Global Capital Flows – FDI Trends

Comment on F. Sachwald "Impact of Changing Production Location on FDI: Global and European Dynamics"

Vanessa Rossi, Oxford Economic Forecasting

This paper begins by pointing out that FDI flows have risen substantially over the last 20 years. Indeed, overall global capital flows are now almost on a par with global exports (and may close the gap by 2010-2015), with FDI accounting for roughly a third of all flows. Total global FDI rose sharply to a peak in 2000, alongside the peak in economic activity (world GDP growth), then fell substantially in the weaker growth period immediately after 2000 before starting to pick up again in the last couple of years. It is also clear from examining the data that a surge in FDI flows between already developed countries has been a major reason for the growth in total FDI (particularly in the run up to 2000) rather than the more traditional "development FDI" flows from developed to developing countries. Thus, attempts to explain FDI must take account of these trends, chiefly the strongly increasing flow of FDI (excluding cyclical dips) and secondly the substantial cross-country flows.

This paper seeks to explore some of the factors behind these FDI flows with reference to the motivations of the companies involved, for example, distinguishing what may be seen as horizontal (market access) from vertical (lower cost base) driven FDI. However, for the latter, there is little discussion of the specific rationale for FDI relationships as opposed to simply extending trade relationships (which would also permit companies to benefit from lower cost production bases without tying up company capital). Motivations for FDI should be linked to the need to control, e.g., brands, quality, delivery, and finance, and cannot be based only on cost base comparisons.

This analysis might be improved by breaking out the M&A part of FDI flows from the rest. M&A activity has accounted for around half of total FDI flows and is mostly across developed countries. M&A motivations may then be examined with reference to asset pricing amongst other factors. The remaining "greenfield" FDI may be more closely associated with the view that global companies use FDI to expand (and control) production activities in lower cost countries, especially those that also offer a growing "home" market as well as export platforms (such as China). This last point cuts across the distinction between horizontal and vertical.

Although the paper does not separate out the issue of M&A, it does attempt to examine changes in R&D strategies. The discussion of R&D is not important in terms of explaining overall capital flows (it is far too small a part of these flows) but can be viewed in the context of (tentatively) suggesting that FDI motivation is not simply related to production and sales activities.