

# **The Determinants of Business Investment**

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Making Reforms Happen in Latin America  
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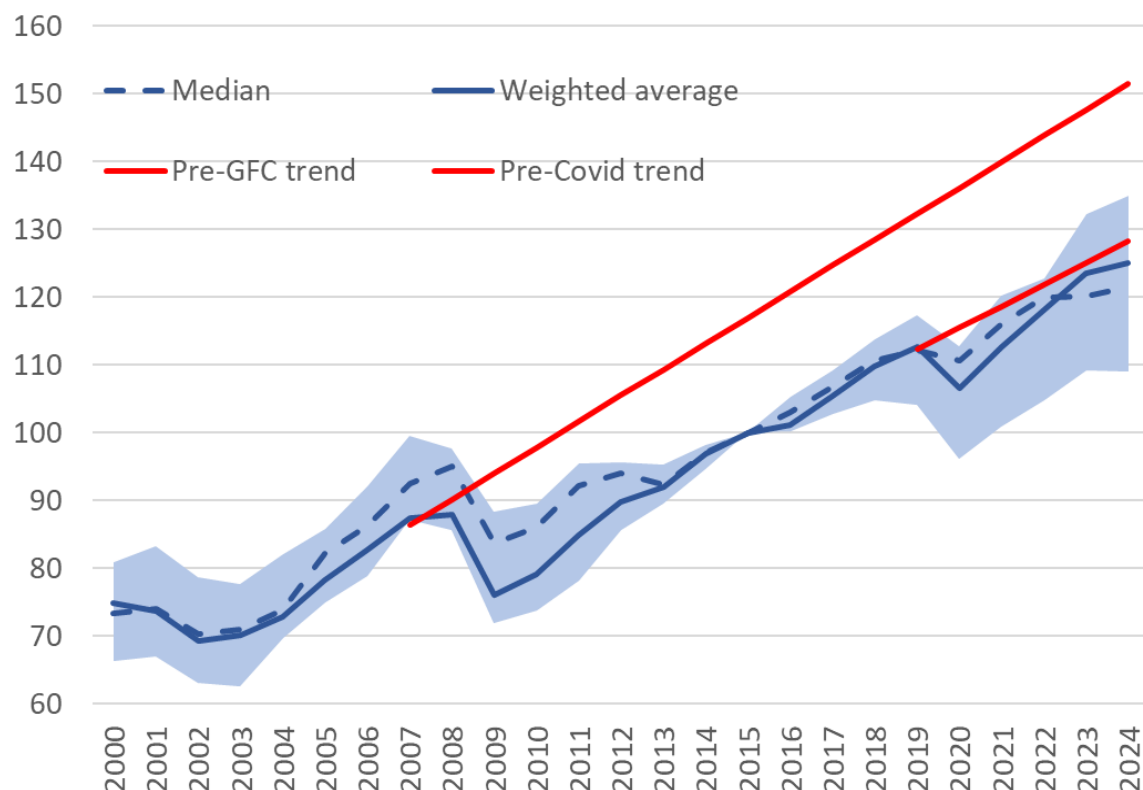
## *Business investment trends*



# Business investment is below its pre-GFC and pre-Covid trends

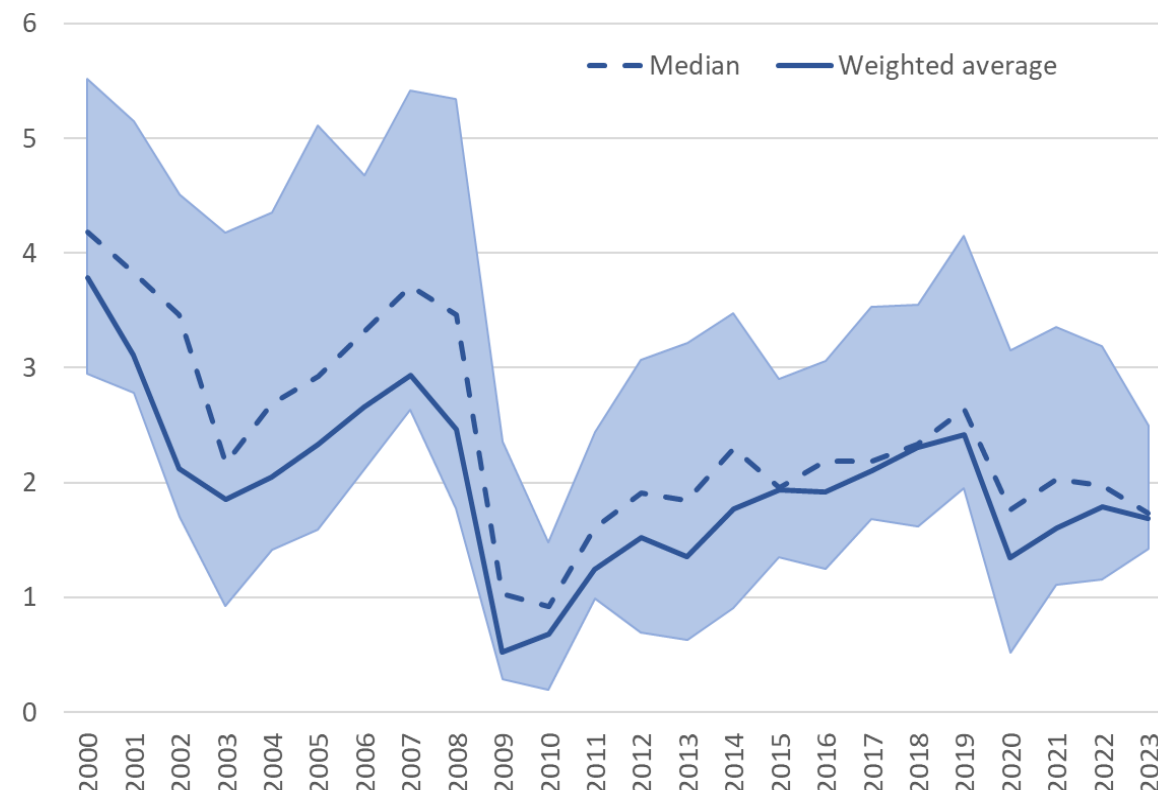
## A. Real gross business investment index

2015 = 100



## B. Net business investment to GDP

% of GDP



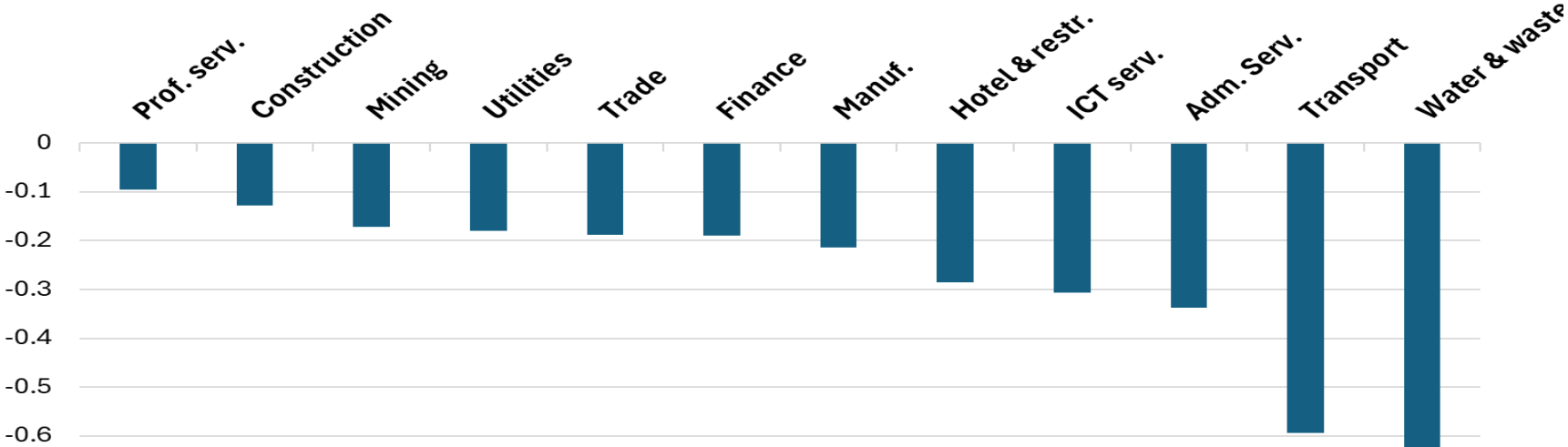
Note: Net investment is defined as gross fixed capital formation minus consumption of fixed capital. Panel A includes the following countries: AUS, BEL, CAN, CHE, DEU, DNK, FIN, FRA, GBR, ISL, JPN, KOR, NLD, NOR NZL, SWE, USA. Trend lines are estimated for two periods: 2002–07 (pre-GFC) and 2014–19 (pre-COVID), and extrapolated beyond these intervals. Country weights are based on GDP in purchasing power parity (PPP) terms for the year 2015. Panel B includes: AUT, BEL, CAN, CHE, CRI, CZE, DEU, DNK, ESP, EST, FIN, FRA, GBR, HUN, IRL, ITA, JPN, KOR, LTU, LUX, LVA, MEX, NLD, NOR NZL, POL, PRT, SVK, SVN, SWE, USA. Business investment includes the combined investment of the non-financial and financial sectors. The shaded areas show the interquartile range.

Source: OECD National Accounts database; and OECD calculations.

# Business investment is weak across all sectors and most countries

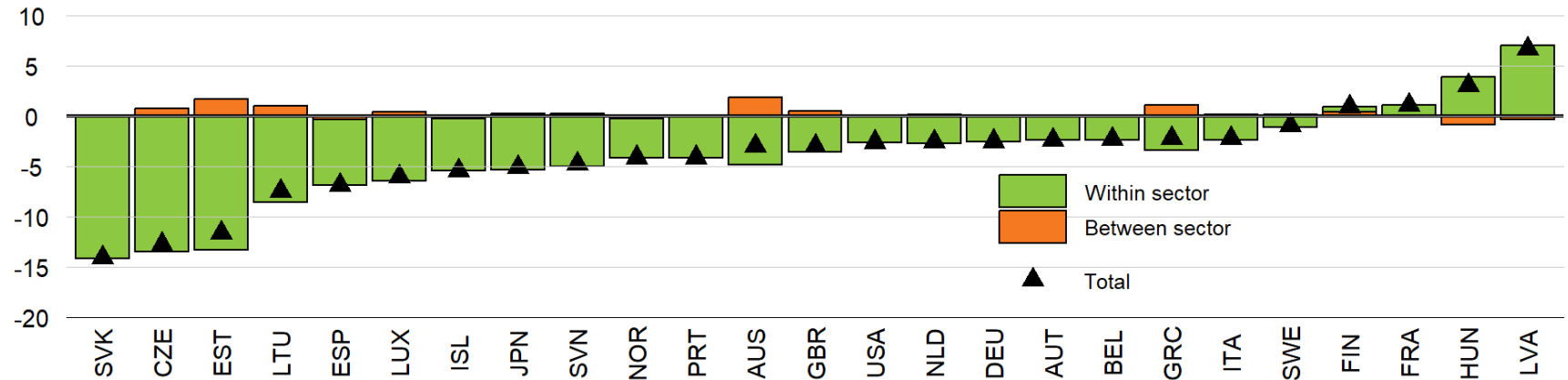
## 1. Change in net investment-to-value added ratio by sector

OECD annual average, 1997-2021, in % points



## 2. Change in net investment to value added ratio by country

1997-2021, in % points



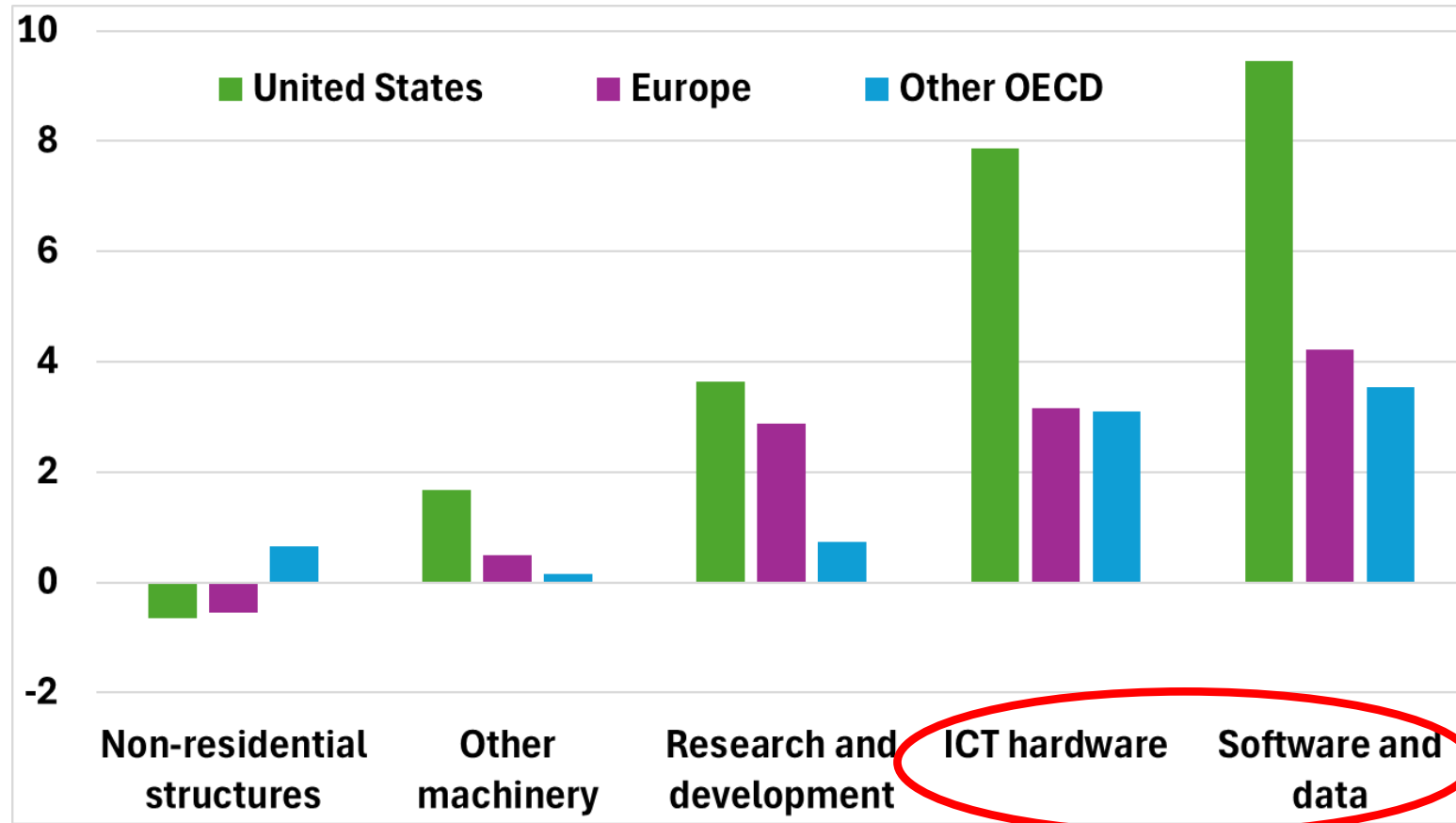
Note: The top figure covers 1997–2021 for countries in the bottom figure, with the net investment ratio defined as gross fixed capital formation minus consumption of fixed capital over value added (current prices); the bottom figure applies a shift-share decomposition (Autor and Salomons, 2018) into within-industry and between-industry effects across countries with available data.

Source: OECD National Accounts



# Investment patterns have shifted towards the digital and knowledge-based economy...

Growth in real gross investment by assets and regions, 2008-2022 (annualized, in %)

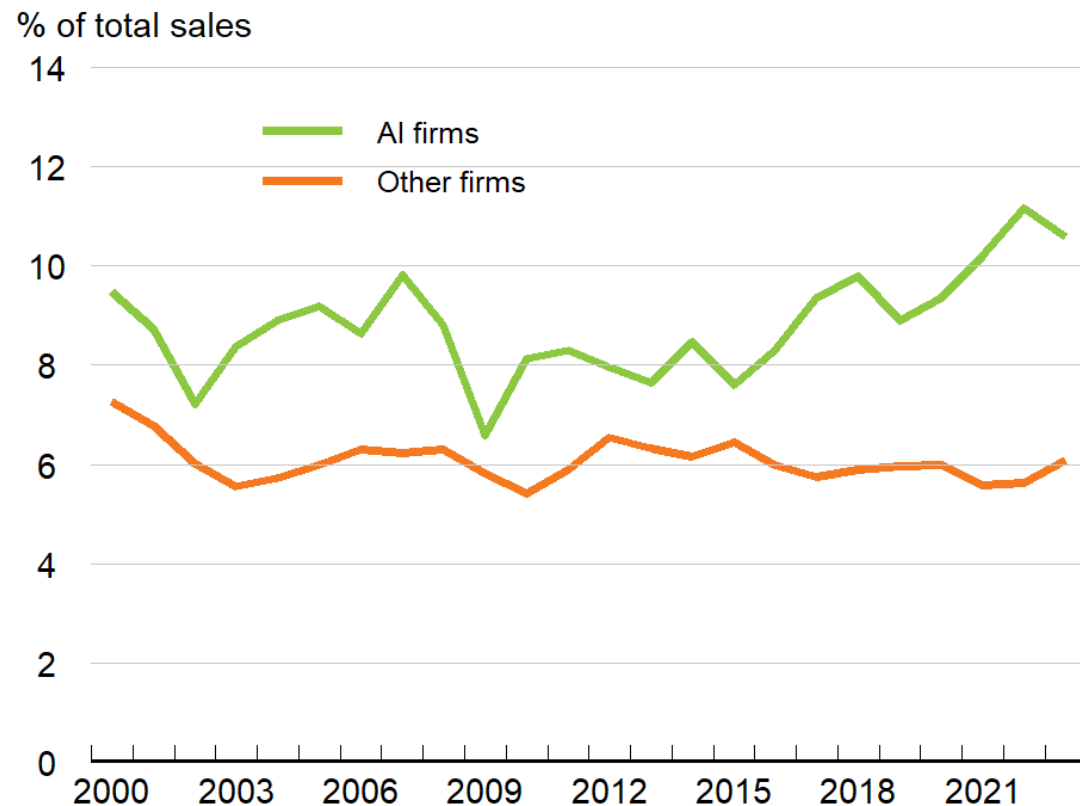


Note: ICT machinery includes both computer hardware and telecommunications equipment. Europe refers to AUT, BEL, CHE, CZE, DEU, DNK, ESP, EST, FIN, FRA, GRC, ISL, ITA, LTU, LUX, LVA, NLD, NOR, PRT, SVK, SVN, and SWE. Other OECD refers to AUS, CAN, ISR, JPN, GBR.

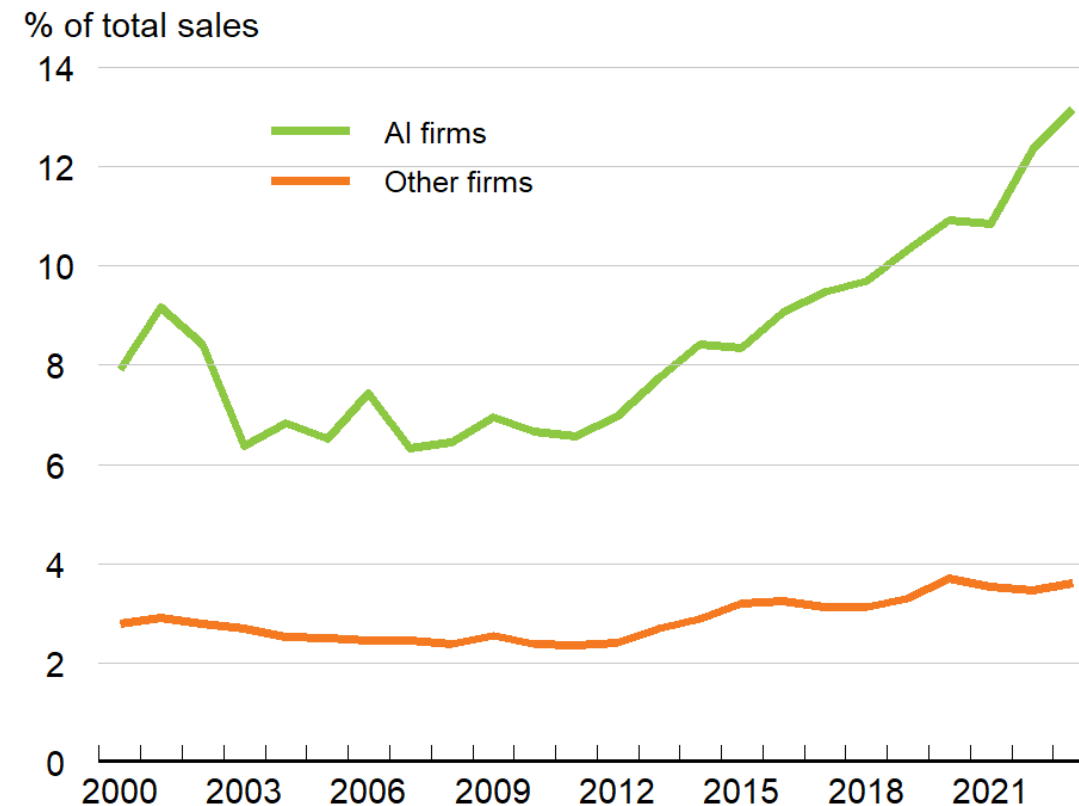
Source: OECD National Accounts.

# ... and AI-related firms increasingly invest more than other firms

**A. Capital expenditure**



**B. Research and development**



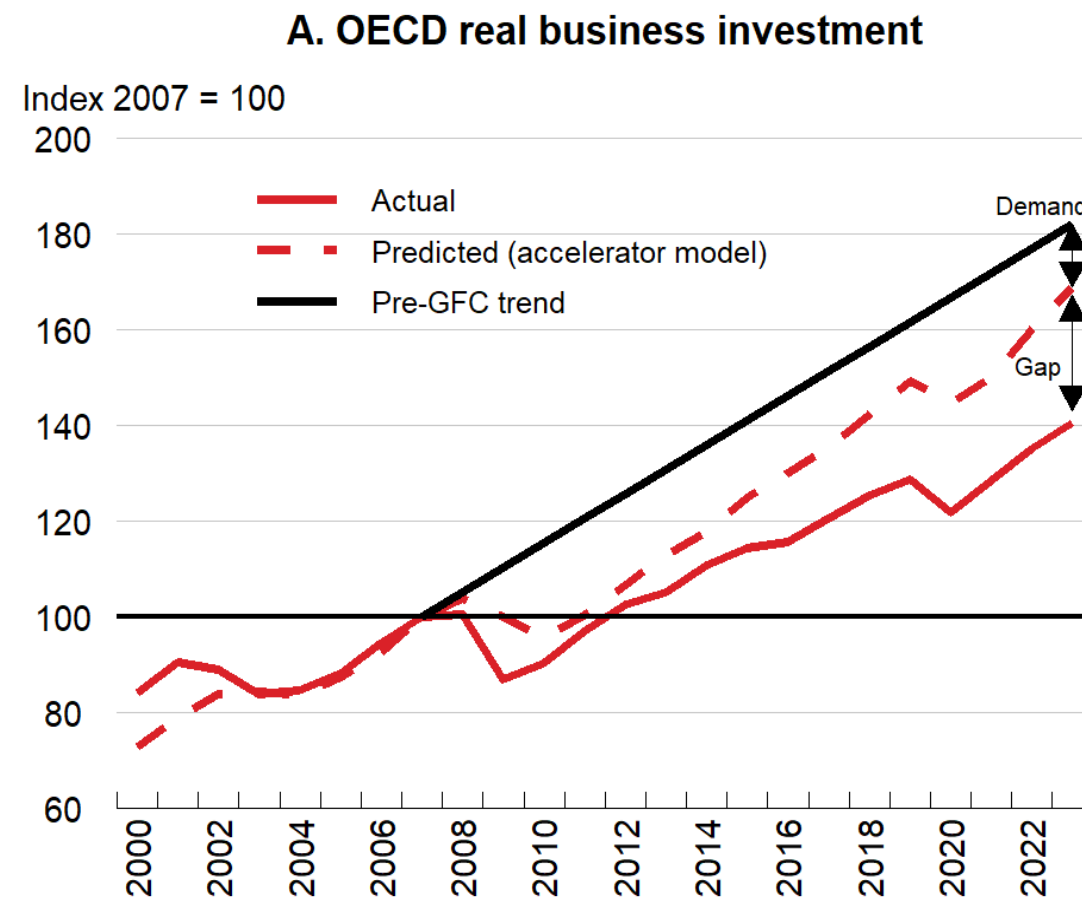
Source: LSEG Worldscope Fundamentals; and OECD calculations.

# *Determinants of business investment*



# Factors holding back business investment

- **Weak demand** explains  $\approx 1/3$  of the investment shortfall (accelerator model).
- **Remaining gap** reflects a mix of other structural and policy factors:
  1. **Elevated uncertainty**  
→ *firms postpone investment decisions*
  2. **Cost of capital**  
→ *supportive overall but rising recently.*
  3. **Weaker competition and business dynamism**  
→ *cash hoarding by firms is a symptom?*



Note: The investment gap is calculated as the shortfall relative to predicted investment from a simple accelerator model that relates real business investment growth to its own lag and to current real output growth. Predicted real business investment is calculated from 2008 to 2023 as the fitted values from the model using actual growth rates of GDP and lagged investment. The overall shortfall in real business investment relative to the pre-GFC trend in 2023 is then decomposed into a part that is explained by the model, interpreted as demand (calculated as trend investment minus predicted investment) and an unexplained part, or 'gap' (calculated as predicted investment minus actual investment, as a per cent of predicted investment)

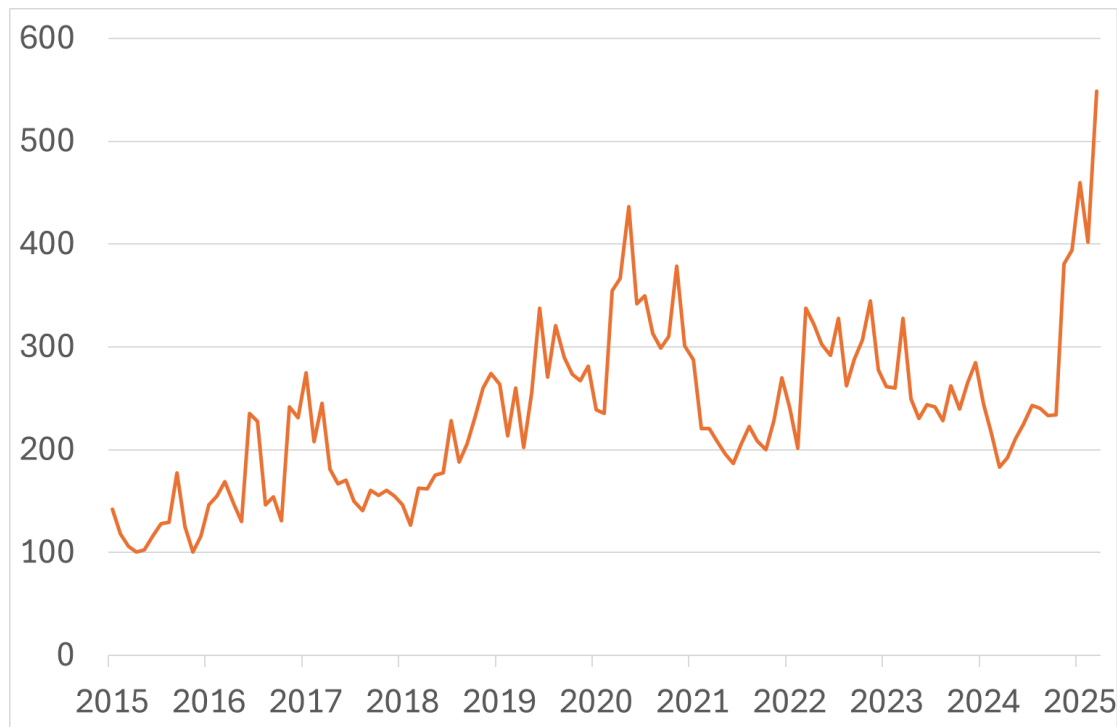
Source: OECD Economic Outlook 117.



# 1. Uncertainty has been increasing and plays a strong role

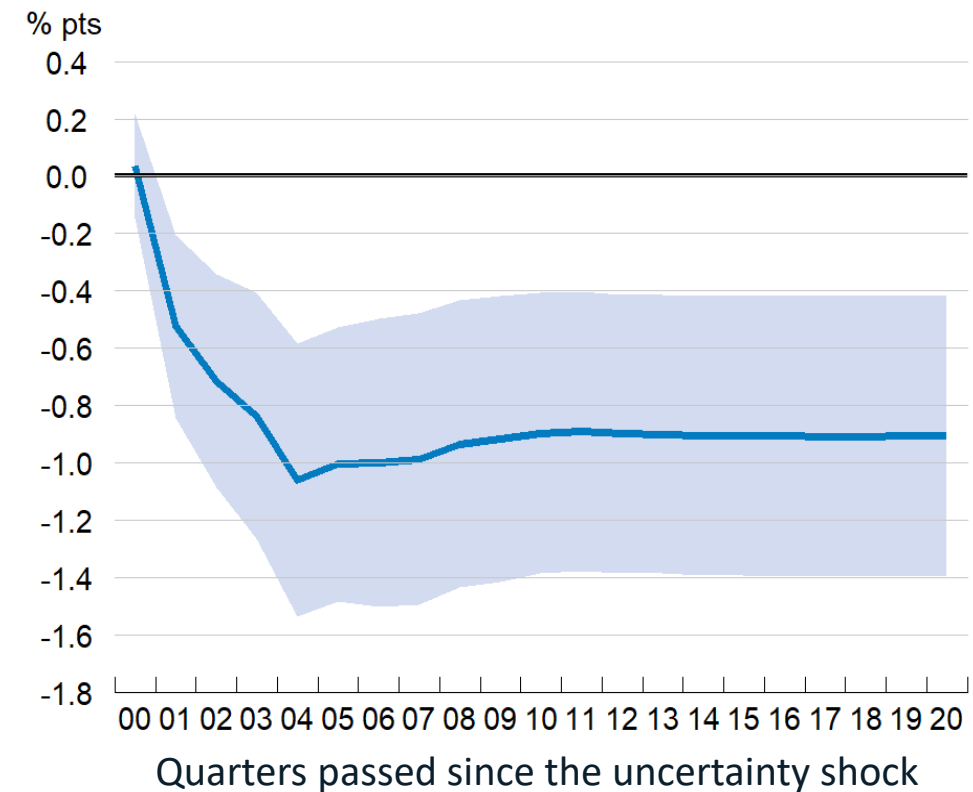
## Policy uncertainty has been rising

Economic policy uncertainty index by Bloom et al 2016, average across countries



## The negative impact of policy uncertainty on business investment

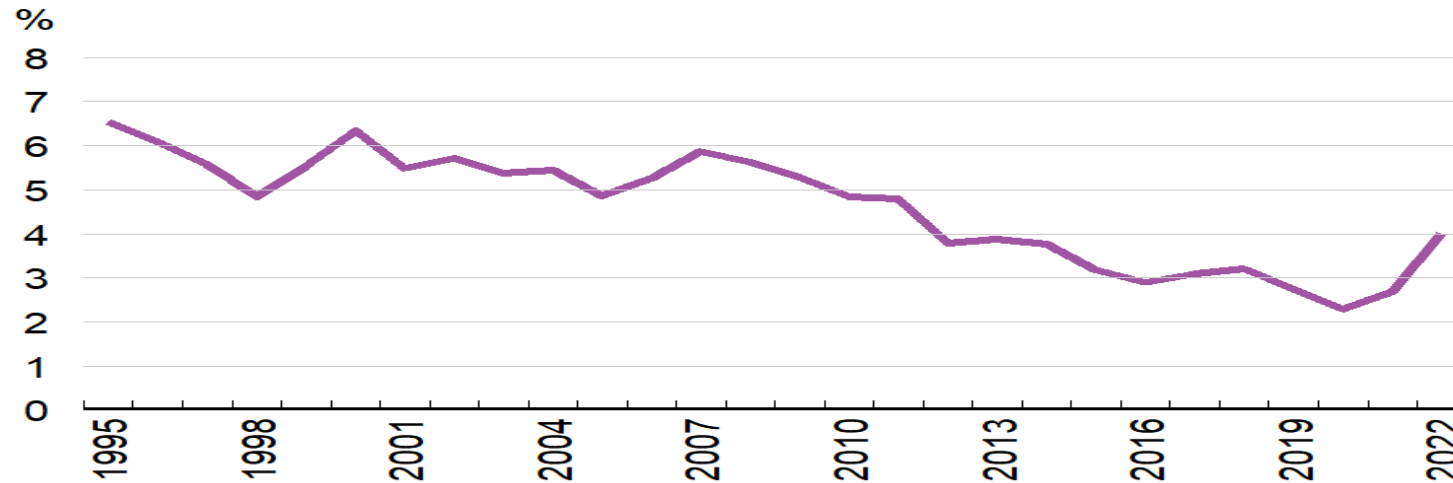
1 st.dev. increase in the uncertainty index



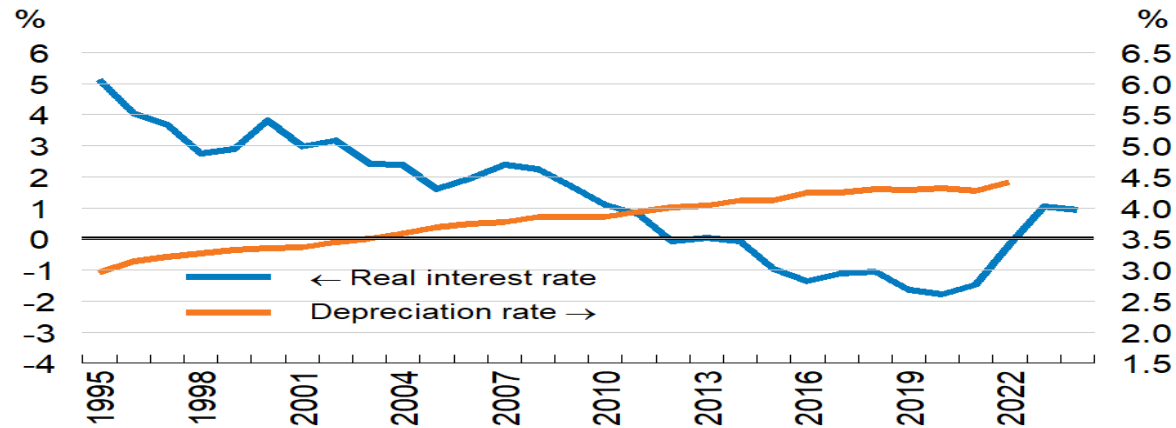
Source: Uncertainty index by Baker, Bloom and Davis (2016); OECD Economic Outlook 117

## 2. Cost of capital has been supportive overall but rising recently.

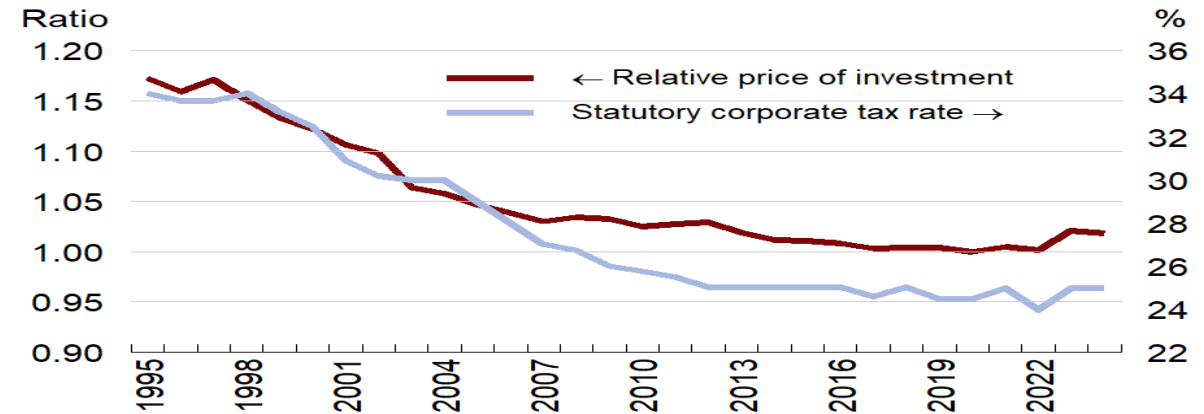
**A. User cost of capital**



**B. Depreciation and real interest rates**



**C. Tax and relative prices**



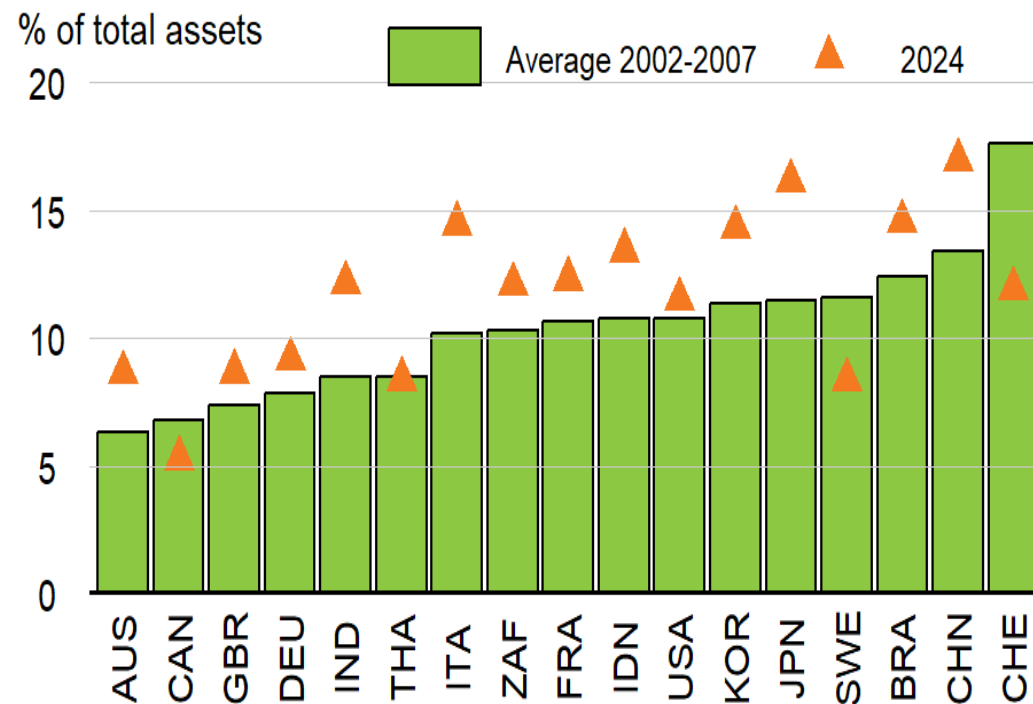
Note: Panel A: The user cost of capital UCC is calculated using the relative price of investment, the real interest rate based on the 10-year government bond yield and 10-year ahead inflation expectations from professional forecasts, the depreciation rate, the statutory corporate tax rate and the share of debt in corporate liabilities (debt plus equity). Panel C: The relative price of investment is measured as the ratio of the investment and GDP deflators. In Panels A, B and C, the country sample includes 15 OECD countries for which data are available (Australia, Belgium, Canada, Denmark, Finland, France, Germany, Japan, Korea, the Netherlands, New Zealand, Sweden, Switzerland, the United Kingdom, and the United States). Median values are shown.

### 3. Signs for weaker competition?

Instead of investing, *most* firms have used savings to accumulate financial assets and return funds to shareholders

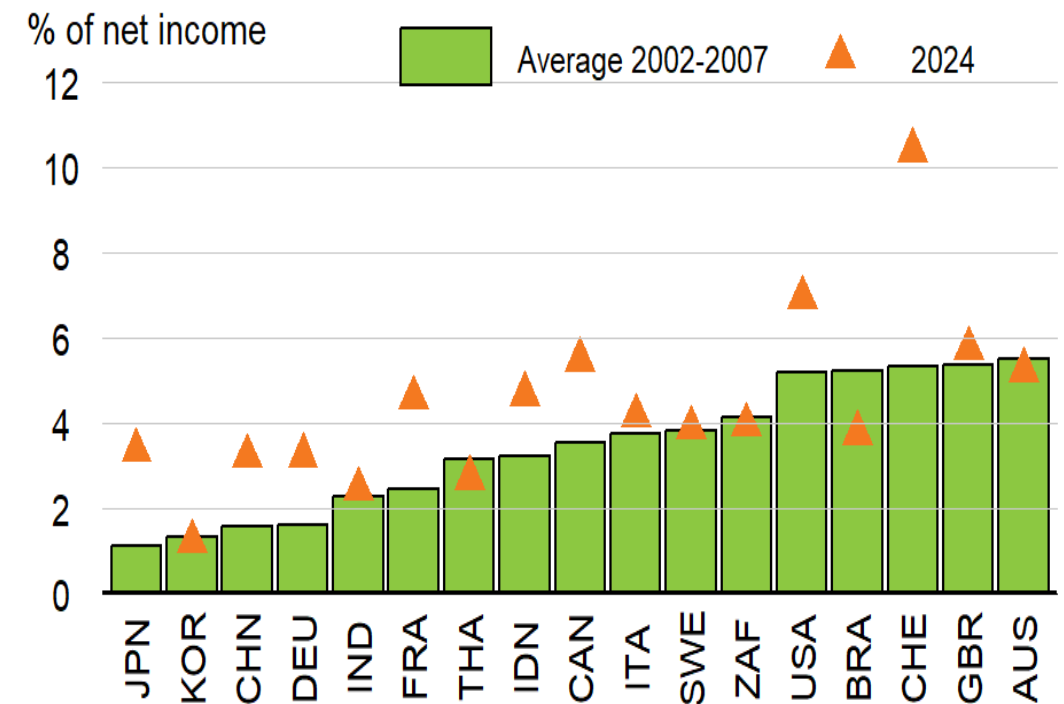
#### Cash holdings

% of total assets



#### Total payout to shareholders

% of net income



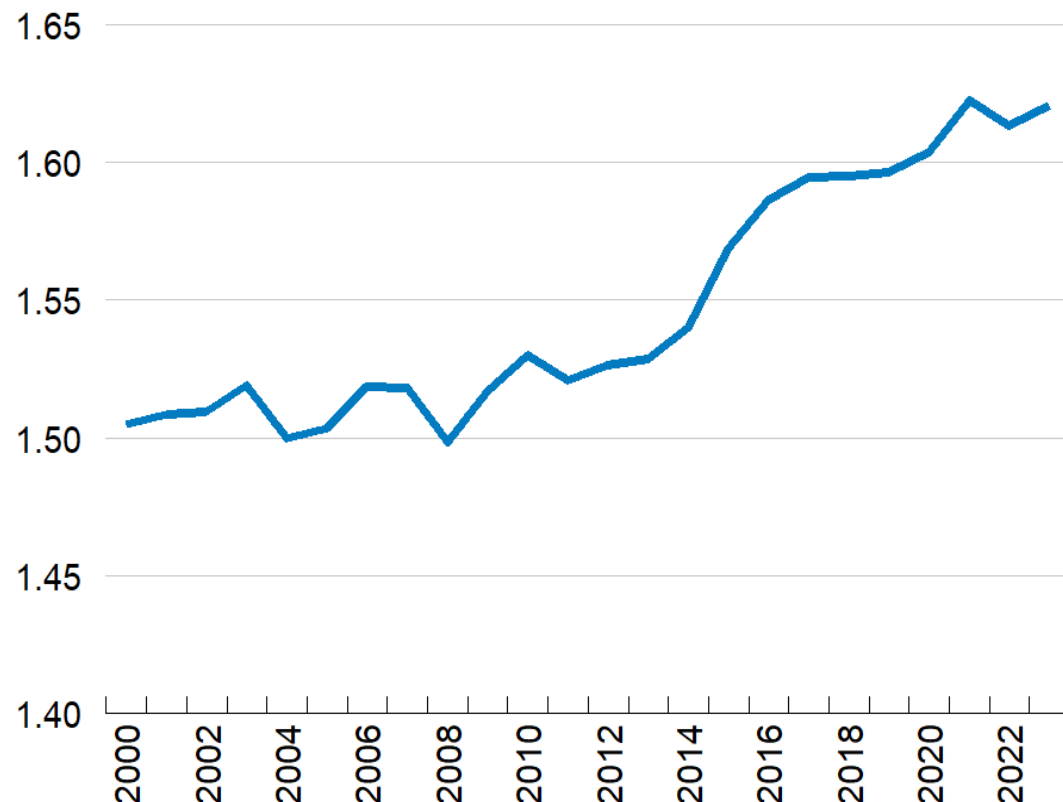
Note: Based on cumulated values across all firms in each country and year. The 2002-2007 average is calculated based on the country-level indicators. Cash holdings is the sum of cash and short-term investments. Total payout is the sum of dividend and share repurchase payments.

Source: LSEG Worldscope Fundamentals; and OECD Economic Outlook 117.



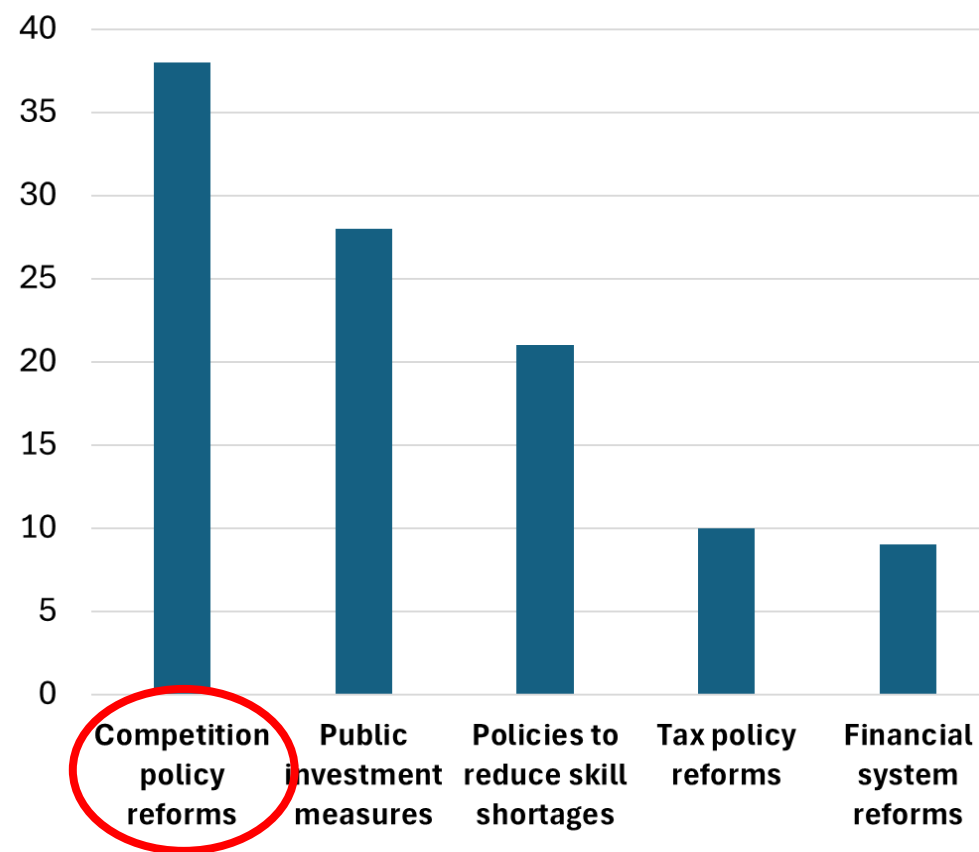
# Competition policy is a key reform area to boost investment

## OECD average markups



## Policy recommendations to boost investment

Number of countries



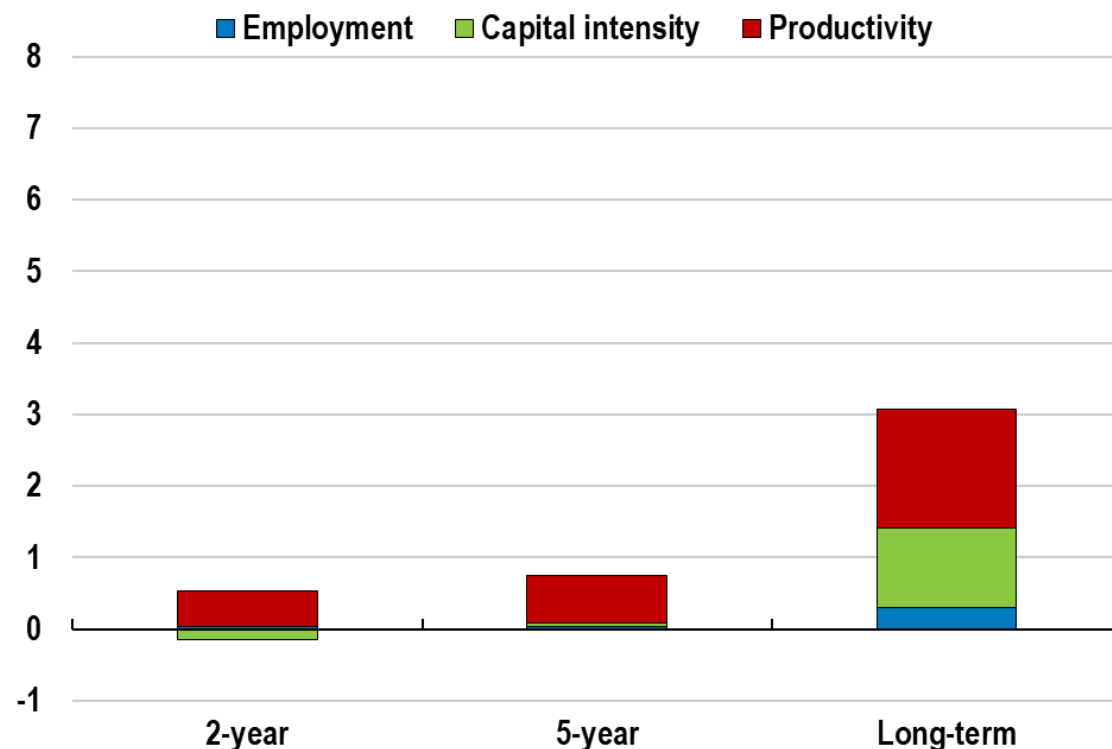
Note: Markups are defined as revenues over cost of goods sold, averaged across listed firms.

Source: LSEG Worldscope Fundamentals; and OECD Economic Outlook 117.

# Product market reforms provide a more competitive environment and boost capital accumulation

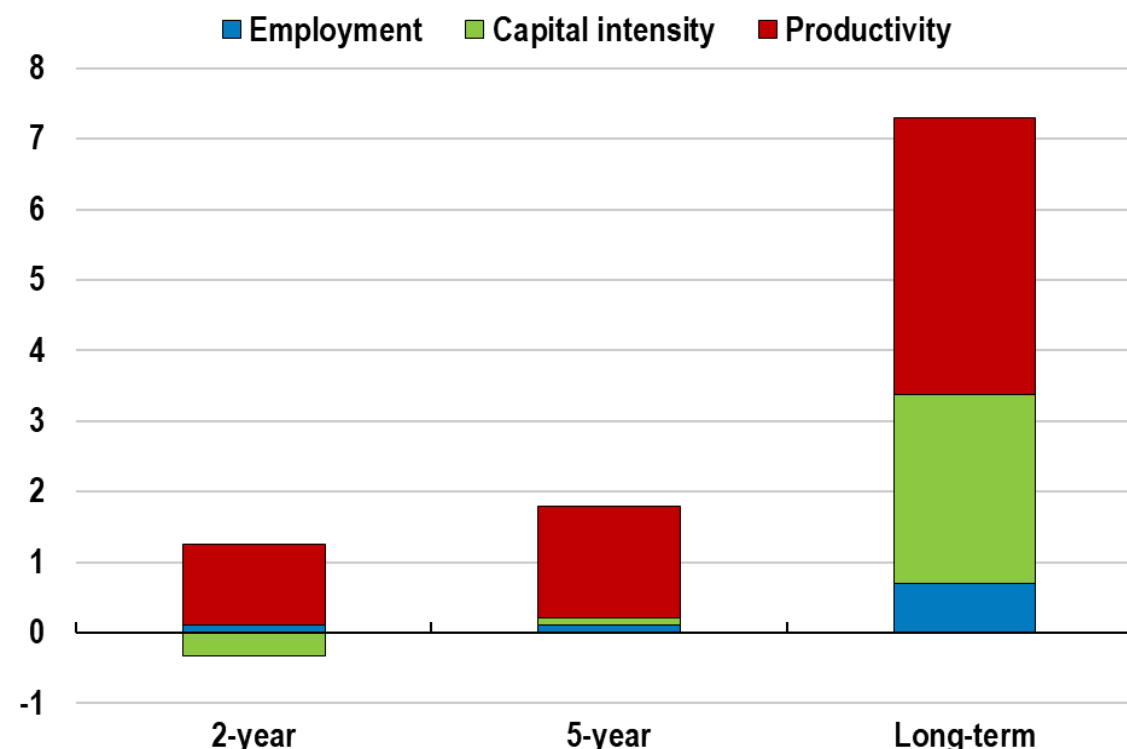
Effect on GDP per capita of closing PMR gap to the average top 5 OECD performers, %

G20 Advanced economies



Effect on GDP per capita of closing PMR gap to the OECD median, %

G20 Emerging-market economies



Note: Productivity refers to multifactor productivity. The left figure reports the average effect for AUS, CAN, DEU, FRA, GBR, ITA, JPN, KOR, and USA, while the right figure shows the average effect for BRA, CHN, IND, IDN, MEX, TUR, and ZAF.

Source: Egert, B. (2018), "The quantification of structural reforms", OECD Economics Department Working Papers, No. 1482, OECD Publishing, Paris

# Thank you

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