# THE IMPACT OF THE FOREIGN DIRECT INVESTMENTS

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***Abstract:*** *The global foreign direct investment was in stark contrast to other key economic indicators such as GDP, international trade and employment, which all registered positive growth at the global level. Economic fragility and policy uncertainty in a number of major economies gave rise to caution among investors. Furthermore, many transnational corporations (TNCs) reprofiled their investments overseas, including through restructuring of assets, divestment and relocation.*

***Key words:*** *foreign direct investment, UNCTAD, global economy*

***JEL classification:*** F21

UNCTAD projects that foreign direct investment (FDI) flows in 2013 are to remain close to the 2012 level, with an upper range of $1.45 trillion. As investors regain confidence in the medium term, flows are expected to reach levels of $1.6 trillion in 2014 and $1.8 trillion in 2015. However, significant risks to this growth scenario remain, including structural weaknesses in major developed economies and in the global financial system, and significant policy uncertainties in areas crucial for investor confidence, including fiscal policy and investment regulations and restrictions. Should these risks prevail, FDI recovery could be further delayed and trends could more closely follow the more pessimistic scenario.

Results from the *World Investment Prospects Survey 2013–2015* (*WIPS 2013–2015*) underline the results of UNCTAD's baseline forecast. According to this year's *WIPS* one half of all respondents remain neutral about the global investment outlook for 2013. However, their expectations for 2014 and 2015 improve sharply. As transnational corporations (TNCs) maintain a cautious approach for the current year, FDI in 2013 will remain close to the 2012 level. However, as investors regain confidence FDI flows could rise in the medium term. There is also the possibility that FDI recovery could be delayed further if the significant risks continue to prevail.

Responses to this year's survey revealed that firms are aware of the persistent risks of the global economy. Investor uncertainty appears to be high, with roughly half of respondents stating that they were neutral or undecided about the state of the international investment climate for 2013. However, by 2015 more than half of the respondents expressed themselves as optimistic or very optimistic (figure no. 1).

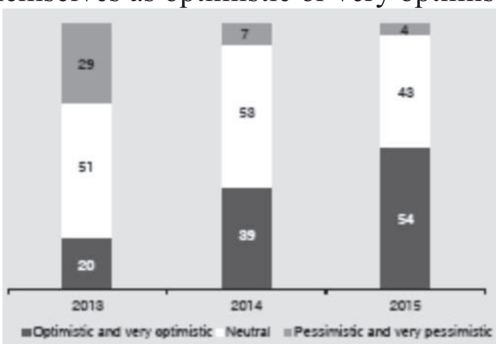


Figure no. 1. TNCs' perception of the global investment climate, 2013–2015 (Percentage of respondents. *Source: UNCTAD survey.*

*Note:* This picture might differ slightly from the one in *WIR 2013* because answers from two more companies have been included in the results of this publication.

Investment promotion agencies (IPAs) were more optimistic in their assessment of the global investment climate and followed a similar pattern. While for 2013, IPAs also showed a high degree of uncertainty, with more than 40 per cent of respondents selecting neutral or undecided for the year (figure no. 2), for the medium-term years their expectations turned decidedly positive with almost 80 per cent of respondents being optimistic for 2015. Part of the reason for this divergence is that IPAs are more representative of emerging markets where growth prospects are brighter. In fact, IPAs tend to be more bullish than TNCs regarding their own country's prospects compared to global prospects.

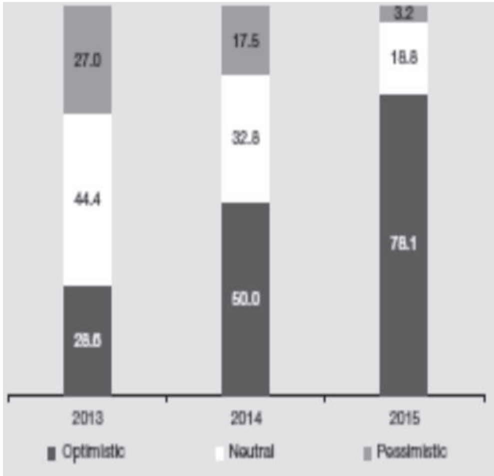


Figure no 2. IPAs' perception of the global investment climate, 2013–2015 (Percentage of respondents)

*Source: UNCTAD survey*

The uncertainty among investors about the global investment climate is related to a number of risks. When asked about the principal factors positively and negatively affecting FDI flows in the medium term (figure no. 3), TNCs in the survey put the state of the European Union economy at the top of their concerns, followed closely by political factors, such as the adoption of austerity policies, the rise of trade protectionism and sovereign debt concerns. Concern about the threat of terrorism and natural disasters follows. Indeed, as shown in *WIR 2013*, many countries have implemented greater numbers of policies that regulate or restrict investment, bringing the share of such measures to a recent high, although investment liberalization and promotion remained the dominant feature of national investment policies.

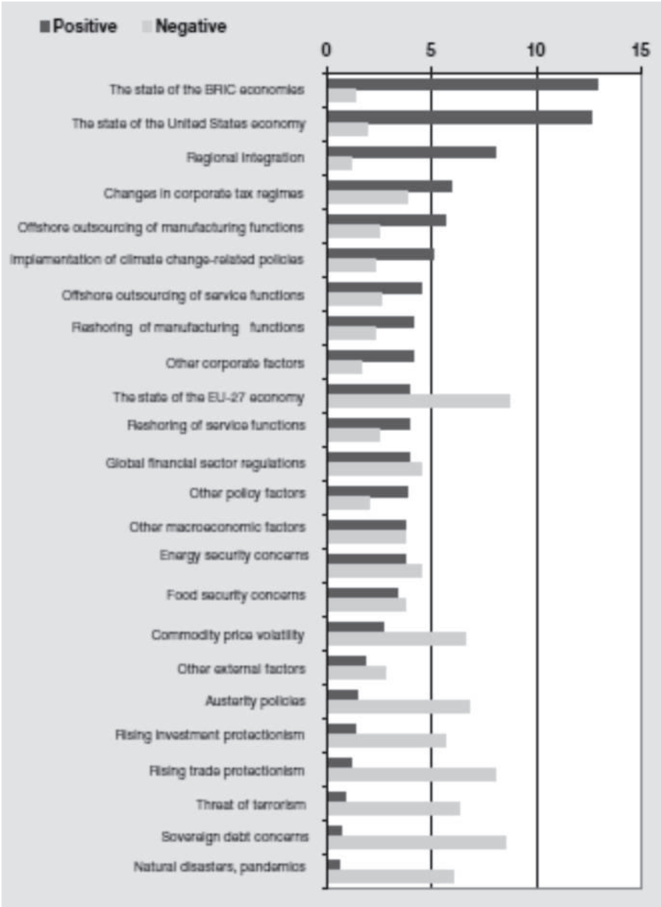


Figure no. 3. Positive and negative factors affecting FDI flows, 2013-2015 (Percentage of respondents)
*Source: UNCTAD survey*

At the same time, TNCs' executives have expressed a high level of confidence in the economies of Brazil, the Russian Federation, India and China (BRIC countries) and of the United States of America. Other factors ranked among the most positively affecting FDI flows are the process of regional integration and changes in corporate tax regimes. Only in fifth position comes the outsourcing of manufacturing functions, chosen by less than 6 per cent of the respondents. The fact that outsourcing or reshoring strategies are ranked well below global economy factors indicates that corporate strategies can only mitigate or adapt to the underlying economic cycle.

Uncertainty among investors about the global investment climate is the reason that a big proportion of enterprises maintain their investment levels relatively constant over the short and medium term. This reflects the prudential approach followed by many TNCs while waiting to see the realization of their positive expectations. At the same time, responses to the survey show that almost half of respondents expect to increase their FDI expenditures between 2013 and 2015, compared to 2012 levels (figure no. 4).

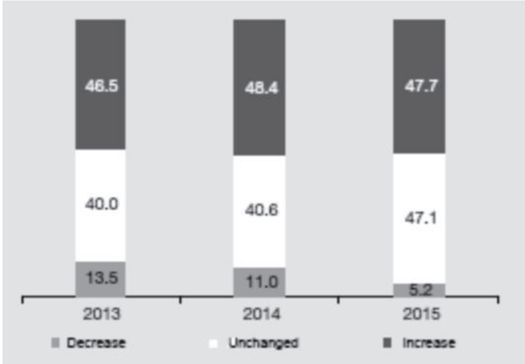


Figure no. 4. TNCs' intended changes in FDI expenditures compared to 2012 levels, 2013–2015 (Percentage of respondents)
*Source: UNCTAD survey*

This year's survey confirms a continued desire of TNCs to internationalize their operations, though at a slower pace with respect to previous years. This is especially true for assets and employment where the level of internationalization reached in 2012 is maintained almost constant through 2015. In contrast, sales which already enjoy a high level of internationalization are expected to increase their reliance on foreign markets in the next few years. Already in 2012, foreign sales accounted for more than half of total revenues for 57 per cent of respondents, and this percentage is foreseen to grow to over 60 per cent. Interestingly, research and development activities, which are usually retained in headquarters, also display a rising pattern of internationalization (figure no. 5). This might reflect the rising human capital skills in foreign markets and enhanced research ability in growing economies in industries such as pharmaceuticals and retail.

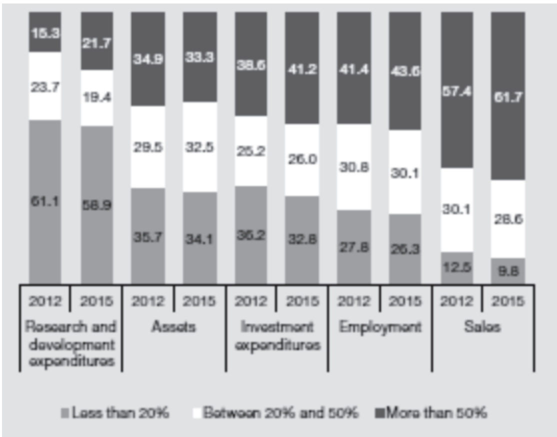


Figure no. 5. Trends in internationalization, 2012 and 2015 (Percentage of respondents)
*Source: UNCTAD survey*

This year's *WIPS* highlights a change in preferences of the ways TNCs enter foreign markets; compared to last year's survey non-equity modes have lost ground. While last year more than 30 per cent of respondents remarked that non-equity modes would be "very" or "extremely" important for them in 2014, this year less than 15 per cent of TNCs executives considered them important currently and only 23 per cent foresaw they would be relevant in 2015 (figure no. 6). Likewise, mergers and acquisitions seem to have lost some of their relevance compared to last year's survey, falling from being considered as very important (in 2014) by more than 40 per cent of respondents to about 30 per cent (in 2015). In contrast, greenfield and brownfield investments are set to grow in importance and have been selected by a range of companies comparable to that of past years. In particular, the expansion of existing projects is growing in importance with more than 45 per cent of respondents stating brownfield investments will be highly important in 2015 (up from 42 per cent of those saying so for 2013).

In the manufacturing and primary sectors, TNCs drove a change in preferences on the mode of entry, with almost half of them stating that brownfield investments and exports would be highly important in 2015. This change in the internationalization patterns underlying the importance of exports and of existing operations is likely to be driven by corporations' need to rationalize their foreign operations and refocus their businesses. This could be particularly true for European-based TNCs suffering from a deep and prolonged crisis, and for mining companies which invested heavily in foreign operations in the past few years. On the other hand, difficulties in managing overseas production through non-equity mode and related inefficiencies, combined with improved competitiveness of North American manufacturing industries, could also have contributed to the loss of importance of this mode of entry.

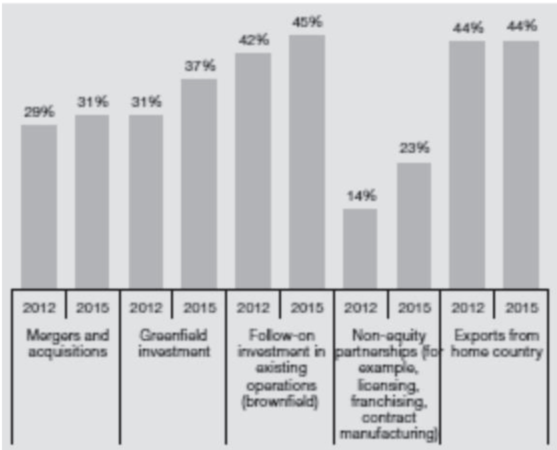


Figure no. 6. Importance of equity and non-equity modes of entry, 2012 and 2015 (Percentage of survey respondents selecting the mode of entry as "very important" or "extremely important")

*Source: UNCTAD survey*

FDI expenditures are set to increase for 40 to 50 per cent of the companies. However, at the same time 10 to 20 per cent of the companies will reduce their investments in the short term; primary sector TNCs may significantly expand their investment plans in the medium term.

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