

TOWARD THE "NEW NORMAL" AFTER COVID-19 – A POST-TRANSITION ECONOMY PERSPECTIVE

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7. Foreign direct investment and the Covid-19 pandemic: The real economy perspective and theoretical implications¹



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Abstract

Purpose: The objective of this chapter is to discuss the effects of the Covid-19 pandemic on the international operations of firms, with a particular focus on foreign direct investment.

Design/methodology/approach: The real economy perspective was adopted, whereby basic relationships in terms of the development of FDI flows and transactions worldwide were analyzed. In addition, primary data from a survey of internationally operating Polish firms were analyzed in order to shed additional light on the influence of the pandemic on international economic activity. In addition to formulating observations with regard to general patterns emerging from the data, an attempt has been made to outline the likely theoretical implications of the pandemic for FDI research.

Findings: In the short term, there was a significant limitation of FDI, caused mainly by the introduction of lockdowns. In the middle and long run, the current crisis will likely translate

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into a continued slowdown in FDI flows. On the other hand, as we may see from the early evidence analyzed in the chapter, the impacts on the international economic activity vary across locations at different levels of economic development, but also between different industries and business models.

Research implications: From a theoretical perspective, we must note that in the short run the existing theoretical concepts can be helpful in explaining the present phenomena. However, in the long-term perspective a number of fundamental assumptions may require several revisions outlined in the chapter.

Originality and value: The chapter includes an analysis of recent macro- and micro-level data on the effects of the pandemic on international business, along with forecasts for the post-pandemic period. Apart from the practical dimension of the analyzed primary and secondary data, the chapter also offers a number of theoretical implications.

Keywords: foreign direct investment, Covid-19 pandemic, globalization, international business.

7.1. Introduction

The Covid-19 pandemic can be treated as an unpredictable side effect of human behavior, which has led to adverse interactions between the functioning of civilization and the natural environment (Gorynia, 2020a, b, c; 2021). Its effect is a crisis of the public health system on a global scale, and the accompanying unprecedented economic crisis, also afflicting the entire world economy (Wolf, 2000). As Roubini (2020) argues, human interference with the natural environment increases the likelihood of contact with disease vectors, such as animals or frozen viruses in glaciers.

An important thread in the ongoing discussion on the economic conditions, manifestations, and consequences of the Covid-19 pandemic is globalization, which – ironically – can be treated as one of the key factors contributing to the above transformations of the natural environment. Indeed, globalization can be seen as the international exploitation of natural resources beyond their capacity, which can be symbolically summarized with such categories as *homo oeconomicus*, profit maximization, GDP growth fetish, or excessive and irrational consumption (Gorynia, 2020d, e). One of the two manifestations of globalization, alongside international trade, is foreign direct investment (FDI). In this sense, there are mutual cause-effect links between the pandemic and FDI. On the one hand, the expansion of FDI as a component of globalization may have contributed to the negative environmental consequences caused by human activity, and conversely the pandemic has far-reaching consequences for FDI flows.

The objective of this chapter is to discuss the effects of the Covid-19 pandemic on FDI. On the one hand, the real economy perspective was adopted and the basic relationships in terms of impacts on FDI flows worldwide and in Poland were outlined, taking into account the effects of this impact to date and the future outlook.

On the other hand, an attempt has been made to outline the likely theoretical implications of the pandemic for FDI research. From the methodological point of view, the text is based on a simplified, descriptive, proprietary analytical framework outlining the basic relationships between the pandemic and FDI.

7.2. The impact of the Covid-19 pandemic on FDI activity worldwide and in Poland

7.2.1. Current macro- and micro-level evidence

The essence of FDI boils down to investing in the development of business ventures outside the country of registration of the company with a view to a long-term involvement in production or service activities in order to obtain benefits most often associated with profit-making. The Covid-19 pandemic has created a global disruption that undoubtedly affects many areas of human activity worldwide (Walsh, 2020). Most country governments between March and April 2020 decided to introduce drastic measures to combat Covid-19. By the beginning of April 2020, it was estimated that more than 3.9 billion people, or half of the world's population, were ordered to stay at home by their governments (Euronews, 2020).

While it may be still too early to quantify fully the effects of the global value chain (GVC) disruptions due to the pandemic, it is clear by now that the initial decline in production in different locations has exerted a strong impact on countries further up and down the supply chain. Countries imposed restrictions on movements to combat the spread of the virus, limiting demand worldwide, while on the other hand, concerns about health and safety of employees led to factory closures, hence afflicting the supply side. This double effect was called the second shock, whereby supply bottlenecks and falling consumer demand led to a global downward spiral, which could discontinue the functioning of cross-border supply chains and afflict FDI.

No wonder that FDI inflows worldwide almost halved in the first half of 2020 as opposed to the 2019 6-month average (UNCTAD, 2020a). As it can be seen in Table 1, the decline was more pronounced in developed economies where it amounted to -75% and brought FDI inflows back to the level of 1994. Interestingly, there are differences in impacts between different modes of FDI (see Table 2). In general, greenfield FDI projects – i.e. foreign subsidiaries established from scratch – were more strongly affected, with a decline of 37% as opposed to the mere 15% for mergers and acquisitions (M&As). In line with FDI flows data quoted above, the M&A deals were clearly more resilient to the pandemic crisis in some developing countries, particularly Asia, but also in transition economies

Table 1. FDI inflows by region, H1 2020 vs. 2019 six-month average

	2019 six-month average*	2020 H1*	Percent change
World	777	399	-49
Developed economies	397	98	-75
<i>Europe</i>	203	-7	-103
<i>North America</i>	156	68	-56
Developing economies	352	296	-16
<i>Africa</i>	23	16	-28
<i>Latin America and the Caribbean</i>	83	62	-25
<i>Asia</i>	246	217	-12
Transition economies	29	5	-83

*in billions of USD.

Source: Own elaboration based on (UNCTAD 2020a, p. 2).

Table 2. Investment trends by type and region, 2020 Q1–Q3 (percent change vs. 2019)

	Cross-border M&As	Greenfield projects*	International project finance**
World	-15	-37	-25
Developed economies	-21	-17	-19
<i>Europe</i>	-5	-17	-17
<i>North America</i>	-32	-25	-34
Developing economies	12	-49	-25
<i>Africa</i>	-44	-66	-49
<i>Latin America and the Caribbean</i>	-73	-53	-34
<i>Asia</i>	60	-42	8
Transition economies	84	-58	-46

*The trend in greenfield projects refers to the first eight months of 2020. ** International project finance refers to (the trend in) the number of deals, as project values for the latest months are unavailable.

Source: (UNCTAD 2020a, p. 6).

at large. Moreover, from a sectoral perspective M&As declined by 76% in the primary sector and 27% in manufacturing (UNCTAD, 2020a). Likewise, greenfield projects declined particularly strongly in manufacturing (49% decline), particularly coke and petroleum products (89% decline).

Regarding the FDI situation in Poland, according to preliminary OECD (2020) data, FDI inflows to Poland fell to USD 5.64 bn in Q1 2020 from USD 7.73 bn in the same period in 2019. In turn, FDI outflows from Poland increased from USD 50 to 252 m, respectively. While the first quarter of 2020 covered only one month of the lockdown, it may be a preliminary sign of the relative resilience of Polish outward FDI (Gorynia & Trąpczyński, 2020).

This appears to be corroborated by firm-level evidence based on the study of N=500 Polish firms from the manufacturing sector, involved in international business (see Figure 1).² Roughly 35% of the surveyed firms reported a slight to significant decline in the number of served international markets in the period March-September 2020 as compared to the comparable period of 2019. For almost

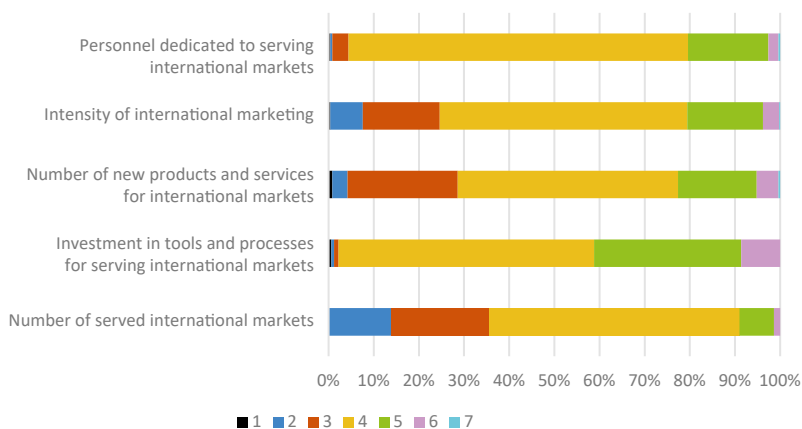


Figure 1. Change of international market involvement during Covid-19 pandemic relative to a comparable period in 2019 (N=500)

Scale: 1 – significant decrease; 4 – no change; 7 – significant increase.

Source: Own elaboration.

30% of them, the number of new products and services for international markets also declined. About 25% acknowledged a reduction of the intensity of international marketing due to a shift in priorities. On the other hand, such areas

² Data were gathered between September and November 2020. Hereby, international business is understood as all forms of foreign market involvement, some of which include FDI.

as investment in tools and processes for serving international markets and the personnel dedicated to serving international markets remained mostly unchanged.

7.2.2. Future outlook

Based on the current situation in international trade and investment, it is not unrealistic to accept that the consequences of the pandemic for FDI will be more devastating and deeper than those of the 2008 crisis (Olivie & Gracia, 2020). According to the World Investment Report 2020 (UNCTAD 2020b), FDI is projected to decrease by a further 5–10% in 2021 and to initiate a recovery only in 2022.

Considering that FDI inflows and outflows from Poland did not show a clear trend and fluctuated significantly in the past years, we can expect deepening declines or a slowdown in temporary increases due to the current situation and the unexpected extent of the second wave of the pandemic since October 2020. It can be assumed that in terms of FDI inflows, the declines in Poland will be lower than their average global level due to the relative investment attractiveness of Poland in Central and Eastern Europe, but also due to the search for new, closer locations in the period of disruption of value chains (Gorynia & Trąpczyński, 2020).

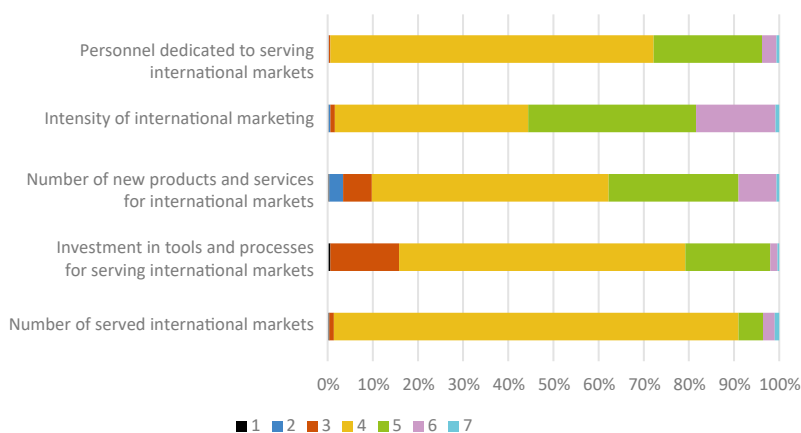


Figure 2. Expected change of international market involvement in 2021 as compared to the Covid-19 pandemic period in 2020 (N=500)

Scale: 1 – significant decrease; 4 – no change; 7 – significant increase.

Source: Own elaboration.

However, the future situation may be less favorable in the case of FDI outflows. In the conditions of falling profits and implementation of ad hoc anti-crisis

measures, decisions on many investment projects may be suspended or postponed, considering the dominance of sales motives among Polish FDI. This skepticism is voiced by the Polish firms doing international business (see Figure 2). Regarding changes in their international involvement until 2021, Polish firms see no change as opposed to the 2020 pandemic period. Moreover, they anticipate further reductions in such areas as investments in tools and processes for international markets and new product launches. In this context, the further development of outgoing FDI may strongly depend on public support instruments for foreign investors.

7.3. Implications of the Covid-19 pandemic in the light of FDI theories

7.3.1. Short-term influence on FDI theories

A number of theoretical approaches have been developed to explain FDI and the rise of transnational corporations (TNCs).³ As it is not the objective of the authors to review FDI theories in detail here, one can refer to some classification attempts, such as the one by Ietto-Gillies (2019), which includes the monopolistic advantage theory, international product life cycle theory, oligopolistic reactions, the geographical patterns of FDI, the currency areas approach, the internalization theory, Dunning's eclectic framework, the Uppsala model, evolutionary theories of TNC, and new trade theories.

In addition, Forsgren (2017) identifies six overarching TNC concepts he describes as “tales:” the Dominating multinational – a tale of market power; the Coordinating multinational – a tale of cost efficiency; the Knowing multinational – a tale of value creation; the Designing multinational – a tale of strategic fit; The Networking multinational – a tale of business relationships, and the Politicizing multinational – a tale of legitimacy and power.

Overall, it can be argued that, in the short term, Covid-19 does not fundamentally challenge any of the FDI concepts per se, because it triggers an economic crisis related to exogenous factors which do affect the real economy and economic policy. These theories, which provide complementary perspectives on FDI, its motives, modalities, and performance outcomes, can help to understand the immediate effects of the pandemic. For instance, if one regards the pandemic from the point of view of uncertainty in foreign markets, the location-centered concepts draw attention to shifts between locations to those less affected by the economic and health crisis. From the perspective of concepts exploring network

³ Due to volume constraints, these approaches can be viewed as synonymous.

relationships, the limitation of cross-border human activity and search for alternative channels fits into the existing network-related concepts. Likewise, resource- and knowledge-focused approaches to FDI hold their validity, albeit drawing attention to specific types of capabilities which generate competitive advantage in crisis conditions, such as operational flexibility, new IT solutions, or the ability to adjust business models to new market demands instead of a reactive cost-cutting approach. On the other hand, the internalization approach underlines the tendency to organize cross-border activities within company borders in order to protect know-how. It can be expected that his line of reasoning will be complemented with a transaction-cost based logic of outsourcing certain processes like manufacturing or foreign distribution in order to minimize overseas footprint and increase the reversibility of operations.

7.3.2. Long-term influence: The “new normality” in economics

With regard to the long-term effect of the pandemic on theoretical concepts of FDI, one can argue that this influence will occur indirectly due to the possible pandemic-induced evolution of general principles of economic activity, whereby the current crisis amplifies some earlier trends. For instance, profit maximization as a dominant criterion in international expansion decisions, including FDI as the most advanced form of internationalization, can likely be supplemented with the resilience logic. In fact, economic effectiveness may not materialize if there is no adequate backup against hardly predictable exogenous shocks that can disrupt FDI networks of firms. Likewise, a visible shift toward self-sufficiency may pronounce itself in the tendency of states to become more independent from international supply channels, which have recently proved fragile, adding to the co-existing trend of skepticism toward globalization and the re-emergence of nation states. At the microeconomic level, the self-sufficiency imperative will possibly express itself, at least to some extent, in a departure from hyperglobalization understood as an excessive fragmentation of value chains across highly dispersed locations (Buheji & Ahmed, 2020). The process of shortening value chains and reducing distance between the individual links is likely to induce a shift toward regionalization in international economic cooperation.

Moreover, the current developments also underline the relevance of environmental criteria in business decisions to make them more aligned with the imperatives of the so called green economy. In the same vein, the attention paid to need for consideration of the climate neutrality and a related withdrawal from pollution-generating technologies can be regarded as an important impulse to include new non-economic variables, both in decision practice and theoretical concepts. Another recommendation pertains to conducting business in ways which reduce excessive inequality at the level of the world and specific countries, whereby

international tax regulations could be among instruments supporting the implementation of these goals (Djankov & Panizza, 2020).

Among further implications for the post-pandemic economic landscape, one can also name the departure from excessive consumerism related to an irresponsible exploitation of the natural environment, pollution growth, and resources depletion, with a whole array of negative effects for individual and public health. Accordingly, the “new normality” would be characterized by a certain set of rules that is still emerging, yet whose initiation occurred before the pandemic and has been catalyzed by the present situation (Manyika, Pinkus, & Tuin, 2000). It must be noted that the modification of existing decision-making algorithms regarding FDI will not occur overnight and is likely to be a long-term process. However, if the said postulates indeed manage to materialize, then the priorities in the contemporary FDI paradigm will inevitably change. The fundamental economic category, which this change will depend on, is the *homo oeconomicus*. Without a fundamental revision of the content of this construct, the new post-pandemic reality may in fact not be free from its current deficiencies.

7.4. Conclusions

The global economic crisis caused by the Covid-19 pandemic shattered the foundations of the market economy on a global scale. In the short term, there was a significant limitation of FDI, caused mainly by the introduction of lockdowns in virtually all countries around the world, with related restrictions limiting human interactions and, therefore, economic activity. In the middle and long run, the current crisis will likely translate into a continued slowdown in FDI flows. On the other hand, as it can be seen from the early evidence reviewed in the chapter, the impacts on the international economic activity vary across locations at different levels of economic development, but also between different industries and business models. From a theoretical perspective, one must note that in the short run the existing theoretical concepts can be helpful in explaining the present phenomena. However, in the longer-term perspective a number of fundamental assumptions are likely to – or rather should – be revisited.

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