BOOK REVIEW

World Investment Prospects to 2010: Boom or Backlash?

An Economist Intelligence Unit (EIU) report written with the Columbia Program on International Investment

At a broader level, World Investment Prospects to 2010 is a highly informative and valuable report that looks at recent trends in global foreign direct investment (FDI) flows as well as their prospects in the near future. The report contains a lot of information and knowledge not only for academics who examine the causes and consequences of global FDI, but also for practitioners and businessmen who make investments outside their home countries. Furthermore, the information is presented and organized in a reader-friendly way that is easy to access and understand. As such, I strongly recommend the report to all academics and non-academics with even a passing interest in the subject of FDI. In addition to looking at recent trends and near-future prospects, the report also analyzes a number of topical issues, such as the issue of a possible backlash against foreign direct investment, the importance of investment promotion in the poorest countries, and transatlantic foreign direct investment.

The main part of the report, by Laza Kekic, looks at global foreign direct investments’ recent trends and forecasts to 2010. In terms of recent trends, according to Kekic’s estimates, world FDI inflows rose from US$656 billion in 2003 to US$955 billion in 2005 in nominal terms. This represents a recovery of sorts from the 2001–2003 global FDI slump, but global FDI inflows as a percentage of global GDP is still only 2.2% in 2005, less than half of its 2005 level. Furthermore, as Kekic perceptively points out, the 2005 global figures were unduly influenced by two large accounting transactions. In constant dollar terms, the FDI recovery of 2004–2005 is even less impressive, especially in developed countries, where FDI has yet to regain the levels prior to the 2001–2003 slump. Therefore, it is most accurate to view the global FDI rebound of 2004–2005 as a modest recovery instead of a full-fledged recovery.

Delving into the numbers more closely, Kekic points out some interesting and noteworthy patterns, such as emerging markets rather than developed countries accounting for the bulk of the increase in FDI inflows in both 2004 and 2005. All emerging-market regions, with the exception of Latin America and the Caribbean, experienced record levels of FDI inflows in 2005. While cyclical factors such as strong external demand and the commodity price boom are primarily responsible for the surge of FDI inflows into emerging markets in 2004 and
2005, structural factors such as market-friendly reforms and consolidation of macroeconomic stability have also played a part. For example, Turkey, which suffers from a history of chronic macroeconomic instability, has managed to attract all-time high (FDI) inflows of almost US$10 billion due to progress in reforms as well as privatization of the telecommunication and financial sectors. While all emerging-market regions have benefited from higher FDI inflows in 2004–2005, FDI into emerging markets remains highly concentrated in the sense that the top ten recipients account for about 60% of all inflows into emerging markets. Among individual emerging markets, China remains by far the biggest single recipient of inflows, accounting for one-fifth of all inflows into such markets.

Kekic forecasts world FDI inflows to rise from US$955 billion in 2005 to US$1,165 billion in 2006, US$1,223 billion in 2007, US$1,285 billion in 2008, US$1,343 billion in 2009 and US$1,407 billion in 2010. Broadly speaking, this represents neither a serious backlash against FDI nor a booming surge in FDI. Kekic expects global FDI growth in the forecast period to be driven primarily by developed countries, in a sharp reversal from the emerging market-driven growth of 2004–2005. In fact, he expects almost the entire increase in global FDI during 2006–2010 to come from developed countries. In particular, the global pick-up in cross-border M&As (mergers and acquisitions) in 2005 is expected to continue into 2006 and beyond. Global cross-border M&As grew by 56% in 2004, and by a further 35% to an estimated US$827 billion in 2005. M&As are expected to remain the main driver of global FDI flows in 2006–2010, which largely explains why developed countries will account for the lion’s share of global growth in FDI. Cross-border M&As in the developed world made up 74% of the total global cross-border M&As in 2005. Among developed countries, the US is and will remain by far the most attractive destination for FDI, with 23% of global FDI inflows during 2006–2010 expected to flow into the US.

Finally, Kekic also takes a more in-depth look at trends and forecasts for the world’s various regions — North America, Western Europe, Asia and Australia, Latin America and the Caribbean, Eastern Europe, the Middle East and North Africa, and sub-Saharan Africa. For each region, Kekic provides a clear and informative picture of the most significant drivers and trends. Another interesting piece of information in Kekic’s section is the similarities and differences between the previous upturn in global FDI, which took place during 1994–2000, and the current upturn, which began in 2004 and is expected to continue until 2010.

Overall, I found Kekic’s section on recent trends and prospects in the near future to be an excellent and indispensable reference material for both academics and the general public with an interest in the trends and prospects of global and regional FDI flows. In the Annex, Kekic clearly explains the econometric basis for his FDI forecasts for 2006–2010. The large number of useful tables, including those in the Appendix, makes it easy for the reader to absorb and understand the information. The three smaller sections on FDI issues of topical interest also complement and dovetail nicely with Kekic’s main section. However, I would like to make a number of minor suggestions for improvement in the hope of further strengthening future versions of such reports on FDI, notwithstanding the very high standards set by this report.
Specifically, I have three more substantive suggestions for improvement. First, it would have been useful to include tables for global trade and perhaps FDI inflows as a share of global trade. It is well-known that the two most visible elements of globalization — international trade and FDI — are mutually reinforcing. FDI has a substantial positive effect on international trade, and vice versa. In view of such interdependence, I found it somewhat wanting that Kekic’s section did not at least touch upon the nexus between trade flows and FDI flows. In this context, the current lack of progress on WTO negotiations may have implications for FDI flows as well. Second, to the extent data is available, it would have been both interesting and informative to examine at least the broader global trends in portfolio investment flows, and compare and contrast with global FDI flows. While the focus of this report is on FDI and not portfolio investment, it would be interesting to see what kind of effect, if any, FDI has on portfolio investment and vice versa. It is possible that FDI and portfolio investment are driven by the same fundamentals and thus, their trends closely parallel each other. Or, it is possible that they are driven by different fundamentals and bear little relation to each other? Third, it might be illuminating to include a limited number of studies which illustrate noteworthy trends in global FDI. For example, Karl Sauvant, in his section on backlash against FDI, notes that in developed countries, opposition to FDI from emerging markets such as China or India is far stronger than opposition to FDI from fellow developed countries. Two examples are the almost hysterical hostility to Chinese oil giant CNOOC’s attempted acquisition of UNOCAL in the US, and the equally vehement antagonism to Indian-owned Mittal’s purchase of Arcelor. Many in developed countries view emerging-market firms as being backed by their respective governments and thus, having an unfair competitive advantage. In any case, case studies of developed-country opposition to emerging-market FDI will help the reader gain a better understanding of what is driving such opposition.

The report contains three smaller sections in addition to the main section on trends and prospects by Kekic. Karl Sauvant’s perceptive section on the backlash against FDI correctly points out that governments’ attitudes toward FDI inflows are based not only on economic factors, but political and social factors as well. Sauvant also warns that we cannot take the current environment of FDI openness for granted and developed countries may end up leading a global backlash against FDI. Such a backlash would be motivated by the growing emphasis on the host country’s development and welfare. Jeffrey Sachs, in his section on the importance of investment promotion in the poorest countries, points out that Malaysia’s experience of FDI unambiguously shows that being an attractive FDI destination depends not only on a favorable business environment, but specific promotional tools as well. Finally, Dan O’Brien emphasizes the role of transatlantic FDI as the backbone of the global economy. O’Brien forecasts transatlantic FDI to grow strongly during 2006–2010, especially from Europe to the US, due to a number of underlying macroeconomic and microeconomic factors.

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