2 Foreign Direct Investment

2.1 Trends and Figures

According to the OECD, foreign direct investment "reflects the objective of obtaining a lasting interest by a resident entity in one economy ("direct investor") in an entity resident in an economy other than that of the investor ("direct investment enterprise"). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated." As a practical matter, an equity share of more than 10% is usually considered the threshold for the control of an asset. In contrast to FDI, investment that does not aim at the exercise of control is usually referred to as Foreign Portfolio Investment (FPI). To be classified as FDI, it does not matter if the direct investment enterprise is incorporated in the foreign country, and is thus a subsidiary or associate company, or not incorporated and is thus a branch. A frequent distinction with regard to FDI is between flows and stocks. Obviously, FDI stocks denote the value of FDI in a given country at a given point of time, while FDI flows denote the amount of FDI flowing to a given country in a given period of time. Another important differentiation regarding the nature of FDI is between Mergers and Acquisitions (M&As) and Greenfield investment. While the notion of M&A is self-explanatory, Greenfield investment refers to investment that includes the establishment of new production facilities such as offices, buildings and factories.

The last few years have seen a considerable growth of FDI. In 2006, FDI flows reached $1,306 billion USD while total FDI stocks amounted to roughly $12,000 billion USD. Compared to 2005, this constitutes a growth in FDI flows of about 38%. As Figure 2.1 indicates, FDI has been on a growth path since the mid-1980s, reaching a peak in the year 2000 and an all-time high in 2007. However, recent figures for 2008 and 2009 evidence the negative consequences of the financial crisis and have caused FDI to fall to 1,114 billion USD in 2009.

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18 OECD (1996), 7f.
Figure 2.1: FDI Flows (Inward) 1970-2009

Source: Own diagram based on UNCTAD Data (http://stats.unctad.org/FDI/)

Foreign Direct Investment now constitutes the largest source of external finance for developing countries.\textsuperscript{24} Nevertheless, the bulk of FDI in 2006, namely more than 60%, went to developed countries.\textsuperscript{25} As figure 2.2 indicates, the countries of Western Europe experienced the highest FDI inflows. Among the emerging and developing regions, Asia appears to be the most attractive FDI location.

\textsuperscript{24} World Bank (2007), p.314.
\textsuperscript{25} Kekic and Sauvant (2007), p.6.