

Tokyo Club Foundation for Global Studies

The Future Structure of International Capital Flows

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Kyoto

**Impact of changing
production location on FDI:
Global and European Dynamics**

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IFRI

Introduction

➤ Paper discusses the dynamics of FDI and more specifically the evolution of its geographical distribution.

Hypothesis of a reorientation of FDI to developing countries: end of the 90s, the Internet bubble generated an FDI bubble to advanced countries

➤ Is relocation of production to low-cost countries a structural long term trend ? Is it sustainable or part of the current global imbalances?

Outline

1. Evolution of FDI and its geographical distribution since the 1980s.

Increasing FDI to low cost countries and impact on trade flows and country specialisation.

2. Review of the literature on the determinants of FDI distinction between horizontal and vertical FDI.

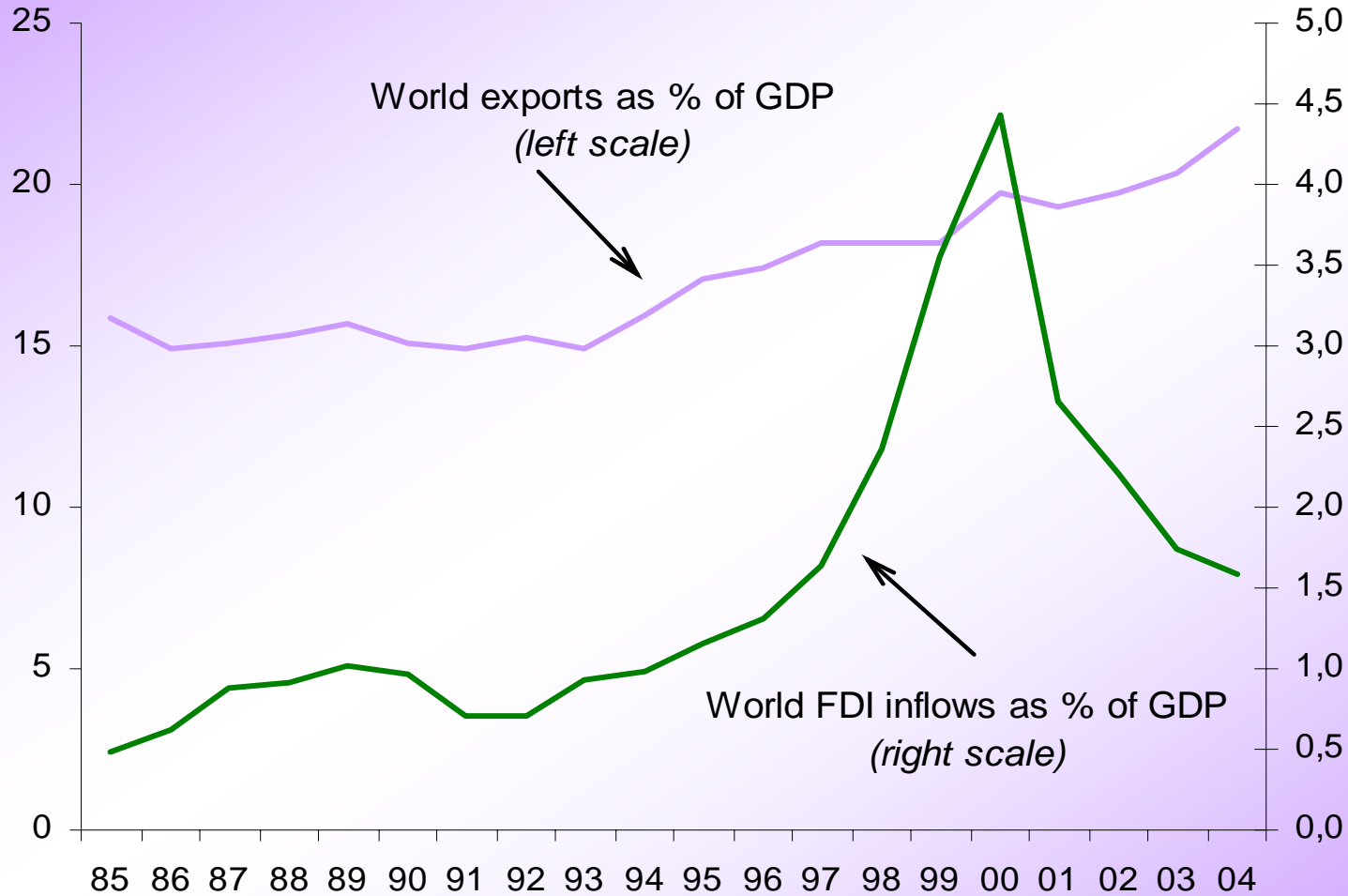
Diversity of activities conducted by multinationals abroad and different factors of attraction (distribution, R&D).

3. Future evolution of FDI and its sector and country distribution

4. Conclusion different from the draft paper: interaction between FDI, relocation of production and global imbalances

1. FDI trends

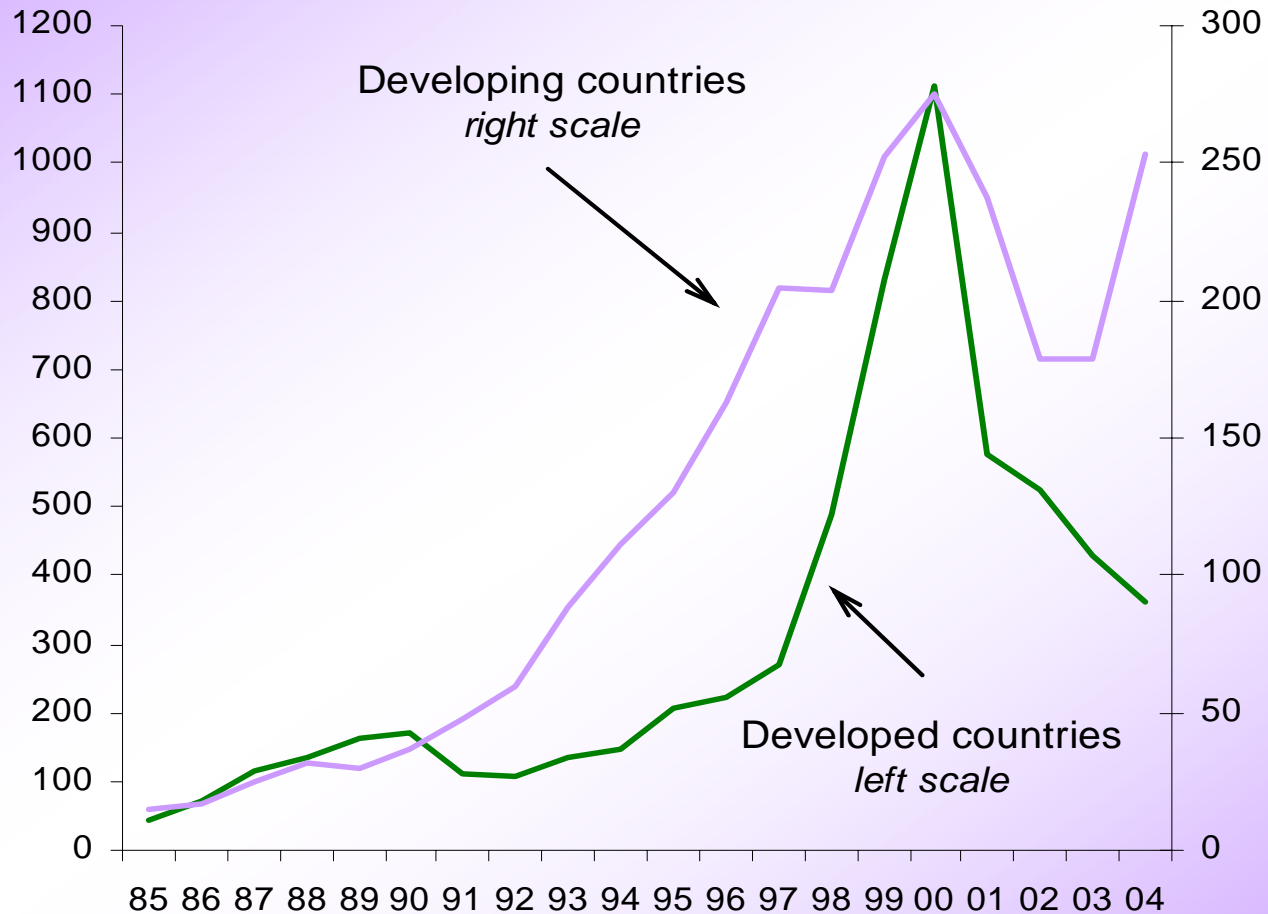
Increasing internationalization and FDI



Source : UNCTAD

1. FDI trends

Divergent dynamics of FDI flows, \$bn

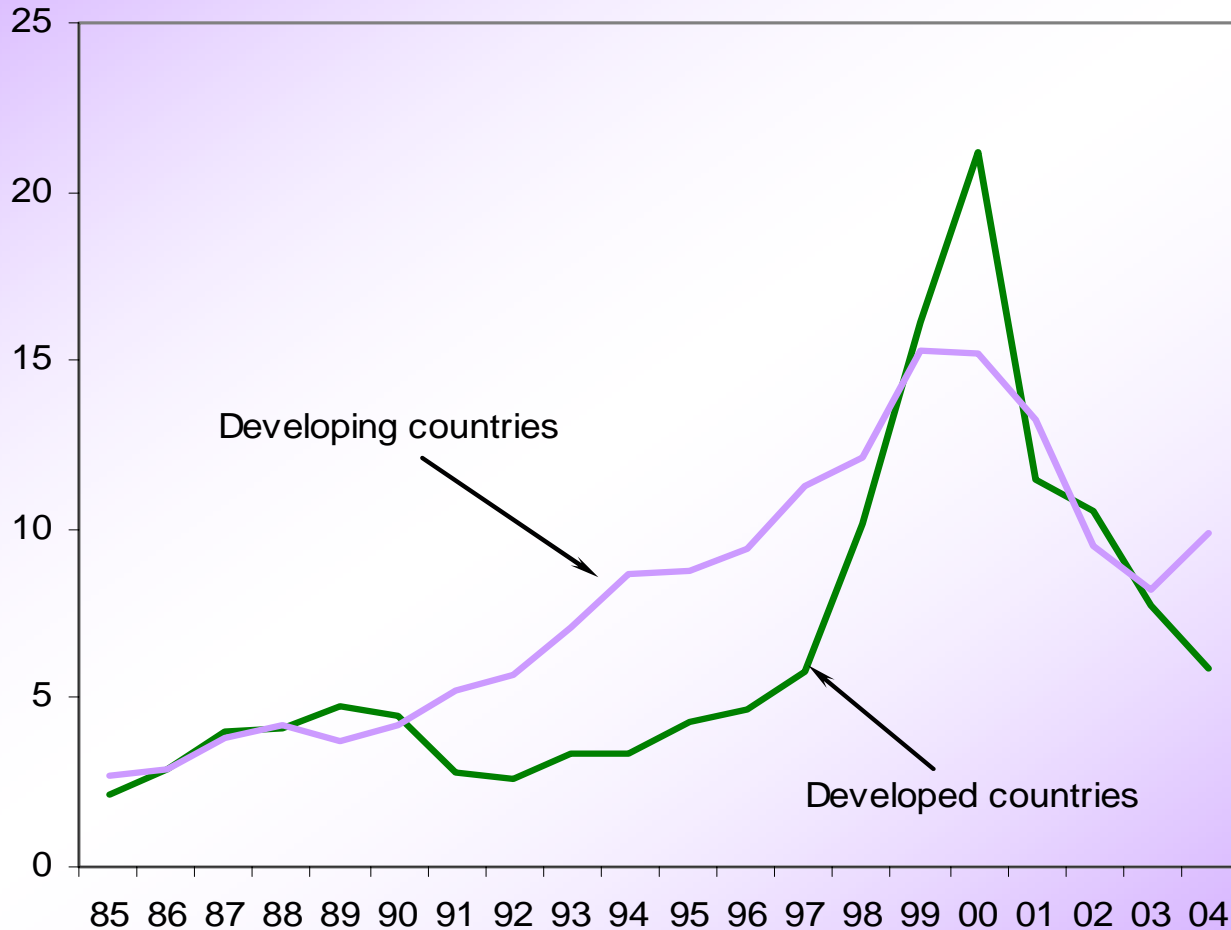


EU NMCs are included in developing countries.

Source : UNCTAD

1. FDI trends

FDI as a % of GFCF



Source : UNCTAD

1. FDI trends

Share of FDI to developed countries, %



Source : UNCTAD

1. *FDI trends*

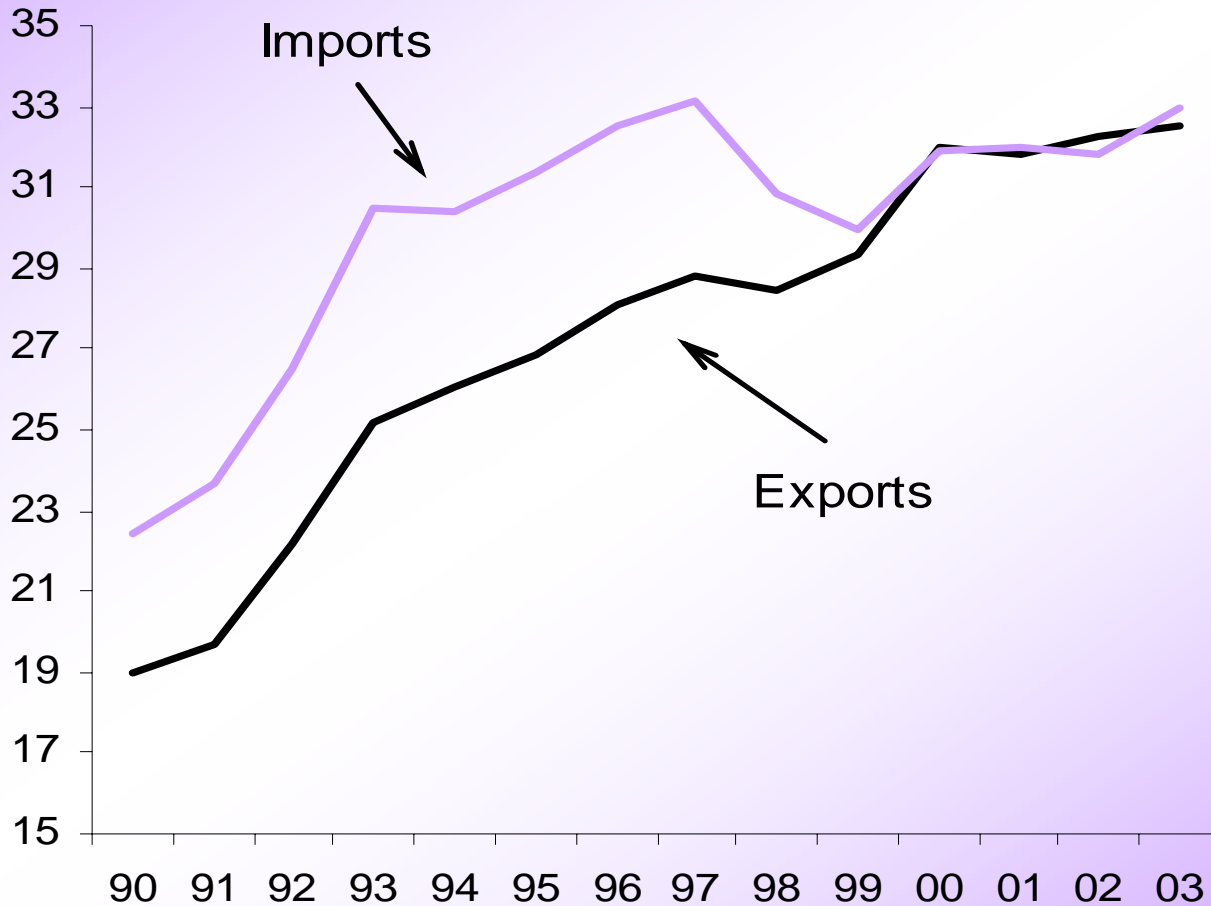
A Historical shift ?

Waves of FDI with different cycles for different countries

- Crises in emerging countries
- Privatization waves in emerging and transition economies
- Internet bubble
- Integration of emerging countries into the global economy and global production networks

1. FDI trends

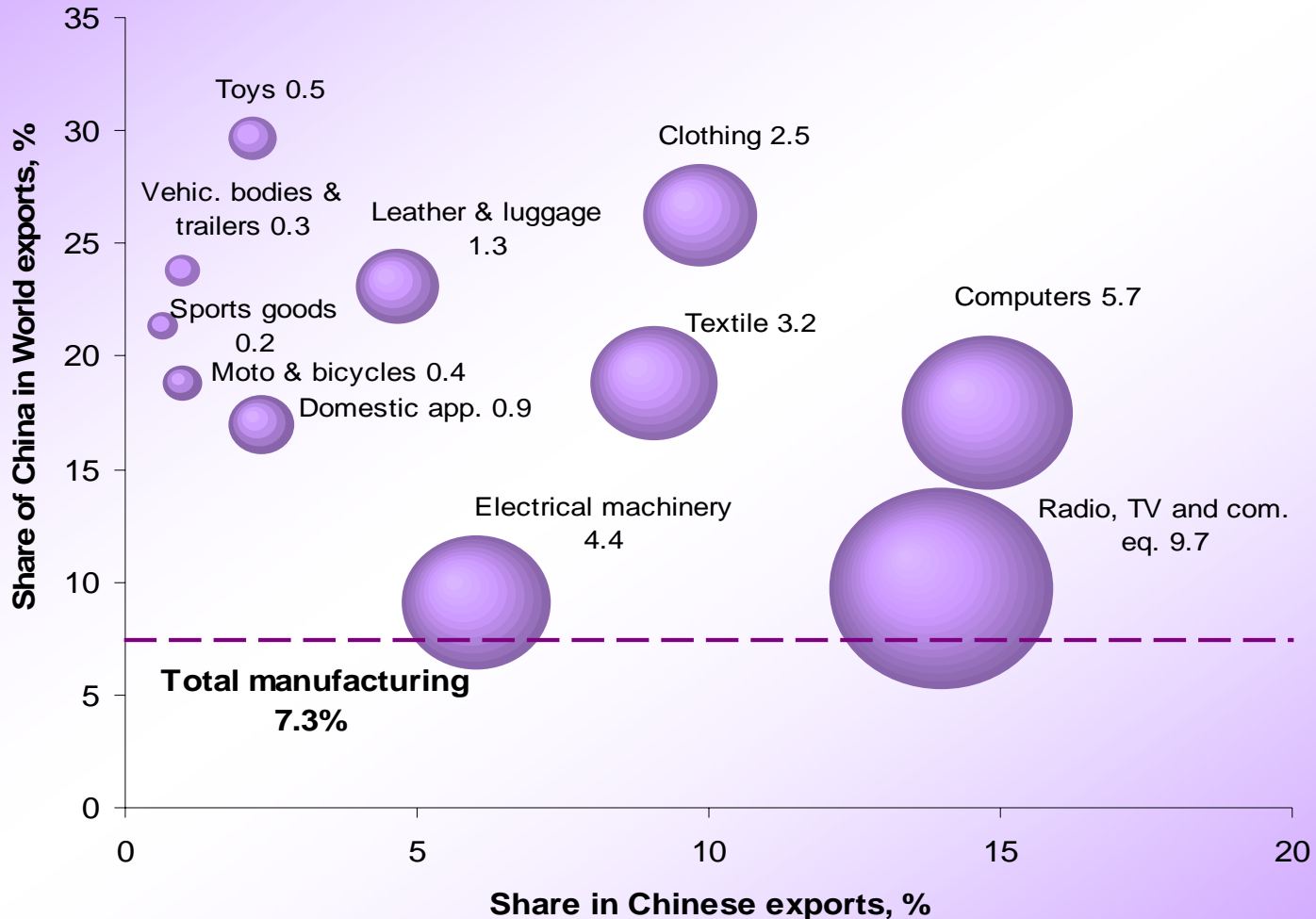
Share of developing countries, in % of world manufacturing trade



Source : UNCTAD

1. FDI trends

Strong sectors in China's exports, %



Size of the bubbles: share of sector in world manuf. exports

Source : IFRI Trade Databas

2. Determinants of FDI

Theoretical predictions on the determinants of Horizontal and Vertical FDI

Determinants	Prediction of the impact on FDI flows, by type of investment	
	Horizontal	Vertical
<i>Characteristics of firms and industries</i>		
Firm-level economies of scale and scope	+	+
Plant-level economies of scale	-	?
Product-specific trade costs	+	-
Difference in factor intensity between stages of production	Not relevant	+
<i>Characteristics of home and host countries</i>		
Size of the host country market	+	No predicted impact
Trade costs between home and host countries (distance, trade barriers...)	+	-
Factor cost differentials between home and host countries	? (+)	+

The role of wholesale affiliates in global networks

➤ Distribution activities such as marketing or after-sales service represent a sizable share of multinationals' global operations.

➤ Wholesale affiliates and horizontal FDI

Wholesale affiliates vs manufacturing affiliates. Data from German firms on the motivation for FDI; from French firms on intra-firm trade by commercial and manufacturing affiliates.

2. Determinants of FDI

Increasing internationalization of R&D

Factor of:	Characteristics of S&T supply	Characteristics of demand
Centralization in the country of origin	<ul style="list-style-type: none"> • Strong S&T capabilities of the country of origin • Economies of scale in R&D 	<ul style="list-style-type: none"> • Country of origin is a lead market
International dispersion	<ul style="list-style-type: none"> • Attractive centers of excellence abroad • Low cost talent pool; increasing supply of scientists and engineers in emerging countries 	<ul style="list-style-type: none"> • Adaptation to foreign markets and local production conditions • New lead markets abroad

Trends since the late 1980s in bold character

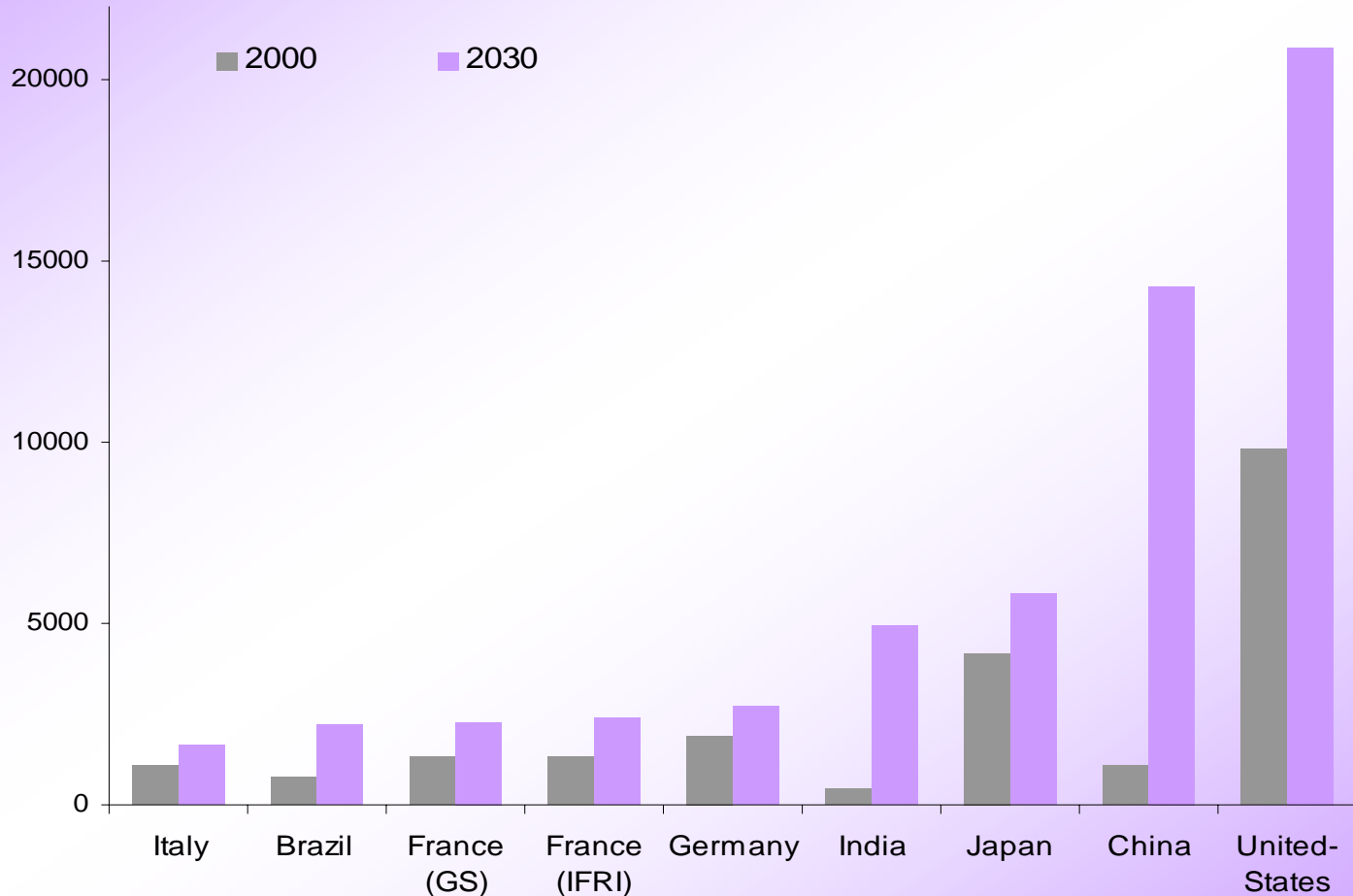
The emergence of global innovation networks

Three types of foreign R&D units

- *Local development center* : demand driven
- *Global research laboratory* : supply driven, asset seeking
- *Global development center* : supply driven, cost reducing, value-for-money

3. Future evolution of FDI

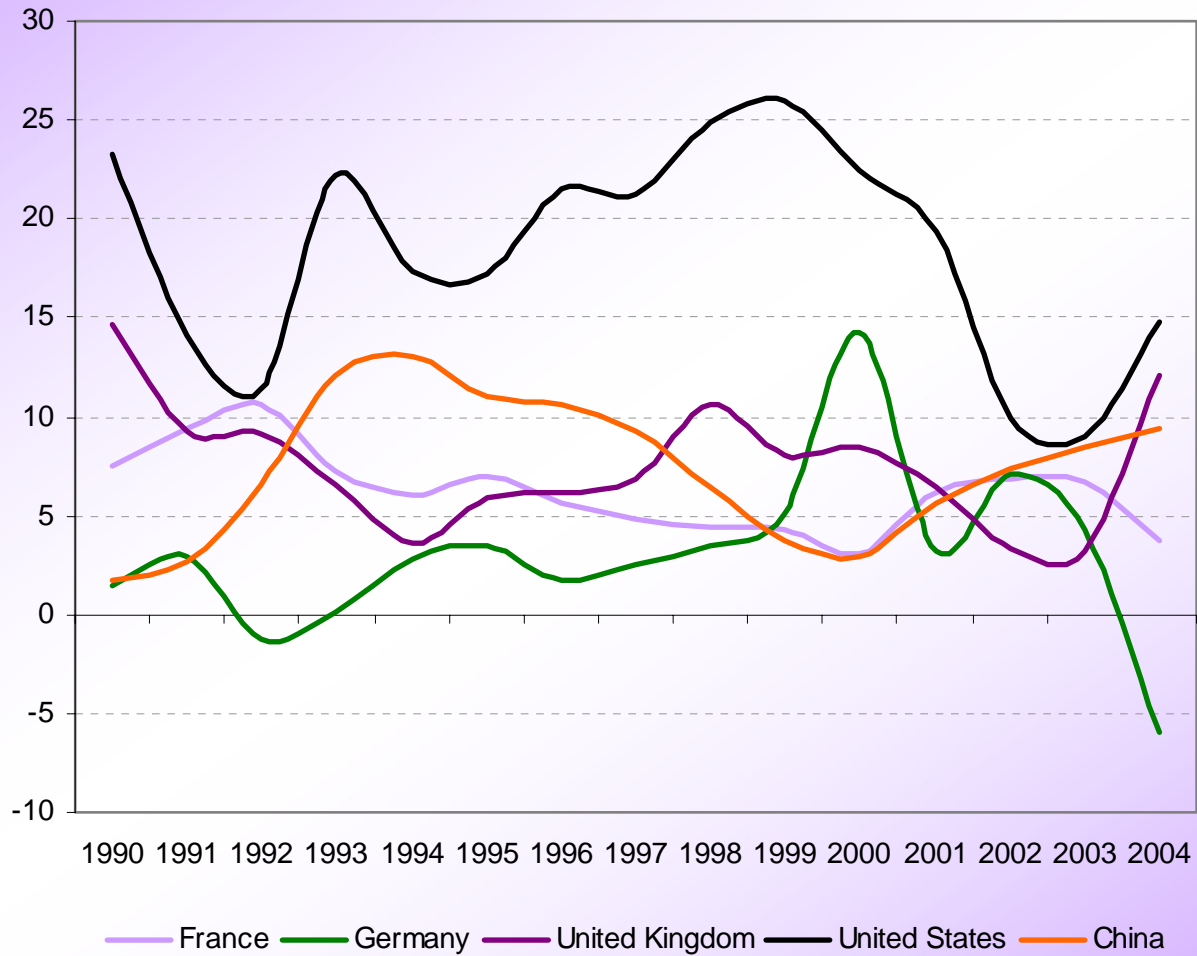
Economic size in 2000 and 2030, in 2000\$ bn



Source : Goldman & Sachs and IFRI

3. Future evolution of FDI

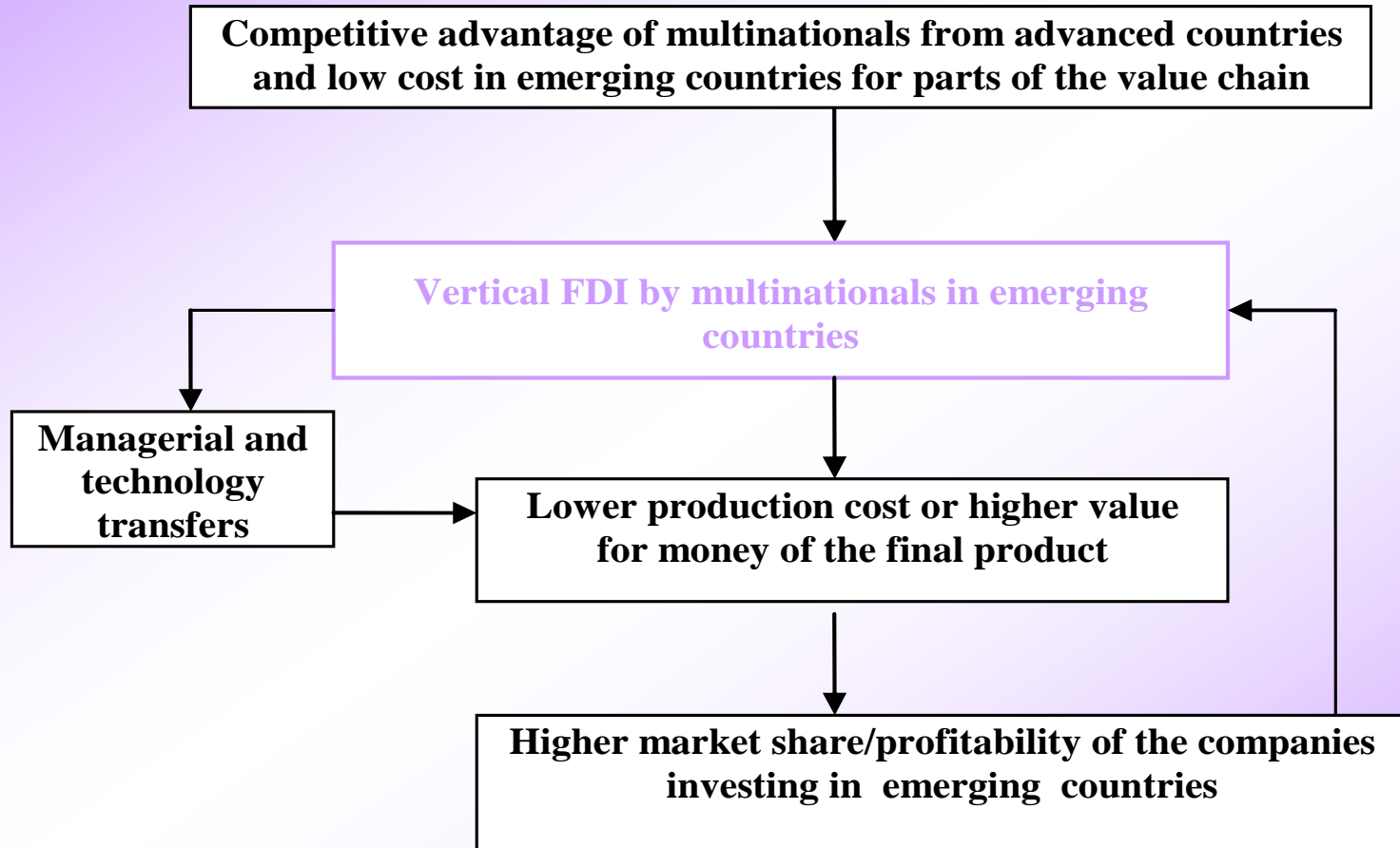
Distribution of FDI flows



Source : UNCTAD

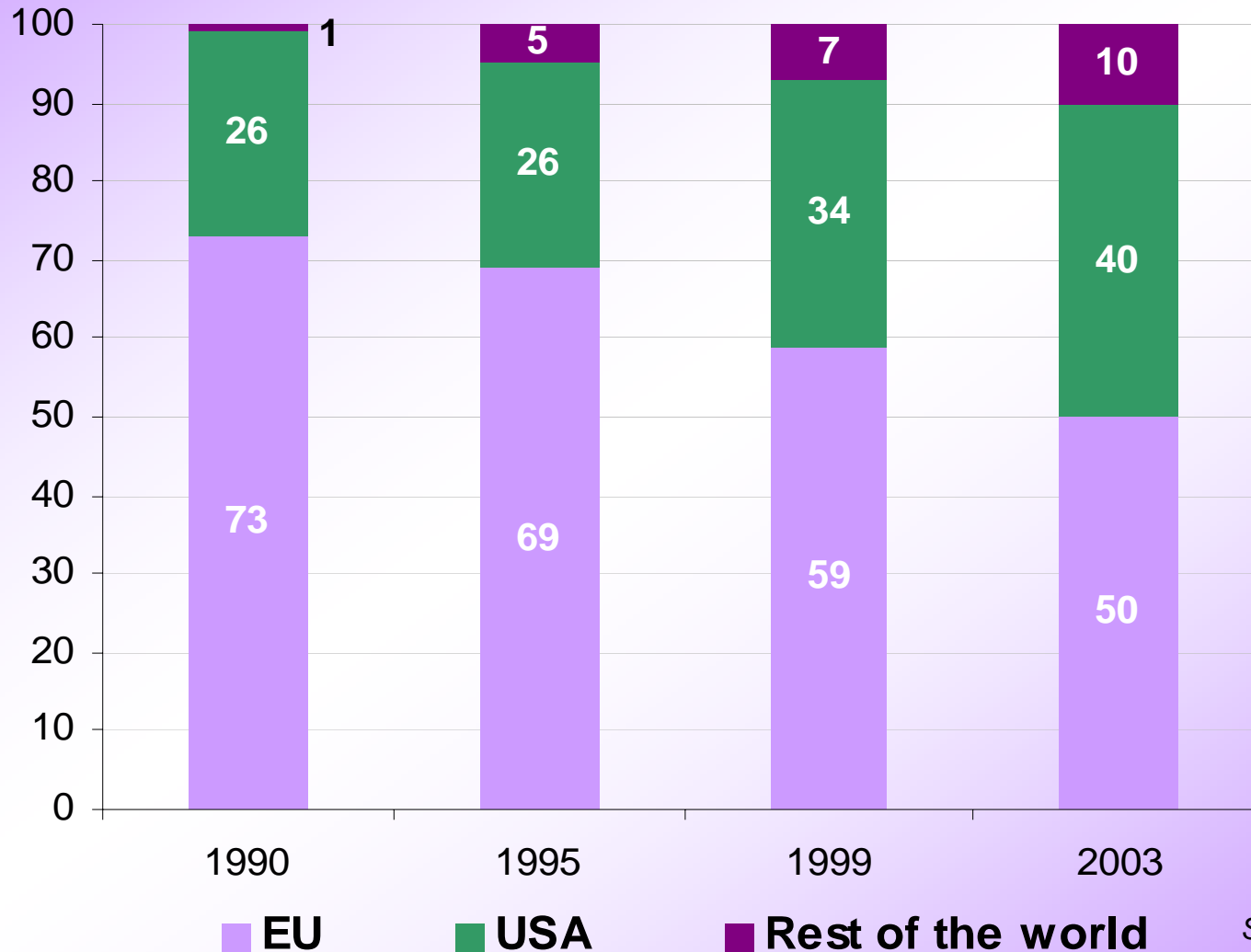
3. Future evolution of FDI

Vertical FDI to low-cost countries



3. Future evolution of FDI

Vertical FDI to high-cost countries



Conclusion

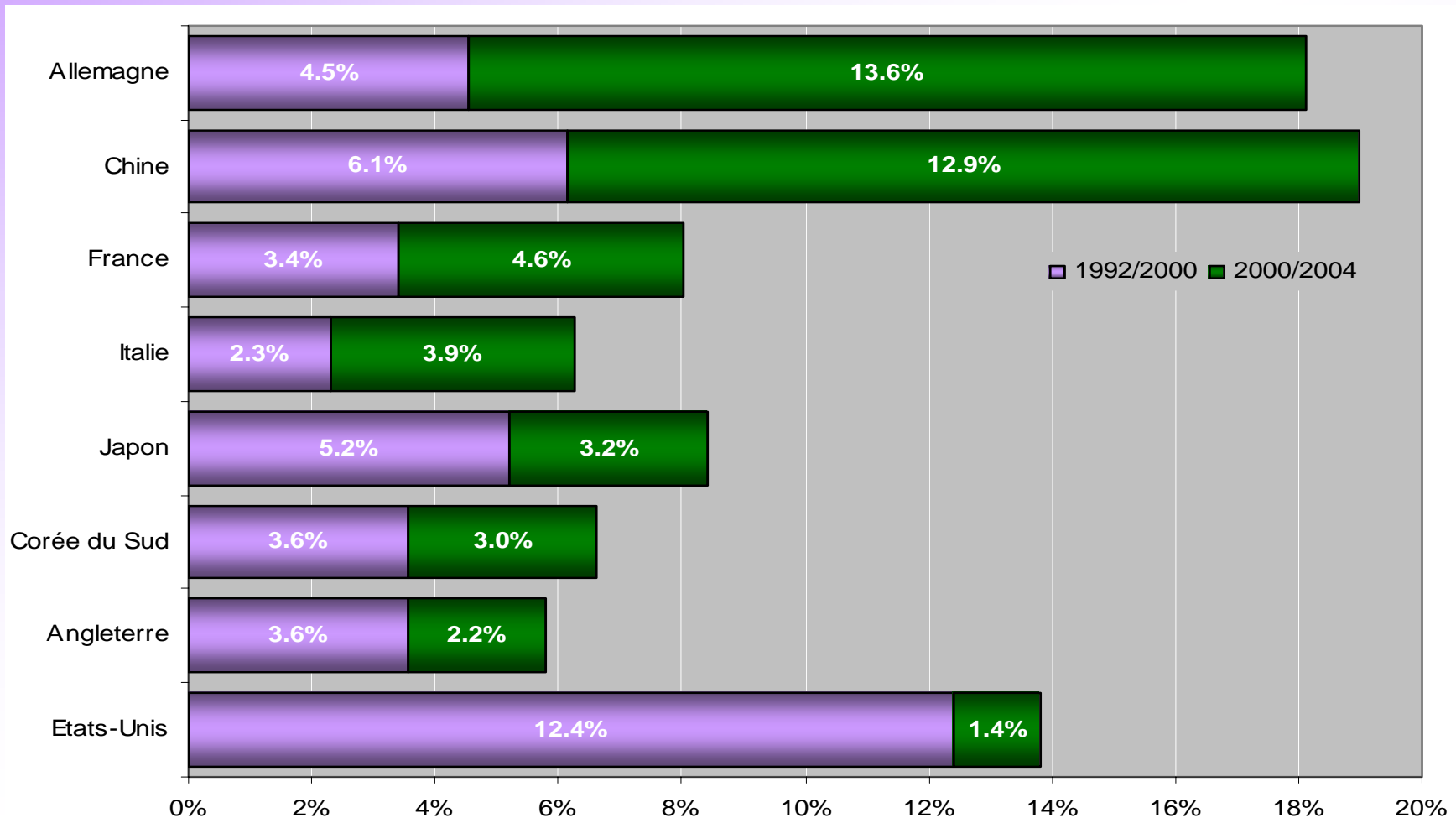
- Structural and shorter term determinants of FDI
- Rosy scenario of global restructuring: Germany?
- Black scenario: relocation of production depresses consumption and contributes to global saving glut.

Factors of crisis and reduction of FDI to developing countries :

- U.S. deficit,
- low EU growth.

3. Positions européennes

Contributions to the growth of world exports, %



Source : WTO