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Foreign Direct Investment in Times of Crisis

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Abstract

This paper compares the current foreign direct investment (FDI) recession with FDI responses to past economic crises. The authors find that although developed country outflows have taken an equally big hit as major developed countries have after past crises, outflows seem to be bouncing back more slowly this time. By contrast with the overall decline in recent years, inflows to emerging markets often remained stable during their past economic crises. Both patterns indicate that the global scale of the current crisis has led to a greater FDI response than after individual country crises in the past. Compared with global economic downturns since the 1970s, the current FDI recession has also been greater in magnitude. The exception is the FDI plunge in the early 2000s, despite the much smaller economic crisis at the time. The authors conclude by recommending that policymakers not just further liberalize FDI regimes—as they find was the typical pattern during earlier crises—but rather use the downturn to rethink their FDI policies with an enhanced focus on "sustainable FDI" promotion.

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INTRODUCTION

During 2007, global foreign direct investment (FDI) flows reached a historical high of around $2 trillion—more than 16 percent of the world's gross fixed capital formation (GFCF) at the time (figure 1).[1] This marked the peak of a four-year upward trend in FDI flows. Along with the subsequent worldwide collapse in real estate values, stock markets, consumer confidence, production, access to credit, and world trade, global FDI flows also began to fall—by 16 percent in 2008—and when worldwide output contracted in 2009 for the first time in 60 years, FDI declined a further 40 percent. During 2010 FDI levels stagnated just above US$1 trillion.

The dive in FDI flows can be attributed to three main factors (UNCTAD 2009a). Firstly, the global financial crisis has led to liquidity constraints for transnational corporations (TNCs) worldwide, as access to credit has tightened and corporate balance sheets have deteriorated. So even if they wanted to, the capacity of firms to invest has weakened considerably. Secondly, the traditional strong link between economic growth and FDI flows means that the world slowdown—particularly in the developed world—has further decreased the appetite of TNCs for new investment abroad. Finally, the crisis has probably fostered a more cautious attitude among managers, resulting in a move away from high-risk projects (such as major infrastructure) to safer assets (in the extreme, government bonds).

Disentangling more detailed implications of the crisis for TNCs is difficult, depending *inter alia* on the types and extent of production and financial linkages between parent firms and foreign affiliates, sector and industry characteristics, host and home state economic performance, modes of entry, and so forth.[2] Rather than trying to sort out the many complex, and at times endogenous, channels through which the crisis has impacted FDI patterns in detail, the aim of this article is simpler. Taking a bird's eye view, we ask just how bad the "FDI recession" has been in the wake of the crisis compared to previous crisis episodes. Has it been unique either in terms of its severity or political response? By comparing the current FDI recession with FDI patterns during and after crises in the past may in turn provide insights to how long the FDI slump can be expected to last. We conclude by recommending policymakers to go beyond simply further FDI liberalization—as was the pattern during earlier crises—but rather use the downturn to rethink their FDI policies with an enhanced focus on "sustainable FDI" promotion.

THE FDI RECESSION IN BRIEF

All main FDI components have been negatively affected since 2007 (figure 2). Even after sales and profits of foreign affiliates began to bounce back in late 2009, parent companies continued to repatriate large shares of their profits rather than invest in host states (UNCTAD 2011). Intracompany loans have

1. FDI figures are from the United Nations Conference on Trade and Development (UNCTAD) throughout.

2. For recent micro-level evidence, see Alfaro and Chen (2010).

dwindled as well, as TNCs have restructured their operations—for instance, by relocating activities to countries that have weathered the crisis—and compelled their foreign affiliates to assist parental balance sheets at home. As a result, host countries have not only tried to attract new FDI during the crisis, they have struggled to retain what they already have. As we shall see later, this pattern is very similar to past crises, where the fall in more liquid FDI components was the main driver when FDI levels declined. What is perhaps more worrying is therefore the proportionate decrease in equity investment. This is notable, as equity investments reflect the long-term strategic commitment by multinationals to their host countries and are typically not determined by short-term factors such as liquidity demands or tax considerations, unlike reinvested earnings and intracompany loans (Desai, Foley, and Hines 2003; Ramb and Weichenrieder 2005). The stagnant level of equity investments may therefore signal that a recovery of FDI flows could take longer after this crisis, a possibility we will return to later.

Given that the crisis started in Western countries and economic growth is by far the most important determinant of FDI, it comes as no surprise that FDI flows to and from developed countries have declined the most so far (figure 3). The downturn has had a particularly strong impact on Western banks and financial institutions, which as a result had to cancel, postpone, or downscale cross-border mergers and acquisitions (M&As)—the most important mode of entry for FDI. The global drop in FDI has therefore primarily been due to the dive in cross-border M&A deals of developed-country companies since 2007, which has led to a 67 percent decline in cross-border M&As worldwide (despite a slight M&A rebound in 2010).

For emerging economies, FDI remained an important stabilizer in the early stages of the crisis. While their net inflows of portfolio investments and bank lending were negative in 2008 (IMF 2009), their FDI inflows actually increased, albeit at a slower pace than previous years, and outflows grew as well. But as the credit crunch and recession spread to emerging markets in the second half of 2008, both their outflows and inflows of FDI started to decline, and 2009 was therefore the year when the FDI recession became truly global in character. Apart from the drop in M&As, this was also reflected in greenfield investments—a more important source of FDI in emerging markets than developed economies—which dropped 15 percent in emerging economies from 2008 to 2009. In 2010, however, FDI inflows began to recover slightly driven by strong performance in much of Latin America and Asia.

Uncertain FDI Outlook for the Coming Years

So what does the future hold? On the one hand, there are undoubtedly economic and political factors at work to counterbalance the current slump in global FDI. First of all, a number of major emerging economies have weathered the crisis better than developed countries and developing and transition economies now account for more than half of global FDI inflows—the highest share ever recorded. This geographic shift in the distribution of global FDI flows is likely to continue, as positive growth prospects

in countries like India and China provide strong incentives for TNCs with the necessary funds to invest, particularly through market-seeking and efficiency-seeking FDI. And with respect to outflows, developing and transition economies accounted for more than 25 percent of global outflows in 2009—also the highest share on record—compared to less than 10 percent just 10 years earlier. This development is likely to continue as well, as many "Southern" TNCs are increasingly investing abroad, and particularly so in other emerging markets (Sauvant, Maschek, and McAllister 2010).

Secondly, the policy response to the crisis has been rather favorable to TNCs overall. With respect to the international investment regime, some countries are slowly moving toward a rebalancing of rights and obligations between investors and their host countries. Yet, this shift in favor of host countries is not directly related to the crisis, but rather a response to the rising number and impact of investor-state arbitrations over the last decade (Waibel et al. 2010). And it should not be taken as an indication that the international investment regime is unraveling, as investment promotion and protection treaties are still signed in large numbers, either as stand-alone agreements or as parts of preferential trade agreements. Finally, it is worth recalling that although the rush to sign investment treaties has indeed slowed compared to a decade ago—and a few countries have even begun canceling theirs—this is unlikely to have a significant impact on global investment flows (see e.g., Yackee 2010 and Poulsen 2010).

For rather than investment rules on the international level, *national* FDI regimes are the main policy drivers of FDI flows. And where data are available, there are no signs that the crisis has led to a protectionist backlash at this level either. While expropriation of foreign assets in the natural resources sector was beginning to become fashionable before the crisis in parts of Latin America, for instance, falling commodity prices in the initial stages of the crisis made expropriation less attractive for policymakers (Lloyd's 2009). With respect to less extreme forms of FDI restrictions, recent years have seen an increase in limitations on cross-border M&A activity, particularly when target firms were considered strategic industries or when investment was facilitated through sovereign or quasi-sovereign entities (Sauvant 2009). But these trends began before the onset of the crisis, and there are no signs that they have been augmented in recent years (OECD and UNCTAD 2010). And although some national bailout packages are likely to have particularly adverse effects on FDI—either directly (i.e., by being closed to participation by foreign-owned firms), or indirectly (i.e., by allowing government officials greater discretion to favor national firms)—most investment initiatives taken during the crisis have been aimed at facilitating, rather than restricting, FDI (UNCTAD 2009a). So while opinions vary whether beggar-thy-neighbor policies are on the rise in the trade regime,[3] the general trend is clearly toward greater openness for TNCs in most corners of the world.

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3. Compare, for instance, several contributions by the Global Trade Alert (e.g., *Broken Promises: a G-20 Summit Report by Global Trade Alert*, 2009) with D. Rodrik's The Myth of Rising Protectionism, *Business Standard,* October 13, 2009. Also

That said; there are also reasons to be pessimistic about the prospects for FDI over the coming years. While the world economy has begun to expand once again, growth remains sluggish in many corners of the world, when considering the magnitude of (potential) output lost in recent years (figure 4). And although China is moving toward private sector–led growth once again, austerity reforms are likely to slow the recovery in key Western markets. Combined with tight credit (despite low policy interest rates), this will dampen the ability of firms to expand activities at home and abroad even further. Finally, risks of currency wars loom large as global imbalances persist, and remaining sovereign and bank vulnerabilities heighten concerns about the stability of the global financial system. With this in mind, organizations such as UNCTAD are perhaps be overly optimistic, when expecting FDI to return to 2008 levels as soon as next year (2010b).

Given these uncertainties, it may be informative to look at FDI patterns during past crises for hints about the prospects for recovery in TNCs' investment activity. Not because past events are necessarily a good indicator for present conditions, but rather to see if the current FDI recession is unique in terms of its scale or policy reactions.

FDI DURING PAST CRISES

Individual Country Crises

We begin by looking at FDI patterns during individual country crises. As a benchmark for the 2007 subprime crisis in the United States, Reinhart and Rogoff (2008) assembled historical data on 18 bank-centered financial crises in developed countries. Unlike the current downturn, however, several of these were relatively minor affairs and we therefore focus on the so-called "big five" systemic financial crises, which all led to major drops in economic performance for several years: Spain (1977), Norway (1987), Finland (1991), Sweden (1991), and Japan (1992).

Figure 5 plots the median country real GDP growth and FDI trajectories from one year before the crises to three years after. Median, rather than mean, values are used so that results are not driven by outliers. As the crises were in developed countries, the impact on outflows may be particularly illuminating for the current FDI downturn: when median real GDP growth turned negative one year into the crises—as global GDP did in 2009—outflows had fallen as much as developed country outflows fell during the current downturn, almost 60 percent. But while that marked the end of the downward trend in outflows after individual country crises, 2010 figures available at the time of writing indicate that developed country outflows were still contracting two years into the current downturn (UNCTAD

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see G. Hufbauer, J. Kirkegaard, and W.F. Wong, *G-20 Protection in the Wake of the Great Recession*, Peterson Institute for International Economics, September 2010.

2010a). So, while outflows almost converged on precrisis levels three years after the onset of individual country crises, recovery might well take longer this time.

Moving on to emerging markets, figure 6 again plots median country real GDP growth and FDI trajectories around seven famous emerging-market crises for which we have data. By contrast with developed country crises, it indicates that outgoing FDI from emerging markets has been more resilient during the current downturn compared to emerging-market crises in the 1990s and early 2000s. Partly due to the increasing internationalizing of "Southern" TNCs today and the decoupling of key emerging markets in the early stages of the current crisis, the relative drop after individual country crises was much larger than the approximately 20 percent decline in outgoing investments from emerging economies observed since 2007.

Despite their growing role as sources of FDI, however, emerging markets are still primarily capital importers. So for our purposes inflow patterns are the main interest in the aftermath of emerging-market crises. And just as today, several emerging economies did experience falling inward FDI levels during and after their economic crises. After the 2001 crisis struck Argentina, for instance, inward FDI collapsed to levels similar to those of the early 1990s. Nevertheless, as in the case of developed country crises, inflows to emerging markets were stable overall, or indeed rising, during and after their crises (figure 6).[4] Stability was often backed up by FDI liberalizing policies. Following its crisis in the mid-1990s, for instance, Mexico liberalized important sectors of its economy over and beyond its NAFTA commitments (see e.g., Haber 2005). The East Asian crisis likewise sparked liberal FDI reforms in a number of countries resulting in considerable policy convergence across the region with respect to FDI regulation (Athukorala 2003 and UNCTAD 2000, pp. 148 and 150). So rather than fostering FDI protectionism, past crises generally led to increased liberalization—as appears to be the case today.

Yet the resilience of FDI inflows to emerging economies after their crises is in marked contrast to the grim FDI developments in 2009, where M&A deals and greenfield investments declined in most emerging markets—despite the equally open investment policy environment. And, although slowly beginning to rise again in 2010, inflows to emerging markets remained more than 20 percent below their 2008 level.

One indicator of the greater effect of this crisis on inflows to emerging markets compared to past crises is that earnings and intracompany debt exhibited much more procyclical patterns than equity investments during past crises in emerging markets (World Bank 2009, pp. 51–54). In order to limit the impact of economic turmoil in host countries without having to sell off assets, TNCs often reduced intra-company loans to a much greater extent than equity holdings (figure 7). As an example, American TNCs

4. This has been observed before. See Lipsey (2001), Sarno and Taylor (1999), Ramstetter, (2000), Athukorala, (2003), and UNCTAD (1998).

in countries affected by the Asian crisis repatriated *all* their income from the region to parent companies (World Bank 2009, p. 52).[5] Thus, while TNCs—like portfolio investors—typically pulled out funds from emerging markets in economic turmoil, they didn't give up on their long-term strategic commitment there. This is somewhat in contrast to the current downturn, where equity investments have declined substantially in both absolute and relative terms.

Fire Sale FDI

One reason FDI flows have not constituted the same stable source of finance for emerging markets during this crisis, as they did during crises in the past, may be that liquidity constraints make so-called "fire sale" FDI less widespread today than in past crises (Calderon and Didier 2009). Fire sale FDI occurs when plunging domestic prices, combined with greater access to finance by foreign firms, leads to bargain sales of domestic assets to foreign buyers, typically through cross-border M&As.

The phenomenon has mostly been discussed in the context of the East Asian crisis, where the low price for acquired domestic firms has been offered as an explanation for the sharp rise in cross-border M&As, while domestic M&As declined (Aguiar and Gopinath 2005). Survey evidence suggests that 60 percent of large M&A deals in South Korea, for instance, were perceived by the seller and/or buyer to have been acquired at bargain prices below their "real" value (Zhan and Ozawa 2001, p. 67). More generally, firm-level liquidity appears to have played a key role in the spurt in foreign acquisitions of East Asian assets at the time. Also, acquisitions tended to be control seeking to a greater extent during the crisis than in normal years, and they were quickly sold back to domestic buyers after the crisis (Acharya, Shin, and Yorulmazer 2007, 2009).

But does this mean that fire sales were a defining characteristic of the Asian crisis and perhaps of economic crises in general? Not necessarily. Cross-border M&A levels in the crisis-hit countries were actually quite limited compared to other regions (Zhan and Ozawa 2001, p. 71). This goes both for the ratio of M&A sales to FDI flows (figure 8) and the total value of M&A deals. Both Argentina and Brazil, for instance, had higher values of foreign M&As than Indonesia, South Korea, Malaysia, the Philippines, and Thailand combined.

Also, proactive governments often assisted troubled local firms to avoid foreign takeover at bargain prices (Zhan and Ozawa, 2001, pp. 69-72). Governments in Malaysia, South Korea, Indonesia, and Thailand thus actively intervened, and at times blocked negotiations over the sale of local assets to foreign investors. As a result, much of the fire sale that actually *did* take place in East Asia was targeted at securi-

5. Similarly, while there was a net inflow of US FDI to Mexico in 1995, the current assets of US affiliates there dipped while equity components remained stable, suggesting pullout of liquid funds (Graham and Wada 2000, pp. 794–796).

tizing nonperforming loans (as opposed to real business units), which can hardly be regarded as a contentious "loss" of valuable national assets.

Accordingly, it is questionable whether fire sales of domestic companies and assets were particularly widespread even in the East Asian crisis. So while some international investors undoubtedly took advantage of bargain prices spurred by past crises and investors with easy access to funds (such as some sovereign wealth funds) do the same today, it remains an open question whether fire sale FDI is a general characteristic of economic crises. Hence, it seems doubtful that low levels of FDI flows during the current downturn can be explained solely, or even mainly, in terms of lower levels of fire sale FDI.

The more obvious—though related—explanation for the greater impact of the current crisis on FDI flows is the global scale of the downturn, which has inflicted financial injury on TNCs around the world, forcing them to downscale FDI activities. Accordingly it may be informative to review crises that were not specific to individual countries, but rather global in character.

Global Crises

We follow Freund (2009) in identifying 1975, 1982, 1991, and 2001 as prolonged global downturns. In these episodes, world real GDP growth: (1) fell below 2 percent; (2) dropped more than 1.5 percentage points from previous five-year averages; and (3) was at a minimum level compared to two years before and after. Figure 9 plots global real FDI inflows against GDP growth around the four crises.

During the oil shocks and the downturn in the early 1990s, it took an average of three years for FDI flows to bounce back after their first dip. These swift recoveries took place in the context of policies largely favorable toward FDI. Despite trade policies taking a protectionist flavor during the 1970s and 1980s, both European and American policies towards FDI remained largely liberal. Starting with the United States, the approach toward inward FDI of both the Carter and Reagan administrations was principally based on a doctrine of neutrality (Graham and Krugman 1995),[6] and both administrations strongly supported US investment overseas, rhetorically and by launching the US Bilateral Investment Treaty (BIT) program. Similar developments took place in Europe, where the Single European Act of the mid-1980s liberalized large parts of the European continent to foreign investment (OECD 1992), and more and more European countries began treaty programs to protect and promote their investors abroad. Furthermore, the debt crisis and global downturn in the 1980s similarly led the majority of Latin American countries to remove legislative and administrative barriers, which previously closed large swaths

6. Though the Committee on Foreign Investment in the United States (CFIUS) was created to keep track of investors coming to the United States, partly due to the rise of Japanese multinationals, it rejected very few M&A deals in practice and certainly did not imply that the United States was closing its doors to inward FDI.

of the continent to foreign firms (Williamson 1990). Likewise in the early 1990s most countries further liberalized their FDI regimes despite the downturn (UNCTAD 2010b).

But despite policy responses largely comparable to today, the FDI recessions were of course far from similar to the current one. Just as the three global crises were minuscule compared to the one today, so were the initial FDI drops when compared to the collapse since 2007. The worst drop of the three was the 35 percent decline from 1981 to 1983, yet it still didn't come anywhere near the decline from 2007 to 2009–10. The more interesting comparison is therefore the FDI recession of the early 2000s. Here the halt in developed country M&A deals led real inward FDI to fall more than 40 percent in 2001. The decline continued with 25 percent in 2002 and a further 12 percent the year after, which made the FDI collapse even greater than the one the world is facing now. Global FDI had still not recovered to its 2000 level by 2006,[7] which raises the question whether we should expect the current FDI recession to be as prolonged—or even longer—as after 2001.

A Return to the Early 2000s?

Despite the greater FDI collapse in the early 2000s, the answer could very well be in the affirmative. This is for several reasons. First of all, equity investments have been affected to a greater extent during the current crisis than in the early 2000s (UNCTAD 2009b). As mentioned above, equity investments are typically made for the long term and their proportionate decline this time around may suggest that if anything, recovery will be longer, not shorter, than after the 2001 FDI recession.

Second, trade flows have dropped much more during this downturn than in recent global crises (Baldwin 2010). Just as the current crisis is the largest since the Second World War, so has been the trade collapse and world trade may take a while to return to trend levels for badly hit regions—notably the United States and the European Union (IMF 2010). Since TNC parents and their foreign affiliates typically account for one-half of global trade, slow recovery from the trade collapse will undoubtedly take its toll on FDI flows.

Third, if the policy response to the downturn in the early 2000s was exceptionally protectionist, the (overall) liberal FDI policies pursued today may lead to a more rapid FDI recovery. But as with earlier global crises as well as individual country crises, the 2001 FDI slump did not lead to FDI protectionism. While security concerns prompted several countries to tighten their FDI regulations in the years

7. It should be noted that global FDI would have been higher in 2005 had it not been for the Homeland Investment Act, which created a one-year tax incentive for repatriation and led to a massive withdrawal of retained earnings from US foreign affiliates that year. From around $80 billion in 2004, repatriations rose to almost $300 billion in 2005, and then dropped again to approximately $100 billion in 2006. As a result, reinvested earnings of American affiliates abroad dropped from around $160 billion in 2004 to a negative $10 billion in 2005, and then bounced back to almost $220 billion in 2006 (Bureau of Economic Analysis, table 7a).

after 9/11, this did not reverse the overall trend of prior decades, where investment liberalization and promotion "replaced red tape with red carpet treatment of foreign investors" (Sauvant 2009, p. 222). In other words, governments tended to either liberalize, or maintain already liberal FDI policies during the crisis—just as they seem to be doing today.

Fourth, an alternative argument against a recovery path as long as the early 2000s could be that TNCs from emerging economies are now in a position to take the lead. In recent decades, emerging economies appear to have performed better after advanced economies' downturns (IMF 2010, box 1.1). Countries like China and India that are rapidly increasing in importance as both hosts and sources of investment could thus soften the current FDI recession. But, although growing in importance, one should not exaggerate the role of emerging-market outflows: For now they constitute only around one-fourth of world FDI outflows. So although favorable investment prospects in key emerging markets combined with increased South-South flows does imply that emerging-market FDI could bounce back faster than that of developed countries[8]—as they in fact did in the early 2000s—Southern TNCs can surely not be relied upon to pull global FDI out of its current slump. Full recovery from the FDI recession will only come when New York, London, and Frankfurt can again become M&A powerhouses. And given the injury the crisis has inflicted on Western banks and corporate giants, this will take time.

Fifth, while world stock markets also plummeted in the early 2000s, global real GDP growth never went below a positive level of 2 percent. This contrasts with the current downturn, in which the global economy experienced negative growth during 2009. This in particular makes it unlikely for global FDI flows to recover more quickly after the current downturn than they did after the 2001 plunge. With this in mind, there are no persuasive reasons to expect precrisis levels again (around $2 trillion) before at least 2014.

CONCLUSIONS

When gazing into the "crystal ball" to forecast when, and how, the world will recover from the FDI recession, it is worth recalling that just as economists' predictions of financial resilience before the crisis turned out to be false, any predictions of recovery could similarly be wide of the mark. This includes our own. But even if the worst of the current downturn has faded in the rear-view mirror and world FDI bounces back quicker than we expect, do our observations provide any implications for investment policymakers?

We think so. First of all, it is important to keep in mind that the scope and duration of the FDI recession primarily depends on how governments address the underlying macroeconomic risks of the

8. This expectation accords with the results of a June 2010 survey conducted by the Economist Intelligence Unit on behalf of the Multilateral Investment Guarantee Agency (MIGA). According to those soundings, around 40 percent of the almost 200 surveyed executives expect to increase their investments to developing countries over the next year (MIGA 2010)

global economy in the coming years—including continued threats to financial stability. Here FDI policies play only a minor role. And even if restraints on protectionist urges can go some way to facilitate investments from abroad—and in some cases enhance the benefits of existing FDI (Moran 2005)—in most countries this will do little to eradicate the damage resulting from the crisis. Investment policymakers should therefore avoid myopia: in the vast majority of countries, the recovery path from the crisis will not be paved by ever greater incentives for TNCs, more favorable investment contracts, or a rush to enter into investment treaties.

Rather than desperately scrambling to increase the volume of FDI flows, officials might instead use the downturn as an opportunity to take a step back and update their thinking. In recent decades—including during times of crises—host country FDI policies have largely focused on increasing the volume of inward investment. In some cases, this is indeed still necessary. But surely not all FDI promotes development, so larger quantities of foreign investments cannot be the indicator of a successful FDI policy as such. To increase the positive impact of FDI for economic development, and avoid the damages, officials should instead consider a "sustainable FDI" strategy, which enhances not only the quantity of investments, but also the "quality" (Vale Columbia Center and WAIPA 2010).

Naturally, administrative and political constraints will prevent wholesale reforms of FDI regimes—particularly as the crisis demands a focus on other pressing policy areas for most governments. So a more prudent and realistic approach will instead be to target the most binding constraints for sustainable FDI promotion.[9] These are bound to be country and sector specific. If more fair contract and treaty negotiations can provide the greatest benefits for a country, scarce resources would be best spent investing in more in-house legal expertise. If it is greater links between foreign investors and domestic firms, providing technical and other support to potential domestic suppliers could prove instrumental (see UNCTAD 2001). In some cases environmental damages will be the greatest obstacle for sustainable FDI promotion, and yet in others foreign investors taking advantage of nontransparent and corrupt state institutions is what must be addressed. And so forth.

Suffice it to say, this is easier said than done. It requires considerable expertise and institutional capacity at national and subnational levels, features that are often absent in emerging markets in particular. And if not carefully implemented, reforms could conflict with investment treaty obligations, and thereby expose governments to expensive investor-state arbitrations. Multilateral organizations, aid donors, and nongovernmental agencies will therefore clearly have important roles to play. Academics can contribute too. Rather than providing long laundry lists of institutional and governance reforms, they could instead focus on operational methodologies to identify where investment policymakers realistically

9. See generally the ideas on a diagnostic approach to development policies by Hausmann, Rodrik, and Velasco (2007).

can get the '*biggest bang for the reform buck*' (Hausmann, Rodrik, and Velasco 2007). Finally, TNCs can often benefit as well from promoting more sustainable and transparent FDI regimes.

Ultimately, however, policy reforms have to start at home. Governments therefore ought to consider whether the crisis should simply prompt more liberalization in an attempt to attract TNCs—as was the pattern during earlier crises—or rather mark the beginning of sustainable FDI regimes at the national and international levels. In most cases, the balance between the two will do little to prolong or shorten the FDI recession over the next few years, but it will surely have important economic and social welfare implications over the longer term.

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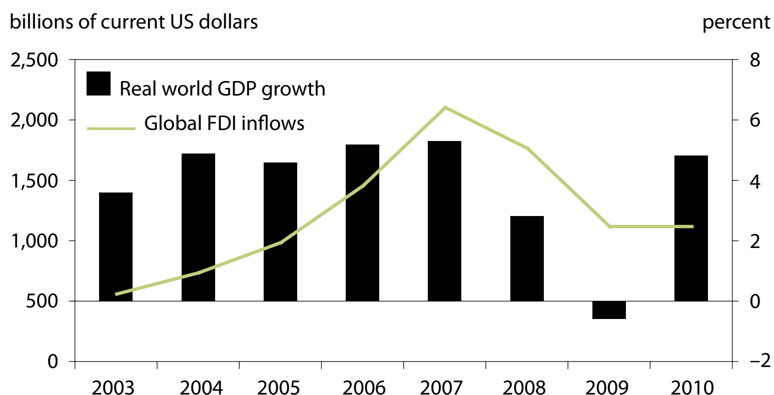
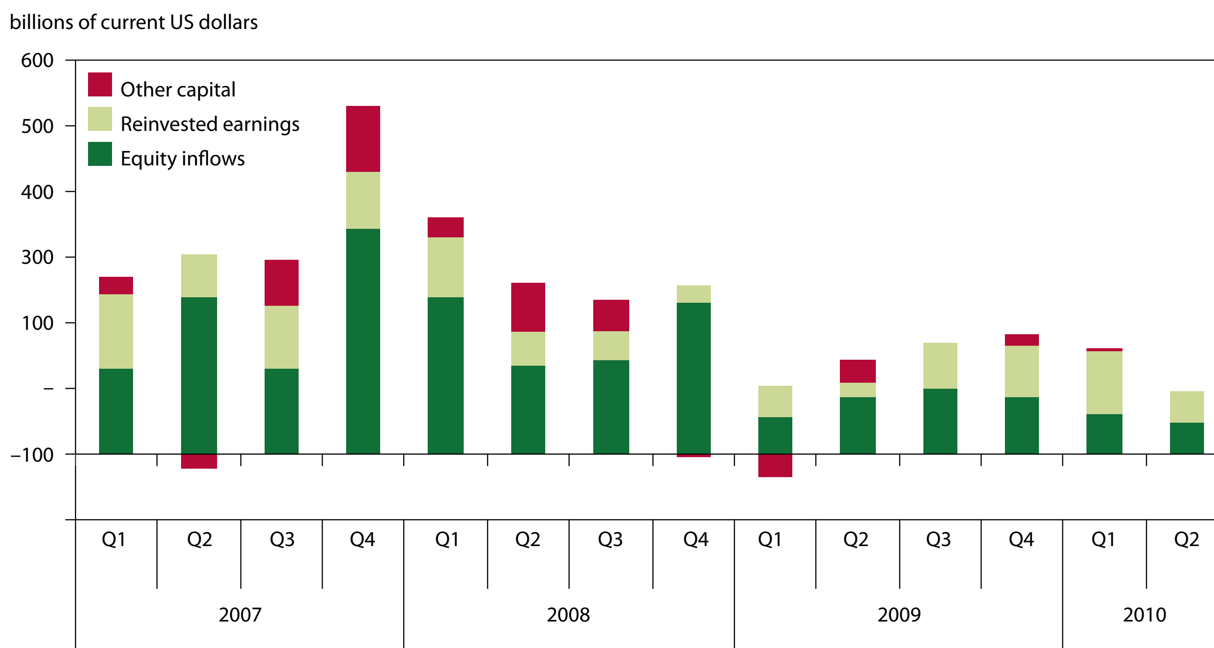
Figure 1 The foreign direct investment (FDI) recession, 2003–10



Sources: United Nations Conference on Trade and Development; International Monetary Fund.

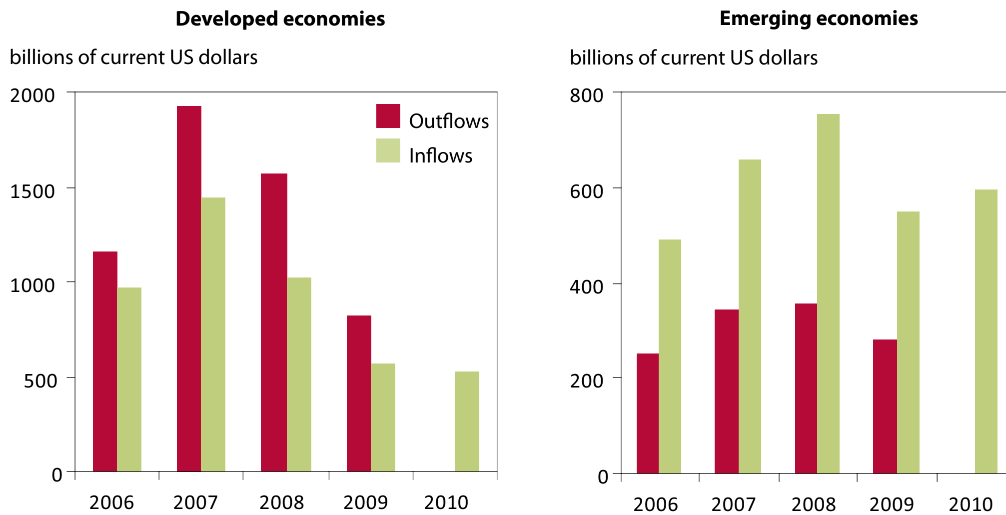
Figure 2 Quarterly FDI components for 36 selected countries, 2007 Q1–2010 Q2



Note: Data are for Agentina, Australia, Belgium, Bulgaria, Chile, Denmark, Estonia, France, Germany, Hong Kong, Hungary, India, Ireland, Israel, Japan, Kazakhstan, Latvia, Lithuania, Mexico, Moldova, Netherlands, New Zealand, Norway, Panama, Philippines, Poland, Portugal, Russia, Slovakia, Sweden, Switzerland, Taiwan, Uganda, United Kingdom, United States, and Venezuela.

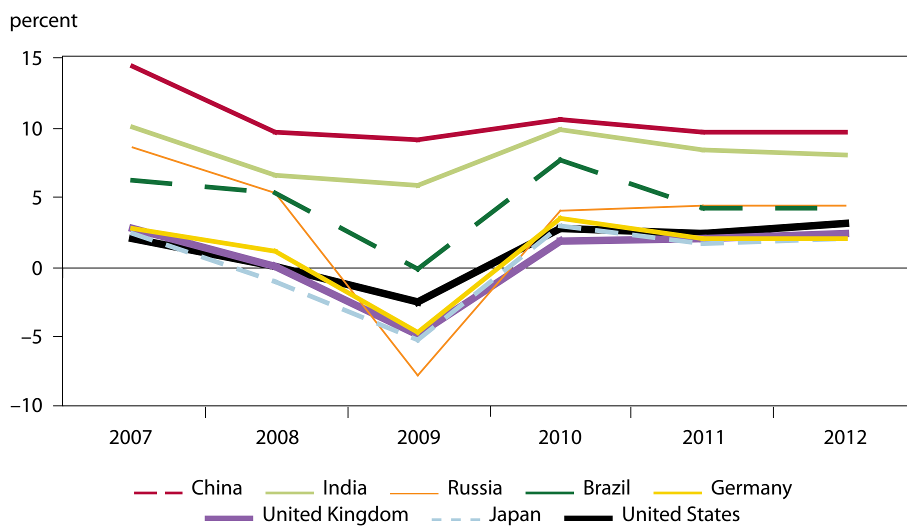
Source: United Nations Conference on Trade and Development.

Figure 3 FDI flows, 2006–10



Source: United Nations Conference on Trade and Development.

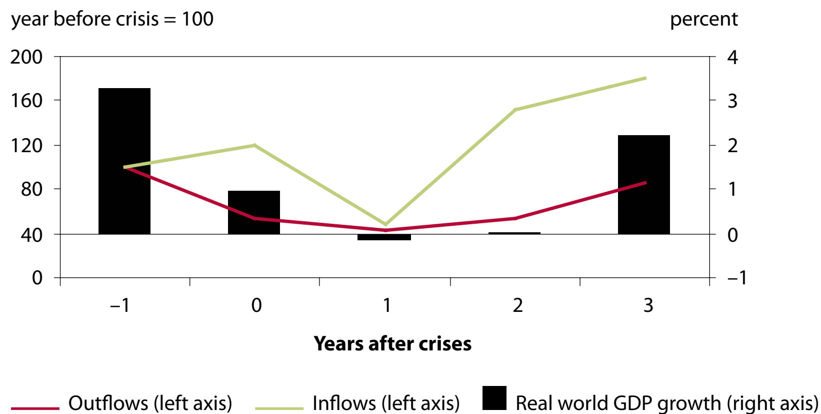
Figure 4 Real GDP growth, selected countries, 2007–12



Notes: 2010 figures and onwards are estimates.

Source: IMF, *World Economic Outlook*, October 2010.

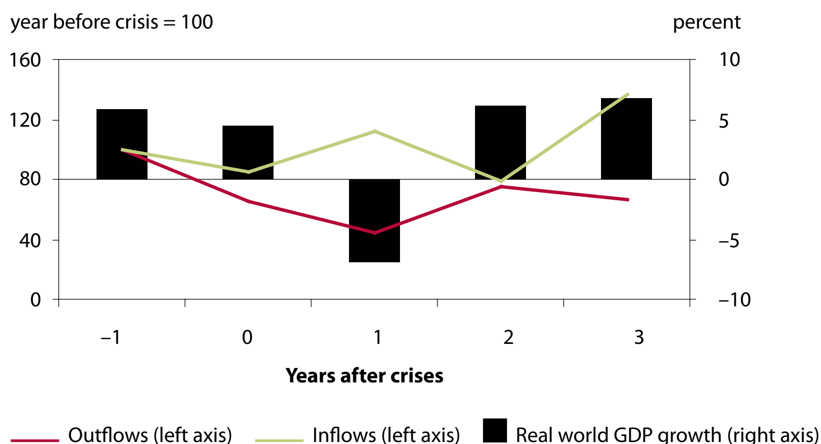
Figure 5 Median GDP growth and FDI trajectories after the "big five"



Notes: The "big five" refers to the bank-centered financial crises in Spain (1977), Norway (1987), Finland (1991), Sweden (1991), and Japan (1992). All FDI figures were initially converted into constant prices using the US GDP deflator.

Source: Authors' calculations based on UNCTAD.

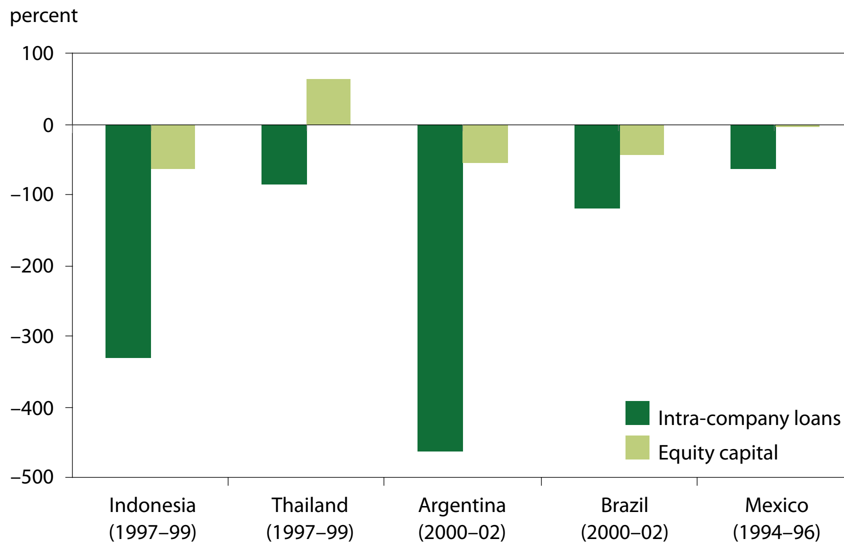
Figure 6 Median GDP growth and FDI trajectories after 7 emerging-market crises



Notes: The crises are Argentina (2001), Korea (1997), Mexico (1994), Malaysia (1997), Philippines (1997), Russia (1998), and Thailand (1997). Mexico has been excluded from OFDI figure due to extreme index values caused by small FDI levels. All figures were initially converted into constant prices using the US GDP deflator.

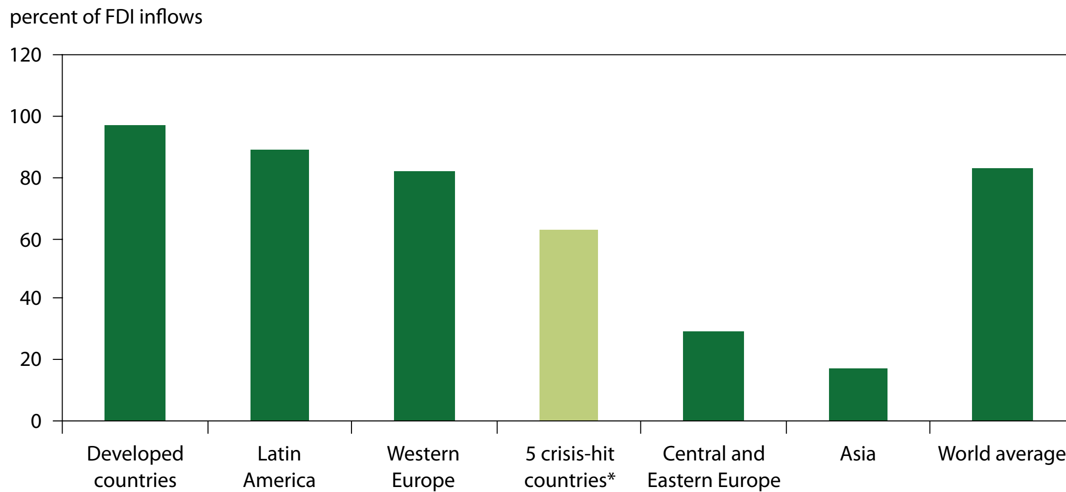
Source: Authors' calculations based on UNCTAD.

Figure 7 Intracompany loans versus equity components of FDI during financial crises



Source: World Bank (2009, 53).

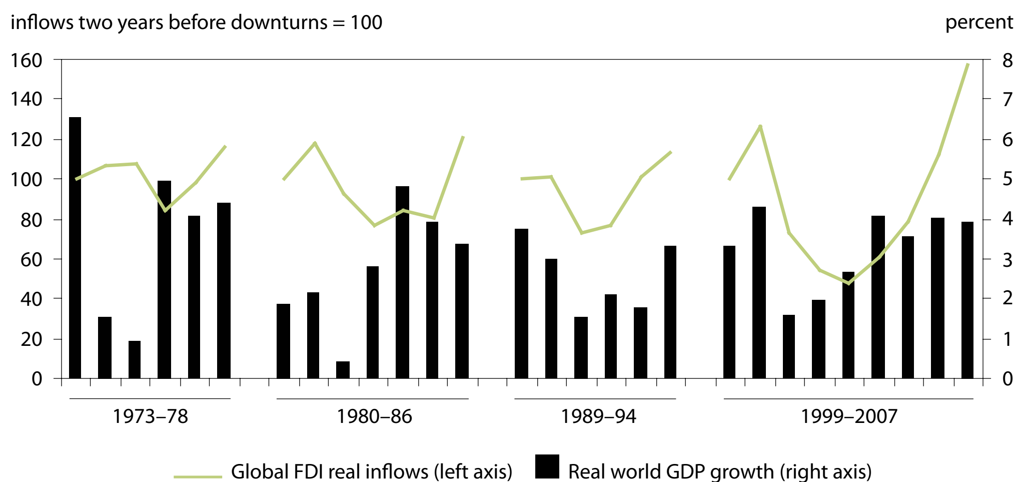
Figure 8 Cross-border mergers and acquisitions, 1997–98



* Indonesia, Korea, Malaysia, the Philippines, and Thailand.

Source: Zhan and Ozawa (2001, 71).

Figure 9 FDI responses to four global downturns



Note: FDI figures were initially converted into constant prices using the US GDP deflator.

Source: Authors' calculations based on UNCTAD.