

# Multinational Enterprises' Reactions to Regional Integration



Third CEPII-IDB Conference



*Just*

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# Outline

- I will discuss the papers from the following perspectives:
  - How do RTAs and other related factors (BITs, e.g.) affect MNE's location decisions?
  - How do changes in FDI affect the host country?
- Discuss Eden's and Barry's papers
- Policy implications
- Discuss some more technical aspects of the trade-productivity study for Mexico

# “MULTINATIONALS AND THE NEW REGIONALISM IN THE AMERICAS”

- Very good overview of:
  - literature on MNE location motives and different strategies
    - Only caveat: macroeconomic and firm analysis split is somewhat artificial
    - More microeconomic studies are needed (econometric and case studies)
    - More theory
  - how liberalization processes affect these strategies
  - Current situation and threats in the Americas
- The importance of FDI in services: we need more and better theory as well as empirical analysis

# Share of Service FDI in Total Flows

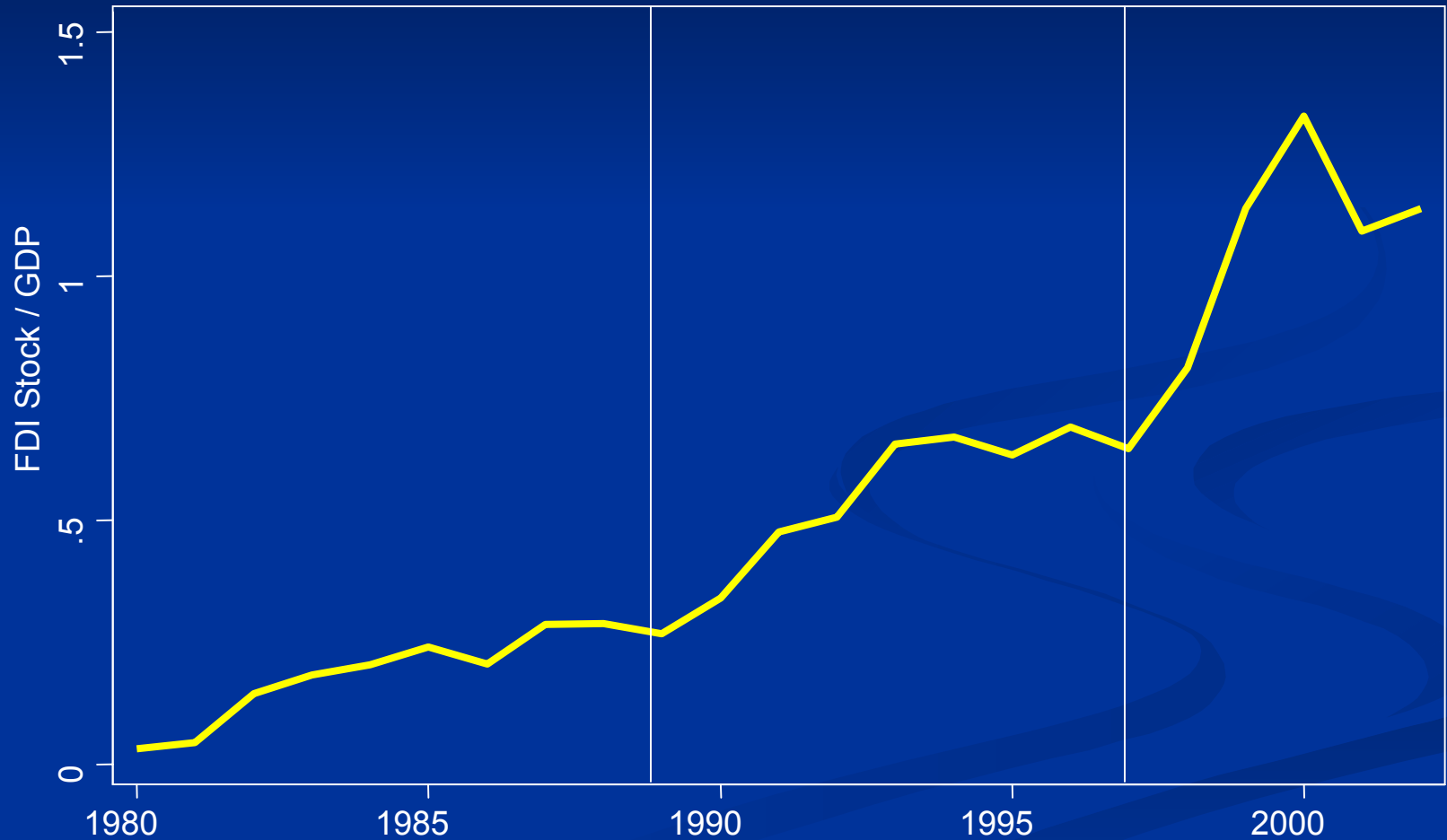
Country	Avg. Share (2000 – 2002) %
Ireland	50.19
Mexico	59.57

Source: Own calculations based on UNCTAD, 2005

# “MULTINATIONALS AND THE NEW REGIONALISM IN THE AMERICAS”

- The magnitude of FDI changes

# Ireland - Inward FDI Stock



# Mexico – Inward FDI Stock



# “MULTINATIONALS AND THE NEW REGIONALISM IN THE AMERICAS”

- The magnitude of FDI changes
  - Mexico's FDI / GDP ratio went from 5% in the early 1990's to around 10% by 2000
  - Ireland's case is even more impressive
  - Big differences persist; by 2000 FDI Stock / GDP in Ireland is 150 %, while for Mexico it is just 10 %!
- Changing patterns: insiders vs. outsiders; diversion vs. creation, etc.

# FDI and Trade Growth - Mexico

	Period	Within NAFTA	Rest of the World
FDI	89 – 93	19.48 %	17.42 %
	96 – 00	19.49 %	29.53 %
Trade	89 – 93	20.00 %	14.87 %
	96 – 00	18.26 %	17.14 %

# Frankel Barry's Paper

- Very interesting case study, because...
  - Ireland was a relatively under-developed country within the EU
  - Located in the periphery
  - Impressive convergence in standards of living
  - FDI – based industrial policy
- “How did they do it?”
- What lessons can be extrapolated to LAC?

# Frankel Barry's Paper

- High presence of FDI for a prolonged period of time
- However, no significant impact on economic performance for a long time
  - Type of FDI? Tariff jumping / vertical FDI
  - Macroeconomic factors (difficult to disentangle)
  - Non-monotonic effects of integration on peripheral countries (as predicted by Baldwin et al., 2003)
- It is hard to separate the deepening of EU integration from Ireland's own changes in institutions and policies

# Frankel Barry's Paper

- Paper makes the point that the main factors to understand the success of Ireland are domestic policy changes
  - Education and Human Capital
  - Institutional improvements linked to EU deepening (Daude and Stein, 2004)
  - Macroeconomic stability also linked to EU (EMU)
  - Change in FDI target sectors: R&D and spillovers
- What about EMU's effect? It would be interesting to analyze the effect on UK, EMU and outside FDI

# Policy Discussion

- Should policies be designed to promote especially FDI?
  - Not necessarily!
  - Evidence so far shows that spillovers are limited
  - Ireland receives a lot of FDI, but also portfolio investment...

# Shares in Total Private Capital Stocks

Country	FDI	Equity	Debt	Loans	Total
Argentina	53.25	2.74	20.08	23.93	100.00
Brazil	44.88	15.17	21.73	18.22	100.00
Canada	34.23	16.62	35.01	14.14	100.00
Chile	62.36	5.42	10.70	21.52	100.00
Colombia	52.41	6.44	20.53	20.62	100.00
Ireland	28.37	21.79	23.16	26.68	100.00
Mexico	40.25	19.69	23.94	16.12	100.00
New Zealand	38.15	7.83	25.27	28.75	100.00
Peru	67.58	6.71	5.06	20.65	100.00
Venezuela	53.35	2.55	25.53	18.56	100.00

Source: Daude and Fratzscher, 2005

# Policy Discussion

- Should policies be designed to promote especially FDI?
  - Not necessarily!
  - Evidence so far shows that spillovers are limited
  - Ireland receives a lot of FDI, but also portfolio investment...
- Less corrupt, more transparent, financially developed, investor friendly countries exhibit a smaller FDI share (Daude and Fratzscher, 2005)
- Tax incentives seem to have only marginal effects

# Policy Discussion

- A development strategy that makes the country more business friendly in general seems more promising
  - This can also avoid reallocation of investments in a RIA (Daude et al, 2003)
  - There are some general rules: property rights, rule of law, policy predictability, macro stability, openness
  - Other specific factors like the kind of infrastructure or human capital have to be determined on a country-by-country basis
  - IDA shows also that active industrial policies and promotion is relevant; institutional aspects matter

# De Hoyos and Iacovone's Paper

- Unfortunately, it does not address FDI:
  - MNE reaction's to the NAFTA
  - Impact of MNE on domestic firms' performance
  - Potential channels:
    - Competition effects, but also:
    - Spillovers (positive or negative)
    - Linkages:
      - forward (better services, lower costs of inputs, etc.)
      - backward (demand induced improvement of intermediate inputs)
  - Addressing these issues would make the paper a much more original and important contribution

# De Hoyos and Iacovone's Paper

- Use of labor productivity is a serious shortcoming of the paper
  - TFP is the relevant variable rather than partial productivity (currently an increase in the capital stock would be interpreted as an increase in productivity)
  - Standard solution is to use:
    - Olley and Pakes (1996) or Levinsohn and Petrin (1999)
    - “Non-parametric” approach (Tornqvist indices)
  - The necessary information is available (López-Córdoba, 2003)
  - Imported inputs channel: use output rather than added value
  - Market power and TFP dispersion (Syverson, 2004)

# De Hoyos and Iacovone's Paper

- The authors should be more explicit why integrated plants are assumed to be different
  - Maquiladoras
  - Vertical integration and reduction in barriers: more efficient allocation of production stages
  - This is consistent with estimations
  - What is the importance of FDI in the different types of plants?
  - Multi-plant firms

# De Hoyos and Iacovone's Paper

- Identification of NAFTA effect
  - Could just reflect different impact of RER or aggregate cycles
  - Paper discusses these issues, but does not give a satisfactory solution
- How to deal with entry and exit?
  - Might be important to understand productivity dynamics
  - Exit is on the “to-do” list; entry?

# De Hoyos and Iacovone's Paper

- Firm level controls
  - Age: vintage capital models
  - Financial aspects
    - Credit constraints might be relevant
    - Balance sheet effects on the liability side of Tequila crisis
  - Market power
- Some evidence of MNE effects:
  - López-Córdoba (2003) finds a positive inter-industry spillovers of FDI (forward and backward) and negative intra-industry effects

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