

Davies, Ronald B.

Article

Thoughts on the demise of FDI

Economics: The Open-Access, Open-Assessment E-Journal

Provided in Cooperation with:

Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

Suggested Citation: Davies, Ronald B. (2019) : Thoughts on the demise of FDI, Economics: The Open-Access, Open-Assessment E-Journal, ISSN 1864-6042, Kiel Institute for the World Economy (IfW), Kiel, Vol. 13, Iss. 2019-23, pp. 1-5,
<https://doi.org/10.5018/economics-ejournal.ja.2019-23>

This Version is available at:

<https://hdl.handle.net/10419/193917>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



<https://creativecommons.org/licenses/by/4.0/>

Thoughts on the demise of FDI

Ronald B. Davies

Abstract

This essay addresses the recent deceleration in the pace of global FDI and asks whether multinational corporations are actually in retreat. It identifies the forces that are slowing the expansion of FDI, and sketches the role that multinational corporations will play in the future.

(Published in Special Issue [FDI and multinational corporations](#))

JEL F21 F23

Keywords Foreign direct investment; multinational corporations

Authors

Ronald B. Davies, University College Dublin, Ireland,

Citation Ronald B. Davies (2019). Thoughts on the demise of FDI. *Economics: The Open-Access, Open-Assessment E-Journal*, 13 (2019-23): 1–5.

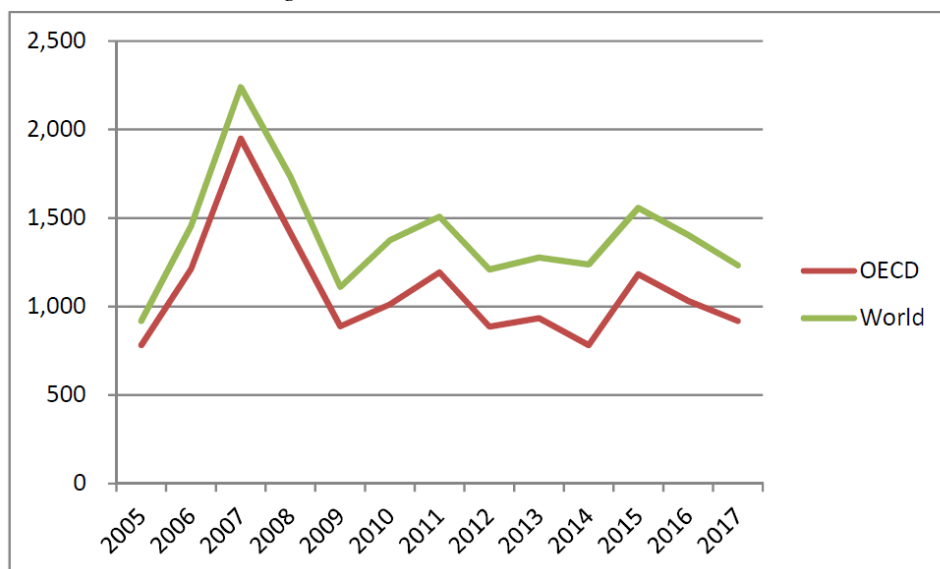
<http://dx.doi.org/10.5018/economics-ejournal.ja.2019-23>

In the early 1990s, the global economy saw an explosion in foreign direct investment. This dramatic increase built on several changes, including the opening of formerly closed economies (from both a relaxed entry into blocs such as the European Union as well as the initial openings of China and the former Soviet Union), declines in trade barriers that spurred intra-firm trade along the global value chain, and improvements to information technologies that eased coordination across distances. The ability to lower costs via global supply chains and to employ tax reducing measures served to place multinationals firmly at the forefront of firms with regards to productivity and profitability. This superstar level of performance catapulted multinational firms into the spotlight. On the business side, it attracted increased interest in investing in multinationals and encouraged more firms to explore foreign investment as a way to expand. In the popular press, the multinational became both a hero for its potential to contribute to development and a villain for its potential abuses of weak local labour or environmental regulations. Finally, the academic literature is no less enthralled by the phenomenon as the contributions to this special issue attest.

More recently, however, there are some suggestions that the dramatic growth in FDI may be drawing to a close. As shown in Figure 1, outbound FDI flows from the OECD and the world overall, while still positive, have flatlined relative to the upward trend prior to the economic crisis of 2008. Just as there are multiple causes of the initial rise in international investment, this change also likely has numerous drivers.

First, there is the likely possibility that profitable investment opportunities are starting to dry up. When the transition economies initially opened up, they presented both consumer markets desirous of products from the West and a ready supply of acquisition targets, particularly in the form of formerly state-owned enterprises. Thirty years on, it is looking increasingly as if some of the excess consumer demand is being sated. For example, in early 2019, Apple announced

Figure 1: Real FDI outflows over time



Source: OECD (2019). Values measured in real billions of constant US dollars (2010 base year).

that iPhone sales were much lower than anticipated, down nearly 10% from projections a few months earlier (Vanian, 2019). This was especially true in the transition economies where indications are that consumers are no longer willing to replace their phones as quickly as they previously had been. Likewise, most state-owned enterprises that can be privatised have been. Finally, while low wages in east Asia made expansion of global value chains highly profitable, rising wages have reduced the gains to be had. Thus, the low-hanging fruit to be found in the 1990s and early 2000s is much harder to come by.

Second, the global shift towards populism has reversed the trend towards increasing trade liberalization. Most obvious are the headline-grabbing introductions of steel and aluminium tariffs of the US administration and the still-wildly uncertain outcome of the UK's decision to leave the European Union. Indeed, these changes have been shown to have negative impacts on multinationals because of the friction increased trade barriers introduce to the operation of global value chains (see, for example, Davies and Studnicka, 2018, who examine the impact of Brexit). Less dramatic changes are also afoot. In several countries, governments are becoming more aggressive in their ability to halt corporate takeovers. For example, in 2017

Germany expanded its pre-existing law allowing the government to halt non-EU acquisitions in sensitive industries such as defence or IT security to a looser set of "critical infrastructure" industries including transport systems and utilities (Chazan, 2017). An alternative way to see this is to examine the OECD's FDI Regulatory Restrictiveness Index (OECD, 2017). Between

1997 and 2003, the average restrictiveness in the OECD fell by 22% with a similar fall between 2003 and 2010. This then illustrates the increasing openness even within the developed world noted above. Since then, however, the index has remained constant, pointing towards the regulatory chill multinationals increasingly face. These regulations matter since, although mergers and acquisitions currently make up only about one-third of investment projects, in terms of monetary value they still account for the lion's share of FDI activity (see Davies, Desbordes, and Ray, 2018).

Finally, even among pro-globalists, public opinion is becoming more critical of multinationals. While there is still the push and pull of labour and environmental policy, taxation issues have risen to the forefront. While it has long been recognized that multinationals can and do manipulate internal transactions to minimize their tax burden, the extent of the loss in revenues is only now becoming apparent, with some authors suggesting that as much as 40% of multinational profits avoid taxes by the use of tax havens (Tørsløv, Wier, and Zucman, 2018). It is perhaps no surprise that there has been a renewed international push towards curbing aggressive tax planning, most notably via the OECD's Base Erosion and Profit Shifting initiative. If successful, this will undoubtedly cut into the remarkable after-tax profitability of multinationals.

Combining these trends, some have suggested that the day of the multinational is over (see the Economist, 2017, for an example). I, however, would argue that while it may be the case that the astounding growth of foreign direct investment may be largely over, this does not mean they will lose their relative importance. Chief among these reasons is the role that multinationals play on the global innovation stage. The EU's R&D Scoreboard (2017), which surveys the R&D activity of 2500 leading innovators, finds that these firms make up roughly 90% of global business-funded R&D. Further, the vast bulk of these firms are part of a multinational corporate structure. Thus, it is fair to say that most innovation globally is done by multinationals. If the

areas for growth are no longer to be found in untapped consumers, unarbitrated production locations, or unacquired targets, the most likely venue for future growth will be via technological growth. Here, multinationals are clearly well situated to succeed. In addition, the increasing use of patent boxes – a tax scheme which reduces the tax rate applied to the income from patents – appears to not only spur innovation especially for multinationals that have the ability to shift the location of where R&D activities are done (see Alstadsæter, et al., 2018, and Skeie, et al., 2017). As such, this might provide a new mechanism for tax avoidance even as others close. Therefore, if technology is going to be the avenue forward, multinationals are poised to continue to lead the way.

Beyond this, while there is currently a pendulum shift towards protectionism, one part of pendulums is that they eventually swing back the other direction. Given their prior experience and their maintained, if smaller, global structures, multinationals will be first in line to take advantages of future liberalisations.

Thus, while certain factors that explained the explosion of FDI during the 1990s and 2000s may be gone for good, I believe that the importance of multinationals as a driving force in the global economy will be maintained for a long time to come.

References

- Alstadsæter, A., S. Barrios, G. Nicodeme, A.M. Skonieczna, and A. Vezzani. (2018). Patent boxes design, patents location, and local R&D. *Economic Policy*, 33(93), 131–177.
<https://doi.org/10.1093/epolic/eix021>
- Chazan, G. (2017). Germany expands powers to block takeovers. *The Financial Times Online*.
<https://www.ft.com/content/5087c106-66fc-11e7-9a66-93fb352ba1fe>. Accessed 7 January 2019.
- Davies, R.B., R. Desbordes, and A. Ray. (2018). Greenfield vs. merger and acquisition FDI: Same wine, different bottles? *Canadian Journal of Economics*, 51(4), 1151–1190.
<https://doi.org/10.1111/caje.12353>
- Davies, R.B. and Z. Studnicka. (2018). The Heterogeneous Impact of Brexit: Early Indications from the FTSE. *European Economic Review*, 110, 1–17.
<https://doi.org/10.1016/j.eurocorev.2018.08.003>
- European Union Joint Research Centre. (2018). The 2017 EU Industrial R&D Investment Scoreboard. Luxembourg: Publication Office of the European Union.
<http://iri.jrc.ec.europa.eu/scoreboard17.html>
- Economist (2017). The multinational company is in trouble. *The Economist Online*.
<https://www.economist.com/leaders/2017/01/28/the-multinational-company-is-in-trouble> Accessed 7 January 2019.
- OECD. (2017). FDI Regulatory Restrictiveness Index.
<http://www.oecd.org/investment/fdiindex.htm> Accessed 7 January 2019.
- OECD. (2019). OECD.Stat. <https://stats.oecd.org/> Accessed 7 January 2019.
- Skeie, Ø.B., Å. Johansson, C. Menon and S. Sorbe (2017). Innovation, patent location, and tax planning by multinationals. OECD Working Paper No. 1360.
<https://doi.org/10.1787/b08459e5-en>
- Tørsløv, T. L. Wier, and G. Zucman (2018). The missing wealth of nations. NBER Working Paper 24701.
<https://www.nber.org/papers/w24701>
- Vanian, J. (2019) Here's what analysts are saying about Apple's slowing I-phone sales. *Fortune Online*.
<http://fortune.com/2019/01/03/apple-iphone-sales-china-analysts/> Accessed 7 January 2019.

Please note:

You are most sincerely encouraged to participate in the open assessment of this article. You can do so by either recommending the article or by posting your comments.

Please go to:

<http://dx.doi.org/10.5018/economics-ejournal.ja.2019-23>

The Editor