THE IMPACT OF THE ECONOMIC CRISIS ON THE DYNAMIC OF INTERNATIONAL FDI

Lenuţa **Carp**
Alexandru Ioan Cuza University of Iaşi
lenutza_carp@yahoo.com

Abstract: *FDI flows are internationally recognized for the benefits they generate (technological transfer, know – how, industrial reorganization, raising the number of working places). Foreign capitals increased significantly under the impact of globalization and accelerated the interdependencies between economies up to 2007, but, in the current crisis, the dynamic of FDI flows was affected in a negative manner, both in developed economies and in the developing ones. The aim of this paper is to reveal and analyze the evolution of FDI flows in the period 2007 – 2010, emphasizing the strong impact that economic crisis exerts. The results of the analysis presents the descending trend up to 2009, since 2010 being noticed a slight recovery which continued in the first trimester of 2011 and according to the forecasts will continue in the future.*

Keywords: FDI, crisis, economic growth, impact, mergers, acquisitions
JEL Classification: E22, G01, G34

INTRODUCTION

The role foreign direct investment (FDI) play in the economy of the beneficiary country, thanks to the advantages they provide is widely recognized. The globalization and enhancing the interdependence of international markets have simplified the free movement of foreign capital flows, thus exerting a crucial impact on economic development. FDI are considered the main factor in the globalization of the capital, and through it of the entire economy (Joong – Wan, 2003) through the influence that exerts on the modernizing process of the host country economy, these flows being appreciated as "the critical element of the economic growth, the promoter of the intensive, qualitative and efficient factors" (Munteanu and Tudor, 2009).

The evolution of FDI during the economic crisis emphasizes two fundamental aspects: on the one side, the descendant trend foreign capital flows recorded during the recession, but on the other side the unexpected changes considering the destination of these flows, raising the importance of developing and transition countries. The analysis of the international FDI flows reflect the crucial impact that the international economic – financial crisis has on FDI characteristics, on global commercial operations, the influences being different in various countries, from one sector to another, emphasizing the necessity of a sound and stable financial system.

1. FOREIGN DIRECT INVESTMENTS – STIMULATING FACTOR OF ECONOMIC GROWTH

The definitions given to the concept of FDI in the relevant literature reveals especially the capital transfer conducted by the foreign investor to develop economic activities in the beneficiary country through creating and extending the firms. The Balance of Payments Manual of IMF and OECD (1999) Benchmark Definition demonstrate foreign investors gain in a higher level of control, of influence and a raised level of power in the management of the resident company in the economy of another country. IMF (2009) includes in the category of foreign investor the one who has at least 10 % of the social capital of a company, being incorporated or unincorporated in a public or private enterprise or represented by a group of persons related or connected or not to companies which implement their activities in others countries than home.

FDI flows are a special form of foreign inflows, in which category Alfaro (2009) includes only Greenfield investments which permit the development of new production capacities or taking the control over an existing firm. The OLI paradigm Dunning developed presents the advantages foreign investor benefit through the decision of relocating his production in exterior: location, property and externalization. The options of foreign investors are justified first by their wish to reduce costs and to extend their economic activities for serving other markets through easing the access to supply and sales markets for raising their operational efficiency.

Foreign investors are motivated by an ensemble of factors which are in connection with the economic situation of the company, the development potential, the position and the structure of the market, the behavior in the competition, the existing of a certain level of internationalization and the experience gained from foreign contracts (Bojar and Zminda, 2008). The penetration of foreign capitals in the beneficiary country is also encouraged by the politics and tactics applied by responsible agencies for stimulating the access of FDI flows in the national economy. In most of the countries, FDI flows play a fundamental role in ensuring the national welfare through technological transfer, industrial reorganization, but the contribution that domestic investments have on following this objective cannot be neglected.

Foreign capital is an essential element of the privatization process of enterprises from the state sector of the host country, influencing the economy by stimulating development and competitiveness. The favorable economic and financial implications of FDI in former communist countries from Central and Eastern Europe are reflected by a higher rate of economic growth, through creating or extending the production capacities and the appearance of new consumers and new tax payers. We need to admit that, beside the positive effect FDI generate (the improvement of the living standard of the population, the movements in the structure of occupied population, the favorable impact on the balance of payments by financing the current account deficit), foreign inflows may also have negative consequences at the macroeconomic level, whose appearance is directly dependent on the implementation process of the investment (Ivan and Iacovoiu 2008).

2. THE FDI DYNAMIC IN THE PERIOD 2007 – 2010 DURING THE ACTUAL CRISIS

"The longest, the deepest and the most comprehensive economic recession in EU history" in the approach of the European Commission, the crisis also manifested at the level of commercial and financial relations among countries through the strong decline of trade and investment flows in the EU, between member countries and the non – member ones, but also between the first ones and the global economy.

The global recession has left its mark on the dynamic of foreign inflows and the multinationals activity on international markets which encountered difficulties in obtaining the financial resources for performing the operations or extending them intern or extern. The turbulence on the international financial markets and the limitation of the financing possibilities drove to the appearance of the problems in the balance of the firms which were confronted with the risk of not ending the project. Foreign investors found themselves in the situation of restraining their expansion plans because the previsions for recovery of international activities were pessimistic. The consequences of the crisis on FDI flows are different in various countries, from one sector to another, according to statistics foreign inflows to developed countries are the most affected ones.

After a strong decrease at the beginning of 2000, FDI recorded a continual increase reaching in 2007 the value of 1979 billion dollars. The ascending trend of foreign capitals is confirmed by the values of some indicators used for performance evaluation (the value of Greenfield projects and transnational operations, the number of working places created across border). The increase of FDI volume was sustained by the accelerated development of multinationals, of interrelations between economies that facilitated technological transfers and the liberalization of international exchanges. UNIDO (2009) confirm the strong decrease of foreign investments, both on the inflows and the outflows side with a percentage of 34 %, respectively 52 %.

The domino and the contagious effect of the international financial markets played a fundamental role in the propagation and spreading the consequences of the crisis, influencing the investments carried out in 2009 on the emerging markets and developing economies presented a 35% decrease, unlike developed economies where the decline was 41%. In 2010, the inflows in the developed economies easy contracted with almost 1% up to the value of 602 billion dollars under the influence of uncertainties considering international debts, but the inflows in less developed countries increased with 12% reaching 574 billion dollars, thanks to encouraging the recovery the economy and stimulating local demand.

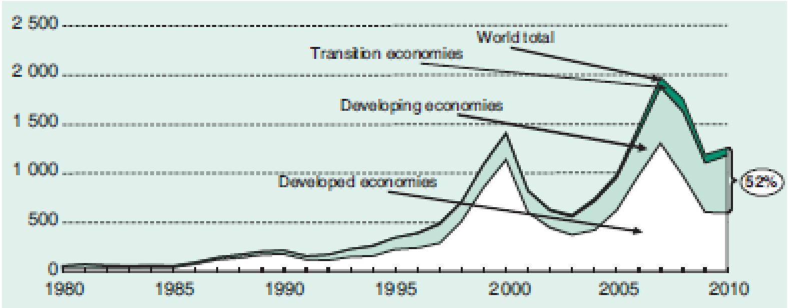
Table 1 – The structure of FDI inflows and outflows by regions and level of development in 2007 – 2010 (billion dollars)

Region	FDI inflows				FDI outflows			
	2007	2008	2009	2010	2007	2008	2009	2010
World economy	1971	1744	1185	1244	2175	1911	1171	1323
Developed countries	1307	965	603	602	1829	1541	851	935
Developing countries	573	658	511	574	294	309	271	328
Africa	63	73	60	55	11	10	6	7
Latin America and Caraibe	169	207	141	159	62	81	46	76
West Asia	78	92	66	58	34	40	26	13
South, East and South – East Asia	261	284	242	300	187	178	193	231
South – East Europe and CSI	91	121	72	68	52	61	49	61
Weight in global flows			(%)					
Developed countries	68,8	57,5	50,8	48,4	84,8	81,5	74,5	70,7
Developing countries	26,9	35,6	42,9	46,1	12,9	15,4	20,8	24,8
Africa	3,0	4,1	5,3	4,4	0,5	0,5	0,5	0,5
Latin America and Caraibe	7,8	10,3	10,5	12,7	2,5	4,3	4,3	5,7
West Asia	3,7	5,1	6,1	4,7	2,1	2,0	2,1	1
South, East and South – East Asia	12,3	15,9	20,9	24,2	7,0	8,6	13,9	17,5
South – East Europe and CSI	4,3	6,9	6,3	5.47	2,3	3,1	4,6	4,6

Source: UNCTAD (2010), UNCTAD (2011), World Investment Report

The evolution of FDI flows in the analyzed period emphasized a significant decrease of global inflows with almost 37% in 2009 reaching the value 1185 billion dollars, while for the outflows the decrease was about 43%, down to 1171 billion dollars. In 2010 we have witnessed a moderate increase of world FDI flows to the value of 1244 billon dollars and even in these conditions the flows are 15% lower than the value before the crisis and 37% under the peek of 2007. The enhanced volume of FDI in emerging markets is justified by the favorable economic performances obtained by these countries.

Figure 1 – FDI inflows, global and by group of economies in 1980 – 2010



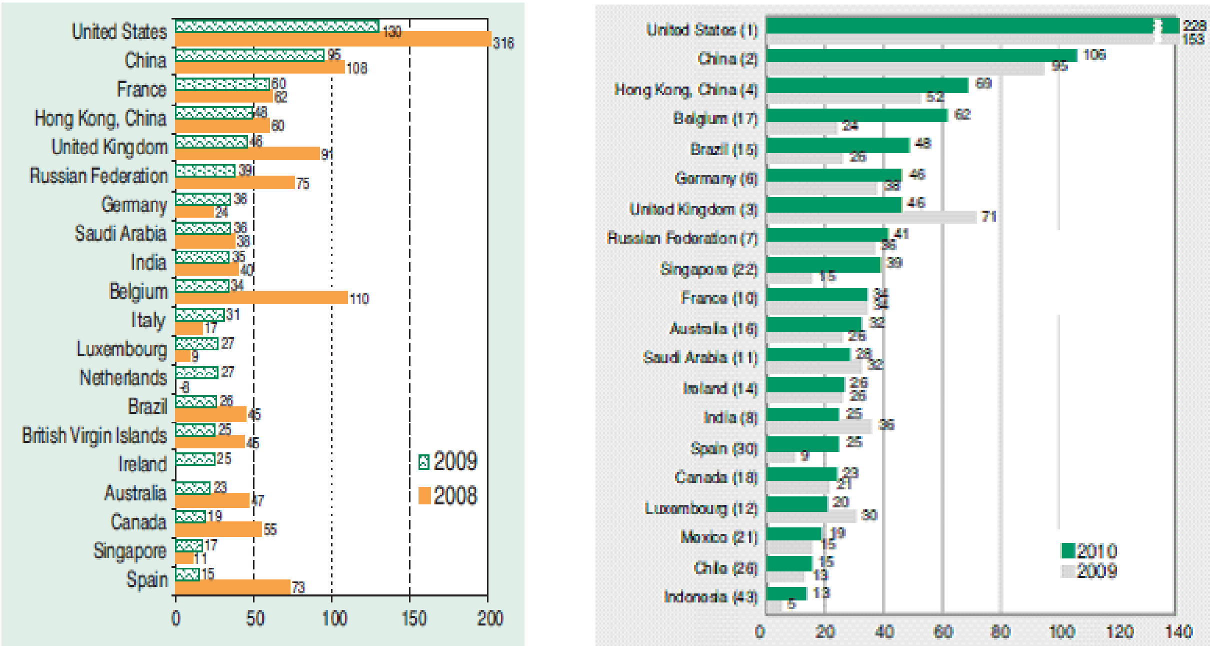
Source: UNCTAD (2011), World Investment Report

The actual economic crisis emphasized the flexibility of developing and transition economies to the current global economic situation, the increased volume of FDI at the beginning of the crisis in 2008 by 16 %, respectively 3 %, but in 2009 the contraction was about 21 %. LinYifu (2008) sees as a fundament for the strong momentum of the demand the FDI expansion considering that these flows have a high contribution to the world economic extend recorded in this decade, being very likely that the prevention of the deflation and economic depression to depend on maintaining a high degree of this increase. The relative decline of foreign capitals in new member states of the EU is strongly correlated to the restructure of productive capacities which determined new investments and rationalizations.

The significant impact on FDI flows is represented on the one hand by the negative dynamic of FDI because of the recession of the interdependency relationship on global financial markets and on the other hand by the increase of uncertainty under which foreign capitals change.

The actual financial crisis has produced changes in the hierarchy of beneficiaries and investors, through raising the relative weight held by developing and transition countries. International statistics proved the EU has a weak position as a fundamental recipient of FDI flows, the beneficiary top being dominated by the presence of developing and transition economies which in 2010 represent half of top 20, comparative to 7 positions in 2009. The United States and China have maintained their position in the chart and Indonesia was included for the first time.

Figure 2 – The main beneficiaries of FDI in the world in 2008 – 2010



Source: UNCTAD (2010), UNCTAD (2011), Word Investment Report

In the analyzed period, 2007 – 2010, we found that transnational operations of mergers and acquisitions have a major share in the FDI structure. In 2009, the value of investment in the primary sector decreased with 47 %, but the one in the agriculture sector also decreased. The most affected sector by the global economic recession is the non-metallic mineral products along with the mineral and metallic product industry. The sharp drop in the value of mergers and acquisitions caused the significant part of FDI decline in 2009. The volume of acquisitions abroad contracted with 35 % (65 % as a value) while the number of Greenfield investments increased with 15 % as the turbulence on the stock market reflects in the prices value of transnational operations.

Table 2 – The structure of FDI by type and host country in period 2007 – 2010

Host country/ economy	Mergers and acquisitions – net transnational operations				Greenfield investments			
	2007	2008	2009	2010	2007	2008	2009	2010
World economy	100	100	100	100	100	100	100	100
Developed economies	74	72	69	66	52	46	46	49
EU	39	38	32	32	39	34	30	31
United States	18	17	17	16	7	6	9	10
Japan	2	2	2	2	1	1	1	1
Developing countries	22	23	23	25	42	47	48	45
Africa	2	2	1	2	3	5	5	5
Latin America and Caraibe	6	6	5	8	7	7	9	8
Asia	14	16	16	16	32	35	34	32

South - East Europe and CSI	4	5	8	9	6	7	6	6
Russian Federation	2	3	4	6	3	4	3	3
Total number of cases	7018	6425	4239	1802	12210	16147	13727	4104

Source: UNCTAD (2010), World Investment Report

The actual economic crisis contributed to the development of new investment opportunities as a consequence to the decrease of active prices, restructuring some industries and developing new areas of activity.

For the following period, the objective was to encourage the economic growth as an effect of recovery of the economic activity and the volume of transnational operations. In the long term, the aim is to implement an international and efficient system, closely supervised stimulating the increase of FDI volume. According to UNCTAD estimations, FDI flows will continue their ascending evolution to reach 1400 – 1600 billion dollars in 2011, taking into account that the inflows in the first trimester of 2011 increased comparative to the same period of the previous year, following that in 2012 – 2013 the value of the flows to be close to 1700 billion dollars, respectively 1900 billion dollars.

The international economy recovery will occur in the context of conduct and compliance with an expansion plan of activities and transactions (mergers and acquisitions) of multinationals, the impact on increasing the volume of FDI promoting development of cross – border operations.

CONCLUSIONS

After a strong upward trend in FDI by 2007, foreign capital flows were deeply affected by the economic and financial crisis, both on the side of developed economies but also at the level of developing and in transition countries, the impact ranging from countries and on different sectors.

The national and international authorities manifest intensive concerns for the world economy recovery to achieve the aim of boosting economic growth, a process influenced by the stability of financial system and the politics and strategies adopted by the authorities to attracting a growing share of FDI, to combat effects on foreign capital flows, to atract international investment by appropriate policies, to create favorable conditions for attracting new flows of FDI and foreign investors and to restore confidence in international business.

International operations and economic activity recovery is a process that takes place with difficulty, being affected by inherent risks characteristic of the business and investment climate in the regulations that govern them. Statistics show that FDI flows have a fundamental role in ensuring increased growth rates due to the benefits they generate in the host economy.

Although multinationals have a cautious nature of their activities on international expansion and development of their investment plans, in the global economy was a slight upward trend which, according to forecasts will continue in the future.

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