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## Editorial: Foreign direct investment in the light of the recent crisis

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Aristidis P. Bitzenis\* and Vasileios A. Vlachos

Department of International and European Studies,  
University of Macedonia,  
156 Egnatia Street, Thessaloniki 54006, Greece  
Email: bitzenis@yahoo.com  
Email: papers@icib.eu  
Email: vlachosuk@hotmail.com  
\*Corresponding author

**Biographical notes:** Aristidis P. Bitzenis is an Associate Professor at the Department of International and European Studies, University of Macedonia, Thessaloniki, Greece. His main research field includes FDI, entrepreneurship, privatisation, globalisation, the European business environment and corporate restructuring in South-East Europe. He has published extensively and participated in various conferences in his research field. His research record and forthcoming publications include seven books (four of which are in the Greek language), 16 book chapters, 15 entries in encyclopaedias, 36 journal articles, nine papers in conference proceedings and 15 research grants. His latest book is an edited volume titled *Mergers and Acquisitions as the Pillar of Foreign Direct Investment*, published by Palgrave Macmillan in August 2012. He supervises graduate and PhD students on issues with regard to international business, entrepreneurship, transition economies, the European Union or foreign direct investments.

Vasileios A. Vlachos is a Research Officer of Thales European Programme titled 'The Shadow Economy (Informal Sector) in Greece: Size, Causes and Consequences'. His research interests focus on direct investment, employment and activities in the shadow economy. He has published eight books and edited volumes, 18 papers in peer-reviewed journals, 13 chapters in edited volumes and has participated in several international conferences and workshops. He is currently a member of the organising and the scientific committees of the International Conference on International Business and has been associated with the coordination of international conferences and workshops in the past.

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### 1 Inward and outward FDI before and after the crisis

The recent global 'crisis' emerged as a subprime mortgage and an energy (oil shock of 2007 to 2008) crisis that was triggered in 2007 and gradually developed into a financial, sovereign debt and eventually, an economic crisis without precedent in post-war economic history. This financial crisis became a sovereign debt crisis that still threatens the growth and development potential of Eurozone states. The development and impact of the recent crisis is not discussed here.<sup>1</sup> However, by using the crisis as a starting point

we shall observe the difference in the trends of foreign direct investment (FDI) and discuss whether our conceptualisation about its primary determinants should alter.

**Table 1** Inward and outward FDI stock (percentage of total world)

<i>Direction/economy/year</i>		<i>2000</i>	<i>2004</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	
Inward	Emerging economies	8.1	8.2	8.7	9.7	9.9	11.8	11.5	12.1	11.4	
	Transition economies	0.8	1.6	3.5	2.5	3.2	3.6	3.5	3.5	3.6	
	Developed economies: US	39.9	26.8	22.4	18.7	19.2	19.7	19.4	19.5	21.9	
	Developed economies: Asia	0.9	1.1	1.0	1.6	1.4	1.4	1.4	1.2	1.0	
	Developed economies: Europe	32.9	45.7	44.6	46.4	44.1	39.9	39.6	38.5	37.4	
	Developed economies: Oceania	1.9	3.2	2.7	2.5	2.9	3.1	3.2	3.2	2.7	
	Developing economies excl. China	21.0	19.3	23.9	25.8	26.5	29.5	29.5	30.5	29.6	
	China	2.6	2.2	1.8	2.4	2.6	2.9	3.4	3.6	3.8	
	USA	37.1	24.0	19.6	15.9	16.3	16.8	16.6	16.8	19.4	
	European Union (28)	31.3	43.2	41.8	42.7	40.5	35.9	35.4	34.4	33.7	
	Eurozone	21.7	31.6	29.5	30.5	28.7	25.0	24.8	23.1	22.6	
	Outward	Emerging economies	3.2	3.7	4.4	5.4	5.2	5.8	6.4	6.9	6.6
		Transition economies	0.3	0.9	2.0	1.4	1.7	1.9	1.9	1.9	2.1
Developed economies: US		36.6	31.6	30.0	22.0	25.1	25.6	23.6	24.9	26.9	
Developed economies: Asia		3.6	3.3	3.1	4.4	4.1	4.2	4.7	4.7	4.1	
Developed economies: Europe		47.2	51.8	49.5	54.8	51.9	49.6	49.5	47.0	46.1	
Developed economies: Oceania		1.3	2.2	2.0	1.8	2.1	2.3	2.1	2.2	1.9	
Developing economies excl. China		10.7	9.9	12.9	14.5	13.8	14.9	16.2	17.1	16.6	
China		0.3	0.4	0.6	1.1	1.3	1.5	1.9	2.1	2.3	
USA		33.6	28.4	27.3	18.8	22.1	22.6	20.6	21.9	24.1	
European Union (28)		43.8	47.6	45.2	49.6	46.5	43.8	43.4	41.1	40.3	
Eurozone		29.8	33.6	32.9	36.6	35.2	32.9	32.5	30.7	30.1	

Source: UNCTAD [online]  
<http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx>  
 (accessed 14 May 2015)

**Table 2** Inward and outward FDI flows (percentage of total world)

<i>Direction/economy/year</i>		2000	2004	2007	2008	2009	2010	2011	2012	2013	
Inward	Emerging economies	7.5	14.4	8.8	8.2	8.9	13.5	12.1	17.3	17.0	
	Transition economies	0.4	4.0	4.4	6.5	5.8	5.0	5.6	6.3	7.4	
	Developed economies: US	26.9	18.5	16.7	20.2	13.6	15.9	15.5	15.3	17.2	
	Developed economies: Asia	1.1	1.5	1.6	1.9	1.4	0.3	0.5	0.8	1.0	
	Developed economies: Europe	51.6	31.6	45.5	31.8	33.5	30.7	31.7	18.3	17.3	
	Developed economies: Oceania	1.2	6.0	2.3	2.8	2.2	2.5	4.1	4.3	3.5	
	Developing economies excl. China	16.0	30.4	25.4	30.8	35.8	37.5	35.3	45.7	45.1	
	China	2.9	8.2	4.2	6.0	7.8	8.1	7.3	9.1	8.5	
	USA	22.2	18.4	10.8	16.8	11.8	13.9	13.2	12.1	12.9	
	European Union (28)	49.7	31.0	43.2	30.3	29.7	27.0	28.8	16.2	17.0	
	Eurozone	35.5	18.4	27.8	20.0	19.9	22.3	22.2	8.8	13.1	
	Outward	Emerging economies	2.2	4.8	4.7	4.4	5.9	8.8	7.1	9.7	8.0
		Transition economies	0.3	1.5	2.2	3.1	4.1	3.9	4.3	4.0	7.0
Developed economies: US		15.1	36.8	20.2	19.4	28.0	21.3	25.6	31.4	27.0	
Developed economies: Asia		2.8	3.9	3.6	6.8	6.5	4.4	6.6	9.3	10.0	
Developed economies: Europe		69.6	44.5	58.7	52.3	36.8	40.3	38.2	22.2	23.3	
Developed economies: Oceania		0.4	1.0	0.8	1.6	0.9	1.4	0.7	0.4	0.5	
Developing economies excl. China		11.8	11.7	13.3	14.1	18.8	24.0	20.3	26.2	25.0	
China		0.1	0.6	1.2	2.8	4.8	4.7	4.4	6.5	7.2	
USA		11.5	32.1	17.4	15.4	24.6	18.9	22.6	27.2	24.0	
European Union (28)		65.2	40.8	55.5	49.2	32.8	32.9	34.2	17.7	17.8	
Eurozone		40.7	28.8	38.0	37.2	25.9	28.2	24.7	11.3	13.3	

*Source:* UNCTAD [online]  
<http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx>  
 (accessed 14 May 2015)

Firstly, the entry mode of cross-border mergers and acquisitions (M&As) have stopped leading the FDI race (for a discussion see Bitzenis and Vlachos, 2012). Until 2007 and particularly in developed economies, the majority of FDI was in the form of cross-border M&As.<sup>2</sup> The eruption of the recent global crisis in 2007 has altered this trend. The size of cross-border M&As increased for the first time after the eruption of the crisis in 2010, in which year its size was about one third of the record high it reached in 2007. On the other

hand, Greenfield FDI is leading the race from 2008 onwards, mainly because of the sharp decrease of cross-border M&As in the end of the previous decade.<sup>3</sup>

Moreover, while in 2013<sup>4</sup> both Greenfield FDI and cross-border M&As decreased in developed economies, developing and transition economies exhibited quite an increase. In particular, more than two thirds of cross-border M&As by developing economies were directed to developing and transition economies and half of these investments involved foreign affiliates of developed-country multinationals, transferring their ownership into the hands of developing-country multinationals.<sup>5</sup>

Another change of trends caused by the crisis concerns the direction of FDI. Tables 1 and 2 depict the particular change. Table 1 reflects changes from a medium to long-term perspective by depicting inward and outward FDI stocks. According to Table 1, emerging and developing economies were less hit by the crisis and continued to increase in terms of inward and outward FDI stock. On the other hand, developed economies experienced a severe impact in terms of inward and outward FDI stock. European states in particular, have experienced the greater loss. For example, the European Union (EU) exhibits a loss of approximately 9% of total world inward and outward FDI stock respectively, while the Eurozone exhibits a loss of approximately 8 and 6.5% of total world inward and outward FDI stock respectively.

Table 2 reflects changes from a short to medium-term perspective by depicting inward and outward FDI flows. Table 2 indicates that after the crisis developing economies have gained the lead and that from 2011 onwards, it is them (with and without China) that attract the majority of inward FDI flows. Table 2 also shows that from 2012 onwards, emerging economies have managed to match the size of inward FDI flows that developed economies attract in Europe and US. On the other hand, the majority of outward FDI flows remains with developed economies despite the severe decrease of outward FDI flows in European economies due to the crisis and the rapid increase of outward FDI flows in developing economies (including China), which have managed to outperform the developed economies in Europe and US.

## **2 FDI determinants: what has changed?**

Does the aforementioned change of trends imply a change on the importance of FDI determinants? Or to put it differently, can FDI theory discussed both in international business and international economics literature provide an explanation for this change of trends?

Firstly, the attraction of the bulk of global FDI by developed economies signals the fallacy of an economic theory strand, which suggests that capital should flow from capital-abundant economies (with lower rates of return) to capital-scarce economies (with higher rates of return). Secondly, if we were to ignore the impact of the crisis, we would more or less in general agree that the benefits of advanced institutions and infrastructure, and the superior overall business environment of developed economies outweighs the attractions of greater market dynamism and lower costs in developing and emerging economies. However, the trends of FDI depicted on Tables 1 and 2 indicate that this notion is on the verge of change.

The crisis has altered the perspectives of investors regarding the risk associated with developed economies in the sense of the aforementioned. This means that

recession and sluggish growth caused by the economic crisis have put pressure on the lower rates of return of developed economies at the same time as economic turbulence caused by the sovereign debt crisis (particularly in the Eurozone states) inflates the level of risk. Moreover, beyond the crisis-born pressures depicted in the difference between the overall economic performances of developing vis-a-vis developed economies, the economic growth of some developing economies such as China and India has created opportunities for demand-driven FDI. As such, an increase of horizontal domestic market-oriented FDI in developing economies would also be an innovation in the typical vertical expansion concept usually associated with FDI in developing economies.<sup>6</sup>

Another possible dimension of the impact of the crisis on FDI flows is the notion of fire-sale FDI: the simultaneous outflow due to rising levels of risk caused by the crisis and inflow due to the consequent decreasing value of assets (particularly of distressed firms). A recent study that explores the notion of fire-sale FDI in EU during the financial crisis indicates that this is not exactly the case (see Weitzel et al., 2014). Although EU countries with higher sovereign default risk and lower economic demand seem to attract more foreign buyers in the crisis period, lower domestic credit is associated with less FDI activity. The results for EU countries with lower domestic credit are in conflict with the notion of fire-sales. However, the lack of empirical evidence of fire-sale FDI is not EU specific. Stoddard and Noy (2015) who explore the notion in developing and emerging economies around financial crises do not find empirical evidence of fire-sale FDI despite their conclusion that financial crises affect FDI flows negatively.

The aforementioned imply that the macroeconomic conditions of the host economy have gained a key role in determining the direction of FDI flows to such an extent that they overshadow any opportunity arising from the purchase of assets which are currently undervalued due to external economic conditions. However, before reaching a conclusion, another dimension of the crisis associated with FDI determinants has to be considered: the change of focus in macroeconomic policy formulation. The austerity measures accompanying fiscal consolidation, which primarily concerns the EU and especially the economies most affected by the sovereign debt crisis, have two major implications for the importance of inward FDI and the means of host economies to gain in their attractiveness. Firstly, fiscal austerity indicates the requirement for inward FDI to substitute for the loss in public investment spending, as long as this form of fiscal discipline is at force. Secondly, the policy mixture accompanying fiscal austerity in the Eurozone (and the EU), which aims to boost competitiveness via internal devaluation in order to improve the balance of the current account, indicates the emphasis given on factors' costs and particularly, labour costs.

A very interesting finding in relation to the aforementioned is that recovery through inward FDI flows is falsely perceived to be hindered by labour costs. Katsimi et al. (2012) find that since excessive wages do not affect the return on capital, and profits are responses to changes in the economic, political and institutional environment, there should not be a priori statement for a negative relationship between them. Such findings connote the non-price factors of competitiveness (innovation for example) captured by the Kaldor's paradox: the positive correlation observed between the international competitiveness of several countries and their relative unit labour costs.<sup>7</sup>

**Table 3** Correlations between unit labour costs and inward FDI

FDI series/economy/business sector	Mining and quarrying			Manufacturing			Construction			Financial intermediation		
	Pearson	Spearman rank	Kendall rank	Pearson	Spearman rank	Kendall rank	Pearson	Spearman rank	Kendall rank	Pearson	Spearman rank	Kendall rank
Flows												
Germany	-0.35	-0.36	-0.27	0.14	0.03	0.02	0.65**	0.70**	0.53**	0.07	0.27	0.2
France	-0.18	-0.07	0.00	-0.11	-0.04	-0.02	0.22	0.24	0.16	0.17	0.09	0.05
Italy	0.11	0.20	0.11	-0.21	0.00	0.05	0.83*	0.88*	0.78*	-0.16	0.01	0.02
Spain	0.15	-0.11	-0.13	0.51	0.32	0.27	0.49	0.54	0.34	-0.70**	-0.74**	-0.60**
Portugal	0.22	-0.50	-0.33	-0.72**	-0.39	-0.27	-0.08	-0.02	0.02	-0.50	-0.52***	-0.40***
Greece	0.55***	0.32	0.16	0.22	-0.04	0.02	0.43	0.35	0.24	0.02	-0.03	-0.05
Ireland	n.a.	n.a.	n.a.	-0.09	-0.30	-0.16	n.a.	n.a.	n.a.	-0.22	0.13	0.07
Stocks												
Germany	0.15	-0.08	-0.17	-0.52***	-0.70**	-0.49**	0.92*	0.97*	0.89*	0.71*	0.73*	0.60*
France	0.80*	0.89*	0.77*	-0.38	-0.39	-0.31	0.96*	0.99*	0.96*	0.78**	0.74*	0.56**
Italy	-0.13	-0.18	0.04	0.54***	0.50	0.34	0.96*	0.86	0.72	0.70**	0.68**	0.49**
Spain	0.57	0.61	0.52	0.68***	0.54	0.43	0.69***	0.54	0.43	0.74***	0.50	0.33
Portugal	n.a.	n.a.	n.a.	0.19	0.13	0.07	0.79*	0.87*	0.69*	-0.60***	-0.84*	-0.72*
Greece	0.39	-0.57***	-0.345	0.40	0.58***	0.45***	-0.05	-0.13	-0.13	0.36	0.49	0.38***
Ireland	n.a.	n.a.	n.a.	-0.30	-0.18	-0.11	n.a.	n.a.	n.a.	0.33	0.43	0.29

Notes: (1) Own calculations of data from OECD stat extracts. Available: <http://stats.oecd.org/> (accessed 14 May 2015).

(2) \*, \*\*, \*\*\* indicate significance at the 1%, 5%, and 10% level respectively.

(3) 'n.a.' indicates that there is no data available.

In order to stimulate further discussion we explore the correlation between unit labour costs and inward FDI. Table 3 indicates the Pearson, Spearman rank and Kendall rank correlations between unit labour costs and inward FDI stocks and flows of four business sectors in Eurozone's core and peripheral economies. We assume that stocks can depict a longer-term trend than flows. A straightforward implication from our findings is given by the statistically significant coefficients which indicate that there is a strong or very strong positive relationship between inward FDI stock and unit labour costs in the construction sector (excluding Greece) in Eurozone's core and peripheral economies included in our sample. Similar findings but of a lesser strength are also about the positive relationship between inward FDI stock and unit labour costs in the financial intermediation sector (excluding Portugal). The rest of the significant correlation coefficients indicate relationships which are country and/or sector specific. The only clear cut implication about the importance of unit labour costs as a determinant of inward FDI is given in Germany's manufacturing sector and Portugal's construction sector.

Nevertheless, this is by no way an attempt to evaluate the importance of unit labour costs in attracting FDI. It is rather another observation that aims to question their importance, following the preceding discussion which has already pinpointed several arguments about their strength as determining factors before, in and after the crisis. As such, the discussion thus far leads to the conclusion that the macroeconomic conditions of the host economy have gained a key role in determining the direction of FDI flows.

### **3 The content of this special issue**

The discussion thus far has hinted towards the title of this special issue, which is 'FDI in the aftermath of the current global economic crisis'. The papers included in this special issue emphasise on the impact of the crisis on several aspects of the FDI phenomenon, discussing its determinants as much as numerous forms of its externalities. The issue can be broadly divided into three thematic sections according to the papers' context. The first section concerns FDI externalities and in particular its effect on the host's entrepreneurship, employment and productivity and moreover, the comparative contribution of FDI to a host's economic growth. The second section is about the performance of FDI activities. The third section explores the factors assumed to be obstructing FDI. What follows is a brief overview of the papers included in this special issue.

Nadia Doytch explores the impact of inward FDI flows on density of newly registered firms, a proxy used by the author for entrepreneurship. The author utilises a data set covering 96 countries for the period 2004 to 2012. After controlling for the level of capital formation, institutional quality and several indicators of the cost of doing business, the author finds that inward FDI has a significant impact on the host's firm creation.

Hussain Ali Bekhet and Mohamed Ibrahim Mugableh analyse the equilibrium relationships and the dynamic causality directions among inward FDI and employment. The authors use annual time-series data for the period 1972 to 2012 covering five Malaysian economic sectors and find that granger causality was not present at all sections.

Subaran Roy explores the effects of FDI on total factor productivity growth. The author utilises a data set covering 89 countries for two decades and finds that the initial distance of a country from the technology frontier in determining the net effect of FDI on total factor productivity growth.

Ioannis Tampakoudis, Demetres Subeniotis and Manolis Skouloudakis focus on the role of inward FDI vis-à-vis other determinants of economic growth. The authors use annual data from 1980 to 2010 and two different country samples: one comprised of five developing countries and one of the G7. Beside the anticipated varying effects of inward FDI on economic growth, the authors also find that (their proxies of) financial development is the most significant variable, exhibiting similar effects across samples.

Dimitris Manolopoulos explores whether the performance of R&D activities being part of horizontal and/or vertical FDI expansion depend on compensation. Based on data drafted from questionnaires the author finds that the financial dimensions of compensation, hierarchical organisational designs and increased job security, altogether advance value-exploiting R&D activity.

Imre Ersoy and Kazım Okan Erol focus on the impact of the financial crisis on the inward FDI of EU (15). The authors use annual data from 1980 to 2012 and find via a dynamic panel data analysis that the financial crisis is one of the most important determinants of inward FDI flows in the EU (15), increasing in particular, inward FDI flows in Greece, Italy, Ireland, Portugal and Spain.

Finally, Aristidis Bitzenis and Vladimir Zugic explore the factors obstructing FDI in Serbia's manufacturing sector. Based on data drafted from questionnaires the authors find that investors in Serbia's manufacturing sector confirm that bureaucracy is the biggest barrier followed by barriers related to macroeconomic and legal factors.

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## Notes

- 1 For a discussion see Bitzenis et al. (2013).
- 2 For the 1990s, see United Nations Conference on Trade and Development (2001, p.12). For the period following after the 1990s until mid 2000s see United Nations Conference on Trade and Development (2007, p.15).
- 3 See United Nations Conference on Trade and Development (2011, pp.10–11; 2014, p.7).
- 4 Until 2013, the year for which we had the latest data available by the time of writing this paper.
- 5 See United Nations Conference on Trade and Development (2014, pp.7–8).
- 6 Recent researches explore how multinationals change their export-oriented investments to market-oriented investments in developing countries. For example, for China, see Huang and Wei (2015). Moreover, with reference to the rising trend of cross-border M&As by developing economies were directed to developing and transition economies, a recent survey published by the World Bank (Gómez-Mera et al., 2015) indicates that emerging market multinationals exhibit a strong regional bias with (primarily) a market and efficiency-seeking orientation.
- 7 If an increase of the relative export prices of developed high-income economies is accompanied by improvements on other quality factors, then the negative effect of price increase is offset. On these terms, the labour costs that outpace improvements in labour productivity may threaten the economy's cost competitiveness, *ceteris paribus*, only if other quality factors do not improve (for example, if products are not as innovative any more and expenditures for research and development increase). For a discussion, see Vlachos (2013, pp.193–194).