



FDI in the Region Will Recover This Year After Sliding in 2009

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Foreign direct investment (FDI) in Latin America and the Caribbean (LAC) was expected to fall considerably in 2009 as a consequence of the global economic crisis. ECLAC's preliminary estimates suggest that the region received around \$82 billion, a 37 percent contraction with respect to the historical record of \$130 billion in 2008.

The global economic downturn reduced the incentives and capacity to sustain previous FDI levels. First, economic growth in LAC, an important determinant of FDI, shrank from 4.1 percent in 2008 to -1.8 percent in 2009, lowering the incentives to step up production capacity and thus to invest. Second, the contraction and increased cost of commercial credit forced companies to rely on their own resources to finance investment and as market prospects declined so did corporate profits, thus constraining the capacity of firms to finance new investments or mergers and acquisitions with their own funds. Third, a high level of perceived risk and uncertainty during 2009 may have resulted in companies' investment plans being scaled back as a contingency plan in case of worsening economic conditions.

Although FDI is expected to have fallen in the entire region in 2009, the crisis has had a longer effect on the flows to Mexico and the Caribbean Basin than to South America. Mexico and the Caribbean Basin will experience their second consecutive year of falling FDI. The sub-regional economic slowdown in 2008 and recession in 2009, coupled with the contraction of their main export market, the U.S. economy, eroded the incentives for market-seeking and export-oriented FDI, resulting in an overall decrease of FDI in this sub-region. FDI flows to South America are also expected to have fallen in 2009, after attaining an historical high in 2008. This contraction in FDI flows is the result of the high volatility in commodity prices and regional economic slowdown in South America, which reduced incentives for natural-resource-seeking and market-seeking FDI. Brazil, Mexico, Chile, Colombia and Argentina, which normally account for approximately 80 percent of all the FDI received in LAC, are expected to fall in a range that goes from -17 percent to -48 percent.

Despite this steep contraction in FDI to the region, it is worth highlighting that such flows remain high from a historical perspective and above the average of the FDI flows received in the last 10 years. Furthermore, over the last two decades FDI has proved to be the most important and

stable capital flow to developing countries, in comparison to others such as commercial loans, portfolio investment or official flows.

Furthermore, it should be noted that FDI is one of the most important sources of technology transfer across the globe, which accounts for 90 percent or more of domestic productivity growth. Besides being a form of financing, FDI is also a fundamental channel for knowledge and technology transfer, which can foster economic growth. For this reason it is crucial that governments in LAC keep promoting policies that enhance absorptive capacities, such as improving public education, strengthening their institutions and expanding and improving the quality of their physical, scientific and technological infrastructure, in order to maximize the benefits from the FDI to the region.

FDI investment in LAC for 2010 is expected to recover its upward trend, especially as growth prospects increase (2.4 percent globally and 4.1 percent in LAC) and foreign investors' perception on risk and opportunities improve. However, the important issue for LAC is not how much FDI it receives, but how much knowledge and technology the countries can absorb and then transform into productivity and economic growth.

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