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GLOBAL FDI IN DECLINE DUE TO THE FINANCIAL CRISIS, AND A FURTHER DROP EXPECTED

The year 2008 marked the end of a growth cycle in global foreign direct investment (FDI), with worldwide flows down by more than 20 per cent. Due to the global financial crisis, the capacity of companies to invest has been weakened by reduced access to financial resources, both internally and externally, and their propensity to invest has been severely affected by collapsed growth prospects and heightened risks. Being at the epicentre of the crisis, developed countries suffered from a one-third contraction in total FDI inflows in 2008. Developing economies started to feel the impact later, but the worst is yet to come.

UNCTAD releases its estimate for global FDI at the beginning of each year. According to the latest estimate (see UNCTAD/PRESS/PR/2009/001), global FDI inflows are likely to have fallen by more than 20 per cent in 2008, and will probably decline further. The negative impact of the current financial crisis and its economic aftermath on FDI flows are expected to continue, at least in the short term, and a quick recovery is unlikely.

Global FDI down by more than 20% in 2008 due to global financial crisis

The current global financial crisis is probably the most severe for the world's financial system since the one which sparked the Great Depression in 1929. It has gone far beyond the financial sector and has seriously affected the real economy. Ample evidence of its negative impacts on FDI has been observed. On the one hand, tighter credit conditions and lower corporate profits have weakened companies' capability to finance their overseas projects. On the other hand, the looming global economic recession and a heightened appreciation of risk have eroded business confidence and therefore companies' propensity to expand internationally. As a result, many large transnational corporations (TNCs) have revised their global expansion plans, and a large number of greenfield and cross-border merger and acquisition (M&A) projects are being cancelled or suspended. The trend is widespread, hitting many sectors ranging from extractive industries to manufacturing and services.

The deterioration of the investment situation has been progressive: the crisis had a relatively limited impact on global FDI flows in 2007, but has begun to bite since early 2008. Preliminary data for 2008 has confirmed the significant dampening impact of the crisis. According to the estimate that UNCTAD released recently, global FDI inflows are expected to have declined by about 21 per cent in 2008, to an estimated $1.4 trillion (see figure below).

The sharp decline in global FDI in 2008 marks the end of a growth cycle which lasted four years. For policymakers, major concerns are how long the downturn will last and how deep it will go. For the short-to-medium term (2010–2012), UNCTAD proposes three scenarios (see figure below), the probability of which depends on a range of factors, including in particular the evolution of the financial crisis itself, the severity and duration of the global recession, and the efficiency and effectiveness of policy responses.

Inflows to developed countries were the most affected

The global financial crisis began in the developed world, and has been rapidly spreading to developing and transition economies. Its economic impact varies widely, depending on region and country. Developed countries have been directly hit, and FDI inflows to these countries were the most affected. Indeed, UNCTAD estimates show that FDI inflows have fallen in many developed countries in 2008, mainly as a result of the protracted and deepening problems affecting financial institutions and the liquidity crisis in financial markets. The decline in inflows has been particularly significant in countries such as Finland, Germany, Hungary, Italy and the United Kingdom. For the developed world at large, the drop was about 33 per cent compared with the 2007 level.

In terms of prospects in FDI inflows to developed countries, a few positive forces are still at work. In particular, the financial crisis and the tough economic period ahead may create good opportunities for companies to

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buy bargain assets, which can help promote cross-border M&As. Also, the various economic stimulation programmes recently launched in many developed countries may have a positive impact on FDI inflows. However, at least in the short run, the negative impacts of the ongoing crisis are likely to remain dominant, and a further decline in FDI inflows is expected.

For developing and transition economies, the worst is yet to come

In developing and transition economies, preliminary estimates suggest that FDI inflows were comparably more resilient in 2008. For them, the growth of FDI inflows, while much lower than in 2007, might still have remained positive. Nevertheless, the estimated 4 per cent growth rate for 2008 as a whole does not reflect the current critical situation in these economies, as the worst impact of the global financial crisis on FDI inflows was transmitted to them mainly in the last quarter of the year.

According to the *World Investment Prospects Survey* undertaken by UNCTAD last year, four of the top five investment destinations preferred by the world's largest TNCs are Brazil, the Russian Federation, India and China (the so-called BRIC economies). Interestingly, all these countries are estimated to have experienced a rise in inward FDI in 2008. However, the difficulties and uncertainties in their economies have increased substantially after the sudden worsening of the global financial crisis in September and October 2008. Coupled with the reduced availability of capital worldwide, this has led to a reverse of a growth cycle of inflows to these economies at year's end.

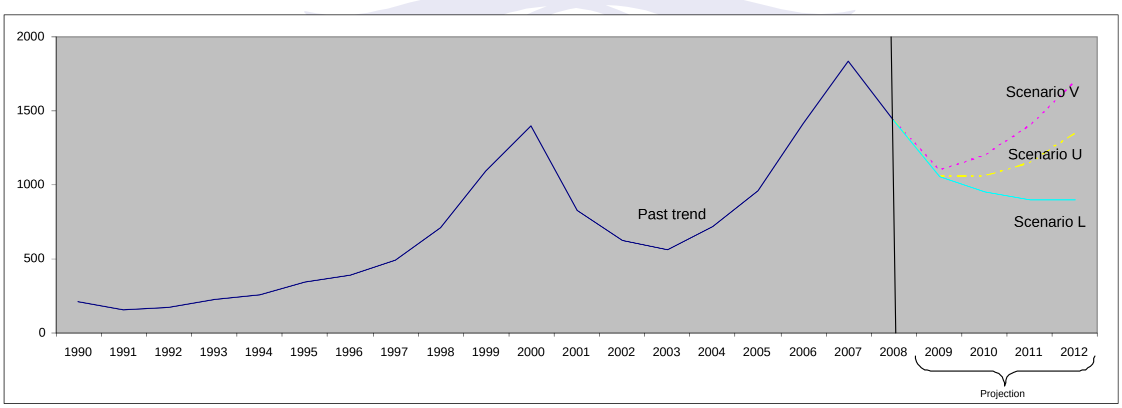
Governments around the world need to resist the temptation of protectionism

FDI flows are likely to decrease significantly on a global scale in the short-to-medium term. For many countries, this may have a strong impact on their economic performance. The effectiveness of public policy responses – at both the national and international levels in dealing with the financial crisis and its economic consequences – is crucial for creating favourable conditions for a relatively quick recovery in both FDI flows and economic growth. The challenges are to restore the credibility and stability of the financial system, to provide the "right" stimulus to investment, and to renew the commitment to an open economy.

So far, no signs of a significant direct impact of the crisis on the policy and legal environment for FDI have been observed. However, there are concerns regarding the implications of the new policies of nationalization and State control, as well as of signs of rising protectionism, for global capital flows. For the Governments of both developed and developing countries, it is important to resist the temptation of "quick-fix" solutions, and to maintain an overall favourable business and investment climate. In this regard, investment promotion agencies can play a proactive role in both retaining existing TNC activities and stimulating new investments.

Source: UNCTAD.

Global FDI inflows, 1990–2008, and three scenarios for the period 2009–2012



Source: UNCTAD, based on FDI/TNC database (www.unctad.org/fdi statistics) and UNCTAD's own estimates.
Note: The shapes of V, U and L scenarios are for illustrative purposes only and not based on any statistical methods.

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