14.7 Foreign direct investment and economic development

Introduction: In this activity you'll explore the definitions of FDI and you'll explore some of the trends in cross-border investment, including who the biggest companies are that do it, which countries receive it and what impact it may have on the level of development of recipient nations.

Learning objectives: By the end of this activity, students will be able to…

- Describe the nature of FDI and multinational (or transnational) corporations (MNCs or TNCs)
- Explain the reasons why MNCs expand into economically less developed countries.
- Describe the characteristics of economically less developed countries that attract FDI, including low cost factor inputs, a regulatory framework that favors profit repatriation and favorable tax rules.
- Evaluate the impact of FDI for economically less developed countries

Part 1: What is FDI and who receives it? To better understand this question you'll do some reading from the United Nations Conference on Trade and Development (UNCTAD).

1. Read and paraphrase the definition of FDI

When a firm or investor in one country makes a "lasting investment" in a firm in a foreign country, consisting of at least 10% of ownership. The foreign investor intends to exercise control over a foreign enterprise.

2. Read and paraphrase the definition of a transnational corporation (TNC) from the same site.

A company based in one country that controls assets in foreign countries.

3. The first thing to highlight is the fact that FDI is by no means a phenomenon unique to less developed countries. For a clearer understanding, read pages 10 and 11 of the 2015 World Investment Report from the UNCTAD. Answer the following questions after reading.
   a. What factors explain the 16 percent drop in global FDI flows in 2014?

FDI flows declined in 2014 due to weakness of the global economy, political uncertainty for investors and "elevated geopolitical risks". Generally, there was more uncertainty among TNCs with regards to the returns on new investments abroad, therefore fewer investments were undertaken.

   b. What was the total dollar amount of FDI inflows in 2014?

$1,230 billion ($1.23 trillion)

c. What percentage of total FDI flows in 2014 were into developing economies? (calculator needed)

$681/$1,230 = 55% of total FDI flows went to developing countries

d. Which country received the most FDI inflows?

China

e. From what region does more FDI originate than any other?

“Developing Asia now invests more abroad than any other region”

f. What percentage of total global FDI in 2012 was in services? What percentage was in the primary sector? What accounts for the relatively large percentage of total investment in services?

In 2012 services accounted for 63% of the global FDI. This is mostly due to increased liberalization in the exchange of services between nations and the increasing tradability of services.

g. What is “greenfield investment”? Why do you think developing countries attract most of the greenfield investment (as opposed to developed countries)?

⅔ of greenfield investment (construction of new plants/facilities/capital or infrastructure) goes to less developed countries, most likely because these countries do not already possess the infrastructure that more developed economies do. They also tend to compete to attract greenfield investment by offering tax incentives to MNCs who invest in new facilities in the country.

h. How many people are employed by multinational enterprises (MNEs) abroad?

about 75 million people

i. What percentage of total FDI inflows went to Africa? (calculator needed)

$54 billion / $1,230 billion = 3.66%

j. How did lower commodity prices in 2014 affect FDI flows to South America? Explain this relationship.

FDI into Central America declined due to low commodity prices. Lower prices reduce the returns on investments in mining, agriculture, etc… so MNCs are less likely to invest in these sectors, largely based in LEDCs

k. Summarize the long-run trends in FDI flows to the following types of country:
   i. the “least developed countries”

Over the past decade (2004-2014) FDI tripled to LDCs

   ii. “landlocked developing countries”

FDI quadrupled to these countries over the last decade.

   iii. “small island developing states”

FDI has tripled to these nations over the last decade.

l. Why is FDI particularly important to the types of countries referenced in the previous question?

Despite the fact that the dollar amount of FDI flowing into the least developed countries is quite small, it makes up a large percentage of their very small GDPs. It also tends to have a “more diverse development impact compared with other sources of finance”. FDI into weak economies increases economic diversification and “fosters greater resilience and sustainability in these countries”

Part 2: Who does the investment? To answer this question you’ll study some data and information from the Guardian and *Topforeignstocks.com.*

First, examine the data for the top 100 non-financial transnational corporations. Note that you can organize the data based on any of the variables (ranking, country, industry, etc…)

1. What are the three most represented industries in the list of the 100 largest TNCs?

Petroleum, Electrical equipment, Motor vehicles

2. How many Swiss firms are in the top 100?

Five Swiss firms (ABB, Novartis, Glencore, Roche and Nestle)

3. What does the share of a company’s total assets invested abroad tell you about the company’s business strategy?

The larger its foreign assets, the more the company depends on foreign resources for its supply chain.

4. How many of the top 100 largest TNCs are from a developing country? Which developing countries are represented on the list? Why do you think so few of the world's large TNC are based in developing countries?

China (3 firms), Brazil, Malaysia

Next, read this article from *the Guardian*.

1. Based on the charts included in this article, how is Africa fairing in the competition to attract FDI?

Africa has attracted a tiny proportion of total FDI, only around $57 billion of over $1.3 trillion

2. How many of the top 20 countries for FDI inflows are developing countries? How many of them are in Africa?

Brazil, Mexico, India, Colombia, Indonesia

3. How does the current amount of FDI flowing into developing countries compare with the target level of annual investment needed for developing countries to meet their sustainability needs between 2015 and 2030?

The target level of investment needed to achieve the SDGs is $3.5 - $4.5 trillion. The current amount of FDI is just $1.3 trillion, and only about half of that is going to developing countries. So, the current FDI flowing into developing countries is only about 1/7 of that needed to meet the SDGs.

4. How can the gap between the actual level of FDI and the target level of investment to achieve the Sustainable Development Goals be filled? What role could aid play in helping fill this gap?

Governments in developing countries can help fill that gap by investing in welfare-improving public goods. Aid can help fill that gap. Increased FDI could help as well. But there are many obstacles to all three of these achieving the target level of investment.

5. Why do you think FDI fall short at fulfilling the investment needs in areas such as climate change mitigation, water and sanitation, health and education?

These are all market failures that have long-term implications. The private and public sectors have always struggled to address problems that for which the benefits of solving are not *purely private but social benefits*. This is a tragedy of the commons.

6. To what extent can the private sector provide the necessary elements for sustainable development of the poorest countries?