IMPACT OF THE COVID-19 PANDEMIC ON FOREIGN DIRECT INVESTMENT

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ABSTRACT

Foreign direct investment is an important instrument in the economic growth and development of each national economy. At the same time, they are considered one of the key elements of the globalization process, as they significantly affect the mobility of production factors and world trade flows. Decisions on location choice and form of investment can be made by foreign investors depending on the political and economic situation in the country or the development and stability of specific sectors. The main goal of this paper is to determine whether the crisis caused by the COVID-19 virus has affected FDI mobility. That is, whether in 2020, as the first year of the pandemic, compared to the previous period (2018-2019), there were significant changes in FDI flows. The period covered by the research is from 2018 to 2020. The methodology applied in this research is based on a quantitative approach using available secondary data from the UNCTAD database. The results show that the crisis caused by the COVID-19 virus contributed to a significant reduction in the fluctuation of capital. Specifically, total FDI decreased by about 35% in 2020 compared to 2019, which indicates the negative impact of the COVID-19 crisis on FDI flows.

Key words: Foreign direct investment, Competitiveness, COVID-19, Crisis.

INTRODUCTION

For a country to be able to attract foreign capital, it must first provide a favorable investment climate. Therefore, it is very important that there are stable business conditions, political and social stability, favorable foreign trade, customs, foreign exchange treatment of joint ventures, available, reliable, trained workforce, and access to raw materials and other domestic sources of supply. Foreign companies usually have better operational solutions that can transfer to the domestic economy. These are most often large companies that often employ domestic suppliers and provide technical assistance, education and information needed to improve the quality of their products. Thus, they can benefit not only from increased revenue but also from increased production efficiency. On the other hand, by creating a good investment climate for foreign investors, the state creates additional opportunities for domestic companies and the development of new ideas. The positive impact of foreign direct investment is most pronounced in industry, service development, trade, and the transfer of new technologies. Industries of developing countries in which foreign capital has entered usually achieve good business results and stimulate the country's overall economic recovery (Marjanović & Domazet, 2021a). With the greater globalization of economic activities and the fluctuation of foreign capital, labor and services, countries have begun to "compete" with each other, which will attract as many economic entities as possible to its territory, and thus investments.

The effects of potential foreign investment on the economy are mostly positive, and the key evidence lies in their dynamic growth in recent decades. Until the beginning of 2020, we witnessed the success of some countries in Southeast Europe, which with relatively high inflows of foreign direct investment, experienced equally high export growth rates and attracted a significant number of large projects of multinational companies, especially in the automotive industry. Countries that are competitive and provide foreign investors with an attractive investment environment have had significant economic growth in the last 20 years. However, all that has changed in the last two years due to the consequences of the COVID-19 pandemic.

LITERATURE REVIEW

Nowadays, foreign investments are a necessity and a need for most countries. This is one of the reasons why countries are trying to be more competitive to attract new investments. One of the most efficient ways to increase the country's comparative advantages is foreign direct investment (Marjanović & Domazet, 2021a; Fang et al., 2021). Foreign investment is one of the success factors of the national economy in the global market. Also, attracting foreign investment is necessary for most countries for stable growth (Marjanović & Domazet, 2018). Most developing countries are largely dependent on foreign direct investment and short-term external financing (Mehar, 2021). On the other hand, multinational companies strive to consider all aspects of potential investment and make timely decisions. In making investment decisions, foreign companies usually first take into account the country's economic position (Marjanović et al., 2022; Sharma, 2021). The foreign company chooses the location for investment based on the size of the country but also the potential risk that may adversely affect the company's operations (Garcia et al., 2013). If the level of competitiveness of a country is at a high level, a significant inflow of FDI can be expected, which to some extent may affect its economic growth and development (Marjanović & Domazet, 2021). According to Giofre (2021), portfolio investments react much faster to the interventions of the Government of one country, which in the future may be important to minimize the negative effects produced by the COVID-19 pandemic.

The COVID-19 pandemic has led to a global economic, trade, and investment crisis (Handoyo, 2020). It also caused great damage to the world economy, as it led to the closure of borders between countries, which affected the economic activities of most countries. The negative trend was particularly present in FDI inflows, rising unemployment, and declining foreign trade between countries (Petrovskaya et al., 2022). Using bilateral FDI flows from 173 home countries and 192 host countries, Hajakawa et al. (2022) measured the severity of the damage caused by COVID-19. Based on the analysis, they concluded that the COVID-19 pandemic in the host country had a negative impact on FDI in the manufacturing sector, while in the home countries, the impact on FDI was insignificant. On the other hand, in the services sector, the COVID-19 pandemic had a negative impact on FDI in both groups of countries, which was particularly pronounced in greenfield FDI.

DATA ANALYSIS AND FINDINGS

With the appearance of the COVID-19 virus, there was a significant increase in competition between the countries of a certain region, all aiming to create opportunities and thus provide additional inflows of foreign investment. This form of competition usually occurs between neighboring countries, with significant tax reforms in terms of the competitiveness of tax systems. It is extremely important for each country to be more competitive than the country in the immediate vicinity, which should contribute to a greater inflow of foreign investment. This is especially important during the global crisis when the fluctuation of free capital on the world market has significantly decreased.

The main feature of foreign direct investment is that it can significantly contribute to economic growth and development of a national economy. Therefore, one of the goals of each country is to provide a sufficient inflow of foreign direct investment. Until the advent of the COVID-19 virus, foreign direct investment had a growing trend globally. However, at the beginning of 2020, with the appearance of the COVID-19 virus, there was a reduction in the fluctuation of free capital on the world market. The main goal of this paper was to determine whether the emerging crisis caused by the COVID-19 virus affected the mobility of foreign direct investment. In order to obtain adequate answers and draw certain conclusions, it was necessary to perform an analysis of FDI inflows in the two short-term observed periods. That is, to determine the fluctuation of FDI in the first year of the pandemic (2020) compared to the period before the pandemic (2018-2019). The period covered by this analysis was from 2018 to 2020. An appropriate methodology based on a quantitative approach was applied, while secondary data from the international UNCTAD database were used in the analysis.

In the first part of this paper, performed an analysis of FDI mobility at the global level. Table 1 shows the total amount of foreign direct in countries categorized according to their economic development (developed economies, developing economies, and transition economies) from 2018 to 2020.

Table 1: FDI inflows (millions of dollars)

	2018	2019	2020
Developed economies	707,649	748,999	312,170
Developing economies	692,480	723,385	662,562
Transition economies	36,604	57,844	24,160
World total	1,436,732	1,530,228	998,891

Source: authors, based on the UNCTAD data

Based on the presented data, the inflow of foreign direct investments in 2018 and 2019 amounted to about $ 700 billion, in both developed and developing countries. In the given period, countries in transition lagged significantly behind these countries regarding FDI inflows. However, compared to 2018, during 2019, FDI in these countries increased by about 58%. These countries have realized that creating an adequate investment climate that will favor FDI is necessary. That is a period when countries in transition were largely trying to adapt their markets to the demands of foreign investors. However, the COVID-19 pandemic has significantly affected FDI fluctuations globally. If we compare the inflow of FDI in the year before the pandemic and the first year of the COVID-19 pandemic, the situation is as follows:

a. the total amount of FDI in 2019 was $ 1,530 billion, while in 2020, the amount was $ 998 billion, which is a reduction of FDI by about 35%;
b. the total amount of FDI in developed countries in 2019 was $ 749 billion, while in 2020, this amount was $ 312 billion, which is a decrease in FDI by about 58%;
c. the total amount of FDI in developing countries in 2019 was $ 723 billion, while in 2020, this amount was $ 662 billion, which is a decrease in FDI by about 8%;
d. the total amount of FDI in transition countries in 2019 was $ 58 billion, while in 2020, this amount was $ 24 billion, which is a decrease in FDI by about 59%.

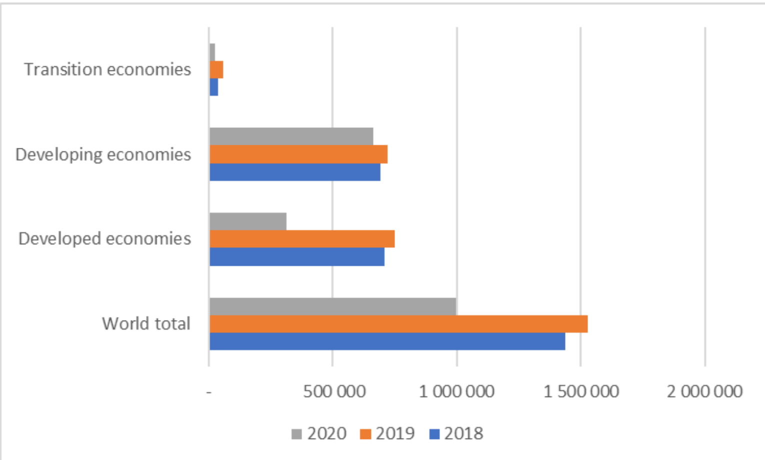

Figure 1: FDI inflows, 2018-2020 (millions of dollars)
Source: authors, based on the UNCTAD data

Based on all of the above, it can be concluded that the consequences of the COVID-19 pandemic decreased by 35% at the global level. Countries in transition and developed countries are the most affected, given that in the first year of the pandemic, there was a decrease in FDI in these countries by 59% and 58%, respectively. The pandemic affected developing countries the least, as FDI inflows in these countries, fell by only 8%.

In the second part of this paper, an analysis of the mobility of foreign direct investment in European Union countries from 2018 to 2020. Data on FDI inflows to EU countries are shown in Table 2.

Table 2: FDI inflows in EU countries (millions of dollars)

	2018	**2019**	**2020**
Austria	5,287	968	- 17,340
Belgium	30,821	2,886	8,437
Bulgaria	1,143	1,717	2,426
Croatia	1,171	1,336	1,304
Cyprus	- 1,735	26,183	- 3,647
Czech Republic	11,010	10,108	6,293
Denmark	1,198	3,587	1,151
Estonia	1,498	3,091	3,156
Finland	- 2,171	13,612	2,575
France	38,185	33,965	17,932
Germany	62,073	54,063	35,651
Greece	3,973	5,019	3,572
Hungary	6,410	3,884	4,169
Ireland	- 16,096	81,104	33,424
Italy	37,682	18,146	- 388
Latvia	967	874	873
Lithuania	977	1,169	479
Luxembourg	- 16,757	14,792	62,145
Malta	4,024	3,784	3,917
Netherlands	87,671	48,963	- 115,300
Poland	15,996	10,853	10,080
Portugal	7,115	12,084	6,324
Romania	6,219	5,791	2,322
Slovakia	1,675	2,449	- 1,930
Slovenia	1,384	1,227	529
Spain	53,495	8,515	8,928
Sweden	4,221	10,112	26,109
EU Total	**347,437**	**380,281**	**103,190**

Source: authors, based on the UNCTAD data

Looking at the total inflow of foreign direct investments at the level of the European Union (Table 2) in 2018, it was over $ 347 billion. In the following year, FDI increased by 9% ($ 380 billion). However, in the first year of the COVID-19 pandemic, there was a drastic reduction in FDI inflows to EU countries, which was reflected in a 73% drop in these investments compared to 2019.

Some EU countries were in a situation of reduced FDI inflows even before the global crisis caused by the COVID-19 virus. At the very beginning of the analysis, comparing the inflow of FDI in 2018 compared to 2019, it is clear that more than half of the EU countries have encountered the problem of reduced FDI inflow. The COVID-19 virus has further caused reduced FDI intensity and fluctuation in EU countries. If we talk about the decline in FDI in 2020, the negative record is held by the Netherlands, followed by Austria, Cyprus, Italy, and Slovakia.

However, it is also worth noting that some EU countries attracted more FDI in 2020 compared to the year before the pandemic. Observing individually by country, the largest recipient of FDI during 2020 was Luxembourg, with over $ 62 billion (an increase of 320% compared to 2019). Sweden also had a higher inflow of FDI in 2020 with $ 26 billion (an increase of 158% compared to 2019). In addition to these two countries, only Spain, Malta, Hungary, and Estonia can boast a small increase in FDI in the first year of the COVID-19 pandemic compared to the previous year.

Perhaps it is even more important to determine how much foreign direct investment the EU countries have managed to attract in the observed period concerning the overall fluctuation of these investments at the global level.

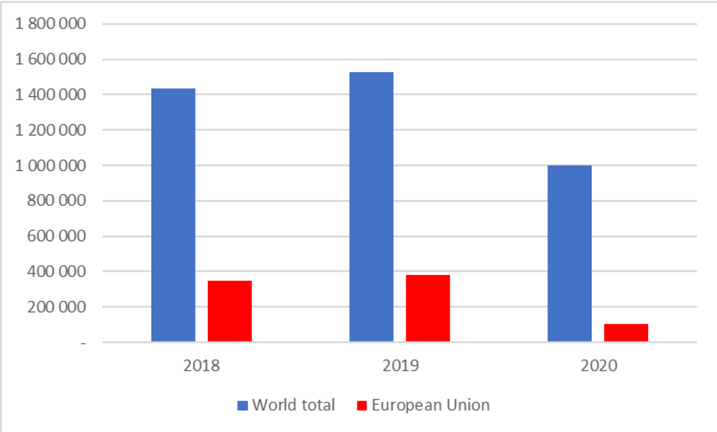

Figure 2: Total FDI inflows, 2018-2020 (millions of dollars)
Source: authors, based on the UNCTAD data

According to official UNCTAD data, comparing total FDI at the global level and FDI at EU level, the situation is as follows: (a) in 2018, EU countries attracted 24% of total world investment, (b) in 2019, EU countries attracted 25% total world investment and (c) in 2020, EU countries attracted 10% of total world investment.

Based on the above, it is more than clear that the global crisis caused by the COVID-19 virus has greatly affected FDI mobility. Most countries in the European Union are particularly noteworthy in decline in foreign direct investment. The situation is no better in other regions of the world. The trend of decreasing FDI fluctuations continued in 2021, and it is expected that in 2022 the world market will stabilize and recover from the consequences caused by the COVID-19 virus.

CONCLUSION

Foreign direct investment has a very significant impact on the economic growth and development of each national economy. On the one hand, they increase the efficiency of multinational companies, while on the other hand, they significantly help the development of that economy. If competition increases, companies will seek to invest in other countries, which automatically means that investments are based on efficiency. In contrast, the growth of FDI will significantly increase the competitiveness of companies.

In a situation when the COVID-19 pandemic has significantly slowed down the flow of free capital on the world market, foreign investors are taking special care of their investment. When the world economy is in crisis, investors usually invest capital in countries with economic growth, pursue a stable macroeconomic policy, and have a stable political situation. However, the consequence of the economic and social crisis caused by the COVID-19 virus contributed to the decline in aggregate demand, which was accompanied by a decline in investment, both domestic and foreign.

Developed countries and countries in transition most felt the lack of foreign direct investment. This situation is very unfavorable for many economies, given that FDI has been significantly represented in a large number of economies in recent years. In order to deal with the global crisis and the lack of FDI in the most efficient way, countries need to pursue a rational economic policy, ensure a good fiscal position and create an economic environment that will allow foreign investors to invest in one of these economies. It is very important to create a support program to attract foreign investment in targeted sectors, which will be created as a response to the economic challenges facing countries, which are the result of the COVID-19 pandemic.

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