SEA - Practical Application of Science
Volume II, Issue 1 (3) / 2014

Elena Chirilă DONCIU
„Alexandru Ioan Cuza" University of Iași

IMPACT OF ECONOMIC CRISISON FDI

Methodological articles

Keywords
Foreign direct investment
Economic crisis

JEL Classification
E22, G01, P33

Abstract

The economic crisis hashad a severeimpacton the economyworldwide. The investment activityhasstrongly feltthe crisisand causeddramaticchangesin the hierarchy oflarge investors. The financial systemdid not haveavailabilityfor creditsandfunding fromcompanies' ownresourceswasextremely limitedinterms of reducingprofits.The purposeof the paperis theanalysis ofglobalforeign direct investmentunder the effect ofthe largestfinancial and economic crisis. The research results show adramatic decline inforeign direct investmentsflows perceivedandgeneratedin 2009, and the fact that since 2010there has been aneasycomeback.

INTRODUCTION

With globalizationandthe currentglobal financial crisis, the issue of foreign direct investment (FDI) and their impact on the economycontinues to bea hot topicforresearch andeconomic practice. Because of thebenefits and the impact thatFDIhave onthe economiesof the host countries, the evolution of globalFDI flows is a topic of interestfor bothhost countriesandforeign investors.

World's economy is facing an economic crisissince 2007.Once themagnitude ofthe economic shock has increasedsincethethird semesterof 2008, the internationalmacroeconomic contextexperiencedlargenegative changes.

Under the impact ofglobalization, the economic crisis startedin the U.S.in 2007, following the collapse ofthe housing markethas spreadgloballysurprisingly fastanddistrust was generalizedinternationally.

Amidthe economic crisis,big companieswere heavilyaffectedfinancially, with a sudden collapsein sales.

It was in 2009 when, under the influence of the dramatic external and internal events, the financial and economic crisisrapidly spreadthroughout theglobal economy. Developed and emergingcountries were equally affected and states had to interveneheavily toavoid collapse. Too rigiddependenceon foreign capitalinthe countries of Centraland Eastern Europemade themvulnerableto the crisis, some of them facing even nowadayseconomic difficulties.

In the currenteconomic environment, foreign direct investment, byvolume, structureand qualityare the mostimportantdriver of economic growthbecause theyprovideefficient use ofhuman resourcesavailable to theeconomy, innovativedevelopmentof the economy, growth of scientific progress, increased productivity and a boost of theGDP.

FDI -FEATURES

The issue offoreign direct investment andtheir influenceon the economycontinues to bea topic of interestforresearch andeconomic practice. Thusovertime differentdefinitions have been given to the conceptof 'direct investment'.

The Explanatory Dictionaryof the Romanian Languagedefines the investmentas aplacementoffunds, of equityin a companyor abusiness (Opera, 2010).

Generallyit can be acceptedthat anyplacementof fundsin the economic, social, cultural, administrative, military, etc. to ensureregeneration orgrowthof the assets, laborcoverage of the activities orpromotion oforganizations orbusinesses' goalsisan investment (Zaiţ, 2008).

United Nations Conference onTrade and Development defines foreign direct investment (FDI) as thoseinvestments thatinvolve along-termbusiness relationshipreflectingalastinginterestofan economic entity(direct investororparententerprise), as well as its control onan enterpriseresident ina country other thanthat of the investor (UNCTAD, 2009).

The OrganizationforEconomic Cooperation andDevelopment considers as FDIthoseinvestments made inorder to establishsustainableeconomic relationsorexercisesignificant influence overthe managementof a business(OECD, 2010).

National Bank of Romaniabelieves thatforeign direct investmentis along terminvestment relationshipbetweena resident entityandanon-resident entity, which usuallyimpliesthat the investor exertsasignificantinfluence on the managementof the companies in which he invested (BNR, 2009).

Forthe International Monetary Fund, FDIis a categoryofinternational investmentthatreflects the purposeof an entity residentin a country(direct investor) to obtaina lasting interestin anenterpriseresident inanother country(direct investment). Lasting interestimplies the existenceof along-term relationshipbetween thedirect investorand the company (International Monetary Fund, (2011).

Foreign direct investment(FDI) reflects the placement ofequityby foreign investors(non-residents) in other countries for theestablishment and development ofcompaniesin various fields.Foreign direct investmentreflectsforeign elements, represented bycapital, landplacementprocess, technological streams,knowledge,management, goods and services (Voinea, 2008).

In conclusion, FDIrepresents the relationship betweena resident entityandanon-resident entity, usually - along-term investment relationship and the investorhas a significant influenceorcontrol.

ROUTES OFTRANSMISSION OFTHE ECONOMIC CRISISANDTHEIR IMPACT ONFOREIGN DIRECTINVESTMENTFLOWS

The current globaleconomicand financialcrisisaffectsboth the abilityof firms to invest, asa result of reducedavailability offunding, andtheirpropensityto invest, because of the pessimisticmarket perspectivesandeconomic outlook. The effects ofthe crisis onglobalFDIflowoccurmainly throughthree channels, namely the reduction ofaccess to finance, the pessimistic economic outlookpessimisticandrisk aversion (Reinhart, 2011).

Reduced access to finance - financial factors have negatively affected the ability of firms to invest, both internally and externally, tight credit conditions and lower profits reducing companies' financial resources for domestic and external investment projects. On the one hand, credit became less abundant and more expensive. For example, the extent of debt has dramatically increased in the last months of 2008 and still remains at a high level. Bank loans and funds available for takeover transactions with indebtedness have also dropped a lot. This deterioration of the external environment of funding for non-financial companies contributed to increasing inability to invest in foreign operations or in merger arrangements and acquisitions abroad. On the other hand, low incomes of large companies from a wide range of industries in Europe, Japan or the United States, according to declared or planned profits beginning with the 4th semester of 2008, have reduced their capacity of funding the companies.

Pessimistic outlook - a pessimistic evaluation of market prospects, especially in developed economies that pass through the biggest of the post -war recessions, reduced the propensity of companies to invest for the expansion of production capacity, both internally and externally.

Risk aversion-the investment plansof companiesmayalso bediscouragedbecause ofthe high level ofperceived risksanduncertainties, in order toresistthe worstscenariooneconomic and financialconditions. A lot ofcompanies have implementedprograms to reducecostsevenmore drasticthanthe worstscenarios forbusiness prospects.

Investment plans ofthe largest companieshave been affected by thedifferent aspects ofthe current crisis. Regardingthe negative impact onexpansion plans, according to the studyUNCTAD-WorldInvestmentProspectsSurvey2009-2011, the companies responded thatresponsible forthis are theeconomic crisis, thefinancial crisisand the volatility ofexchange ratesby 86%, 79% and51%, respectively(Figure no. 1) (UNCTAD, 2009, 2010, 2011).

The impact of thesenegative factors, however, can vary significantlydepending on thetype of investment, namely investmentin search ofmarkets,in search ofefficiency andin search of resources (Hansen, 2006). The declineinthe propensityto investoverseascan takevarious forms, up todivestmentsand restructuring.

EVOLUTION OFFDIFLOWS IN THE CURRENTGLOBAL ECONOMIC CRISIS CONTEXT

After theonset of the crisisin 2007, the global economicdownturnreduced thetotal volume offoreign direct investmentby about 15% in 2008 (Tidiane, 2010). FDI inflowspeakedin 2007, with a record of1.971 billiondollars.Althoughdeveloped countries haveregistereddeclinein FDIin 2008, developingcountries, taken as a whole,showed amodest increase. Aftera decline of16% in 2008, FDI inflowsfell bya further 32% in 2009 to €1.185 billionUSD, while outputfell by almost43% to 1.101 billionUSD (Figure no. 2; Figure no. 3).

In 2010, globalFDIinflowsrosemodestlyby 5percentto1,244billion dollars.Whileoverall industrialcapacityand world tradeare alreadyat thepre-crisis level, global FDI flowsin2010 remainedalmost 15% below the averageof2005-2007 andnearly37% below the recordregisteredin 2007.Althoughin 2010FDIrecovered, there is someuncertainty about therisk factorsof the post-crisis business environment, such asthe unpredictability ofglobal economic governance, a possiblewidespreadsovereign debtcrisis, instabilityin the financial and tax sector insome developed countries, the rising of inflationand the signsof„overheating" of the most importantemergingmarket economies (Figure no. 4).

Once the economic crisis was triggered, there have been some major changes in overall FDI tendencies that will most likely take off in the medium and long term.
Firstly, the relative weight of emerging economies and in process of transition, as countries of destination, and as sources of global FDI is expected to continue growing.
With the onset of the crisis, FDI flows towards developing countries have significantly changed. Although overall global FDI towards developing countries rose sharply, there were significant regional differences. FDI flows to some of the poorest regions decreased. Flows to Africa, to the least developed countries, to landlocked developing countries, and to small island developing states have continued to decline, the East and South - East Asia and Latin America had a substantial increase in FDI inflows. FDI flows to Africa, for example, fell by 9% in 2010 (UNCTAD, 2012). FDI to the primary sector, especially the oil industry continued to be the main destination for FDI flows to the continent. This trend has led Ghana to pass to the rank of major host country, but also made Angola and Nigeria decline in FDI flows.

Since 2007, the growth of FDI in developing countries is characterized by significant regional differences. The bulk of FDI inflows to South America in 2007 was directed towards extractive industries and natural resource-based production. The increasing of inflows in the countries of Central America and the Caribbean can be explained largely by the dynamics of FDI in mining, steel and banking, which are not primarily geared towards the U.S. market. FDI has played a major role in increasing the export performance of Peru. Between 1990 and 2006, exports of metallic minerals soared from $ 1.5 billion to $ 15 billion, with an increase in total exports from 42 % to 62 % (UNCTAD, 2011). In 2010, FDI flows to Latin America and the Caribbean increased by 13 %. The largest increase was recorded in South America, where the growth rate was 56 %, Brazil being the largest recipient of FDI in the region. FDI outflows from Latin America and the Caribbean increased by 67% in 2010 due to mergers and major transnational acquisitions by large companies in Brazil and Mexico(UNCTAD, 2011). Latin America mostly exported goods and imported production goods.

These savings, which have absorbed almost half of FDI inflows in 2009 are those that describe the overall recovery of FDI. Developing economies became important in 2010 both as beneficiaries of FDI and as foreign investors. While international production, and recently international consumption have shifted to emerging economies or in transition, large companies invest in effective marketing projects in these countries. For the first time since 1980, they have absorbed more than half of global FDI flows in 2010, respectively 51.6 %. FDI outflows from developing economies and in transition increased sharply, by 21 % in 2010.

Secondly, the flow of investmentinthe manufacturing sector, services andprimary sector didn’t havethe sametrend.In 2010there is achange inthe sectoral distributionof external investment projects, manufacturessectorregistering a growthofFDIoutflows, representing 48% oftotalFDIoutflows.The recovery ofFDI flowsin2010 hasmajorfluctuations onsectors andentryways. FDIin services,which wereresponsible for muchof the declineinFDI flowsdue tothe crisis,continued to declinein 2010, together withthe ones in the primary sector. Allmajor industriesbased onservices (business, finance, transport, communications and utilities) fell, but at different pace,FDI inflowsin the financial industryhaving oneof the strongestdeclines.

Thirdly, despite the impact on the flow of FDI, the global crisis has not stopped the growing process of internationalization of the production. The reducing of sales and profits for foreign subsidiaries of multinational firms in 2008 and 2009 was lower than the overall contraction of the world’s economy, the share of foreign affiliates in global GDP reaching a level of 11%. The number of foreign employees of multinational firms grew by 3.4 % in 2009. Developing economies and transition are now host for the majority of employment of foreign subsidiaries. Earnings of foreign subsidiaries increased by 7.5 % in 2009, largely due to the 15% increase in capital inflows. This increase of ISD capital was due to the significant come-back of the global market for capital grants and import flows of FDI, which, although remained at a positive value, slowed down considerably the pace of expansion. Sales of foreign affiliates rose by 9.1 % in 2010, reflecting the recovery in developing and transition countries.

The global crisis has reduced the funds available for FDI, leading to fewer purchases. While low prices on the stock markets have led to the reducing of the transaction value against the global restructuring, they also provided opportunities for multinational companies to access financing. The sharp drop in of cross-border mergers and acquisitions is what caused most of the decline in FDI in 2009. While greefield investment rose by 15 %, purchases abroad contracted by 34%. Mergers and acquisitions are usually more sensitive to financial conditions than greenfield investments as stock market turmoil affects the value of prices on which are based mergers and acquisitions, mergers and acquisitions investment cycle being usually shorter than that of greenfield projects.

In 2010, economic performance improved in many countries, and growing profits of foreign subsidiaries have raised reinvested earnings to nearly double the level of 2009. The other two components of FDI - investment flows type „equity” and borrowings among companies - declined in 2010. Private FDI „equity” type in 2010 were directed mostly to developing and transition economies. FDI from SWF’s fell to 10 billion dollars in 2010 from 26.5 billion in 2009. Increasing

FDI from these special funds in 2011 is linked to a global more gentle business environment. Regarding the value of direct investment flows perceived worldwide in 2012, it was of about 1350 billion dollars, reflecting a 18% decrease compared to the previous year, representing a lower level than the flows recorded in 2006-2008 and 2010-2011. The value of direct investment flows perceived worldwide in 2012 was of about 1350 billion dollars, reflecting a 18% decrease compared to the previous year, representing a lower level than the flows recorded in 2006-2008 and 2010-2011. FDI flows attracted by developing economies in 2012 marked a slight decline compared to 2011 (4.4%), while the decrease in the group of transition countries has been over 9%. The value of FDI received by developing Asia (about 407 billion dollars) decreased by 7%, while that of FDI attracted to Latin America and the Caribbean (nearly 244 billion U.S. dollars) decreased by 2 % . The decline registered in Central America and the Caribbean could not be compensated by an increase of 12% in FDI inflows attracted by South America. The investors' preference for countries such as Brazil, Chile, Colombia, Argentina, Peru is explained by the abundant natural resources and also by the rapid expanding of the middle class in these economies, attracting FDI in search of the market (UNCTAD,2013). In Africa, the perceived value of FDI flows in 2012 exceeded $ 50 billion dollars, marking an increase of 5%.

CONCLUSIONS

For a better integration in the international economy and in particular the European economy, the reform and restructuring process of the economies in Central and Eastern Europe, including Romania, needs consistent foreign direct investment flows (FDI), which can be achieved by increasing the global nature of the production process. This aspect, together with the existing global nature of trade, requires a new approach to the identification and distribution of resources. For all countries, a component of development strategies and an essential tool in developing a strong and dynamic private sector is attracting FDI. These investments facilitate the access to foreign markets indirectly through the effect of complementary implementing collateral technology and know-how.

Given the analysis we can say that the worldwide economy has passed since 2008 through a period of unusual developments, characterized by declining or weak resume of growth in developed countries and a fairly robust growth in many emerging countries. Regarding foreign direct investment, the economic crisis has had a negative impact on them, since statistics show that in 2008 and 2009, investment flows have declined, registering a slight recovery in 2010.

Foreign investment is an engine of economic development for the Central-Southeastern European countries. These countries have a high capacity to absorb foreign investment capital, because there are prerequisites for transforming these resources into additional economic value. Until achieving the optimal level of foreign investment, legal and fiscal measures, monetary and any other measures should be focused on stimulating investment, this representing an important lever for economic value creation and achievement of a higher level of social welfare.

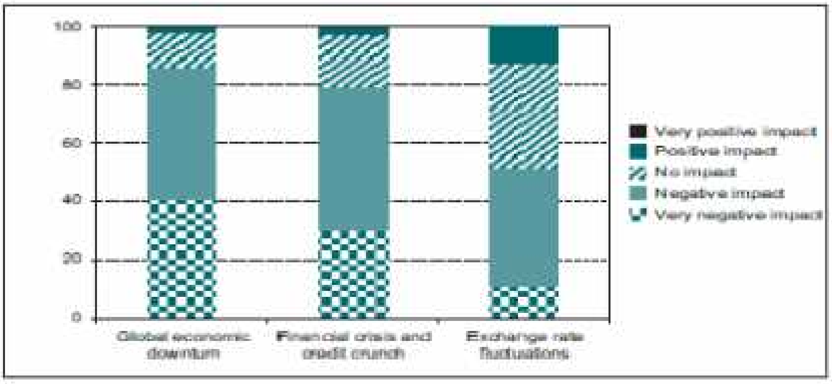
References

[1] Banca Națională a României, *Raportul privind evoluția investițiilor străine directe în România,* Direcția statistică, 2009;
[2]Hansen, H. & Rand, J. (2006). *On the causal links between FDI and growth in developing countries*, The World Economy, 29, pp. 21-41;
[3] International Monetary Fund, (2011). *Word Economic Outlook Database*; www.imf.org;
[4] OECD (2010), *Measuring Globalisation: OECD Economic Globalisation Indicators* OECD, Paris;
[5] Opera I., Pamfil C.G., Radu R. & Zăstroiu V. (2010). *Dicționarul Universal al Limbii Române,* București, Ed. Litera, volumul 5, pp. 205;

[6] Reinhart C. & Rogoff K. (2011). *From Financial Crash to Debt Crisis,* American Economic Review No.101, pp.1676-1706;
[7] Tidiane K. (2010). *Investment Climate and FDI in Developing Countries: Firm-Level Evidence,*World Development Vol. 38, No. 4, pp. 498-513;
[8] UNCTAD (2009). *Assesing the impact of the financial and economic crisis on global FDI flows;*
[9] UNCTAD (2010). *World Investment Report* - Division on Investment and Enterprise;
[10] UNCTAD (2011). *World Investment Report - Non-Equity Modes of International Production and Development;*
[11] UNCTAD (2012). *World Investment Report* - Towards a New Generation of Investment Policies;
[12]UNCTAD (2013). *World Investment Report* - Global Value Chains: Investment And Trade For Development;
[13] Voinea G. (2008). *Relații valutar - financiare internaționale*, Iași, Ed. Universității „Al. I. Cuza", pp. 94;
[14] Zaiţ D., (2008). *Evaluarea şi gestiunea investiţiilor directe,* Iaşi, Editura Sedcom Libris, pp. 15.

APPENDICES

Figure no. 1: **Impact of various aspects of the crisis on the company's investment plans (% of reponses)**



Source: Assesing the impact of the financial and economic crisis on global FDI flows, UNCTAD 2009

Figure no. 2: **FDI inflows, by region, 2008-2012**
(Billions of dollars)

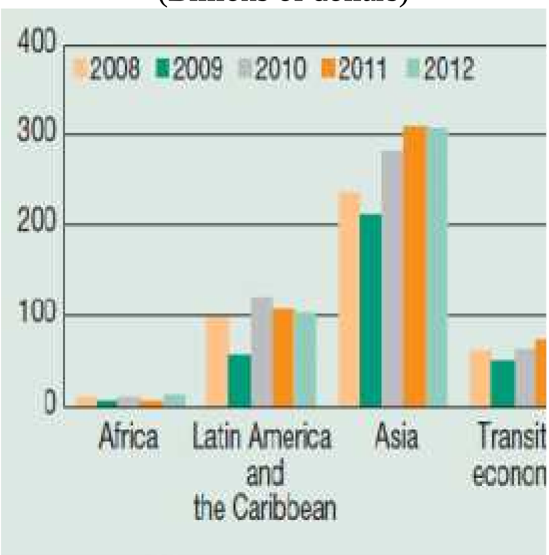
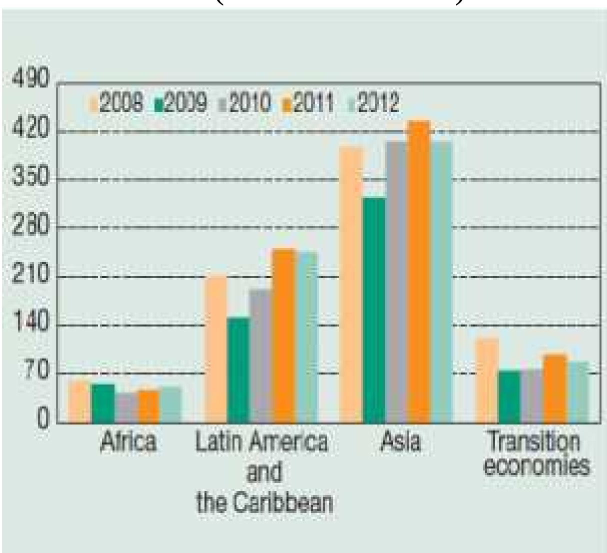
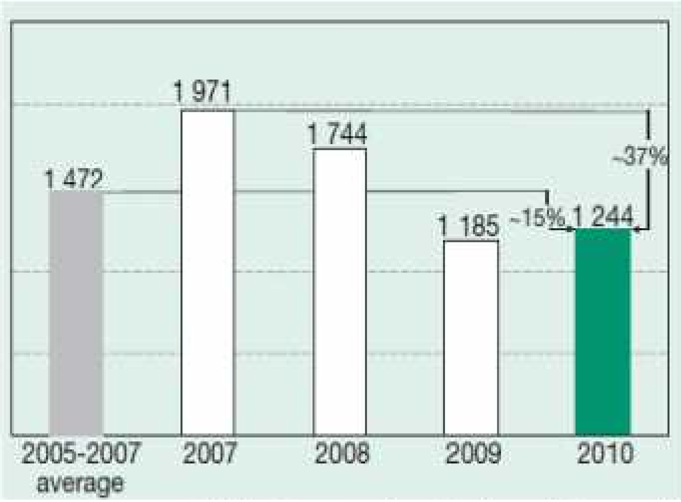


Figure no. 3: **FDI outflows, by region, 2008-2012**
(Billions of dollars)



Source: World Investment Report 2013; Global Value Chains: Investment And Trade For Development, UNCTAD;

Figure no. 4: Global **FDI inflows, average 2005-2007 and 2007 to 2010**
(Billions of dollars)



Source: World Investment Report 2011, Non-equity Modes of International Production and Development