countries seem to be moving faster in this area than developed ones; Malaysia, for instance, is pushing ahead in BOT schemes in the power sector, airports, railways, sewerage and so on.<sup>13</sup> This subject is taken up again under the section on 'new forms' of FDI.

Along with the growth of new forms, the increasing liberalisation of FDI regimes gives investors greater freedom than before to choose ownership forms on economic and commercial grounds. 'Classic' forms of ownership, with complete or majority control, are clearly preferred by some multinational enterprises. This is true of certain services and in manufacturing in activities that involve fast-changing and advanced technologies. The multinational enterprises that prefer clear control tend to be large firms and those with strategies of 'deep integration', moving towards greater global integration of operations, with supplies, resources and R&D distributed in a tightly linked network across various countries.<sup>14</sup> However, even large MNEs often opt for new forms in more mature technologies, in entering countries with difficult entry conditions, and in establishing supply relationships (along Japanese lines) with long-term arrangements in which they can share technology and innovation costs. The rising costs of innovation have also led MNEs to form "strategic alliances" with each other across national boundaries.<sup>15</sup> This makes it more difficult and expensive for newcomers from developing countries to gain access to some new technologies at arm's length, and makes some form of accommodation with multinationals imperative for progress in those technologies.<sup>16</sup>

To conclude, multinational activity is increasing rapidly in the developing world. It is taking new forms in a changing global environment. This environment is marked by rapid technical progress, closer economic ties between nations,

more liberal rules for trade, the emergence of new trading blocs and alliances, and more welcoming environments for the private sector and multinational enterprises.<sup>17</sup> Multinational enterprises are at the forefront of much of this technological advance and the shrinking of economic space, and are adapting their own strategies to the organisational and other needs of globalisation. New organisational forms and management techniques are producing new configurations of comparative advantage for countries and 'ownership' advantages of companies.<sup>18</sup> Host and home governments are trying to come to terms with the irresistible advance of international production, currently by moving towards wholesale deregulation and liberalisation. To some extent this means that international regulation of MNEs

has not kept pace with the advance of international production.<sup>19</sup>

New sources and forms of FDI are constantly appearing, in the developed as well as the developing worlds. The attraction of multinational enterprises to developing countries is taking different dimensions from two or three decades ago, when large protected markets, cheap unskilled labour and the exploitation of natural resources provided the main drive. Increasingly the sustained attraction of FDI into competitive and higher value-added activities requires disciplined and productive labour, high levels of skill, efficient world-class infrastructure, and a supportive network of suppliers, rather than the possession of cheap labour or even exploitable natural resources.<sup>20</sup>