

The FDI Premium of EU Membership

Prof. Nauro F. Campos

Brunel University London and ETH Zurich



Two Acknowledgements

- Most of the work here is joint with Randolph Bruno (UCL), Saul Estrin (LSE) and Meng Tian (LSE)
- Actual title of this talk could well be:
 - **How and Why can FDI Save Europe**

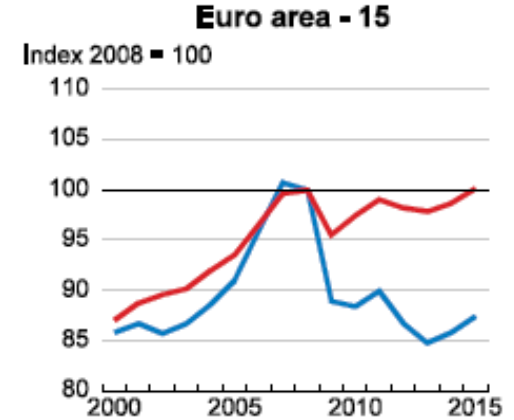
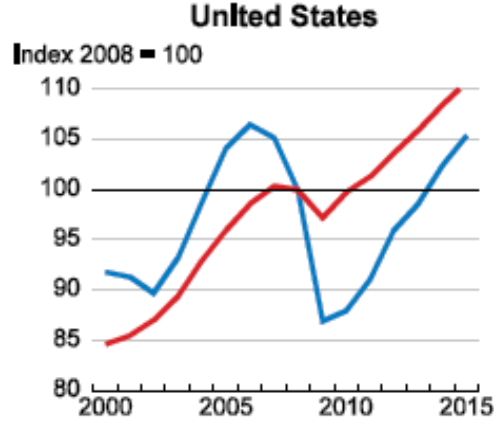
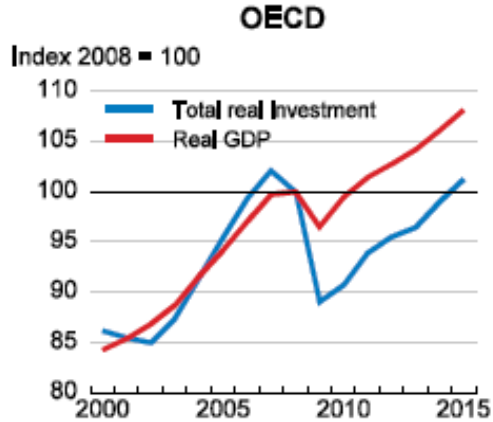
Background and Motivation

- European Union: deep and multidimensional crises
- FDI can be a “silver bullet” (if we can ever find one)
 - This is because of nature and significance of the FDI effects
 - Economic and political implications

EU Crises

- The financial crisis
- The debt crisis
- The economic crisis
- The Greek crisis
- The populism crisis
- The productivity crisis
- The terrorism crisis
- The refugee crisis
- The democratic deficit crisis
- *An investment crisis?*

The Crises



EU Crises

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*... and **BREXIT***

Brexit and the Crises

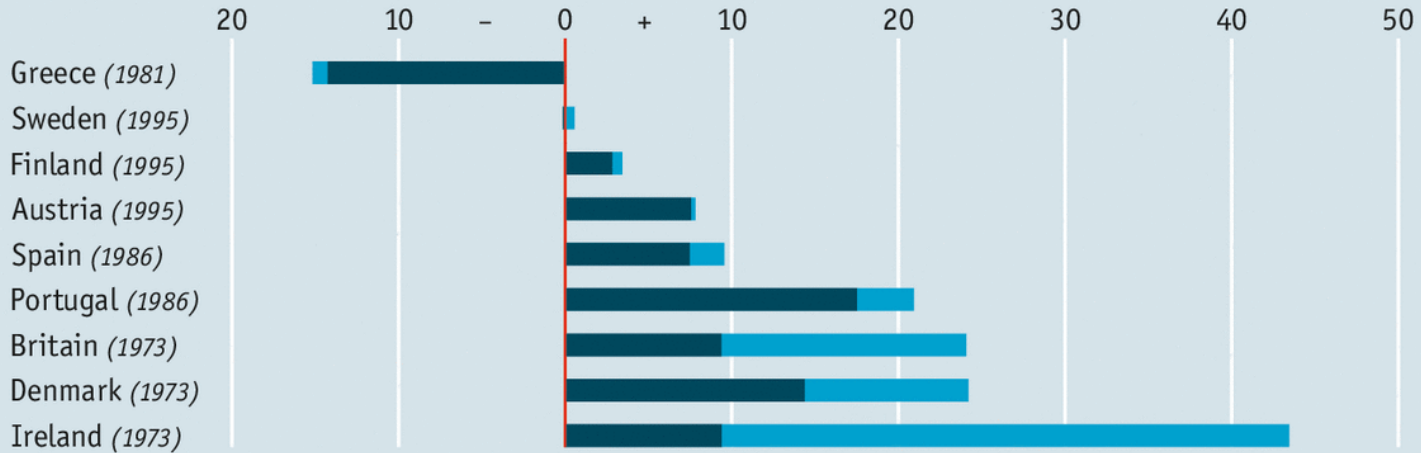
- Brexit raises a number of *existential* questions: value EU membership, dynamics of benefits, whither integration
- These questions will remain with us and the world is watching
- Economic research was “unclear” about purely economic benefits from EU membership

Effect of Joining the EU on GDP per person

A club worth joining

Effect of joining the EU on GDP per person*

Difference between actual level and estimated level if not a member, %
(Year joined)



Source: "Economic growth and European integration: a counterfactual analysis", by Nauro Campos *et al*, forthcoming

*At purchasing-power parity

Mechanisms

- **How** did countries Benefit from EU Membership?
 - Emphasis is often on trade, finance, migration, etc.
- Less investigated mechanisms:
 - FDI
 - Deepening of EU integration

FDI: Benefits and Costs

- Adds to host's capital stock
- Creates new jobs
- Access to up-to-date technology and new management techniques
- Greater access to international markets
- FDI helps stop reversals of structural reforms

- **Risks:**
 - Competition from large foreign companies may eliminate domestic producers
 - This may lead to job losses/low re-investment

Supporting Evidence of Benefits from FDI

- *MACRO*: Small first-order effect, but **thresholds**
 - Human capital
 - Financial liberalization
 - Institutional quality
- *MICRO*: Small first-order effect, but **vertical spillovers**
 - Evidence on horizontal is weaker
 - Yet FDI benefits upstream (suppliers) and downstream (customer) firms

Reasons often given for doubting FDI effects

- Thresholds (FDI is *conditional*)
- Measurement error (Blanchard-Acalin 2016)
- Conceptual issue: FDI, Trade and Global Value Chains in XXI century

Is it Conditional?

- Meta-analysis by Bruno, Campos and Estrin (2017)
- Try explain strength of those *conditionalities*
- Hand-collected info 175 studies (~1100 estimates), 1940 to 2008

- Finding 1: difference between “macro” and “micro” effects is positive and significant (with the former about 6 times larger than latter)
- Finding 2: the benefits from FDI are substantially less “conditional” than commonly thought

FDI measurement error

- Blanchard-Acalin 2016: “What does measured FDI actually measure?”
- Standard criteria is when capital flow involves 10% (or more) of foreign ownership
thus FDI
 - Arbitrary cut-off point
- Noise may make FDI effect more difficult to detect

In 21st century, Trade = FDI = Trade (Baldwin)

- 20th century trade = trade in final goods follows comparative advantage
- 21st century trade = trade in parts/components follows absorptive capacity

- UNCTAD: 60% of global trade now in intermediate goods and services

- GVCs: Global value chains

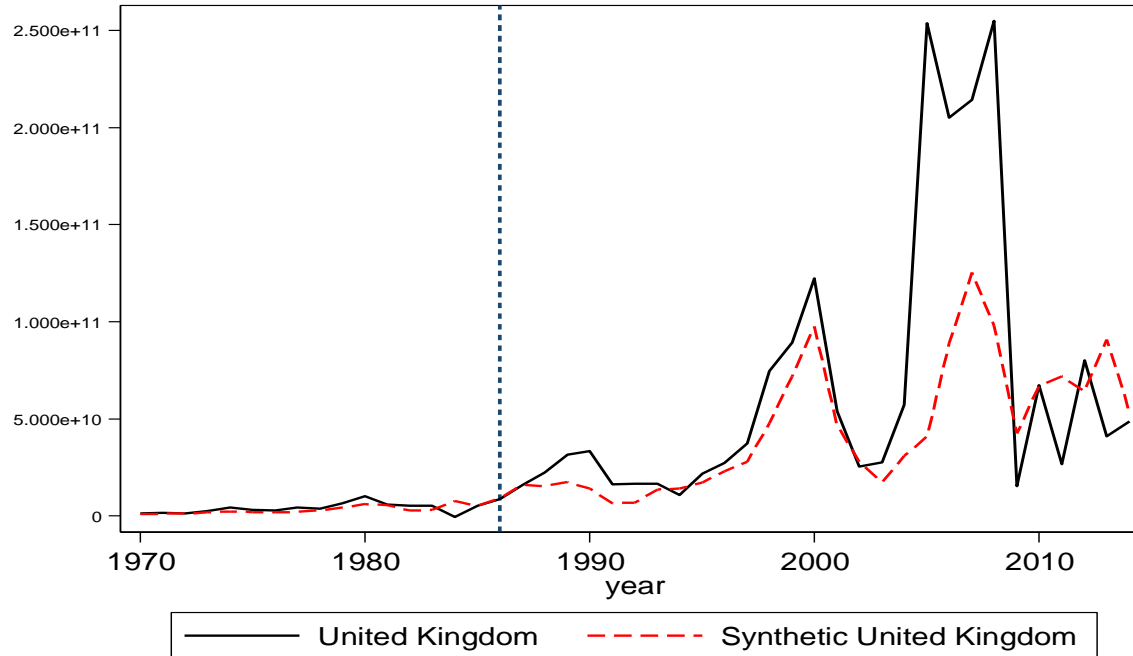
The Gravity of the Trade Channel

- Rose Effect (2000) estimates membership in a currency union translate into massive increases in trade (~300%)
- Baier-Bergstrand (JIE07): EU **127-146%** after 10-15ys vs EFTA by **35%**
- Glick-Rose 2016 critique: using modern econometric techniques (Poisson) estimate goes from 300% to 0%
- What about **FDI**?

De Sousa and Lochard (ScJEc 2011)

- What is the effect of the euro in terms of FDI?
- Main finding is increased FDI stocks by around 30%
- *Find effect varies across EMU members:*
 - Larger for outward investments of less-developed
 - Contrary to expectations of FDI diversion effects, EMU countries have invested more in non-EMU countries since launch of the euro

FDI premium from Single Market: Evidence for the UK



Source: *Bruno, Campos, Estrin and Meng (2016)*

Gravity FDI: Bruno, Campos, Estrin and Meng

Dependent Variable:	(1) Ln(1 + FDI)	(2) FDI	(3) Ln(FDI)
	OLS FE	Poisson	Heckman
EU member (target)	0.285*** (0.077)	0.320* (0.163)	0.132*** (0.050)
EU member (sender)	-0.010 (0.079)	0.828*** (0.191)	0.199*** (0.050)
Ln(GDP, sender)	0.500*** (0.154)	3.903*** (1.462)	0.766*** (0.226)
Ln(GDP, target)	0.473*** (0.056)	3.799*** (1.432)	0.686*** (0.226)
Ln(GDP per capita, sender)	1.450*** (0.154)	-1.125 (1.623)	1.655*** (0.254)
Ln(GDP per capita, target)	0.180 (0.158)	-1.489 (1.513)	-0.010 (0.255)
Observations	33,524	33,147	33,524

FDI Effects

- Synthetic counterfactual suggests more than 25% increase in FDI inflows due to Single Market
- Gravity evidence ranges from about 15% increase of FDI inflows due to EU membership (Heckman) to about 30% (using “better econometrics”)
- Headline finding: 28% FDI increase due to EU membership

Concluding Remarks

- Multidimensional and deep crises in the EU
 - Research was vague on benefits of EU membership
 - Maybe too many solutions (GEMU, Juncker), but priorities?
- FDI can be “silver bullet”, because of
 - Nature, significance and robustness of the FDI effects on productivity
 - Effects are long-term (reinforced by deep integration)
 - Politically, if helps turnaround, may propel support for reformed EU

Grazzi Hafna

