2 Global trends in foreign direct investment

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2018 was the first year since the financial and economic crisis of 2008 to see a drop in worldwide direct investments,[2] by 0.8% to USD 32.9 trillion. The decline came in the wake of numerous geopolitical and economic events (e.g. the US tax reform, the trade conflict between the USA and China, Brexit negotiations and Italy's fiscal dispute with the European Commission). In the year before, global FDI had still seen record growth of 16.6%, driven by the positive performance of financial markets. In 2019, when the US tax reform impact was no longer as strong as in 2018, global FDI stocks grew by 10.7% in 2019 according to preliminary UNCTAD data. In 2020, FDI flows are expected to have declined sharply because of the COVID-19 pandemic, by as much as 40%.

2.1 Global trends in 2018

Box 1

One of the main reasons why global FDI flows slowed in 2018 was that the US Tax Cuts and Jobs Act (TCJA) signed by President Donald Trump in December 2017 entered into force. Among other things, the TCJA covers earnings US companies had kept abroad for several years rather than repatriating them. Under the old system of taxation, a tax rate of up to 35% applied to such earnings upon repatriation. The TCJA enables US companies to repatriate current and past earnings to the USA at a reduced tax rate of 15.5% and 8.0%, respectively, until 2027.[3]

In FDI statistics, profits are recorded as inflows (reinvested earnings) as long as they are not distributed (OECD, 2008).

In 2018, global foreign direct investment inflows (inward FDI)[4] continued the downward trend seen in the previous two years, declining by 12.1% or USD 1.5 trillion USD against 2017 (see chart 8). This decline is mainly attributable to the repatriation of earnings accumulated abroad by US-controlled multinationals in the first two quarters of 2018, after the US tax reform had entered into force in January 2018 (see box 1).

The figures for 2018 indicate that the new tax rules have indeed caused more earnings to be repatriated than in the past. Of more than USD 3 trillion built up in earnings by US companies abroad, several hundred billion of US dollars were repatriated that year.[5] Dividends paid out in 2018 clearly exceeded the profits earned over the same period; hence, reinvested earnings were negative. The resulting liquidity was mostly invested in share buyback programs, distributed in the form of dividends or used for further cross-border mergers and acquisitions (UNCTAD, 2019).

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[2] *Inward and outward FDI of two economies should be the same, once netted, and the same applies to global values. In practice, there are still gaps in recording FDI in some countries, especially regarding outward FDI. For this reason, total global values in this publication are based on inward FDI.*

[3] *https://www.taxpolicycenter.org/briefing-book/what-tcja-repatriation-tax-and-how-does-it-work.*

[4] *Outflows: flows of outward direct investment; inflows: flows of inward direct investment.*

[5] *https://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=512.*

Totaling USD 90.6 billion, US disinvestments also had a major impact on Europe's inward FDI flows, which declined by more than one-third to USD 388.4 billion in 2018, reaching the lowest point since 2014. Major host countries, like Luxembourg, Ireland and Switzerland, recorded disinvestments, while flows to the UK dropped by 35.5% to USD 65.3 billion compared to 2017.

The repatriation of US earnings affected most regions worldwide, but to varying extents. In the industrialized economies, for example, inward FDI flows contracted by 19.9% to USD 761.4 in 2018, while developing regions were hardly affected. Following the record investment of recent years, the latter only saw a minimal decline of 0.2% to USD 699.3 billion. Inward FDI flows also declined in the emerging economies – from USD 49.7 billion to USD 34.5 billion; with a share of 2.3%, their influence on the development of global FDI remained small.

The primary aim of the US tax reform was repatriating funds to promote additional business investments, productivity and thus job creation and to raise the wage level in the USA ("America First"). First analyses show, however, that these expectations may have been fulfilled to a lesser extent than originally expected.[6]

At the same time, continued business cycle concerns and the trade conflict between the USA and China, as well as the increasing protectionism it caused, weighed heavily on global financial markets in 2018. Europe also faced continuing geopolitical tensions as well as concerns about the stability of the global economy. The decisions surrounding Brexit and Italy's fiscal dispute with the European Commission dampened global capital market sentiment as well.

Against this background, FDI stocks contracted by 0.8% to USD 32.9 trillion in 2018. This was the first decline since the financial and economic crisis of 2008, following record growth of 16.6% in 2017 driven by the positive performance of the financial markets (see chart 8). Apart from the setback in 2018, we have seen a continuous rise in FDI stocks worldwide relative to GDP. From 2007 to 2018, global FDI stocks expanded by 7.6 percentage points of GDP, bringing FDI stocks as a share of GDP up to 38.4% at end-2018.

Governments worldwide continually strive to create better conditions for foreign investors through bilateral investment and double taxation agreements as well as national laws. This opens up opportunities for enterprises to generate tax advantages by systematically making use of differences in tax systems through pass-through investments or round-tripping, i.e. by channeling investments through subsidiaries set up in countries with favorable tax laws (e.g. Luxembourg, the Netherlands or Hungary). Profits generated abroad are then not distributed among investors but cumulated in the respective countries in the form of dividends (Yalcin et al., 2015). This phenomenon distorts inward and outward direct investment and makes it harder to interpret FDI statistics in an international comparison.

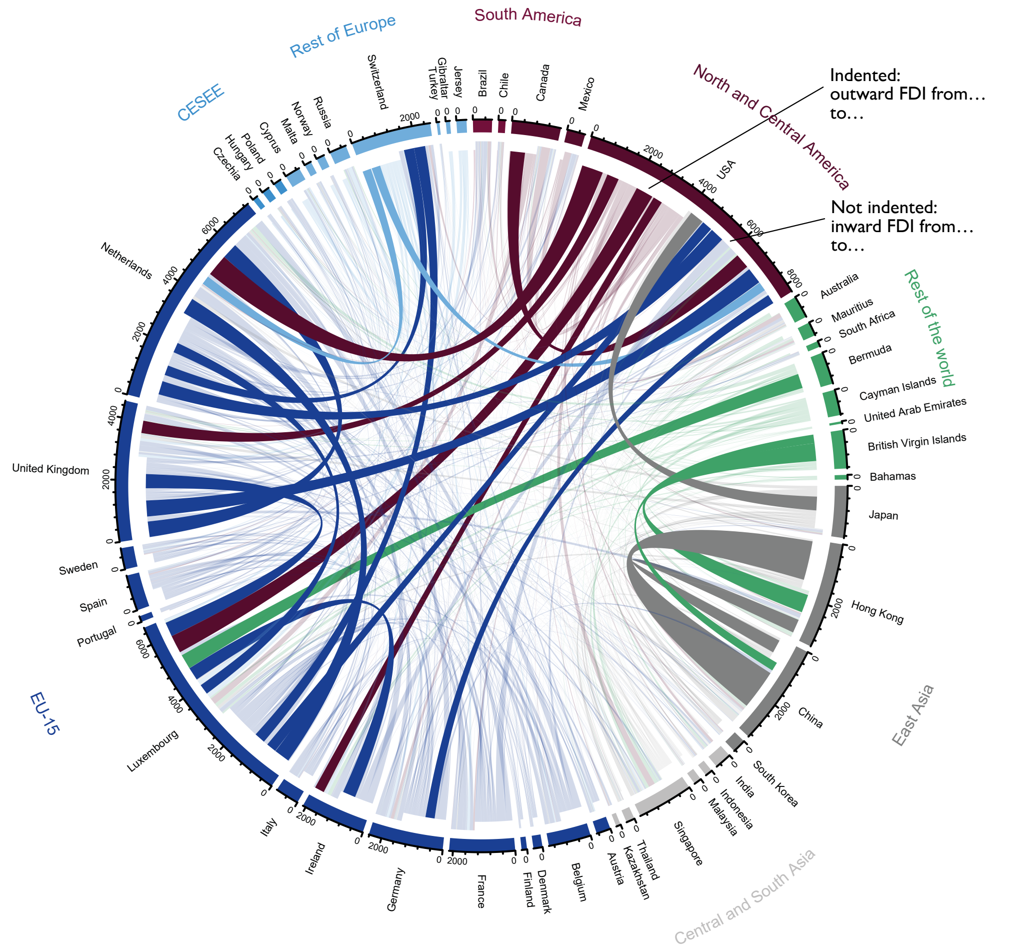
Chart 7 shows the most important bilateral outward and inward FDI relationships as at end-2018, based on the immediate counterparty concept and broken down by continents.[7] It is evident from the chart that tax savings play an important role for the investment decisions of multinational enterprises. Almost half of all inward and outward FDI in 2018 was accounted for by the USA, the United

[6] *https://www.imf.org/en/Publications/WP/Issues/2019/05/31/U-S-46942.*

[7] *IMF Coordinated Direct Investment Survey (CDIS). https://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F-1CE54D6D5.*

Chart 7

Global bilateral FDI relationships in 2018[1]



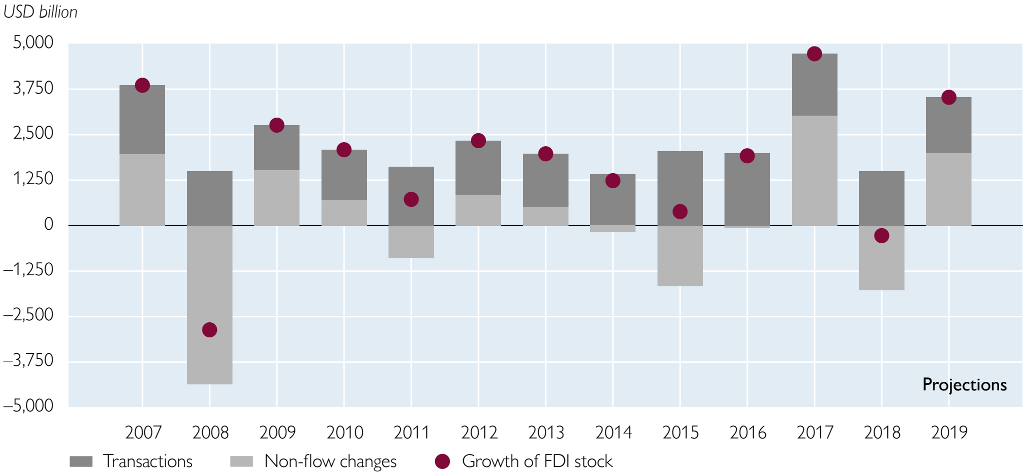
Source: IMF Coordinated Direct Investment Survey (CDIS).

[1] In order to provide a detailed overview, we have selected the most important home and host countries (total value of outward and inward FDI higher than USD 100 billion). Bilateral FDI stocks above EUR 300 billion are shown in bold color and those below EUR 300 billion in light color.

Kingdom, the Netherlands, Luxembourg and Switzerland. Likewise, the largest bilateral FDI relationships originated in these countries or relied on them as host countries. In 2017, the share of special purpose entities (SPEs) in the stock of inward FDI was 95.5% in Luxembourg, 65.5% in the Netherlands and 63.1% in Hungary. This share has also markedly increased in other industrialized countries over recent years.

Chart 8

Global FDI growth (2007–2019)



Source: UNCTAD.

Chart 8 shows the development of global direct investment for the period from 2007 to 2018 and a projection for the year 2019, based on preliminary UNCTAD data[8]. "Non-flow changes" were calculated on the basis of stocks and flows and include price and exchange rate effects as well as reclassifications and residual changes.

In 2008, global direct investments had dropped by 16% to USD 15 billion in the course of the financial and economic crisis and subsequent stock market losses, despite positive inflows of USD 1.49 trillion. This was the first setback since 2002. In the years that followed, global FDI seemed largely unaffected by financial market developments, recovering fairly quickly. In 2010, global direct investments even exceeded pre-crisis levels. Although aftereffects of the crisis and geopolitical tensions resurfaced every now and then, FDI stocks continually expanded until 2017. Overall, worldwide FDI expanded by 83.7% between end-2007 and end-2018.

While transactions have been comparatively stable in recent years despite the financial and economic crisis, price and exchange rate effects have been rather volatile.

These patterns were mainly driven by investors from industrialized countries, as they continued to make the lion's share (77.7%) of direct investment abroad, despite the decline by 42.1% seen because of the repatriation of funds. At end-2018, this group of investors was responsible for 86.9% of global outward FDI, with overall capital of USD 27.4 trillion.

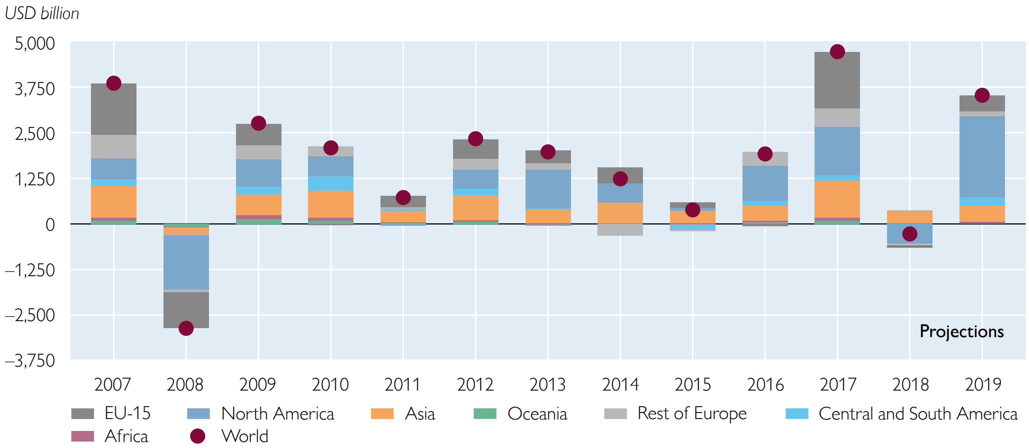
Charts 9 and 10 show a regional breakdown of inward and outward FDI growth between 2007 and 2019.

Although the EU-15, South America and Japan became increasingly attractive for foreign investors and, at the same time, the FDI shares of investors from developing regions grew continually, the regional patterns of global FDI growth

[8] *UNCTAD FDI database. https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx.*

Chart 9

Global inward FDI growth by region (2007–2019)



Source: UNCTAD.

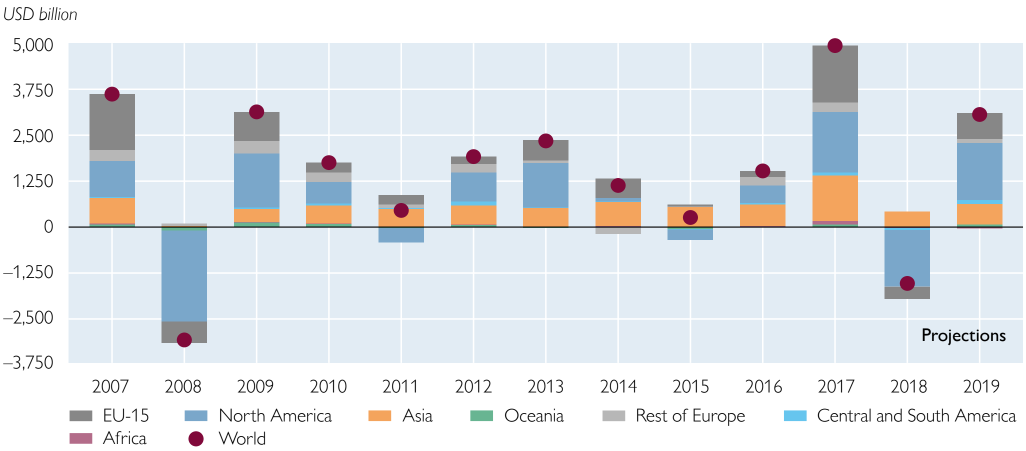
remained mostly unchanged over the entire period. In economically advanced regions, stocks of outward FDI exceeded those of inward FDI, whereas in developing regions and emerging economies inward FDI stocks were higher than outward FDI stocks.

In Austria, foreign-controlled subsidiaries recorded total capital inflows of EUR 4.5 billion in 2018, attracting mainly new investment from Germany (EUR 6.4 billion), whereas US and Russian investors withdrew equity capital from Austria (EUR 2.7 billion and EUR 2.2 billion, respectively). Likewise, the negative performance of stock markets hardly affected Austria's FDI stocks, which increased in both directions (outward: +2.2% to EUR 199.1 billion; inward: +3.3% to EUR 164.5 billion).[9] Hence, at 0.7%, Austrian investors' share in global FDI stocks at end-2018 remained broadly unchanged against the previous year; foreign subsidiaries in Austria accounted for a share of 0.57% of global FDI stocks (see section 1).

[9] *https://www.oenb.at/en/Statistics/Standardized-Tables/external-sector/foreign-direct-investment.html.*

Chart 10

Global outward FDI growth by region (2007–2019)



Source: UNCTAD.

In an international comparison, Austria ranked 22nd as a home country (end-2017: 24th) and 30th as a host country of FDI (end-2017: 29th).[10]

Because of its varied and extensive effects, FDI is a key factor in bilateral linkages worldwide, both in the realm of the economy and social politics. For years, FDI has helped increase GDP growth, promote global financial development and raise living standards. If we look at labor force numbers as an indicator of economic activity, we see that FDI's role in creating jobs has been increasing continually in the past few years. Overall, the number of employees of foreign-controlled subsidiaries reached a global value of 80 million at end-2018.[11] Of these, 261,600 were employed in Austria (total: 3.7 million payroll employees), while Austrian investors contributed 1.14% of jobs with their direct investment abroad.

Direct investment is, as a rule, strategic and long-term in nature. Therefore, stocks are relatively immune to short-term political and economic developments or events. Nevertheless, recent years have shown that FDI can be very sensitive to cyclical fluctuations and geopolitical events.

Recent trends in Europe

In 2018, Europe again lost some of its attractiveness as a location for new investment – not least because of the US tax reform – continuing a trend that had already started in 2016 and 2017. Inward FDI flows declined by 35.8% to USD 388.4 billion. European investors also made fewer investments abroad in 2018 (USD 455.2 billion) than in the three previous years, clearly falling behind Asian investors.

The repatriation of earnings accumulated abroad to the USA affected inward FDI in many European countries, but to differing extents. On the one hand, the United Kingdom recorded a decline in inward FDI flows by 35.5% to USD 65.3 billion, while major host countries – Luxembourg, Ireland and Switzerland – even saw negative inward FDI flows (–USD 16.8 billion, –USD 28.1 billion and

[10] *Annual direct investment survey 2018, Oesterreichische Nationalbank.*

[11] *UNCTAD estimates based on a regression of data for 1980 to 2017.*

–USD 53.2 billion, respectively). On the other hand, several mergers and acquisitions led to higher inward FDI flows in the Netherlands (89% to USD 114.3 billion), in Germany (21.9% to USD 73.6 billion), Spain (16% to USD 45 billion) and France (58.3% to USD 38.2 billion).

Continued geopolitical and business cycle uncertainties in Europe as well as economic dependence on developments in the USA caused significant losses on the European stock and commodities markets. The Euro Stoxx 50 index showed a loss of about 20% in 2018; at the same time, euro-denominated corporate bonds recorded the highest increase in risk premiums seen since the global financial and economic crisis of 2008.[12] These developments had a negative impact on the dynamics of European direct investments, affecting both directions. Consequently, Europe's outward and inward FDI declined for the first time since 2008 (outward FDI: –2.3% to USD 13.9 trillion; inward FDI: –0.8% to USD 12.6 trillion).

Austria continued to contribute a relatively small share to European FDI stocks, coming in 13th in the ranking of outward FDI (1.5%) and in 14th place in inward FDI (1.5%) in 2018. The ranking was led by the Netherlands (outward: 16.2%, inward: 12.7%), the United Kingdom (outward: 12.1%, inward: 14.6%), Germany (outward: 11.2%, inward: 7%), France (outward: 10.1%, inward: 6.2%) and Switzerland (outward: 10.1%, inward: 10.2%), all of them typical FDI investors that saw a continuous rise in stocks of both inward and outward FDI between 2007 and 2018. Within the EU-15, the net balance (outward less inward FDI stocks) went up by 67.4% to USD 2 trillion over the same period.

Austrian outward and inward FDI used to be largely balanced, with both directions of investment recording continuous increases (see section 1) until 2010, when Austrian outward FDI for the first time exceeded inward FDI by EUR 13.9 billion. Since then, outward FDI has exceeded inward FDI, and the balance has continuously increased over time. In the EU-19, Austrian investors' total outward FDI rose by as much as 101.6% to reach EUR 92.7 billion within eight years (from end-2010 to end-2018), whereas investors from EU-19 countries increased their aggregate capital holdings in Austria by just 6.2% to EUR 75 billion. The stagnation in inward FDI from the EU-19 is to some extent due to a restructuring of Bank Austria in 2016 (see tables 2.1 and 2.2 in the "Tables and maps" section).

Chart 11 shows bilateral investment relationships between EU-15 countries and countries of Central, Eastern and Southeastern Europe (CESEE)[13]. We see that, in 2018, the growth of inward FDI in CESEE was very much driven by investment from EU countries, representing 60.4% (EUR 702.2 billion) of inward FDI in CESEE (end-2017: 59.3%).

European FDI statistics have been heavily influenced by multinational groups moving their business operations to the Netherlands, Luxembourg or Ireland to benefit from tax advantages and other incentives, such as enhanced ownership rights and better access to capital markets or sophisticated financial services. Businesses investing capital in countries with favorable tax laws tend to use their subsidiaries to re-invest part of this capital in another country. Through such pass-through activities, the Netherlands, Luxembourg and Ireland have come to be

[12] *https://www.visualvest.de/blog/rueckblick-q4-2018-was-war-los-am-finanzmarkt.*

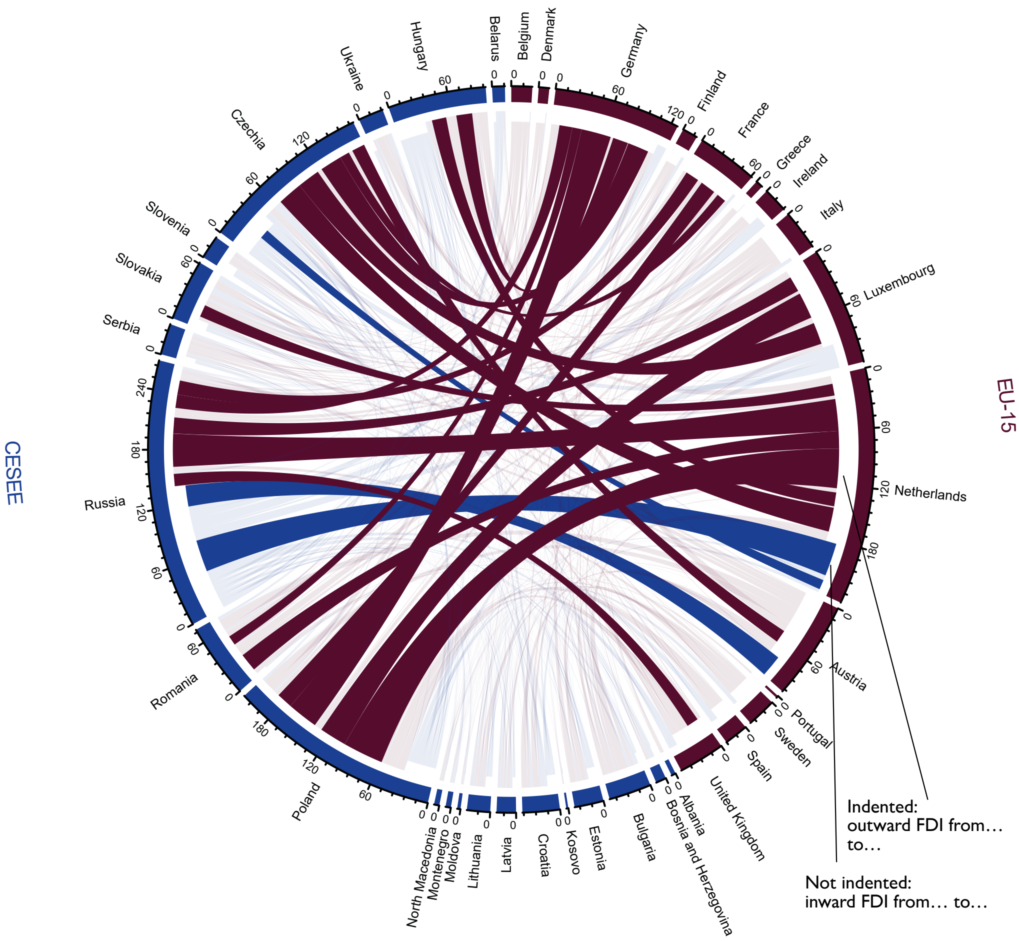
[13] *wiiw FDI Database. https://data.wiiw.ac.at/foreign-direct-investment.html.*

leading investors in CESEE; together, they account for 24.8% of total inward FDI in the region.

Austria is also among the leading investors in CESEE, being able to offer "pass-through" investors in CESEE countries good infrastructure, geographical proximity as well as security, stability and favorable tax conditions for finance-related service providers. At the end of 2018, Austrian investors ranked first in four CESEE countries – Slovenia (23.9%), Croatia (23.1%), Bosnia and Herzegovina (18.3%) and Serbia (13.8%). In North Macedonia (12.9%) and Bulgaria (9.1%), Austria ranked second behind the United Kingdom and the Netherlands, respectively. In Turkey, Austria dropped to the 14th place (end-2016 7%, 4th place) as its share in FDI shrank further to 2.9%. Overall, Austria accounted for 6.4% of inward FDI stocks in CESEE in 2018, thus again ranking fourth behind the three top investors (the Netherlands, Germany and Luxembourg; see chart 10).

Chart 11

Bilateral FDI relationships between individual EU-15 and CESEE economies (end-2018 stocks)[1]



Source: wiiw, FDI Database.

[1] *Bilateral FDI stocks above EUR 10 billion are shown in bold color and those below EUR 10 billion in light color.*

The crisis in Ukraine and the ensuing EU economic sanctions as well as the low oil price made it difficult for Russian enterprises to remain competitive in international markets and gain new market share. At USD 35.8 billion, their investment abroad remained clearly below pre-crisis levels in 2018, as in the three previous years. On the other hand, growing uncertainty on the Russian capital market and lower export demand led to a stagnation of FDI inflows into Russia. Declining by 49% to USD 13.2 billion, they only accounted for 0.8% of overall global investment. Still, with a total of EUR 303 billion in outward and EUR 356.8 billion in inward FDI at end-2018, Russia remained the most important country in the CESEE group.

Next to the Netherlands, Austria remained an attractive location for strategic Russian investors – despite a EUR 3 billion decrease in equity capital bringing the total stock to EUR 22.1 billion in 2018. 13.6% of inward FDI in Austria came from Russian investors, who were the second largest investors after German investors.

Recent trends in the USA

After US inward FDI stocks had reached a record value of USD 7.8 trillion in 2017, favored by the announcement of President Trump's tax reform and the subsequent price gains on global capital markets, they fell to USD 7.4 trillion in 2018 following months of trade conflict between the USA and China. The trade-war ceasefire agreed between the two countries in late 2018 could not stop this negative trend.

Despite political tension and a decline in inflows by 8.5%, the USA remained the largest recipient of global FDI in 2018, attracting USD 253.6 billion.

After the tax reform entered into force in January 2018, US companies withdrew several hundred billion USD of capital worldwide in the first half of 2018. Some of this liquidity was used in the second half of the year to finance cross-border mergers and acquisitions, which increased by some 18%. This in part offset the tax-related slump in outward US FDI but could not prevent the first ever negative outward FDI flows from the USA (–USD 90.6 billion). Overall, the stocks of US investors abroad fell by 17.6% to USD 6.5 trillion.

Recent trends in Asia

China's increasing role in the global economy has a positive impact on FDI growth in Asia. At USD 539 billion in 2018, Asia, for the second time since 2014, recorded more FDI inflows than any other region in the world. China accounted for 9.2% of global FDI inflows in 2018 (end-2017: 8%), which makes it the second most important FDI host country behind the USA.

On the other hand, Chinese enterprises invested about USD 143 billion abroad in 2018 and continued to expand through cross-border mergers and acquisitions, especially in very competitive industries, allowing them to increase their market share in Asia and internationally. US-controlled enterprises, which used to be the top investors abroad, had to cede this rank to Japanese investors in 2018. At USD 143.2 billion, the latter made the largest investments abroad in a global comparison, despite a decline by 13.1%, followed by Chinese and French investors (USD 105.6 billion).

The trend of FDI outflows exceeding inflows in Asia, which started in 2013 (with net outflows of USD 57.6 billion), has been continuing. In 2018, Asia's net FDI amounted to USD 18.1 billion.

Asian-controlled enterprises accounted for EUR 15 billion or 9.3% of inward Austrian FDI, whereas 7.8% of Austrian outward FDI (EUR 15.5 billion) went to Asia.

Recent trends in Africa

Thanks to favorable investment conditions (e.g. low wage level, cheap energy supply and low tax rates), inward direct investments in Africa are similarly stable as in Asia. At USD 50.6 billion they only accounted for 3.3% of global inflows, reaching an overall stock of USD 895.3 billion at end-2018.

Global geopolitical and economic tensions also affected inward direct investment in South Africa, which recorded a decrease in stocks by 11.4% to USD 138.6 billion – despite inflows of USD 5.4 billion (2017: USD 2 billion). Still, South Africa remained the country recording the largest FDI volumes on the African continent, accounting for 76.7% of outward and 15.5% of inward FDI in Africa at end-2018.

2.2 Preliminary data for 2019 and 2020

According to preliminary UNCTAD data the negative trend in global FDI inflows seen in the previous three years could be brought to a halt for the time being, with a moderate rise of 3% (UNCTAD, 2020). Still, at USD 1.54 trillion, global inward FDI flows remained clearly below the average of the last ten years in 2019.

A majority of investments can be attributed to a large rise in cross-border mergers and acquisitions in advanced economies (5.1% to USD 800 million) – in particular in Europe – as the effects of the US tax reform faded. FDI flows into emerging economies increased by 59.1% to USD 54.9 billion, while investments in developing countries decreased by 2.1% to USD 684.7 billion.

Some 82.7% of worldwide investments were made by multinational enterprises domiciled in advanced economies, as US-controlled multinational companies visibly slowed their repatriation of earnings accumulated abroad. Although they increased by 41.6% to USD 1 trillion, the level of outward FDI flows from advanced economies remained relatively low, coming down to only about half of the record high seen in 2007. Outward FDI flows from developing and emerging economies declined by 10% to USD 373.1 billion and by 36.7% to USD 23.8 billion, respectively – causing a significant shift in relative shares.

Though transaction activities were moderate, the stocks of global FDI recorded an increase of 10.7% at end-2019 thanks to rising prices on the global financial markets and greater profitability. Reaching USD 36.5 billion, global FDI stocks accounted for 41.6% of global GDP.

Although Austrian investors withdrew some EUR 7 billion of equity capital in 2019 from Luxembourg, Austrian-controlled subsidiaries abroad received overall capital inflows of EUR 9.7 billion thanks to new investment in den Netherlands (EUR 8.7 billion), Germany (EUR 1.7 billion) and the United Arab Emirates (EUR 2.2 billion). Inward FDI flows to Austria, on the other hand, remained clearly below the level of the preceding two years[14] (EUR 864 million; see section 1). The positive performance of global stock markets also added to a significant increase in outward Austrian FDI stocks (+5% to EUR 209.1 billion) and inward

[14] *https://www.oenb.at/en/Statistics/Standardized-Tables/external-sector/foreign-direct-investment.html.*

Austrian FDI stocks (+6.2% to EUR 175.1 billion). Hence, Austrian investors abroad ranked 22nd, accounting for 0.67% of worldwide stocks. As a host country, Austria ranked 34th with a share of 0.54%.

According to its World Investment Report 2020, UNCTAD expects global direct investment flows to drop sharply by 40% in 2020 in the wake of the COVID-19 pandemic. This forecast is, however, subject to a high amount of uncertainty as it depends on a multitude of factors, such as the duration of the pandemic and the effectiveness of political measures taken to mitigate the impact of the crisis. On the other hand, geopolitical risk factors and continued trade tensions are also increasing the uncertainty of the forecast. The most recent Global Investment Trends Monitor, which was published by UNCTAD on October 26, 2020, sees a drastic reduction of global direct investment flows for the first half of 2020 (–49%).

As financial markets have recovered from the price slumps in March 2020, the effect of the pandemic on global stocks will be less dramatic, although a strong contraction of earnings is to be expected.[15]

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