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Estimated FDI flows in 2001 and the impact of the events in the United States

Note by the secretariat

A. Estimates of FDI for 2001

UNCTAD estimates calculated for the release of the *World Investment Report 2001: Promoting Linkages* just before the tragic events in the United States on 11 September 2001 showed that world FDI flows are likely to decline by 40 per cent this year, to $760 billion (table 1) (see press release TAD/INF/PR30).[1] This would represent the first drop in FDI flows since 1991 and the largest over the past three decades.[2]FDI flows are expected to decrease particularly in developed countries, from $1 trillion in 2000 to an estimated $510 billion in 2001, i.e. by 49 per cent. In the case of developing countries, the decline was estimated to be 6 per cent, from $240 billion to $225 billion.[3] Decreases in FDI inflows are expected in both Latin America and developing Asia, while FDI inflows in Central and Eastern Europe are expected to remain stable in 2001, at $27 billion.

Table 1. FDI inflows, by region, 1998-2001
(Billions of dollars)

Region	1998	1999	2000	2001[a]
World	693	1 075	1 271	760
Developed countries	483	830	1 005	510
Developing countries [b]	188	222	240	225
Africa [c]	8	9	8	10
Latin America and the Caribbean	83	110	86	80
Asia and the Pacific	96	100	144	125
South, East and South-East Asia	86	96	137	120
Central and Eastern Europe	21	23	25	25
Including the countries in the former Yugoslavia	22	25	27	27

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Source: UNCTAD, FDI/TNC database.

[a] Preliminary estimates, made on 3 September 2001, on the basis of 51 countries that accounted for more than 90 per cent of FDI inflows in 2000.

[b] Including the countries in the former Yugoslavia.

[c] If South Africa is included, the figures are 8 in 1998, 10 in 1999, 9 in 2000 and 11 in 2001.

The decline projected by UNCTAD is therefore not related to the events of September 11. Rather, it is mainly the result of a decline in cross-border mergers and acquisitions (M&As), which account for the bulk of FDI. The decline in M&As – both cross-border and domestic – is related to the slowdown in the world economy. The prices of shares, for example, which in 2000 were used to finance some 56 per cent of cross-border M&As, fell significantly**.** A lull in the consolidation processes in certain industries through M&As (e.g. telecommunications, automobiles) also plays a role. The value of cross-border M&As completed between January and early September 2001 stood at some $400 billion, about one third of the total value in 2000.[4] The number of megadeals (deals exceeding more than $1 billion) during the same period was 75, worth $253 billion, which corresponds to some 40 per cent of the total number and 30 per cent of the total value of megadeals in 2000. The value of worldwide M&As (both domestic and foreign) during the first eight months of 2001 was $1.1 trillion, half the value reported for the same period last year. (See table 2 for the largest deals during the first months of 2001.)

Table 2. Largest cross-border M&As recorded during 2001 [a]

Host country	Acquired company	Acquiring company	Home country	Value ($ billion)
United States	VoiceStream Wireless Corp.	Deutsche Telekom AG	Germany	24.6
Germany	Viag Interkom GmbH & Co.	British Telecommunications Plc	United Kingdom	13.8
Mexico	Banamex	Citigroup	United States	12.5
United States	Powertel	Deutsche Telekom AG	Germany	12.3
United Kingdom	Billiton Plc	BHP Ltd.	Australia	11.5
United States	AXA Financial Inc.	AXA Group(AXA-UAP)	France	11.2
South Africa	De Beers Consolidated Mines	DB Investments	United Kingdom	11.1
United States	Ralston Purina Group	Nestlé	Switzerland	10.4
United States	CIT Group Inc.	Tyco International Ltd	Bermuda	10.2
United States	AT&T Wireless Group	NTT DoCoMo Inc.	Japan	9.8
United Kingdom	PowerGen Plc	E.ON AG	Germany	7.3
Germany	Knoll AG(BASF AG)	Abbott Laboratories	United States	6.9
United Kingdom	GKN PLC-Support Services	Brambles Industries Ltd.	Australia	5.8
United States	Harcourt General Inc.	Reed Elsevier Plc	United Kingdom	5.6
Japan	Japan Telecom Co. Ltd and J-Phone Communications	Vodafone Group Plc	United Kingdom	5.5
United Kingdom	Lasmo Plc	Eni SpA	Italy	4.1

Source: UNCTAD.

[a] First eight months only.

B. Effects of the 11 September 2001 events

In light of their potential influence on some of the principal determinants of FDI flows, the tragic events of 11 September can be expected to further accentuate the decline in 2001. In considering the possible impact of the events, it is useful to distinguish between the economic determinants of FDI, on the one hand, and determinants related to the regulatory framework and business facilitation, on the other.[5] The purpose of this discussion is to identify factors that may influence the development of FDI flows.

Economic determinants of FDI

Assuming that the firm-specific conditions inducing outward FDI remain the same, the single most important economic determinants of FDI flows are market size and market growth in the various countries or regions that are actual or potential investment locations for production activities by transnational corporations (TNCs). Due to a weakening of demand in some of the world's largest economies, these variables have already had a sobering effect on FDI. To the extent that the events in the United States accentuate the economic slow-down,[6] this would lead to a further decline of FDI flows. At the same time, many other economic determinants (including the quality of infrastructure, availability of skills and technological capacity available in host countries) are unlikely to be directly affected by the events.

The higher level of uncertainty created by the events, in particular due to increased political risk (risk associated with war and terrorism), may induce some companies to adopt a "wait-and-see" position and put planned investment on hold until they gain a better comprehension of the development of the world economy and the longer-term impact of the events in the United States.[7]

The impact is likely to be uneven, however, affecting various industries as well as host countries in different ways. Industries in which FDI may be especially negatively affected include transportation services, airplane manufacturing, financial services and tourism. Declining markets at home and abroad could lead to a fall in the capacity of TNCs in these industries to invest abroad; they could also reduce the attractiveness of some foreign locations. However, the level of economic growth can vary considerably by country, and TNCs may continue to expand in markets that are still growing at a decent pace or have a potential to do so.[8]

The immediate impact of the events on stock markets will probably accentuate the current decline in cross-border M&As. To the extent that shares are used to finance M&As and their price falls, the value of concluded deals also falls. On the other hand, a further weakening of the world economy could induce some cross-border M&As, for example because companies are in distress or need to merge for various reasons. On balance, cross-border M&A activity in the short term is likely to be further dampened, but the underlying determinants of M&As still suggest that this mode of FDI entry will continue on an upward trend in the longer run.[9]

An accentuation of the slow-down in the world economy would add to competitive pressures in many industries, forcing companies to enhance their cost-efficiency. Faced by more price-driven competition, some TNCs may choose to relocate certain production facilities to low-cost producing countries (or expand them there); in this case there may be some redistribution of FDI flows towards developing countries.

Determinants related to regulatory frameworks and business facilitation

An accentuation of the decline of FDI flows in the wake of the 11 September events may lead countries to step up their efforts to attract FDI flows in 2001. For example, there may be further efforts to liberalize the entry of FDI into host economies – by opening new sectors to foreign investment – and more proactive investment promotion measures.[10] On the other hand, some countries may discourage divestment in various ways.

Short-term versus long-term impacts of the events

To the extent that the tragic events in the United States accentuate the world economic slowdown, and to the extent that FDI flows tend to be pro-cyclical, this is likely to lead to a further decline in world FDI flows in 2001, beyond the 40 per cent decline forecasted before 11 September 2001. World FDI flows in 2001 may even dip to the 1998 level of less than $700 billion. However, of course, flows of FDI, even when declining, add to the existing FDI stock; international production will continue to grow, albeit probably at a slower rate than that seen in the past several years.

It is, however, still too early to tell whether the 11 September events will have more than a short-term effect on FDI flows. The longer-term implications depend on how long the present heightened level of political uncertainty will last and, especially, on the extent and duration of reduced demand in the world economy.

The key policy challenge is therefore to help restore confidence among consumers and investors in order to contribute to a quick recovery of economic growth (and thereby FDI). The swift and concerted response among developed countries to counter the 11 September events, notably through expansive fiscal measures and a lowering of interest rates, is an important step in this direction.

[1] On the basis of information for 51 host countries as of 3 September 2001. These host countries accounted for more than 90 per cent of world FDI inflows in 2000. The available data cover the first two quarters or the first several months of this year. Estimates for 2001 are derived by annualizing these data.

[2] FDI inflows declined in 1976 (by $6 billion or 22 per cent), 1982 (by $12 billion or 17 per cent), 1983 (by $7 billion or 13 per cent), 1985 (by $3 billion or 5 per cent) and 1991 (by $47 billion or 23 per cent).

[3]Estimates of FDI flows to developing countries are strongly affected by the geographical coverage of estimates made by different sources. For example, the Institute of International Finance estimates $130.2 billion in 2000 and $124.4 billion in 2001 in direct equity investments for 29 emerging countries, which include seven countries in Central and Eastern Europe (see IIF, “Capital flows to emerging market economies”, 20 September 2001). In comparison, UNCTAD’s estimate for developing countries is based on data on FDI covering all of Africa (except South Africa), Asia (except Japan and Israel), Latin America and the Caribbean, Oceania (except Australia and New Zealand) and some developing European countries, while that for Central and Eastern Europe is based on all economies of that region.

[4] The data cover completed cross-border M&As deals involving more than 10 per cent equity acquisition only, provided by Thomson Financial Securities Company.

[5] For a full discussion of FDI determinants, see UNCTAD, *World Investment Report 1998: Trends and Determinants* (New York and Geneva: United Nations), United Nations publication, Sales No. E.98.II.D.5, chapter IV.

[6] For a current analysis of the state of the world economy, see UNCTAD, “Global economic trends and prospects”, UNCTAD/GDS/Misc.21, mimeo.

[7] Some companies are reported to have cancelled previously planned investment after the 11 September events (*Business Latin America* (EIU), 24 September 2001).

[8] For example, the Swedish telecommunications company, Ericsson, announced, on 24 September, a doubling of its investments in China in the coming years.

[9] For a discussion of the factors driving cross-boarder M&As, see UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development* (New York and Geneva: United Nations), United Nations publication, Sales No. E.00.II.D.20.

[10] In the case of the Asian financial crisis, Governments stepped up their efforts to attract FDI by, e.g., making regulatory frameworks more hospitable to FDI (including by relaxing M&A regulations) and strengthening business facilitation.