International Business Economics

3. Foreign Direct Investment: Advantages and Risks

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Advantages of FDI to host countries

- Resource-transfer effects
  - Capital
  - Technology
  - Management
- Employment effect
  - Direct
  - indirect

Advantages of FDI to host countries

- Balance-of-payments effect.
  - Current account-surplus/deficit
  - Capital account
- Increases competition and spurs economic growth

Risk of FDI to host countries

- Can drive out local competitors or prevent their development
- Profits brought home ‘hurts’ (debit) a host’s capital account
- Parts imported for assembly hurt trade balance
- Can affect sovereignty and national defense

Potential FDI benefits for the EU

International investments into the EU:

- are worth €5.4 trillion – or about 36% of the wealth produced annually by the EU
- directly support 7.6 million jobs in the EU
- provide capital and technology to foster European research, innovation and competition

Source: European Comission (http://ec.europa.eu/trade/policy/accessing-markets/investment/)

Impacts of FDI inflows to the EU

- *Note*: The following slides are based on empirical results of the EU ESPON 2020 project "*The World in Europe: Global FDI Flows towards Europe*".
- They find that non-EU owned firms make up a relatively small share of the total number of firms in the EU but..
- Non/EU firms have a large direct impact on European economies.

Impacts of FDI inflows to the EU

- Overall, ESPON 2020 researchers found that:

The concentration of non-EU owned firms , both within a given industry and region, is associated with increases in average productivity among local firms.

Impacts of FDI EU regions

Direct impacts of non-European owned firms across different types of territories

	Percentage of all firms	Percentage of total employment	Percentage of operating revenue
Urban regions	1.1%	3.6% (x3.2)	6.6% (x5.9)
Intermediate regions	0.6%	1.3% (x2.4)	3.3% (x5.8)
Rural regions	0.3%	0.8% (x2.3)	1.3% (x4.0)
Capital metropolitan regions	1.7%	4.8% (x2.9)	9.2% (x5.4)
Other metropolitan regions	0.6%	1.8% (x3.1)	3.6% (x6.2)
Non-metropolitan regions	0.4%	1.5% (x3.7)	3.1%(x7.7)
More developed regions	1.1%	3.1% (x2.9)	6.2% (x5.8)
Transition regions	0.4%	2.4% (x6.1)	2.9% (x7.2)
Less developed regions	0.5%	1.0% (x2.1)	2.1% (x4.5)

Note: The table shows the share of the total of each of the three outcome measures accounted for by non-European owned firms in the different types of territories.

Source: ESPON FDI (2018) based on the Amadeus database

FDI Impacts on EU local firms

Productivity spillovers to local firms

	Intra-industry productivity spillovers	Broader regional productivity spillovers
All	0.5%	2.0%
Manufacturing	0.2%	1.4%
Services	0.8%	2.2%
Urban regions	0.4%	1.7%
Intermediate regions	-	1.4%
Rural regions	0.2%	-
Capital city metropolitan regions	-	1.0%
Other metropolitan regions	0.3%	1.6%
Non-metropolitan regions	0.2%	0.8 %
More developed regions	0.3%	1.7%
Transition regions	0.2%	0.4%
Less developed regions	-	-

Note: The figure summarises the findings related to productivity spillovers from non-European owned firms to local firms in Europe across the different types of territories.

Source: ESPON FDI (2018) based on data from the Amadeus database

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		Spillovers to firms within the same sector and region (intra-industry)	Spillovers to all firms in the region (inter-industry)
Knowledge transfer	**Labour mobility** Local firms can hire former employees of foreign firms	+ • Labour movements	+ • Labour movements
Knowledge transfer	**Imitation/ demonstration** Local firms can learn/ copy from foreign firms	+ • Imitation of foreign firms' products and production processes	+ • Imitation of foreign firms' production processes
Knowledge transfer	**Exporting** Local firms can get a foothold on export markets	+ • Learning by exporting • Economies of scale	+ • Learning by exporting • Economies of scale
	Competition Local firms are forced to become more productive or leave the market	+ • Reduction in inefficiency • Faster adoption of new technology − • Increased cost of specialised labour • Dis-economies of scale	− • Increased cost of specialised labour
	Vertical linkages Linkages between foreign firms and local buyers and suppliers		+ • Direct relations between foreign firms and local buyers and suppliers • Economies of scale − • Dis-economies of scale

Source: ESPON FDI (2018) based on the literature survey referenced in the scientific report *Impacts of extra-European FDI towards Europe*

Potential FDI risks for EU countries

- According to the EU commission, potential risks include that foreign investors may seek to acquire control (or exert influence) on critical issues such as technologies, infrastructure, inputs, or sensitive information.
- This risk might be particularly pronounced when foreign investors are state owned or controlled firms.

Source: European Commission (http://trade.ec.europa.eu/doclib/docs/2017/september/tradoc_156044.pdf)

Potential FDI risks for EU countries

- Several EU countries have established and operate FDI screening mechanisms to address, to a certain extent, these potential risks.
- Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, and Spain.
- These EU countries, however, follow different strategies as regards the scope and design of this screening procedures.

Source: European Commission (http://trade.ec.europa.eu/doclib/docs/2017/september/tradoc_156044.pdf)

References

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