THE IMPACT OF THE COVID-19 PANDEMIC ON GLOBALIZATION AND FOREIGN DIRECT INVESTMENT FLOWS

Dr. William L. Casey, Jr.
Babson College, MA

ABSTRACT

The COVID-19 pandemic has inflicted economic pain on the global community as well as physical pain. The pandemic has compounded a series of global problems that preceded the outbreak. These problems include growing nationalism, protectionism, and other forms of anti-globalization. Sharp declines in foreign direct investment (FDI) flows have been recorded, particularly in those developing countries with the greatest need for capital infusions. The short-term effects of the pandemic are already visible with both demand-side and supply-side shocks damaging the global economy. Traditional supply chains have been particularly disrupted. The long-term impact is more difficult to forecast. Whether anti-globalization and declining FDI flows continue over time depends on how national governments, global health agencies, and multinational enterprises ultimately address the underlying economic issues of the pandemic.

Keywords: Pandemic, Multinational Enterprises (MNEs), Foreign Direct Investment (FDI), Global Supply Chains, Globalization

INTRODUCTION

It has been well-established in the scholarly and commercial literature that economic globalization over the past quarter of a century has contributed positively to global growth. An important part of globalization has been the promotion of foreign direct investment (FDI) including the free movement of capital, goods, services, and personnel across international borders (Erixon, 2020). Capital-poor developing countries have been beneficiaries of capital infusions by multinational enterprises (MNEs). Manufacturing companies have been attracted by favorable labor market conditions in developing countries and by the related cost advantages of establishing supply chains in these regions.

Historically, it can be demonstrated that FDI, as a component of globalization, has produced a positive-sum game, bestowing benefits on MNEs, on capital-exporting industrialized countries, and particularly on capital-importing developing nations (Public Response Team of the OECD, 2020; Zhan, 2020). Even before the destabilization effect of the pandemic, other global events have combined to discourage outward FDI by MNEs, including the great recession of 2008 and the global financial crisis of recent memory. Unfortunately, the pandemic has compounded these problems, leading to accelerated disinvestments.

Following an outlining of the economic benefits of globalization and FDI flows, this paper will then examine the pre-pandemic FDI climate, leading to a comprehensive analysis of the negative effects of the pandemic and of pandemic-induced government policy reactions. A concerted effort is made to project short-term and long-term forecasts about what the future holds in this regard.

THE ECONOMIC BENEFITS OF GLOBALIZATION

This paper takes the position that the COVID-19 pandemic and the government policies it has nurtured are threatening the continuation of the efficient international allocation of resources through globalization. This is important for various reasons.

Globalization in the extreme involves the free movement of goods, services, personnel, capital, and other resources across international borders without artificial restrictions or barriers. These freedoms create a business environment that MNEs look for in locating and managing their international operations. Accordingly, this business environment nurtures and supports the flow of FDI capital abroad which in turn creates efficiencies and benefits to (a) investing companies, (b) FDI-exporting countries, and, (c) FDI-importing countries. (Erixon, 2020).

For the investing MNE, outward FDI has enabled firms to capture positive returns from their investments in research and development (R & D), innovations, and new technologies. It has opened access to new markets, thus producing new revenue streams. Outward FDI has also produced cost savings by creating supply chain linkages in areas where labor productivity/wage rate ratios are favorable. For FDI-exporting countries, benefits are linked to the success of MNEs in creating new markets and in translating production cost savings into cheaper imports and lower inflation rates. These benefits are also linked to the creation of expanded business opportunities, profits, and employment in home countries through the repatriation of FDI revenues (Kokko, 2006).

For the FDI-importing country, the benefits are even more visible and perhaps more important, particularly for relatively poor developing countries. For these countries, FDI provides capital, supplementing thin local capital markets as well as advanced technologies, and promoting both supply-side and demand-side efficiencies. Furthermore, exports are spurred as MNEs establish supply chain linkages within, and both income and employment growth are stimulated through the same effect (Erixon, 2020; Loungani & Razin, 2001). MNEs are particularly important as drivers of global trade, accounting for approximately 80 per cent of total exports (Saurav, Kusek, & Kuo, 2020). All countries, including developing countries, have benefitted from the effects of FDI in producing jobs and incomes.

PRE-PANDEMIC GLOBALIZATION TRENDS

It will be argued later in this paper that the current pandemic has already had a damaging effect on globalization—including adverse FDI flows—producing both supply-side and demand-side market shocks and disruptions. In fact, it is estimated that in 2020, the pandemic caused the largest and fastest decline in modern history in terms of international flows, including trade, FDI, and international travel (Altman, 2020).

However, it is important to evaluate the negative impact of the pandemic in its true context. Globalization is under attack and the backlash against the movement of goods, services, capital, and personnel across international borders predates the recent pandemic. The anti-globalization movement has been visible for the past two decades, particularly with the political emergence globally of nationalism, populism, and isolationism (Fukuyama, 2020). Brexit is a good example of this political retreat from open borders.

Therefore, more governments, including in the U.S., have passed restrictive rules and regulations that make it more difficult to move goods and resources freely to and from foreign markets. This has weakened international trade, FDI, and foreign markets' sourcing. Accordingly, MNEs have been motivated to relocate production closer to those home markets where the goods will be sold, regardless of the cost implications (James, 2016).

Perhaps the greatest threat to globalization and to the economic benefits that it bestows is the modern version of "populism". This is an ideology which depicts the "people" as a morally good force and contrasts them with the so-called "elite". The elite are those who place their own welfare above the people (locally based) and who include among their ranks, large corporations, foreign countries, and immigrants.

Supporters of this movement globally include dominant political leaders who present themselves as leaders of the people and as enemies of the elite. Over the past several years, this group has included Donald Trump of the U.S.A., Marine Le Pen of France, Boris Johnson of Great Britain, Beppe Grillo of Italy, and Frauke Petry of Germany. All these national leaders embraced some or all aspects of modern populism and identified themselves as "voices of the people" (James, 2016).

Governmental anti-globalization policies were not the only source of global disruption over the past two decades. Financial instability has played a significant role as well. Weaknesses in the global financial system have been evident in the rise of the corporate debt burden; this has increased holdings of riskier and more illiquid assets by institutional investors, with growing reliance on external borrowing—particularly by developing countries. (Staff of the IMF, 2020).

Compounding the problems of financial instability and over-dependence on external funding are the contagious effects of business-cycle problems, such as the Great Recession of 2008 in the U.S. Such financial instability has spread with particularly damaging effects through trade and investment disruptions in the developing world (Grusky, Western, & Wimer, 2020).

SHORT-TERM IMPACT OF THE PANDEMIC ON GLOBALIZATION AND FDI FLOWS

FDI flows fell by 49 percent during the first half of 2020, and they are expected to fall during the second half of 2020, and during 2021 by 30 percent. This is a significant drop because FDI is a bellwether of globalization (Jetpissova, 2020; Staff of the OECD, 2020).

The slow growth of new investments and the accelerating rate of disinvestments were due to the negative impact of the pandemic on GDP growth in both developing and industrialized worlds. Stagnant growth, recessionary trends, and diminished export performances have all led to an erosion in investor confidence during this period. China, however, was an exception to this trend, enjoying increased FDI inflows during 2020 and early 2021 (Jetpissova, 2020).

Erosion in investment confidence was certainly based in part on the restrictive policies governments adopted in attempting to contain the virus. These restrictions worked towards anti-globalization in the sense that they resulted in reduced international flows of goods, services, resources, and personnel.

It is expected that FDI flows to developing countries will be more affected by current global economic trends. One reason is that developing countries will suffer more because of greater dependency on external capital funding (Alfaro & Chen, 2012). Also, developing countries are vulnerable because the sectors of their economies are more severely affected by the pandemic, namely the primary and manufacturing sectors, accounting for larger shares of FDI inflows in poor countries than in the industrialized world (Seric & Hauge, 2020).

Through 2020-2021, the pandemic has certainly produced both demand-side and supply-side shocks. On the demand side, declines in export activity have accompanied a slowdown in FDI flows. With declining export volumes and revenues, MNEs have become less motivated to test out new global marketing opportunities. In developing countries in particular, the consequences of disease mitigation measures undertaken by governments have led to significant reductions in income generation and in employment. Disruptions have occurred in manufacturing, services, and transportation industries as well (Pak, 2020).

The corporate reaction to global demand-side shocks has been predictable. Faced with high corporate debt, MNEs have been motivated to develop a more conservative investment strategy, involving more of an emphasis on repatriation of earnings from overseas investments, with less of an emphasis on reinvestments of the earnings (Pak, 2020). Also, the evolving MNE strategy includes a diminished willingness to support subsidiary activity abroad, involving significant effects on global supply chain management (Keselowski, 2020).

The demand shocks caused by the pandemic will certainly produce at least a short-term disruptive effect on FDI outflows by MNEs. Predictably, the supply shocks will be more damaging. It may be noted that an important part of globalization is the effort by MNEs to establish global supply chains, particularly in developing countries, seeking to take advantage of favorable labor market conditions including efficient productivity-to-wage-rate tradeoffs.

The pandemic has created uncertainty about the future of complicated supply chain connections in distant global markets. This uncertainty is based in part on the risks of virus containment once the disease spreads in multiple locations (Nikolopoulos, Punia, Schaefers, & Tsinopoulos, 2020; Pak, 2020). MNEs are motivated to locate global supply chains closer to home operations to avoid this risk. Questions arise about the ability of government policy in developing countries to contain the virus, as well as whether these countries will receive their fair share of the vaccines through global distribution channels (Curtis, 2020). According to the People's Vaccine Alliance, consisting of Amnesty International, Oxfam, Frontline AIDs, and Global Justice Now, in 70 developing countries around the world, only one in ten residents is expected to receive a COVID-19 vaccine during 2020-2021 (Oxfam International, 2020).

Supply chain management requires careful planning, particularly if global supply chains extend well beyond home country headquarters. With supply disruptions, accurate forecasting becomes especially important. However, forecasting the evolution of a pandemic, including government policy responses, is a complicated task, given the limited history of pandemic data and the multi-dimensional nature of the problem (Nikolopoulos et al., 2020).

MNE managers are faced with a dilemma. On the one hand, the pandemic has disrupted—and may continue to disrupt—supply chains to create uncertainty about the future and about the post-pandemic government policies that may emerge. To what extent will these policies be restrictive and overly nationalistic, reducing the freedom that MNEs have enjoyed historically in allocating corporate resources efficiently across international borders?

However, abandoning supply chain linkages globally will not be easy. Home country consumers will continue to demand low prices, an historical by-product of efficient global supply chain linkages. Charging high prices for goods produced in high-cost home country markets will not be popular or even competitively feasible (Shih, 2020).

LONG-TERM IMPACT OF THE PANDEMIC ON GLOBALIZATION AND FDI FLOWS

The short-term negative effects of COVID-19 on the global economy are apparent and have been so since the outbreak of the virus. Both global supply-side and demand-side shocks have been occurring since the early 2020s, and they could last at least through 2021-2022. Furthermore, the severity of the shocks has been exacerbated by anti-globalization trends that predated the outbreak, including the political growth of nationalism, populism, and isolationism.

Forecasting the long-term future based on the prevailing pandemic era is a much more formidable task. Policymakers at three key levels—national governments, public health organizations, and MNEs—now operate in unchartered waters and must make difficult decisions without adequate historical data as guidance.

Faced with the challenge of the pandemic, national government policy planners must decide whether to move in the direction of more open or more closed national borders. Should the country in question risk the health of its population through the vulnerability of open borders to pursue economic gains? Should the country retreat further from permitting the free movement of goods, services, capital resources, and people across its borders, or should it placate isolationists by embracing the "populist" political movement? (Nikolopoulos et al., 2020).

A second major policy concern is the distribution of the COVID-19 vaccines. Major health organizations, pharmaceutical companies, and others involved in distribution channels must decide on the volume, timing, and direction of the distribution. Of key importance will be the ability of developing countries in poorer regions to attract their fair share of the vaccine(s).

Early evidence (in late 2020) indicates a problem in this regard. The Center for Global Development reveals that the most promising vaccines are largely covered by advance-purchase agreements, mostly for wealthy, industrialized nations. Poorer countries by the end of 2020 had extremely limited access to the most promising vaccines (Curtis, 2020). This is important because before the pandemic, MNEs had taken advantage of favorable labor market conditions in developing (complex yet profitable) vaccines—thus bestowing benefits both on the corporate bottom-line and on the growth and development of the poor nations.

With the serious supply chain disruptions of recent memory, perhaps the most important decision will be made by the MNEs themselves. The pandemic and its aftermath caused the typical MNE to move supply chain linkages closer to home, abandoning the advantages that favorable labor market conditions in poor countries provided. Will the retrenchment continue despite the competitive disadvantages of moving supply chain contracts out of low-cost markets to higher cost markets to take advantage of more political, commercial, and medical stability? The answer to this question will largely govern whether the disruptive effects of the pandemic will be long-term, or only short-term. In essence, the long-term disruptive effects of the pandemic will depend less on supply/demand conditions in global markets and more on boardroom decision-making in the MNEs, national governments, and in global health agencies.

RECOMMENDATIONS FOR FUTURE STUDY

Certainly, there is evidence that recent trends toward anti-globalization are traceable to the growing political propensity or commitment to populism and nationalism, particularly in the industrialized world. Studies are needed to identify the political, cultural, social, and economic conditions in these countries that promote these deleterious trends.

Industry case studies are also needed to examine the strategies that MNEs employ to establish supply chains on a global scale. Studies are also needed to examine the risks and returns of extending global supply chain linkages to developing countries. Furthermore, studies are needed to examine the benefits and costs of poor-country dependencies on capital inflows (particularly FDI inflows) from the industrialized world.

Finally, as the pandemic proceeds, it is necessary for global health organizations to examine not only the real cost of the extraordinary damages caused by the COVID-19 virus, but also what appears to be an inefficient and inequitable global vaccine distribution system.

CONCLUSION

It is clear from both the scholarly sources and the commercial press that globalization over the past three decades has bestowed benefits on both industrialized and developing countries. A major component of globalization has been the efficient transfer of foreign direct investment (FDI) from capital-rich countries to capital-poor countries. The COVID-19 pandemic has disrupted this efficient resource allocation by producing damaging demand-and-supply shocks globally, including the disruption of traditional supply chains used by MNEs in promoting profitability through cost control.

The pandemic did not create this problem; rather, it compounded the damage caused earlier in the decades of the 2000s through anti-globalization measures by national governments—particularly in the industrialized world—that are traceable to growing nationalism and protectionism. Although the disruptive effects of the pandemic are relatively easy to trace and measure in the short-run, long-run forecasting is much more difficult. Whether the pandemic has long-lasting effects or not depends on the policy responses of national governments, MNEs, and global health agencies.

A happy scenario would arise if (1) the national government policy became more supportive of the free movement of goods, services, people, and capital across international borders; (2) amended policies of MNEs reestablished efficient global supply chain linkages in capital-poor developing countries; and, (3) global health agencies instituted policies designed to assist poor countries to gain their fair share of the anti-virus vaccines to improve the investment climates in these developing regions.

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