FACTORS EXPLAINING THE RECENT SHIFT IN THE DIRECTION OF FOREIGN DIRECT INVESTMENT

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ABSTRACT

According to traditional foreign direct investment theory, developed countries have a comparative advantage over developing countries in attracting FDI inflows. It is argued that Industrialized nations offer more that international investors look for in investment venues, including the size and stability of product markets as well as the quality of labor markets and the effectiveness of government policy, including in the areas of property rights protection and foreign trade openness. In recent years, however, these factors have apparently diminished in importance, causing a shift in the direction of FDI inflows because of rising geopolitical tensions and conflicts, supply chain disruptions, and geoeconomic fragmentation.

Keywords: *Foreign direct investment (FDI), Dunning's eclectic theory, geoeconomic fragmentation*

1. INTRODUCTION

The purpose of this article is to explain why the traditional pattern of FDI flows has changed in recent years. It begins with a historical examination of an earlier period during which time evidence seemed to support the traditional view of FDI theory. The second part of the article examines the reasons for the empirical departure from this pattern.

2. THE TRANSITION

Table1 supports the traditional view that developed countries are more attractive venues for FDI inflows than in the case for developing countries, particularly in lessor developed areas. In the decades including the 1970s, 1980s, and 1990s, total inward FDI expanded sharply from $13,346 million to $1,413,167 million. In 1970, developed countries attracted 71 percent of FDI inflows, a relative share which grew to 81 percent of the total by year 2000.During this period, the share to developing countries declined from 29 percent to approximately 20 percent.

This decline is even more significant if you consider the fact that these UNCSTAT figures lump into the "developing economies" category both the more attractive nations on the threshold of economic development and the capital poor lessor developed countries.

However, there is statistical evidence that a significant transition in the direction of FDI flows has occurred more recently (Table 2). Inflows to developed (more industrialized) countries have remained significant, but there has been a shift in relative shares from 2017 to 2022 with decreased inflows to developed countries and increases in the shares to developing countries, broadly defined. Specifically, capital inflows to the more industrialized nations fell from 57.3 percent in 2017 to 29.2 percent in 2022 and the share to developing countries rose during this time span from 42.7 percent to 70.8 percent (Staff of UNCSTAT, 2023).

3. THE DUNNING ECLECTIC THEORY OF FDI

First, the historical reasons for the preference that multinational enterprises have for investment venues in the industrialized world before the transition can be best understood by application of the Dunning eclectic