

Foreign Direct Investment in Israel: Developments and Trends in the Past Decade

Vladimir Miller and Hanady Azzam*

Abstract

Nonresidents' direct investment in Israel has been growing over the past decade, largely due to net investment flow. New direct investments in equity exceeded earnings accrued for reinvestment during that period, but this trend turned around in 2023 as investment flow declined considerably as part of a global downward trend in direct investment.

An international comparison of foreign direct investment (FDI) indicators over time, testing Israel against selected benchmark countries that resembled Israel in per-capita GDP, shows that Israel ranks high. This ranking recurs against an aggregate of OECD and other countries. These indicators point to the contribution of FDI to Israel's economic growth and suggest the extent of attractiveness of the economy to foreign investors.

*Information and Statistics Department, Bank of Israel.

Introduction

Border-crossing capital flows have been growing considerably the past few decades. The upturn owes itself to the expansion of globalization, which led to regulatory leniencies in various markets, and to technological innovations that allowed investors to diversify their investments in international markets.

Foreign direct investment (FDI), one of the border-crossing investment flows, helps to intensify international economic relations, leverages growth, aids domestic economic development, promotes international trade, and abets sharing of knowledge, technology, and advanced management methods.¹

The Bank of Israel collects and analyzes direct-investment data for the purpose of calculating the national balance of payments and the International Investment Position among other external statistics.² By analyzing trends in foreign investment, the central bank tracks the effect of long-term capital inward flows on the foreign-currency market and identifies periods in which the economy becomes less attractive to foreign investors.³ In addition, analysis of the direct-investment data helps economic policymakers to identify the economic sectors that are attracting direct investments as opposed to those experiencing falling levels of direct investment and allows the government to prioritize areas of high growth potential and adjust its incentives in order to encourage nonresidents to invest.

This paper reviews the data on FDI in Israel in the past decade:

- Section 1: international definitions of FDI statistical terms;
- Section 2: review of FDI trends in Israel and worldwide in the past decade;
- Section 3: examination of the effect of FDI on Israel's economic resilience via analysis and international comparison of accepted FDI indicators;
- Section 4: presentation of main findings of the analysis of FDI in Israel divided by geographic and economic-branch distributions.

1. International definitions

According to the international definitions⁴, FDI is one of five investment categories that appear in the financial account of the balance of payments and the international investment position. Income from direct investment is included as a sub-item of investment income that appears in the current account of the balance of payments.

The Bank of Israel also processes and analyzes FDI data on the basis of countries and sectors of economic activity. It shares the outcomes with the Central Bureau of Statistics and international organizations, which publish them in complementary publications such as the International Monetary Fund's foreign direct investment survey⁵ and the OECD's FDI data by countries and by economic activity⁶.

¹ OECD Benchmark Definition of Foreign Direct Investment, Fourth Edition, 2008. ISBN 978-92-64-04573-6.

² For further information, visit the Bank of Israel website: <https://www.boi.org.il/roles/statistics/external-sector/israel-s-assets-and-liabilities-vis-a-vis-abroad/#mainContent>

³ OECD Benchmark Definition of Foreign Direct Investment, Fourth Edition, 2008. ISBN 978-92-64-04573-6.

⁴ Balance of payments and international investment position manual. Washington, D.C.: International Monetary Fund, 2009.

⁵ International Monetary Fund, *Coordinated Direct Investment Survey*.

⁶ OECD, FDI by Counterpart Area and by Economic Activity, BMDr, <http://tinycc.y0d2001>

1.1 Definition and characteristics of foreign direct investment⁷

According to the international standards for statistics on economic activity vis-à-vis abroad, foreign direct investment is an investment in which a resident of one country acquires control or significant degree of influence over the management of a business entity in another country. The determining rule is a direct ownership of equity

That entitles the holder to 10 percent or more of the voting power in the direct investment enterprise. FDI includes the following financial instruments:

1. share equity: investment in equity or equity rights of a direct investment enterprise that give the investor control or significant degree of influence;
2. Accrued reinvested earnings: earnings not distributed as dividends but rather reinvested in the direct investment enterprise; these earnings are included in the statistics along with foreign direct investment in share equity;
3. inter- company debt (owners' loans) or other debts between a direct investor and a direct investment enterprise, including loans between related companies.

1.2 Distinguishing between direct investment and portfolio investment⁸

The chief motive in direct investment is to influence the management of a company and also, often, to obtain control of the company. This is the main difference between direct investment and portfolio investment, in which the emphasis is on profiting from the realization of equities and securities with no intention of controlling or managing the company. Accordingly, FDI is considered long-term investment whereas portfolio investment focuses on short-term gains.

2. Trends in foreign direct investment in Israel and around the globe in the past decade

2.1 Upward trend in foreign direct investment in Israel

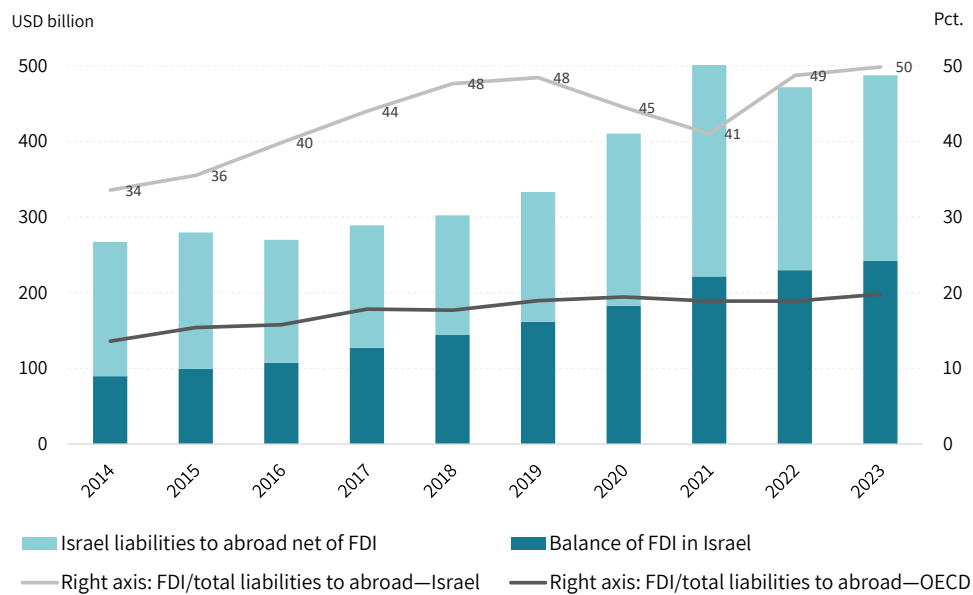
Over the past decade, FDI in Israel has grown by 270 percent, from USD 90 billion in 2014 to USD 242 billion in 2023 (Figure 1). The share of FDI in Israel's total liabilities to abroad climbed by 16 percentage points and came to 50 percent at the end of 2023. In the OECD countries, by comparison, this indicator rose by only 6 percentage points and ended 2023 at 20 percent.

⁷ International Monetary Fund, *Balance of Payments and International Investment Position Manual*, Washington, DC, 2009.

⁸ The investment categories in the financial account of the balance of payments include direct investment, portfolio investment, other investment, reserve assets, and investment in derivatives.

Figure 1: Share of FDI balance in total liabilities to abroad, Israel and OECD countries⁹

USD billion



SOURCE: OECD and Bank of Israel * Other Israeli liabilities to abroad include portfolio investments and other investments

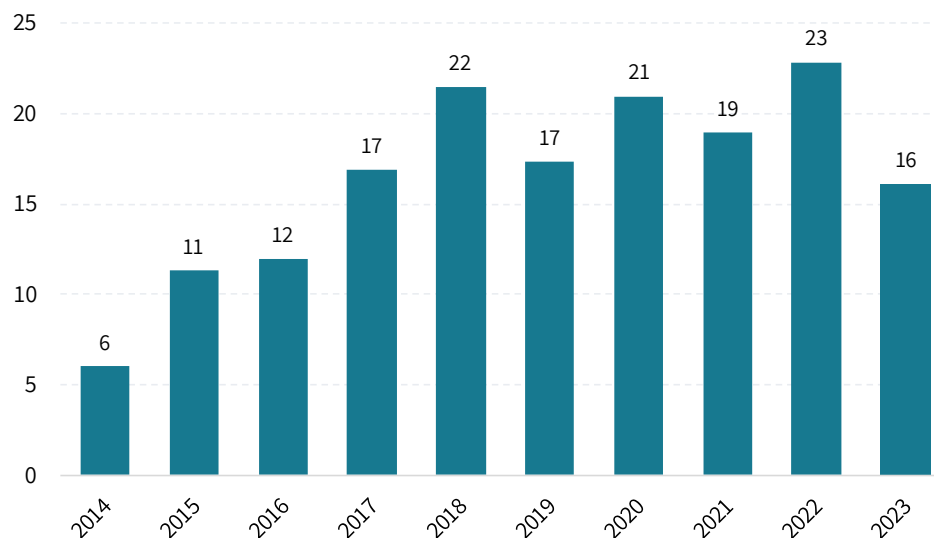
2.2 Foreign direct investment flows

Most of the increase in direct investment balance traces to investment flow (Figure 2):

- Between 2014 and 2018, investment flow grew vigorously, from USD 6 billion to USD 22 billion.
- Between 2018 and 2022, investment flows were stable and strong, at USD 20 billion on annual average with a record USD 23 billion in 2022.

Figure 2: Direct investment flows of foreign direct investors in Israel

USD billion

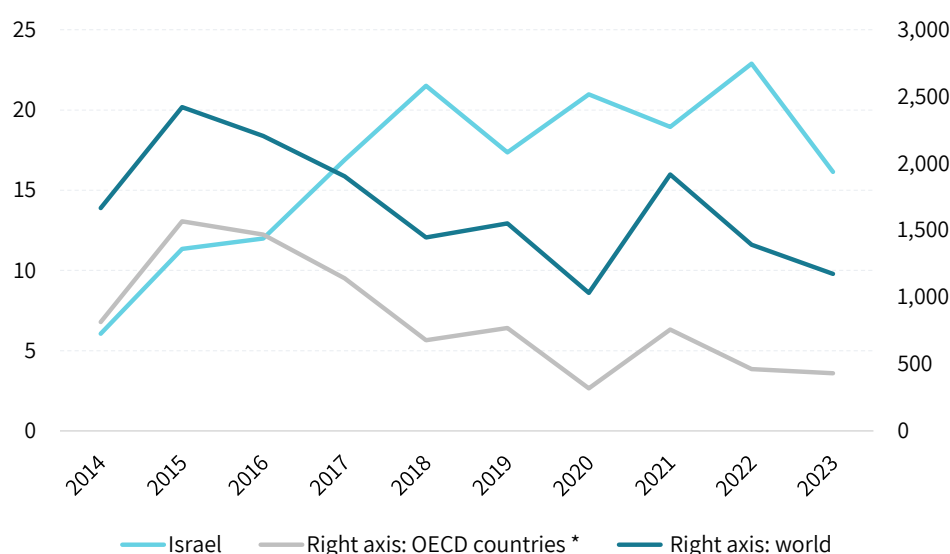


SOURCE: Bank of Israel

⁹ OECD Data Explorer.

- In 2023, FDI flow slumped to only USD 16 billion. Initial data for 2024 suggest that the downturn is continuing. A more detailed analysis of the FDI data for 2024 appears in the section on economic activity vis-à-vis abroad in this publication. It is premature to determine whether the decrease in new equity investment in 2023 means that the Israeli economy has become less attractive to foreign investors, because the downturn was part of a global downward trend in direct investment. Indeed, in 2015–2022 FDI in Israel trended in the opposite direction of the world and the OECD countries, as shown in Figure 3.

Figure 3: Foreign direct investment: Israel vs. other OECD countries and the world
USD billion



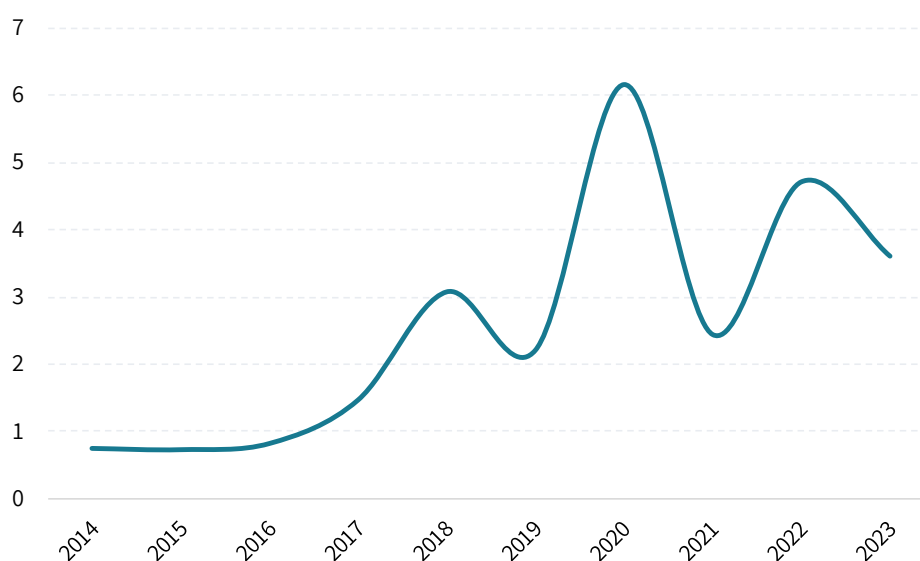
SOURCE: OECD

* Net of Israel

International comparison2.3

The weight of FDI in Israel from the total FDI in OECD countries (Figure 4) increased over the past decade from 0.7 percent to 3.6 percent, peaking in 2020 at 6.2 percent and ranking Israel in seventh place among the thirty-eight OECD member states.

Figure 4: Share of FDI in Israel in total FDI in OECD countries*
Percent



SOURCE: OECD

According to international standards, it is accepted to distinguish between two types of foreign direct investment:

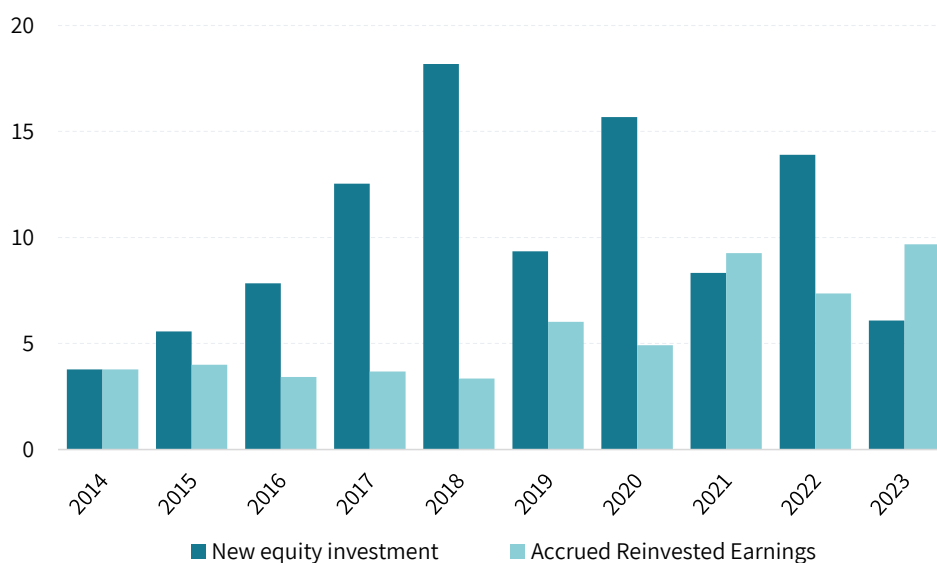
1. New equity investments—in which foreign investors acquire equities by means of an issue or from existing local investors. These investments inject outside capital into the local economy and affect the foreign-currency market.

2. Accrued Reinvested Earnings—investments in which foreign investors choose to reinvest earnings accrued from previous investments. These investments neither inject new capital into the economy nor affect the foreign-currency market. They do, however, help to expand the companies' activity.

Over the past decade, new equity investments in Israel were around USD 10 billion on annual average, exceeding the USD 6 billion annual average of earnings accrued for reinvestment (Figure 5). In the past five years, however, earnings accrued for reinvestment have been rising and set an all-time record level of USD 10 billion in 2023. New equity investments tumbled to USD 6 billion that year.

The increase in accrued reinvested earnings attests to the extent of the success of FDI over time and reflects the continual growth of Israeli firms held by foreign investors.

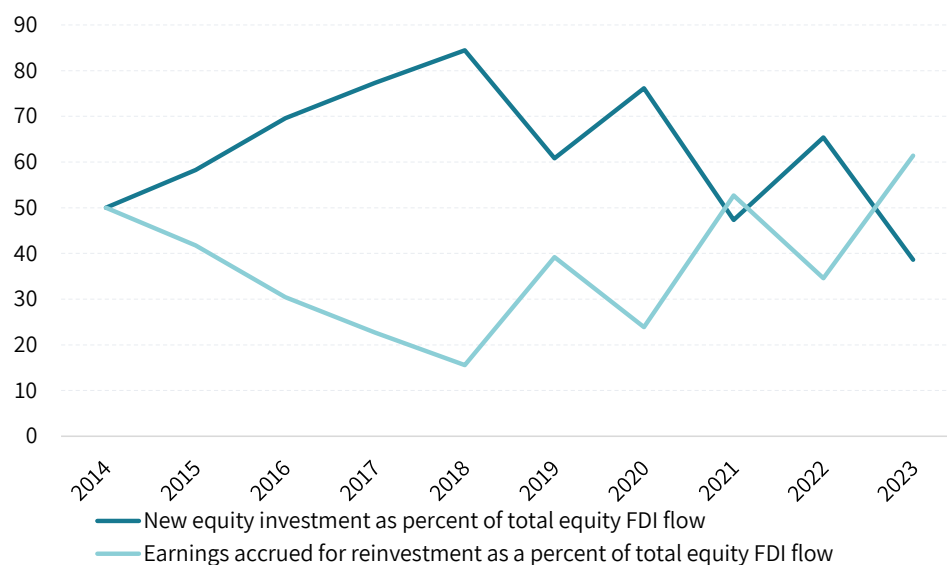
Figure 5: Foreign direct equity investment, parsed by new equity investments and accrued reinvested earnings, USD billion



SOURCE: Bank of Israel

In the past ten years, the share of new equity FDI in total FDI surpassed the share of accrued reinvested earnings in total FDI with the exception of 2023, when the opposite trend was attested (Figure 6).

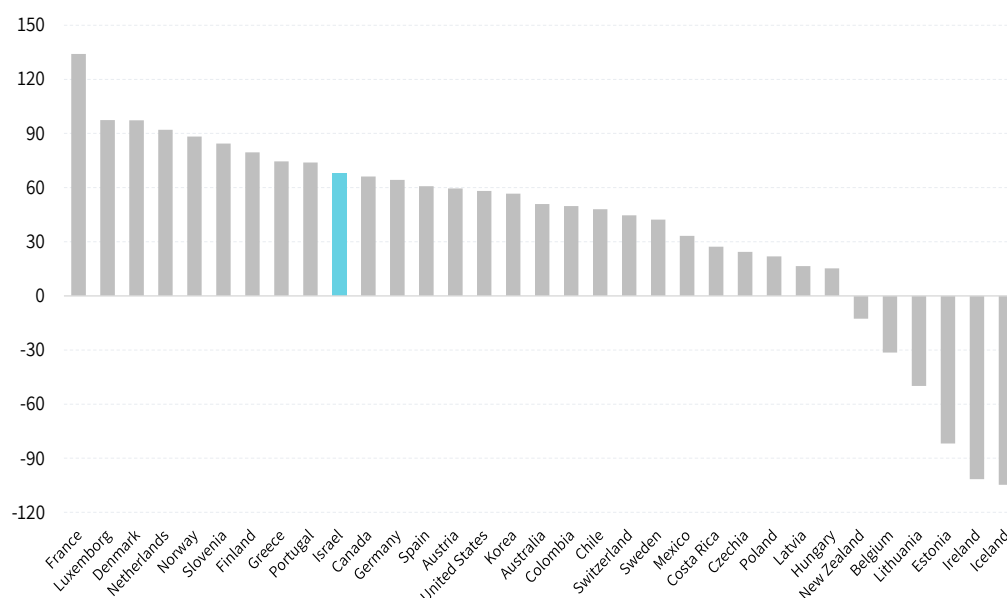
Figure 6: Ratio of new equity FDI and accrued reinvested earnings to total equity FDI
Pct.



SOURCE: Bank of Israel

In comparison with the OECD countries, the ratio of equity FDI to total FDI in Israel was one of the highest on average in 2014–2023, as shown in Figure 7.

Figure 7: Ratio of new equity FDI to total FDI, Israel vs. OECD countries
Annual average, 2014–2023, pct.



SOURCE: OECD

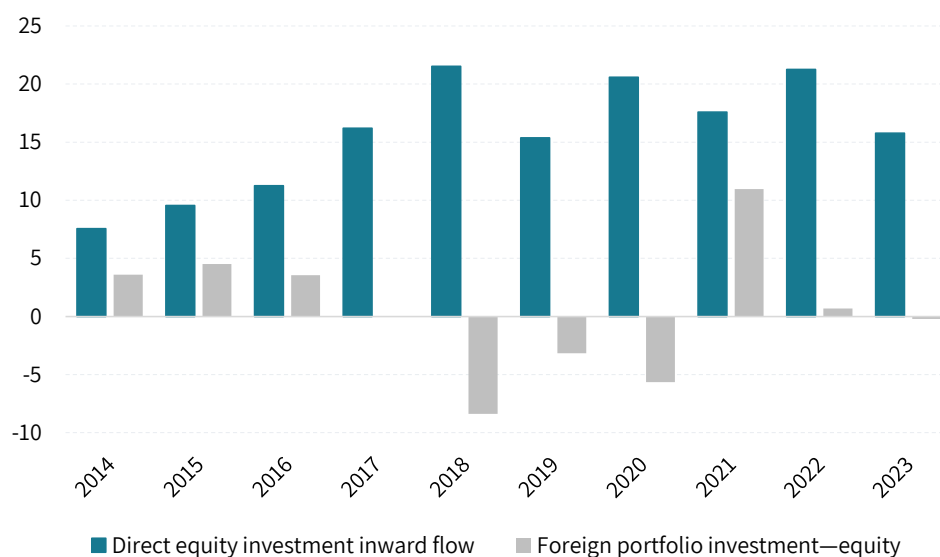
2.4 The effect of FDI on the foreign-currency market

Foreign direct investment flows are a subset of long-term capital inflows and have a structural effect on the foreign-currency market. In the past decade, sizable direct investment flows contributed to appreciation pressure on the NIS and the decrease in their extent in the past year apparently caused this contribution to decline.

Notably, however, these flows do not always affect the foreign-currency market in full because some are not converted into NIS due to business considerations. Also, FDI flows do not necessarily attest to a new inward flow of capital to the Israeli economy. In some direct investment, foreign direct investors¹⁰ acquire equities of Israeli companies from foreign portfolio investors¹¹ in the same companies. In terms of the balance of payments, the resulting increase in direct investment is offset by an equal extent of liquidation of portfolio investment; therefore, it neither reflects an inward flow of new foreign capital nor affects the foreign-currency market.

In 2018, for example, foreign direct investors acquired two Israeli companies from foreign portfolio investors for USD 10 billion. The net direct investment (USD 22 billion) was partly offset by realizations of tradable securities (USD 8 billion), such that the amount of new capital flowing into the economy was smaller than the direct investment (Figure 8).

Figure 8: Foreign direct investment in equity and foreign share-equity portfolio investment in Israel
USD billion



SOURCE: Bank of Israel

3. Selected long-term FDI indices

It is possible to calculate main several FDI indices that measure the extent of globalization in the local economy and the effect of direct investment on various local economic sectors. Analysis of trends in these indicators reveals the contribution of FDI to economic growth and enables policymakers to understand which areas attract investment, prioritize fields with high growth potential, and direct resources to these sectors in order to promote investment in them. In this section of the study, we present an international comparison of various

¹⁰ The international standards for statistics of economic activity vis-à-vis abroad define direct investors as those who have a stake of 10 percent or more in company equity.

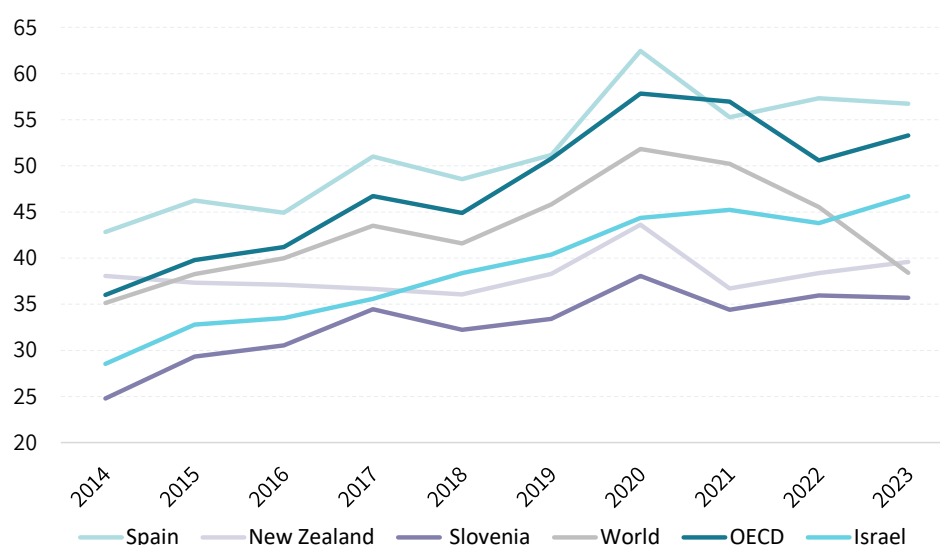
¹¹ The international standards for statistics of economic activity vis-à-vis abroad define portfolio investors as those who have a stake of less than 10 percent in company equity.

FDI indicators against selected benchmark countries that resembled Israel in per-capita GDP in 2023. The benchmark countries chosen for the comparison were South Korea, Slovenia, New Zealand, and Spain

The balance of FDI as a percent of GDP indicator measures the extent of globalization at a given point in time. It reflects the level of foreign ownership in the economy and, among other things, substantiates the strength of the local economy's dependency on foreign economies.

The contribution of FDI to economic growth in Israel has been rising since 2014. In 2023, the share of FDI in Israel's GDP (Figure 9) was 47 percent as against 53 percent on average in the OECD countries, reflecting a 19 percentage-point increase since 2014 as against a 17 percentage-point upturn in the OECD countries.

Figure 9: Balance of FDI in the local economy as a percent of GDP, Israel versus benchmark countries* Pct.



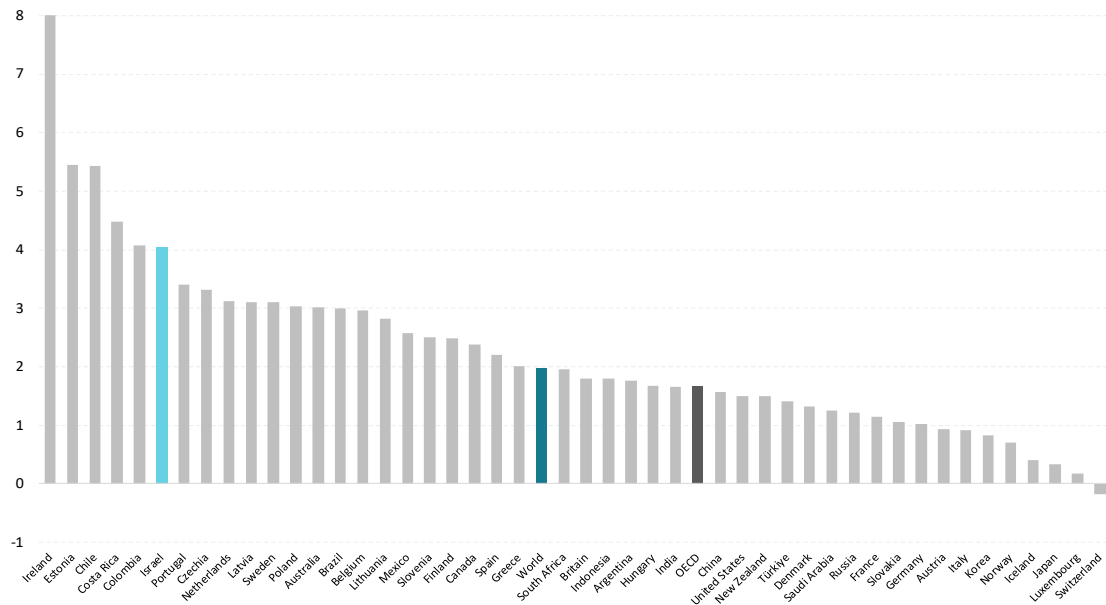
SOURCE: OECD

* See definition at the beginning of the Section 3.

The net FDI flows as a percent of GDP indicator provides information on the relative attractiveness of economies for new investments. An international comparison of this index (Figure 10) shows that Israel's ratio of net direct-investment flow to GDP ¹² was 4 percent on average in the past decade, outpacing most OECD countries.

¹² Applying the analysis presented in "Measuring Direct Investment as a Part of the International Investment Position," published in the Statistical Bulletin for 2016 (Figure 8), we find that the indicator of net direct-investment flows as a percent of GDP for Israel in 2014–2023, 4 percent on annual average, remained stable relative to the 2006–2015 average. At the same time, the annual average of this indicator for the OECD countries and an aggregate of world countries in 2014–2023 declined relative to the 2006–2015 average by 1.2 percentage point in the OECD countries and by 1.1 percentage point in the aggregate of world countries.

Figure 10: Total FDI flows as a percent of GDP, OECD countries, annual average 2014–2023.

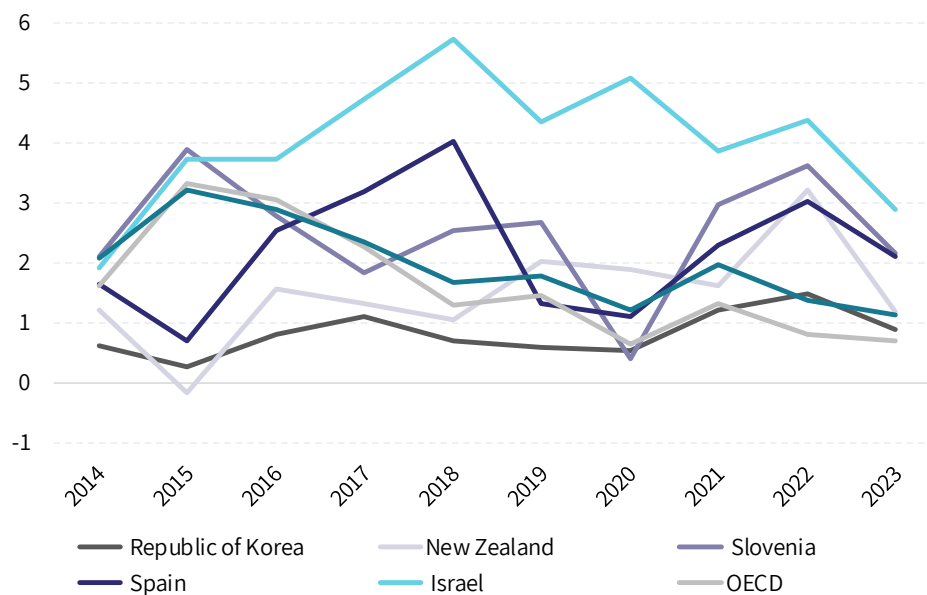


SOURCE: OECD

** For graphic presentation purposes, the X-axis is shown up to 8 percent. The datapoint for Ireland is 12 percent

Over time, the indicator increased up to 2018 and then declined apparently in tandem with the global trend, particularly in the steep downturn in 2023 (Figure 11).

Figure 11: Total FDI flows as a percent of GDP, Israel vs. benchmark countries Pct.

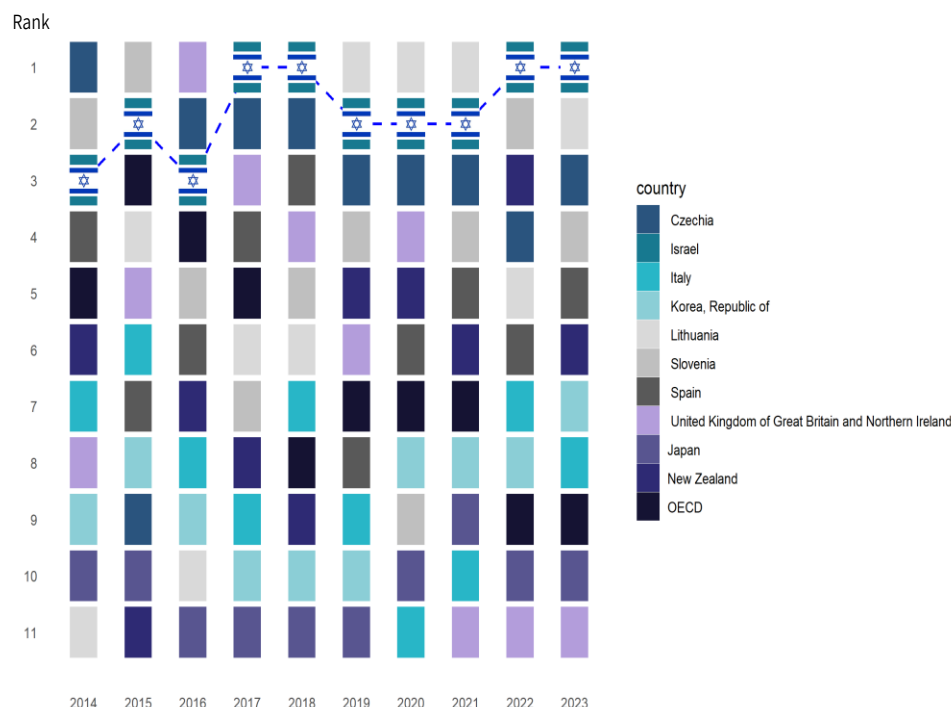


SOURCE: OECD

Among the benchmark countries, however, Israel's FDI as a percent of GDP indicator is the highest, surpassing both the index of an aggregate of OECD countries and one of world countries (Figure 11), as attested on the indicator ranking map (Figure 12).

Israel's persistently high ranking in this indicator over the past decade reinforces the conclusion that Israel is more attractive to foreign investment than are countries with identical per-capita GDP and more alluring than are the OECD countries.

Figure 12: Ranking of selected OECD countries in FDI to per-capita GDP, rank



SOURCE: OECD

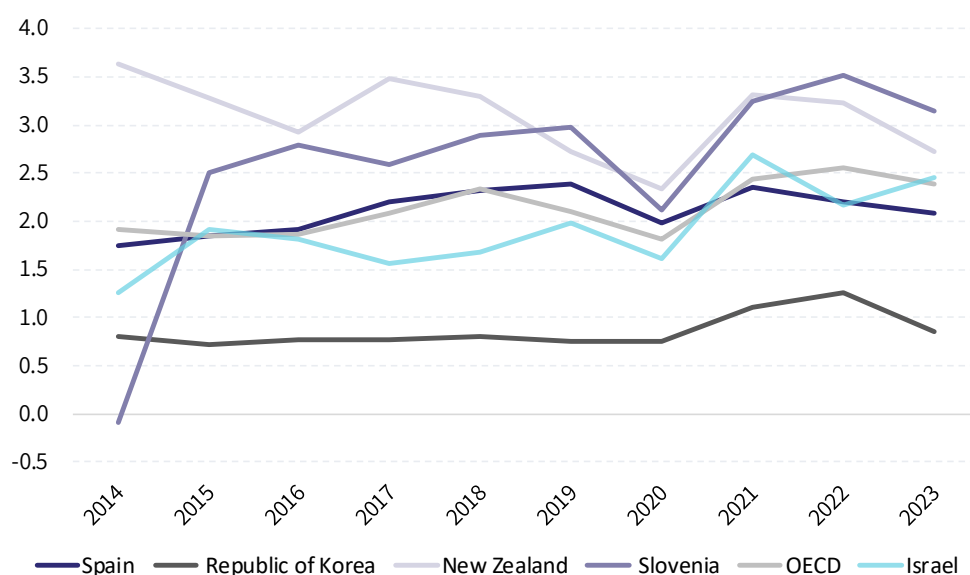
The return¹³ on FDI as a percent of GDP indicator measures income flows from foreign direct investments, including dividends and undistributed reinvested earnings, in percent of GDP terms, yielding information about the growth of existing FDI in the local economy.

The indicator for Israel (Figure 13) rose from 1.3 percent to 2.5 percent in the past decade, mostly during the Covid-19 period and particularly in 2021, as a result of strong earnings (Figure 5) and larger withdrawal of dividends than in previous years by foreign direct investors in Israeli companies in various industries.

This increase in return on investment reflects the worthiness of investing in the economy over time. Israel's attractiveness as an investment destination for nonresidents is reinforced by comparing this index for Israel with that for the OECD countries. The increase in return on FDI was twice as high in Israel during this period (1.2 percentage point) than in the OECD countries (0.5 percentage point).

¹³ Income from FDI in the local economy includes dividends, distributed branch profits, reinvested earnings, undistributed branch profits, and interest on owners' loans. OECD Benchmark Definition of Foreign Direct Investment, Fourth Edition, 2008. ISBN 978-92-64-04573-6.

Figure 13: Return on FDI as a percent of GDP, Israel and benchmark countries
Pct.



SOURCE: OECD

4. Distribution of foreign direct investment in Israel by geography and industrial activity

By analyzing the distribution of FDI in Israel by geographic origin and industrial activity, we are able to identify the leading countries in direct investment in Israel and industries with high growth potential, and thus to adjust the incentives in a way that will promote foreign investment. This analysis singles out the United States as the largest investor and high-tech as the most attractive industry for foreign investors in Israel.

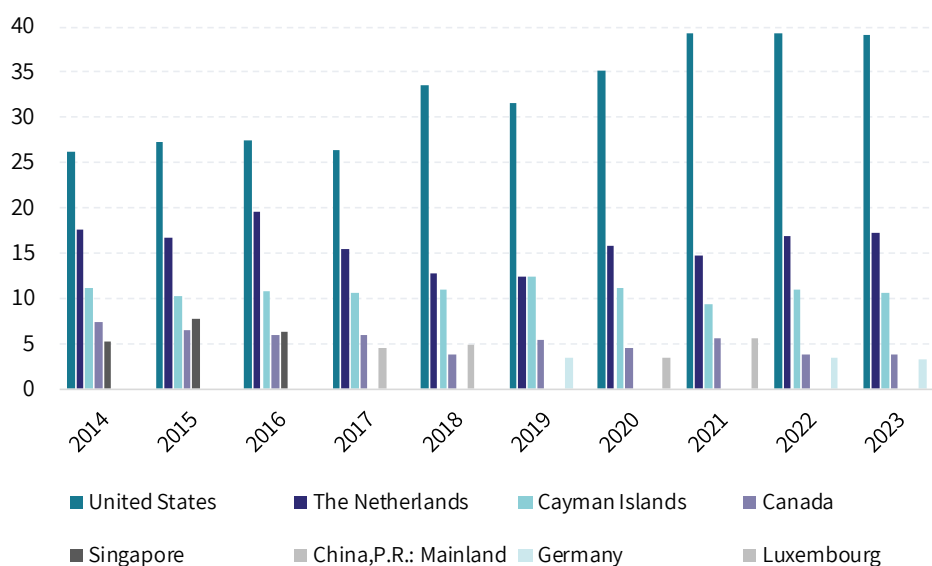
4.1 Distribution of foreign direct investment in Israel by geographic origin

- **United States** is the largest investor, with an average of 33 percent of total FDI in Israel in the past decade¹⁴;
- **Netherlands**: contributed 16 percent of the investment, but much of it is carried out via holding companies that are registered in the country for tax purposes;
- **Cayman Islands** accounted for 11 percent of the investment, most via holding companies.

This analysis is carried out in accordance with direct ownership only. Therefore, it may not reflect the exact origins of the investments due to the use of countries such as the Netherlands and Cayman Islands, which have lenient investment and tax policies and host holding companies that are registered there for tax purposes only (Figure 14).

¹⁴ U.S. direct investment in Israel in 2022 was 0.8 percent of total direct investment of U.S. origin. For further information on this topic, consult the International Monetary Fund's *Coordinated Direct Investment Survey*, <https://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5>

Figure 14: Geographic distribution of FDI in Israel, percent of total direct investment in Israel. TOP 5



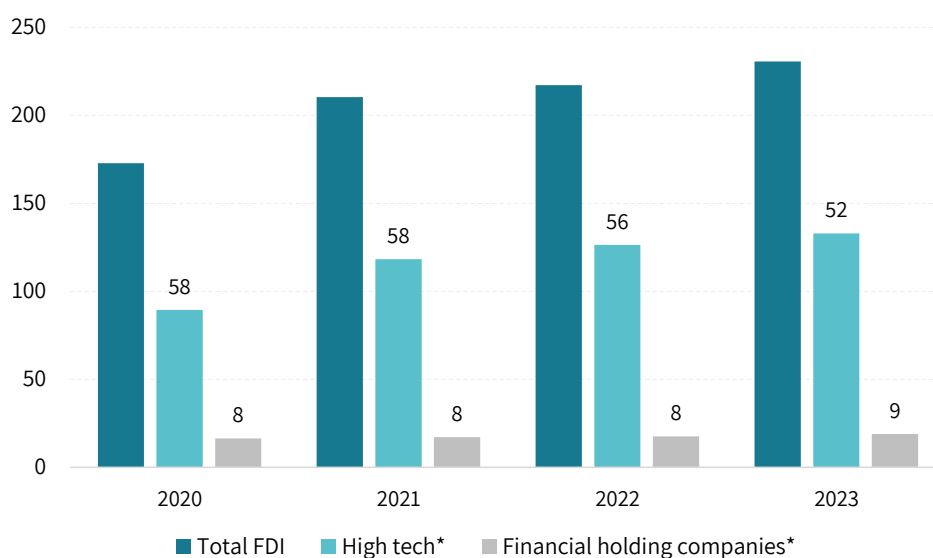
SOURCE: Bank of Israel

4.2 Distribution of foreign direct investment in Israel by industrial Activity

- **High tech** is the leading industry in foreign investment, with the highest balance of FDI;
- **Holding and financial-service companies** rank second;
- **Other industries** account for a wide distribution of the remainder of the investment.

In the past three years, as shown in Figure 15¹⁵.

Figure 15: Total foreign direct investment in Israel: Balances and percentages. TOP 2, USD billion

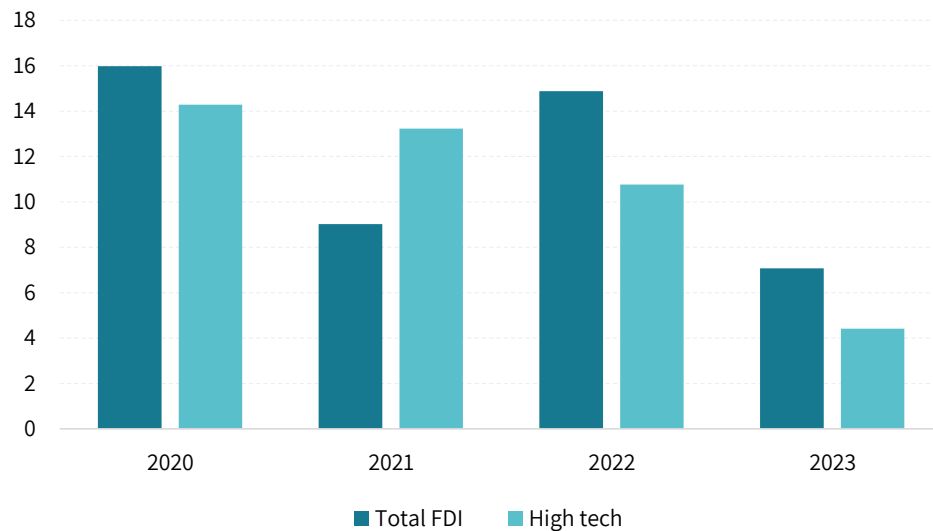


* The high-tech industry, as defined by the Central Bureau of Statistics, includes the following economic industries: Goods: manufacture of conventional pharmaceuticals and homeopathic pharmaceuticals (21), manufacture of computers and optical and electronic instrumentation (26), manufacture of aircraft, spacecraft, and similar (303); services: communication services (61), computer programming, consulting, and accompanying and other services (62), data processing and hosting (file storage on hosting computers), accompanying services, and portals (631), research and development centers (720), and research and development in the field of engineering and natural sciences (721).

¹⁵ Central Bureau of Statistics, "Israel's Direct Investments Abroad and Foreign Investment in Israel by Economic Branch Activity and Countries, 2020–2022," August 5, 2024, <http://tiny.cc/ps24001>. The data are updated to 2022–2023 as processed by the Bank of Israel Information and Statistics Department.

In 2023, the flow of new equity investment in Israel's high-tech industry declined by 60 percent relative to 2022 (Figure 16).

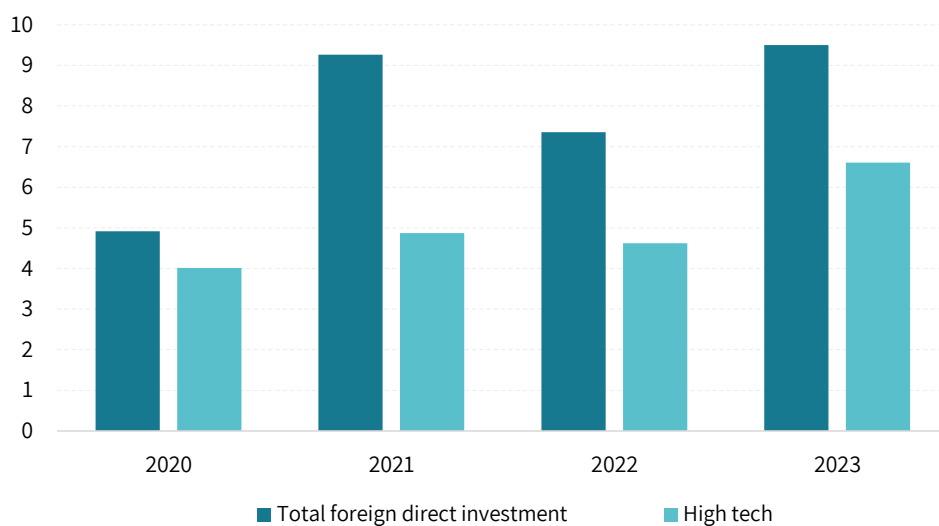
Figure 16: New equity investment as share of FDI in Israel, high-tech industry
USD billion



SOURCE: Bank of Israel

However, accrued reinvested earnings in high tech grew by 43 percent in 2023 over 2022 (Figure 17)

Figure 17: Accrued Reinvested Earnings, foreign investors, high-tech industry
USD billion



SOURCE: Bank of Israel

5. Conclusion

Foreign direct investment in Israel accounts for much of the country's long-term inward capital flow and abets the growth and stability of the local economy.

The balance of FDI in Israel has been growing in the past decade and came to 50 percent of total liabilities of the Israeli economy in 2023—far above the average share of direct investment in the total liabilities of OECD countries.

Most of the increase in investment traced to an upturn in net investment flow, new equity investment in particular, which persisted until a major decrease in 2023 occurred in tandem with international trends. In addition, accrued reinvested earnings increased in the past three years.

In the past decade, Israel has ranked among the leading OECD countries in the FDI indicators that we examined in this study. Israel's rate of net FDI is one of the highest relative to the benchmark countries, and the indicators up to the end of 2023 attest to the strong attractiveness of its economy, foremost its high-tech industry, to foreign investors.

Partial data for 2024 point to continued decline in foreign direct investment, but it is too early to tell whether this means that the economy has become less attractive or whether it marks the continuation of the global decline in this path of investment.