FDI IN FIGURES

July 2018

Global FDI outflows tumble 44% in the first quarter of 2018 due to US tax reform

Little real, short-term impact may mask more significant impact to come

In the first quarter of 2018, global FDI outflows fell to USD 136 billion from USD 242 billion in the previous quarter. This precipitous drop was largely due to a switch to negative outward FDI from the United States. US outward FDI fell to USD -145 billion, registering negative for the first time since the fourth quarter of 2005. This change was due to large repatriations of earnings by US parent companies from their foreign affiliates, resulting in large, negative reinvested earnings (Figure 1).

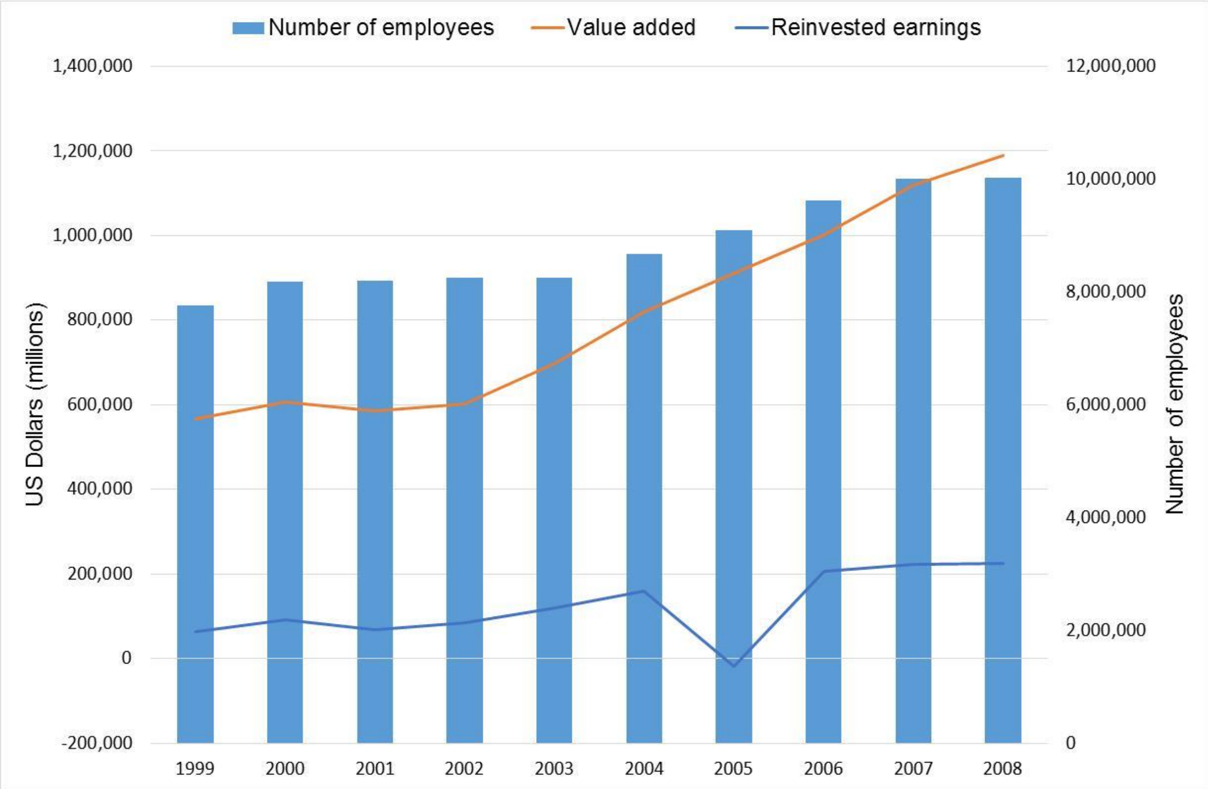
Figure 1: US outward FDI flows by component, quarterly data for 2017-2018

Source: OECD Foreign Direct Investment statistics database www.oecd.org/investment/statistics.htm

The reinvestment of earnings is usually the largest component of US outward FDI flows. The 2017 US Tax Cut and Jobs Acts (TCJA) contained several provisions having both immediate and likely long term impacts on direct investment. One key provision of the TCJA was the one-time tax on undistributed foreign earnings levied in the fourth quarter of 2017. As a result, US parent companies could repatriate the cash they were holding overseas in their foreign affiliates, without additional taxes, beginning in 2018. Estimates of the amount of overseas cash held by US MNEs vary, but all indications are that it is substantial.[1]

[1] Bloomberg estimates that the 50 US multinationals with the largest overseas cash holdings hold USD 925 billion outside of the United States, www.bloomberg.com/graphics/2017-overseas-profits/. Goldman Sachs estimates that US tech companies have undistributed overseas earnings of $3.1 trillion, www.bloomberg.com/news/articles/2017-12-20/what-the-largest-tax-overhaul-in-30-years-means-for-companies

Figure 2: Activities of US multinationals abroad and their FDI reinvested earnings, 1999 to 2008



Source: OECD AMNE Statistics database Outward Activity of multinationals in ISIC3 for 1999-2007 and in ISIC4 for 2008) and US Bureau of Economic Analysis

However, the impact of these cash repatriations on the foreign operations of US MNEs is likely to be minimal in the short term because they involve the sale or disposal of financial, as opposed to real, assets. The negative US outward FDI occurring in 2005 was largely due to the 2004 American Jobs Creation Act, which allowed US parent companies to repatriate earnings from their foreign affiliates at lower tax rates through the end of 2005. As Figure 2 shows, affiliates paid their US parents large dividends from accumulated retained earnings, resulting in negative reinvested earnings in 2005. Yet, there was no discernible impact on the real operations of the foreign affiliates of US MNEs in terms of employment and value added from these repatriations.

This time may be different. The repatriations in the first quarter of this year brought the most immediate impacts of the TCJA on FDI. But longer term effects are more difficult to predict. As seen in Figure 2, reinvestment of earnings quickly returned to their previously high levels following the tax holiday in 2005, but the shift to a territorial tax system will remove many of the incentives for US MNEs to hold large amounts of cash overseas. This, in turn, could result in a structural shift to lower reinvestment of earnings by US MNEs. Due to the complexity of the TCJA, uncertainty about its macroeconomic impacts (such as on US domestic growth and investment), and limited visibility as to the responses of other countries to US tax changes, long-term repercussions are admittedly difficult to predict. But, given the changing incentives for FDI to and from the United States that the TCJA brings with it, real impacts could be significant and long-lasting.