FOREIGN DIRECT INVESTMENT IN EMERGING AND DEVELOPED ECONOMIES

Tatiana Dănescu [1]
Paula Nistor[2]

ABSTRACT: *In the context of globalization, the issue of foreign direct investments and their influence on the development of the emerging economies, continues to be a topic of interest for many economic theories. The need, the importance and the effects of foreign direct investments have attracted the attention of all the states and produced an intense competition to attract the foreign capital. FDI inflows have a very important role in the establishment of new world economic powers. In the world economy, the foreign direct investment are oriented in major proportion to developed countries, but the interest in this type of investment is particularly developed also in the emerging countries who need not only foreign capital inflows, but also the modern managerial experience and access to markets. The aim of this paper is to study and analyze the evolution of foreign direct investment in emerging and developed economies in the last twenty years.*

Key words: foreign direct investment, emerging economies, developed economies, financial crisis

JEL codes: F23, O4, O57, P45, M42

Introduction

An important component of the regional integration process and globalization of world economy are the foreign direct investment, which in the last three decades of XXI century, exercised a strong impact on economic growth, foreign trade and production structures in all over the world .

According to the International Monetary Fund, foreign direct investment "is a category of international investment that reflects the purpose of an entity resident in a country (direct investor) to obtain a long term interest in an enterprise resident in another country (direct investment). Long term interest involves the existence of a long term relationship between the direct investor and the company. It is considered that the participation is long-term if the investor holds more than 10% of the capital of the investee company or voting rights. The distinction between direct investor that follows a long term relationship in the entity, with significant participation in the capital (minimum 10%) and the portfolio investor which is a speculator who not intended to control the holding company in which it invests." (IMF 2011)

Foreign direct investment are defined, according to UNCTAD (United Nations Conference on Trade and Development), as those investments involving a long term business relationship, reflecting a lasting interest of an economic entity (the direct investor) and his control over an enterprise resident in an economy other than the one of the direct investor (business related). By "lasting interest" we understand the simultaneously of two conditions: to establish a long term relationship, and a significant degree of influence on the management of the enterprise. (UNCTAD, 2010)

[1] "Petru Maior" University, Târgu Mureş, Romania, *e-mail: tatiana_danescu@yahoo.com*
[2] "Alexandru Ioan Cuza" University, Doctoral School of Economics, Iasi, *e-mail*: *paaulan@yahoo.com*

The Organization for Economic Cooperation and Development (OECD) considers foreign direct investments those investments made in order to establish a sustainable economic relation or a significant influence over the management of the entity.

In today's world economy, foreign direct investments are seen as an important input of foreign capital. This causes a real struggle in the global economy to obtain the foreign capital

The purpose of this paper is to study and analyze the evolution of FDI in emerging and developed economies. In order to achieve this goal the study use data consisting of annual observation of FDI inflows over the period 1990- 2010 for developed and emerging economies.

Literature review

In the last years, foreign direct investments have become more and more important for the global economic activity. A large number of hypotheses regarding the relationship between FDI and economic growth were developed in the literature.

De Mello found that FDI has positive effects on economic growth in both developed and developing countries, but concludes that a long-term growth in host countries is caused by the external effects of the technology and knowledge of the countries investing in host countries. (De Mello, 1999)

Balasubramanyam found support for their hypothesis that the effect of the increasing of the foreign direct investment is positive for countries that promote exports and potential negative for the one that imports. (Balasubramanyam et al, 1996)

Foreign direct investments are generally considered to have a major contribution in the economic development of the emerging markets. On the other hand, foreign direct investments are also very important for multinational companies. So, both developed and emerging economies have a common interest in encouraging FDI flows, although their goals are different (Resmini 2000, Estrin and Meyer 2004): the positive efects of FDI are important for the host economies, while the corporate growth and the revenues are a typical target for the multinational companies.

Although FDI in emerging economies have been the subject of many economic research, it is unclear why investors prefer to take advantage of emerging countries opportunities despite the fact that they are considered to be slow in the adopting new reforms and suffer from corruption. (Tiju, 2007).

Research Methodology

The aim of this paper is to study and analyze the destination of foreign direct investment inflows. In order to achieve this goal the study use data consisting of annual observations over the period 1990-2010 for emerging and developed economies. Being focused on empirical, contextualized analysis, this study highlights the development of FDI inflows in emerging economies. Future research will study the effects of FDI inflows in emerging and developed economies.

Foreign direct investment in emerging and developed economies

From the research of the specialized sources, results that FDI represented an important source of capital for the emerging economies since 1990. Between 1987 - 1997 the global FDI inflows experienced a duplication every 5 years. Meanwhile, after 1999, the global sales of the multinational corporations have always been more than two times higher than the world exports, making foreign direct investments, more important than trade in terms of the supply to foreign markets.

The beginning of the XXI century was characterized by an acceleration of the globalization process, the global flows of the foreign direct investment being an important manifestation form of this process. Globalization through the FDI has become a part of everyday life for each of us, either by products or services purchased either by work or communication mode.

FDI inflows in emerging and developed economies have followed a growing trend from 1990 to 2000. After the record levels of 2000, the global flows dropped strongly in 2001, for the first time in a decade.

As it can be observed in the table presented below, the FDI inflows had a decline in 2001, in both emerging and developed economies in the context of the global economic slowdown. The investment behavior of the companies was also strongly affected by the short-term changes of the business cycles. This was the effect of the global economic slowdown, especially in the three biggest economies of the world, which had entered all in recession, followed by a decrease in value for cross-border mergers and acquisitions. Total value of these mergers and acquisitions completed in 2001 was 594 billion dollars only half of those of 2000.

As a result the decline of FDI was concentrated mainly in the developed economies, where FDI inflows were reduced by 47% compared with 15% in emerging economies.

Table no.1.

FDI inflows to developed economies and emerging economies between 1990-2009

Economy	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
Developed economies	172.526	114.035	111.141	143.434	150.575	222.484	236.035
Emerging economies	19.010	22.500	22.680	23.965	39.300	47.303	58.404
Economy	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Developed economies	285.390	508.742	852.131	1.138.032	601.041	440.731	369.173
Emerging economies	77.240	77.988	116.519	104.590	88.734	65.032	58.154
Economy	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Developed economies	418.829	619.170	977.887	1.306.818	965.112	602.834	601.905
Emerging economies	98.246	90.287	112.406	156.197	141.201	95.739	158.796

(source, UNCTAD, million dollars)

From the peaking level in 2000, the volume of foreign direct investment inflows in the world has passed in 2001 - 2004 to reductions. In 2007 the FDI inflows exceed the level from 2000. The global economic crisis from 2008 temporarily stopped this trend. Overcoming the financial crisis would bring a change in the world economic order, but this will not influence only positively the role of the FDI in the world economic cycle.

The most developed economies from the emerging economies group are: Brazil, Russia, India and China, known as the BRIC economies. In terms of FDI inflows, they exploded after 1990, until 2009 when with the world-wide financial crisis, their decline began.

China leads in terms of FDI inflows in the entire analyzed period. It is followed by Brazil and Mexico. If we consider the year 2009 the first four emerging economies by foreign direct investment inflows were China, Russia, India and Brazil. According to the cumulative FDI inflows over the period 1990 - 2009, China ranked first again, with a total of FDI inflows of about 1350 billion dollars, followed by Brazil with approximately 349 billion dollars, Russia with 260 billion dollars and India with 169 billion dollars.

In certain periods, between 1990- 2010, there have been times in which countries such as Mexico, Argentina or Poland had overcome some of the BRIC countries (Brazil, Russia, India, and China).

FDI inflows have not been uniform in emerging economies. They were affected by the economic and political situations of each state. An important role in attracting foreign investors is played by the law.

Bulgaria, Latvia, Lithuania, Pakistan, Philippines, Romania, Ukraine and Venezuela are the economies that compared with the rest of the emerging economies have attracted a low volume of FDI. A common feature of these states is the high level of corruption. We can affirm that corruption and the weak law frightens the investors.

All emerging economies have registered a decrease of FDI inflows in 2009 because of the global economic crisis. The only exception was Philippines where FDI inflows have increased in 2009 to $ 1.95 billion from 1.54 billion U.S. dollars in 2008.

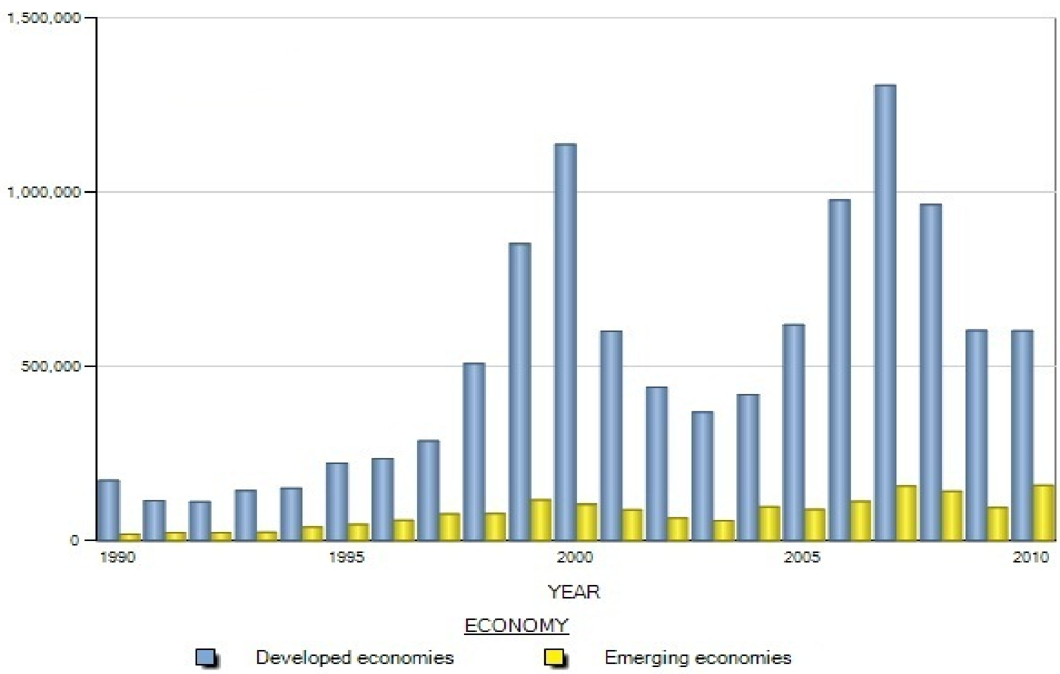

Figure no. 1. - The evolution of FDI inflows in developed and emerging economies in the period 1990-2010, million dollars (source UNCTAD)

Between 1990 – 2010, the volume of FDI inflows was 10,838,025 million dollars in the developed economies and only about 1,675,291 million dollars in emerging economies. The developed economies have attracted almost seven times more foreign investment.

As it can be seen in the chart presented above, foreign direct investments have been clearly more oriented to the emerging countries than to the developed countries. To note that in 2008, because of the global financial crisis, the decline was really high for developed countries and almost insignificant for the emerging ones.

An important issue is the development of these economies in 2008 - 2010, during the global financial crisis. The years 2008, 2009, meant a decrease of foreign direct investment inflows in both developed and emerging economies.

The year 2010 brought new decreases of the FDI inflows in developed economies, being still affected by the global financial crisis. Emerging economies have registered a growth in terms of FDI inflows. FDI inflows have reached the maximum level for the period 1990 - 2010, reaching 158.796 million dollars. This shows once again that the global order is changing.

Global FDI inflows increased modestly by 5 percent to 1240 billion dollars in 2010. While the global industry and global trade are already reached the levels from 2007, FDI inflows in 2010 remained by almost 15% below the same period and with about 37% below the record level achieved in 2007.

According to UNCTAD report, FDI inflows will continue to recover, reaching 1400 - 1600 billion dollars or the pre-crisis level in 2011. They are expected to rise again to 1,700 billion dollars in 2012 and to 1,900 billion in 2013, the record achieved in 2007. The multinational corporations' liquidity, the restructuration of corporations and industry, the increasing stock value, established as support measures during the crisis, creates new investment opportunities for the worldwide companies.

However, in post-crisis the business environment doubt. The risk factors such as the unpredictability of the global economic evolution, a potential crisis of sovereign debt and the instability of financial and fiscal sectors in some developed and emerging economies, can slow down the recovery of FDI.

Emerging economies, the power center for FDI

Emerging economies have become very important in 2010 as beneficiaries of FDI, and as foreign investors. While the international production and, recently the international consumption, have shifted by emerging economies, multinational corporations are investing in efficient market projects in those countries. For the first time they have absorbed more than half of global FDI inflows in 2010. Half of the top 20 host economies for FDI in 2010 were emerging economies.

The inflows to China, the largest recipient of FDI in the emerging world increased by 11% to 106 billion dollars. But with the further increases for salary and for the cost of production, relocation of production based on laborious work slowed the FDI inflows and continues to be redirected to industries and services based on advanced technology. In contrast, some economies, such as Indonesia and Vietnam have earned a reputation for locations with manufacturing low-cost, especially for the cheap labor.

The decline of FDI inflows in South Asia reflects a transfer of 31% of inflows to India and a decrease of 14% in Pakistan. In India, the problems in attracting FDI have been caused by the macroeconomic concerns. Meanwhile, the inflows to Bangladesh, a very important location in South Asia for the low-cost production increased by 30% to 913 million dollars.

In 2010, FDI inflows to developed countries have marginally declined. FDI inflows variation pattern was unequal. Europe took a sharp decline. FDI flows have registered decrease in Japan. A grim perspective of the economy, austerity measures and a potential sovereign debt crisis, as the legislative concerns were among the factors that have helped the recovery of FDI flows. FDI inflows to the United States showed a strong change with an increase of more than 40%.

In developed economies, the restructuring of the banking system, led by the authorities has resulted in a number of reductions for the investments in imported goods. At the same time has generated new foreign direct investment while the goods were exchanged between the important players. The global efforts to reform the financial system and the governments exit strategies will be important for FDI inflows in the financial industry in the coming years.

Conclusion

Changes in the approaches in the international level of investment flows have brought with it the increase of foreign direct investment worldwide, the policies adopted by developed and emerging countries is a key factor in their development.

The global financial crisis of 2008, noted that developed economies have been more affected than emerging economies. The FDI inflows decreased dramatically during 2008 - 2010 in developed countries, and some of them continue to fall today.

Emerging economies have registered smaller decreases, many of them recorded growth in 2010. As can be seen in the chart presented above, in terms of FDI inflows the year 2010 was a record year for emerging economies and developed economies continued to fall. This shows that emerging economies have exceeded the financial crisis and has chances to overcome developed economies.

Many economists believe that in the future, some emerging economies will be the new world developed economies. Today, China increases three times faster than the United States of America, estimating that by 2041, China will be the biggest economy in the world and India will be the third.

Foreign direct investments have an important role in establishing the new economic world order.

In our future research we intend to study the effects of foreign direct investment in emerging and developed economies.

References

1. Anghel E.I., 2002. The foreign direct investments in Romania, Bucharest, Ed. Expert
2. Balasubramanzam V., Salisu M., Sapsford D., 1996. Foreign direct investment and growth in EP and IS countries. The Economic Journal 106, pp. 92-105
3. Baniak A, Cukrowski J, Herczynski J, 2005. Determinants of foreign direct investment in transition economies. Problem of Economic Transition no.48
4. Bonciu F., 2009. The foreign direct investments and the new world economic order Bucharest, Ed Universitara
5. Borensztein E., de Gregorio J., Lee J.W., 1998. How does foreign direct investment affect economic growth? Journal of International Economics, 45, pp. 115-135
6. De Mello L.R., 1999. Foreign direct investment –led growth: evidence from time series and panel data. Oxford Economic Papers 51, pp. 133-151
7. De Mello L.R., 1997. Foreign direct investment in developing countries and growth: a selective servez. Journal of Development studies, 34, pp.1-34
8. Estrin S., Meyer K., 2004. Investment strategies in emerging markets. Edward Elgar, Chetenham
9. Ghidiu I., Danescu T., 2010. Information society - sustainable development premise in a competitive economy, Studia Universitatis „Petru Maior"- Series Oeconomica
10. IMF, 2011. Tensions from the Two-Speed Recovery Unemployment, Commodities, and Capital Flows, World Economic Outlook, April
11. Li X., Liu X., 2005. Foreign direct investment and economy growth: an increasingly endogenous relationship, World Development 33, pp.393-407
12. Moosa I., 2002. Foreign Direct Investment: Theory, Evidence and Practice, Pal grave, New York
13. Romer D., 2001. Advanced Macroeconomics, McGraw-Hill/Irwin, New York
14. Tiju P. K., 2007. Foreign Direct Investment in Emerging Markets, 16th EDAMBA Summer Academy
15. UNCATD, 2011. World Investment Report 2010, available online at http://unctad.org/en/docs/wir2010_en.pdf
16. http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88 (10.09.2011).