Foreign Direct Investment Inflows Decline

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Foreign direct investment (FDI)—investment in enterprises from abroad that gives investors influence over the management of these enterprises—was the largest source of foreign capital in 2003, playing a significant role in shaping the global economy.[1] Yet flows of FDI to recipient countries fell 19 percent, to $560 billion.[2] These "inflows" have been declining since a peak of $1.47 trillion in 2000.[3] Preliminary data for 2004 suggest that this decline has ended, however, with FDI inflows projected to increase to $601 billion.[4] (See Figure 1.)

Reduced inflows to industrial countries were responsible for the whole decline in 2003, with their FDI falling 27 percent to $367 billion.[5] (See Figure 2.) Inflows to low- and middle-income countries, on the other hand, increased marginally to $193 billion.[6] In 2004, this trend appears to have continued, with inflows to industrial countries falling to $315 billion but those to low- and middle-income countries jumping to $286 billion.[7]

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In 2003, the United States was one of the hardest hit industrial countries, receiving 53 percent less in FDI than in 2002 (a total of $30 billion) and less than a tenth of what it got in 2000.[8] France became the largest industrial-country FDI recipient, at $47 billion, although it too experienced a minor dip in inflows (6 percent).[9]

Of low- and middle-income countries, the biggest recipient was China, absorbing $54 billion—on a par with the 2002 investments.[10] (When comparing inflows to the size of the respective economy, however, China ranked thirty-seventh in the world.)[11] Hong Kong, Singapore, Mexico, and Brazil were the next largest, together receiving $46 billion in 2003.[12] These five economies accounted for just over half of the inflows to low- and middle-income countries.[13] All of Africa, in contrast, received just $15 billion, though this did represent a 25-percent increase over 2002.[14]

The vast majority of FDI outflows originate from industrial countries. In 2003, 55 percent came from the European Union and 25 percent came from the United States.[15] Low- and middle-income countries account for only 7 percent.[16]

At $193 billion, FDI was the largest component of external capital flows in low- and middle-income countries in 2003.[17] Official development assistance (ODA), at $69 billion, also played a significant role, especially to many of the least developed countries, whose FDI inflows were relatively minor.[18] Yet while total ODA has hovered at the current level for the past decade, FDI inflows have increased 43 percent.[19]

Cross-border mergers and acquisitions (M&As) are one of the largest sources of FDI.[20] In 2003, these accounted for $297 billion, though the total value of cross-border M&As was down 20 percent, from $370 billion in 2002.[21]

The sectors receiving FDI have changed over the years. While investment directed toward primary industries such as agriculture and mining declined from 9 percent of total FDI in 1990 to 6 percent in 2002, and that in manufacturing dropped from 42 to 34 percent, the share going to services jumped from 49 to 60 percent.[22] In the primary sector, mineral and petroleum extraction accounted for the overwhelming majority of FDI inflows in 2001–02.[23] FDI inflows in the services sectors were more equally distributed, although finance and business services absorbed the largest shares.[24]

The benefits and costs of FDI inflows continue to be mixed. FDI can stimulate economic growth.[25] It can also lead to technology transfers, which can help improve efficiency and reduce environmental impacts.[26] But if profits from these investments are not reinvested or if interest payments on intracompany loans (a source of FDI) are overly burdensome, the economic benefits can be limited.[27] Further, if investments divert production away from traditional sectors and toward goods and services that are polluting or that stimulate unhealthy or unsustainable lifestyles, then FDI can have overall negative impacts.[28]

Whether a country benefits from FDI depends largely on the regulatory environment in the host country.[29] Without effective policies, for example, FDI can push local enterprises out of business or stimulate an inequitable distribution of services.[30]

Figure 1. Inflows of Foreign Direct Investment, 1970–2004

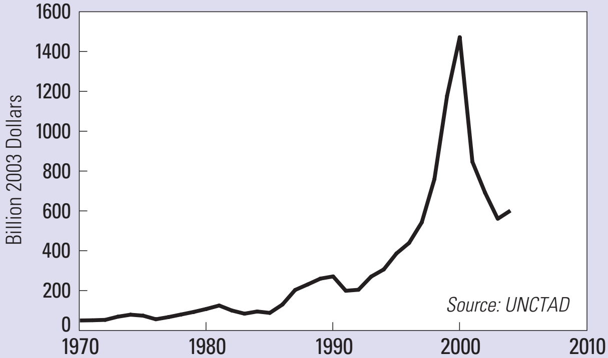
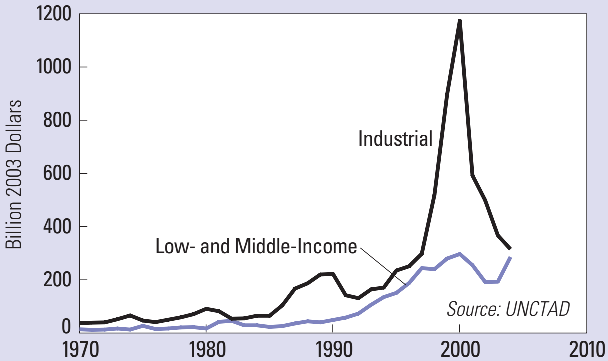


Figure 2. Inflows of FDI to Industrial and Low- and Middle-Income Countries, 1970–2004



Inflows of Foreign Direct Investment, 1970–2004

Year	Total	Industrial Countries	Low- and Middle-Income Countries
	(billion 2003 dollars)		
1970	50	37	14
1971	51	39	12
1972	53	40	13
1973	69	52	17
1974	79	66	13
1975	74	47	27
1976	56	41	15
1977	67	50	17
1978	80	59	21
1979	93	71	22
1980	108	91	17
1981	125	82	42
1982	100	54	46
1983	84	55	29
1984	95	65	29
1985	88	65	23
1986	130	104	26
1987	203	167	36
1988	231	187	44
1989	260	220	40
1990	271	222	49
1991	199	142	58
1992	204	131	73
1993	270	164	106
1994	306	171	135
1995	386	235	151
1996	439	251	188
1997	542	298	244
1998	759	519	240
1999	1,177	897	280
2000	1,471	1,174	297
2001	846	592	255
2002	691	499	192
2003	560	367	193
2004 (prel)	601	315	286

Source: UNCTAD.

(Washington, DC: September 2004), p. 28; trade in goods from IMF, *International Financial Statistics*, online database, January 2005.
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5. UNCTAD, op. cit. note 2.
6. Ibid. Low- and middle-income countries include all countries but those in Western Europe, the United States, Canada, Japan, Israel, Australia, and New Zealand.
7. UNCTAD, op. cit. note 4.
8. UNCTAD, *World Investment Report 2004*, op. cit. note 1, p. 367.
9. Ibid. Luxembourg received the most FDI of industrial countries, but most of this is actually "transshipped" elsewhere (see UNCTAD, *World Investment Report 2004*, op. cit. note 1, pp. xviii, 13).
10. UNCTAD, *World Investment Report 2004*, op. cit. note 1, p. 370.
11. Ibid., pp. 13–14.
12. Ibid., pp. 369–70. Hong Kong and Singapore, like Luxembourg, transfer a significant portion of FDI inflows to other countries (see UNCTAD, *World Investment Report 2004*, op. cit. note 1, p. 18).
13. UNCTAD, *World Investment Report 2004*, op. cit. note 1, pp. 367–71.
14. Ibid., p. 367.
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