Bulletin of the Institute for Western Affairs

IFDI and OFDI developments and policies in Germany in the aftermath of the 2008+ crisis

Marta Götz

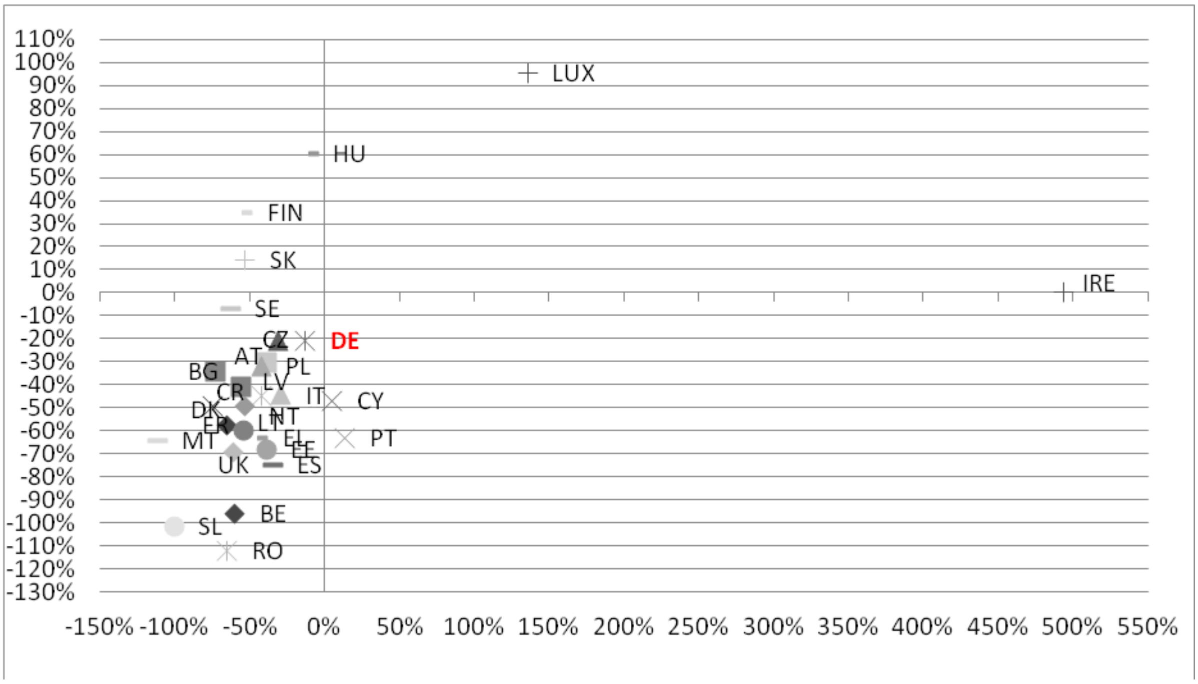
The significant declines in international foreign direct investment (FDI) observed in the aftermath of the 2008+ crisis and the accompanying ideological shifts in the role of the state in the economy have both inspired research on FDI policies in Europe at large and in Germany in particular. Whereas significant crisis-induced adjustments were made in major fiscal and monetary policies, little is known about the possible modifications to policies in other secondary areas of governmental activity such as foreign direct investment. FDI is regarded as being the most advanced form of international capital flows. Whether in the form of Mergers and Acquisitions (M&A) or Greenfield Projects, it is associated not only with pure flows of funds but also with transfers of know-how, technologies, new managerial solutions and forms of organization. The IFDI and OFDI statistics retrieved from the Eurostat and a comparison of pre-2008 and post-2008 figures reveal certain regularities in the magnitude of FDI change in the EU. Analysis of scatter plots shows that the FDI flows of certain countries clearly stand out even if no distinct trends can be detected.

No. 208/2015
18'12'15

Institute for Western Affairs
Poznań

ISSN 2450-5080

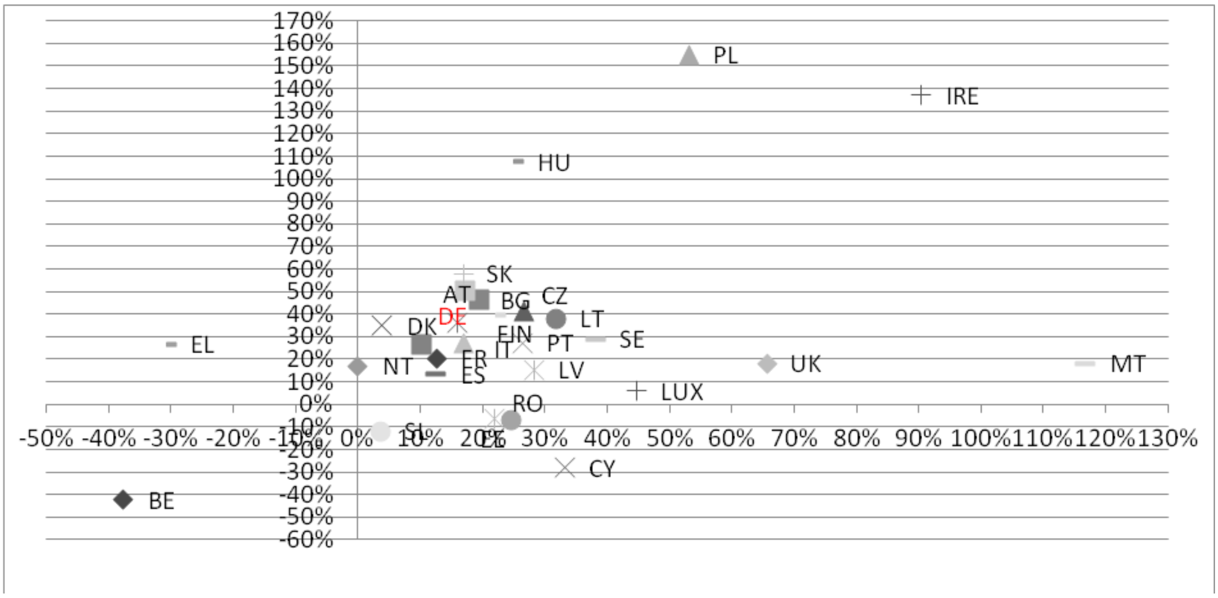
Changes in average FDI flows (2004-2008 vs. 2009-2013, inflows on axis X, outflows on axis Y)



Own elaboration based on Eurostat, 2015

FDI stocks are made up of the flows accumulated over time abroad or in the reporting economies.

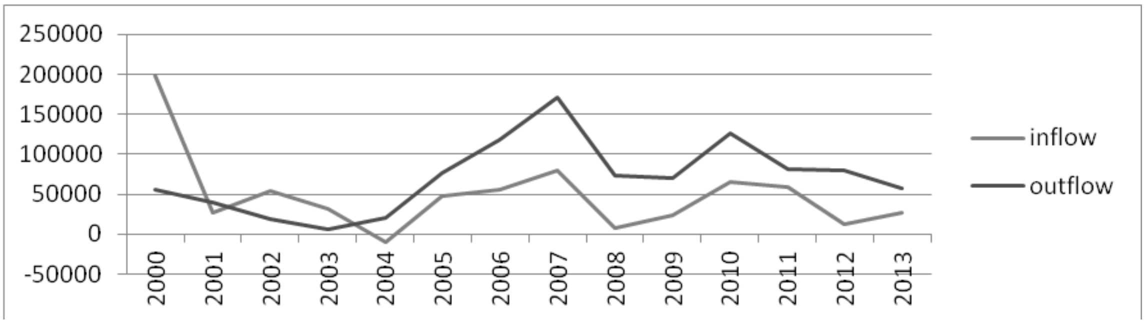
Changes in FDI stocks from 2008 to 2012 (stocks in reporting economy on axis X, stocks abroad on axis Y)



Own elaboration based on Eurostat, 2015

The average value of inward FDI flows directed to Germany in the 2009-2013 period fell by 13% from 2004-2008. The average value of trans-border FDI outflows originating in Germany in the above periods declined by 21%. Nevertheless, such drops did not translate into lowering the accumulated FDI. In 2012, Germany's IFDI stock rose by 16% on 2008 whereas German OFDI abroad increased by 37%. Complementary information from the UNCTAD database confirms that the German IFDI stock increased by 22% from before the crisis to 2012. The German OFDI stock abroad climbed by 28% from 2007. As of 2013, the value of Germany's new inward FDI remained at 67% below the pre-crisis year of 2007. In 2013, OFDI flows from Germany were down by 66% compared to 2007 outflows.

FDI inflow and outflow in Germany (2000-2013, USD million)



Own elaboration based on UNCTAD, 2015

In 2009-2013, Germany's average market integration measured in terms of FDI levels amounted to 1.56, down from the 2.06 level maintained in 2004-2008. With minor exceptions in 2007 (4%), 2009 (2%) and 2010 (1%), Germany has kept its spread between inward flows to GDP and the EU's average inward flows to GDP at the constant level of 3%.

One can hypothetically assume that such (post)crisis fluctuations in FDI flows can be explained by Germany's policies. While it is hard to imagine that Germany's policies could have an impact without resorting to sophisticated econometric methods, it seems worthwhile inquiring whether any policies were in fact modified. The FDI policy is a very broad category encompassing a variety of measures, agencies, levels and areas. It may be described as a general strategy as well as in terms of practical, administrative issues. Besides specific regulations that foster or hamper FDI and dedicated bodies tasked with dealing with foreign investors, various subnational provisions or complementary rules are in place that can also exert profound influence on FDI. It seems worthwhile viewing the FDI policy against the background of the government's overall activities. It was particularly post the 2008+ crisis that the ruling parties of the EU member states found themselves forced to bring their economies into alignment through a combination of the opposed approaches of carrots (rescue packages) and sticks (unparalleled austerities). The German administrations in power since the year 2000 have invariably accumulated deficits. Although a slight improvement came around 2007, the crisis has left its mark on public finance also in Germany widening the gap between revenues and spending. Although revenues rose by 18% from 2007 to 2014, they were nevertheless outperformed by spending which increased even more sharply by 21%. For a complete picture of the trends followed by the government's general revenues and expenditures, one needs to examine deficit and debt levels against the allowed thresholds. In 2013, Germany reported a balanced budget with revenues equalling expenditures. Yet, its debt of 78.1% of the GDP exceeded the allowable threshold of 60%. The Global Competitiveness Report 2014-2015 ranks Germany's "public institutions" as the 7th best across the EU with a score of 5.2 points. In the category of "government efficiency", Germany scored 4.5 elevating its ranking to 7th best among all EU member states.

The most basic classification of FDI policies distinguishes between OFDI and IFDI as well as hostile and friendly approaches to FDI. Given the lack of a reliable single source of FDI policies worldwide, a number of indicators stored in the repositories of international organizations have been selected on the basis of a review of relevant databases. These may be seen as the best possible substitutes for genuine FDI polices. In particular, reference may be made to (1) the OECD's Investment Regulatory Restrictiveness Index (IRR); (2) the Reform Responsiveness Index (RRI); (3) the existing Bilateral Investment Treaties (BITs) provided by the EU and UNCTAD; (4) claims lodged under Investment State Dispute Settlement procedures (ISDS) reported by UNCTAD; (5) the Doing Business ranking of the World Bank; (6) statistics on the number of OFDI support centres provided by the EU Commission; (7) the corporate income tax rates published by the US-based Tax Foundation; (8) the attractiveness ranking provided in the Global Competitiveness Report of the World Economic Forum; (9) the Index of Economic Freedom – an annual guide published by *The Wall Street Journal* and The Heritage Foundation and (10) indicators on discriminatory measures that are "harmful to foreign commercial interests", as reported by the Global Trade Alert. The above provide insights into the progress achieved in ongoing reforms, the degree of openness to the international community and the level of compliance with existing anti-discriminatory laws.

Germany has been mentioned twice by the Global Trade Alert in the context of having launched measures that are harmful to investment. One such measure was the nationalisation of the Hypo Real Estate bank and the expropriation of its minority shareholders (as of October 13, 2009), the other: a review of foreign investments on national security and public policy grounds (launched on April 18, 2009). The number of ISDS cases filed against Germany has increased from 2 to 3 since 2008. Despite its position as leader in terms of the number of BITs concluded (134), or perhaps as a result of such a position, Germany has only concluded three new BITs since 2008. Its investor regulatory restrictiveness index is low at 0.023. The GCR assess Germany's FDI attractiveness at 4.8, which is above the EU average of 4.5. The overall picture that emerges from the above assessments of Germany's inward FDI policy may suggest that the country's policy towards incoming investors remains friendly.

Germany is among the countries that lag behind the EU average in launching the OCED recommended reforms (scoring 0.073 vs. the EU's 0.200). Its position in the Doing Business ranking has also deteriorated from 2014 to 2015. Nevertheless, Germany's score in the Heritage Freedom ranking has improved (+3.2). The official number of Germany's OFDI support providers, i.e. 78, places the country at the very head of the European Union. Germany's corporate income tax rate has been fluctuating since 2007 and is currently above the EU average (at 2.95). Based on changes in the basic indicators applied in its outward FDI policy, the OFDI policy being pursued by Germany seems to be rather unfriendly.

Once a given country's approaches to the IFDI and OFI have been combined, they are suited for classification into one of the FDI policy models:

1. an open model – both types of FDI are seen as making positive contributions to the economy;

2. a closed model – outbound and inbound investment is associated with losses to the national economy;

3. a competitive model – the state seeks to stimulate the rise of internationally competitive domestic companies while restricting foreign investment which is perceived as posing a threat to incumbent businesses;

4. a capital model – the state clearly seeks to promote capital accumulation and prevent the outflows of domestic businesses while attracting foreign investment.

The above classification must be regarded with caution as a rudimentary template for simple cross-country comparisons in the policy domain which remains rather underexplored despite the profound changes taking place in this area. The reason for this is that, firstly, in the aftermath of the crisis, economic patriotism, nationalism and protectionism are being revived by politicians struggling with meagre growth and even bleaker outlooks. Secondly, there is another related trend of growing popularity of the idea of reindustrialization. Governments see the return of industry as a chance to overcome negative declining trends in mature, aging economies at the risk of secular stagnation. Thirdly, FDI policy following the Lisbon Treaty has been shifting from the national to the supranational level and into the exclusive remit of the European Commission. Fourthly, the crisis and the abuses that have been revealed, including speculative capital flows, have prompted decision-makers to revisit the current methodological approach to foreign investors which has lead to a more precise definition of genuine FDI opposed to capital in transit. Fifthly, the TTIP, which is currently under negotiation, appears to be a game changer for the FDI landscape. While its full impact remains unclear, it is expected to be profound.

A combination of the evaluations of changes in Germany's IFDI and OFDI policies suggests the country is pursuing a friendly IFDI and an unfriendly OFDI policy. Therefore, in the proposed typology, Germany may be regarded as an example of the capital model.

FDI policies pursued by Germany

Total of IFDI policy	Total of OFDI policy	Presumed treatment of IFDI	Presumed treatment of OFDI	Profile / model
4 pos. 2 neg.	4 neg. 2 pos.	Friendly	Unfriendly	Capital model

Own proposal

The above classification of Germany's FDI policies draws on a set of variables which, in most cases, have been fairly imperfect substitutes for FDI policy measures selected in view of the limited availability of data and/or the sensitivity of the subject matter. Hence, the findings must be treated with caution to prevent possible misinterpretations. An interesting area for further research would be to find whether the identified approach is aligned with the policy evolution stipulated by Dunnings' Investment Development Path (IDP).

All views expressed in this article are exclusively those of its author.

This article presents selected outcomes of the Research Project "The State's role in Europe's (post)crisis economy – policies towards foreign direct investment" funded by the National Science Centre by decision DEC-2014/13/B/HS4/00165 and presented during the conference "Germany in the modern world. The economic aspect" organised by Institute for Western Affairs and Konrad Adenauer Stiftung on 2nd December 2015.

Konrad Adenauer Stiftung

Marta Götz is an economist at the Poznań Institute for Western Affairs.