The effect of EU accession on the dynamics and composition of FDI inflows to new EU countries

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UNCTAD

Outline of presentation
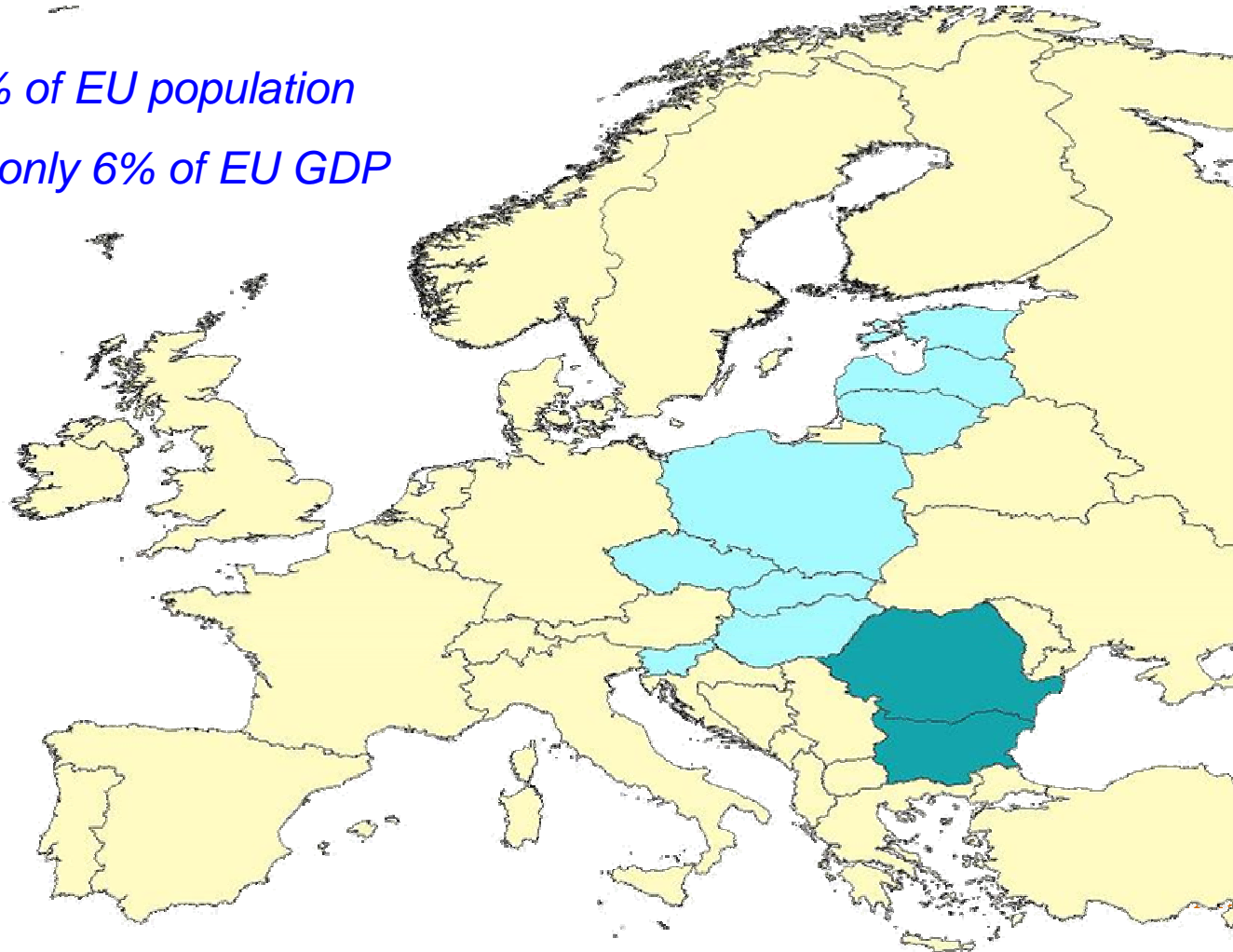
- Patterns of inward FDI

- FDI potential and performance

- Preliminary econometric results

- Conclusions

Context
New EU member countries

- *21% of EU population*
- *but only 6% of EU GDP*

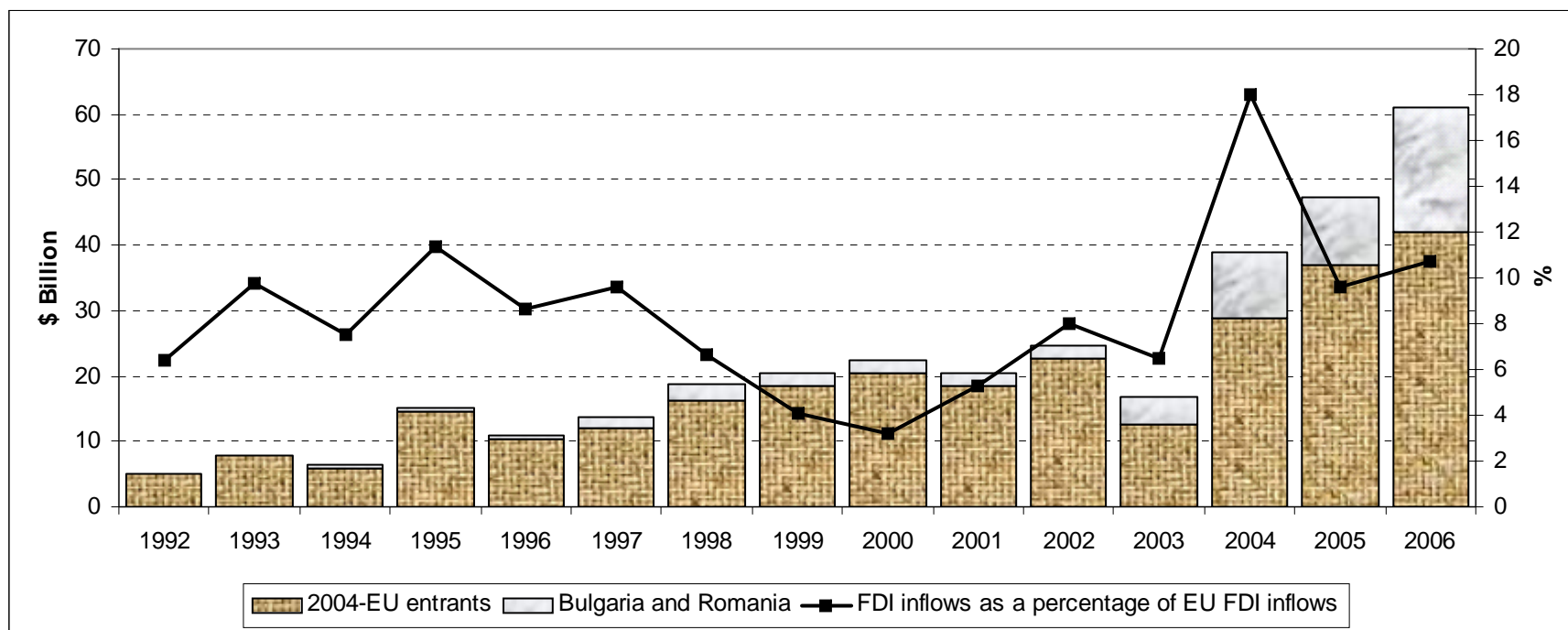# FDI trends

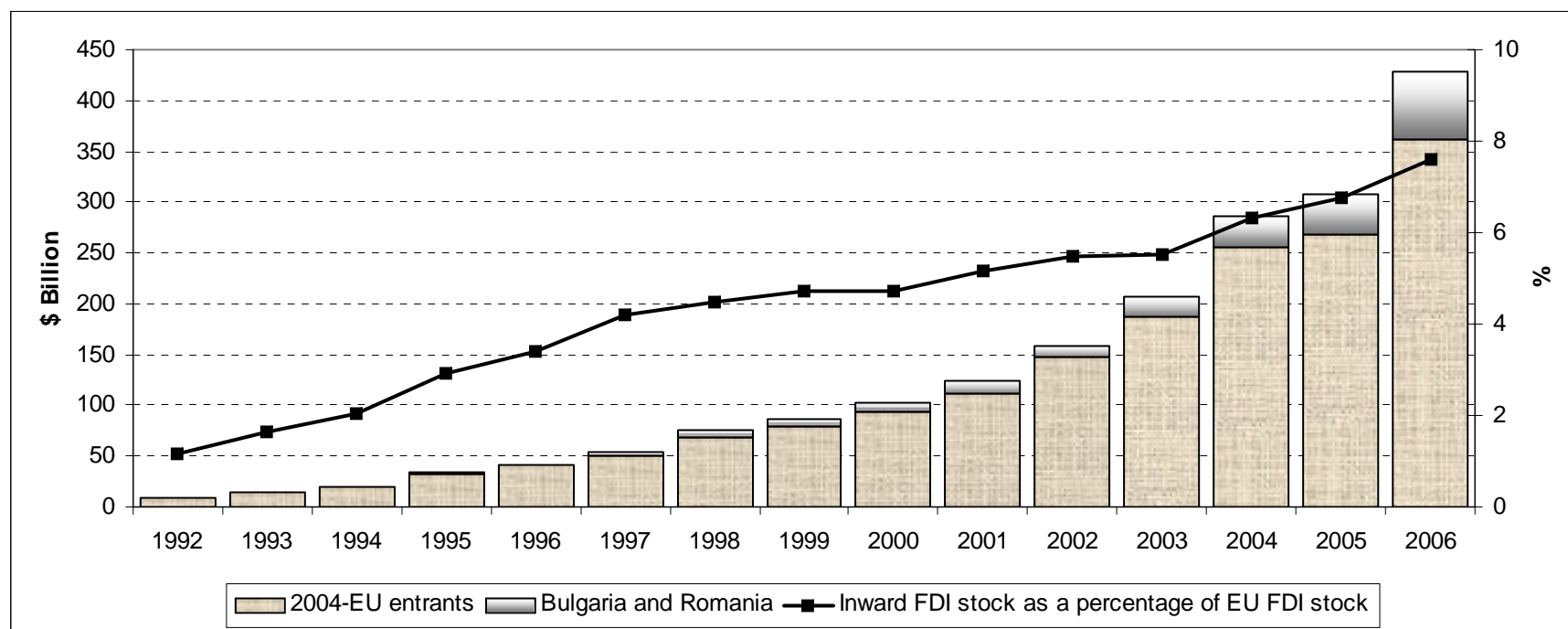# *FDI inflows and their share in EU total*
1992-2006

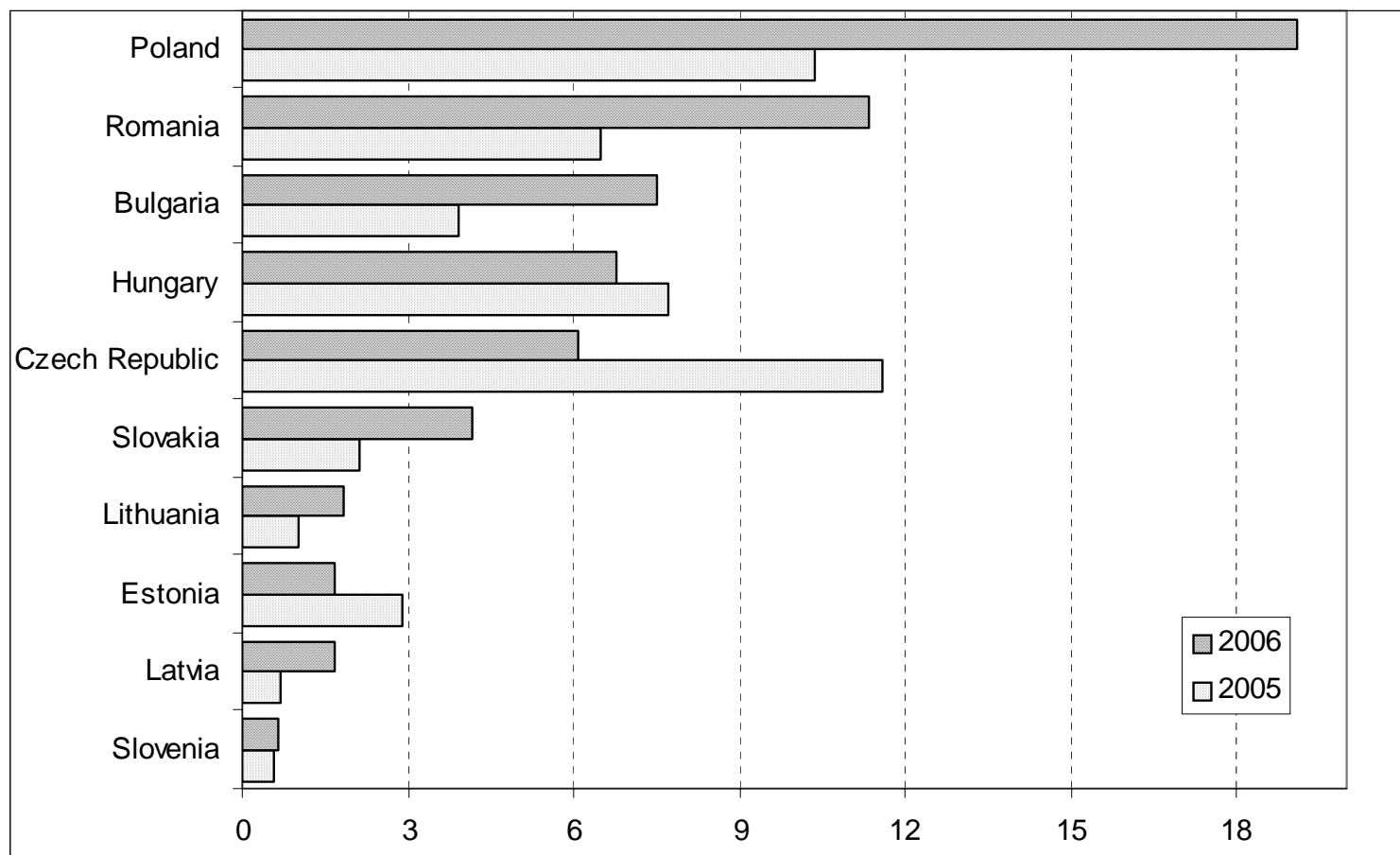Source: UNCTAD, FDI/TNC Statistics

Inward FDI stock and its share in EU inward FDI stock
1992-2006

Source: UNCTAD, FDI/TNC Statistics

FDI inflows by country,
2005-2006

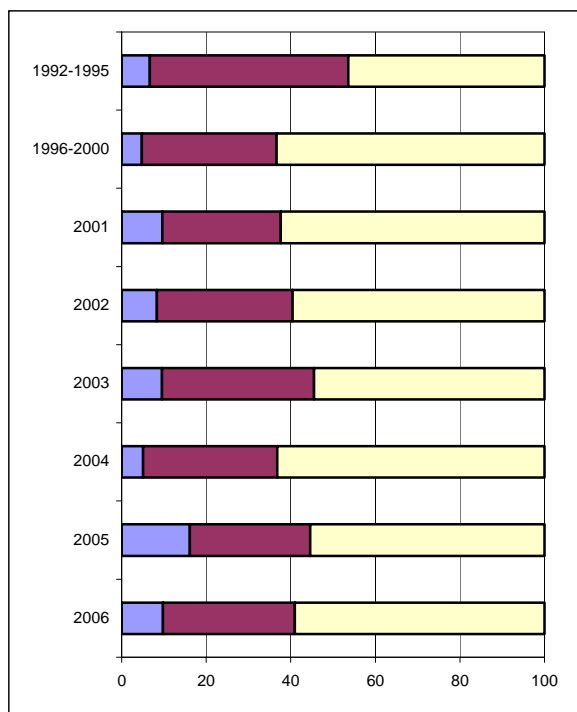Source: UNCTAD, FDI/TNC Statistics

Cross-Border M&As

- FDI and M&As are linked via privatization in new EU-members

- M&As move together with FDI

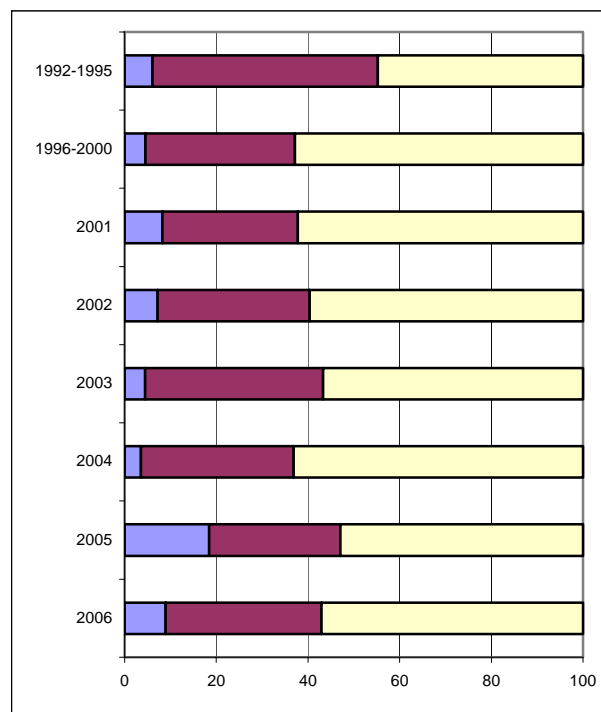- M&A data are better than FDI (Thomson Financial)

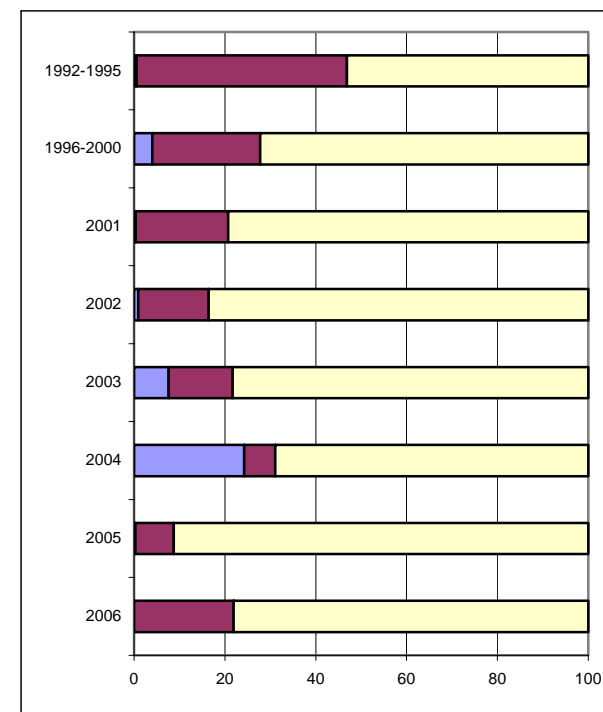# *Sectoral composition of cross-border M&As*
(per cent)

Source: UNCTAD, FDI/TNC Statistics

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Cross-Border M&As in new EU members
(selected industries, per cent)

1992-1998

- Business activities 1%
- Food, beverages and tobacco 18%
- Finance 22%
- Motor vehicles and other transport equipment 14%
- Transport, storage and communications 29%
- Electric, Gas, and Water Distribution 16%

1998-2003

- Business activities 5%
- Electric, Gas, and Water Distribution 14%
- Finance 41%
- Transport, storage and communications 35%

2004-2006

- Business activities 16%
- Electric, Gas, and Water Distribution 15%
- Finance 25%
- Transport, storage and communications 42%

Source: UNCTAD, FDI/TNC Statistics

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Cross-Border M&A sales in new EU members
(selected countries of origin, per cent)

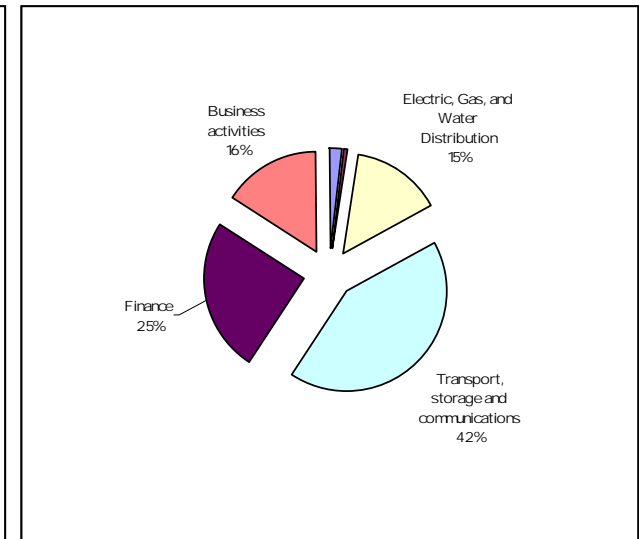|	1992-1998	1999-2003	2004-2006
Austria	2.14	7.68	19.04
Belgium	2.37	4.33	1.33
Czech Republic	2.06	0.59	3.73
France	7.19	24.46	5.27
Germany	23.24	9.63	5.39
Hungary	0.49	4.81	1.70
Italy	8.31	4.98	2.55
Netherlands	10.94	7.15	1.90
Poland	2.49	3.10	7.85
Spain	0.17	0.48	9.19
Sweden	3.99	4.12	5.19
United Kingdom	7.61	5.32	12.43
Switzerland	1.94	3.29	0.43
United States	9.79	7.07	7.15
Australia	1.09	0.10	4.39

- Decline of Germany, Netherlands and Italy;

- Rise of United Kingdom, Poland, Spain and quick rise of Austria;

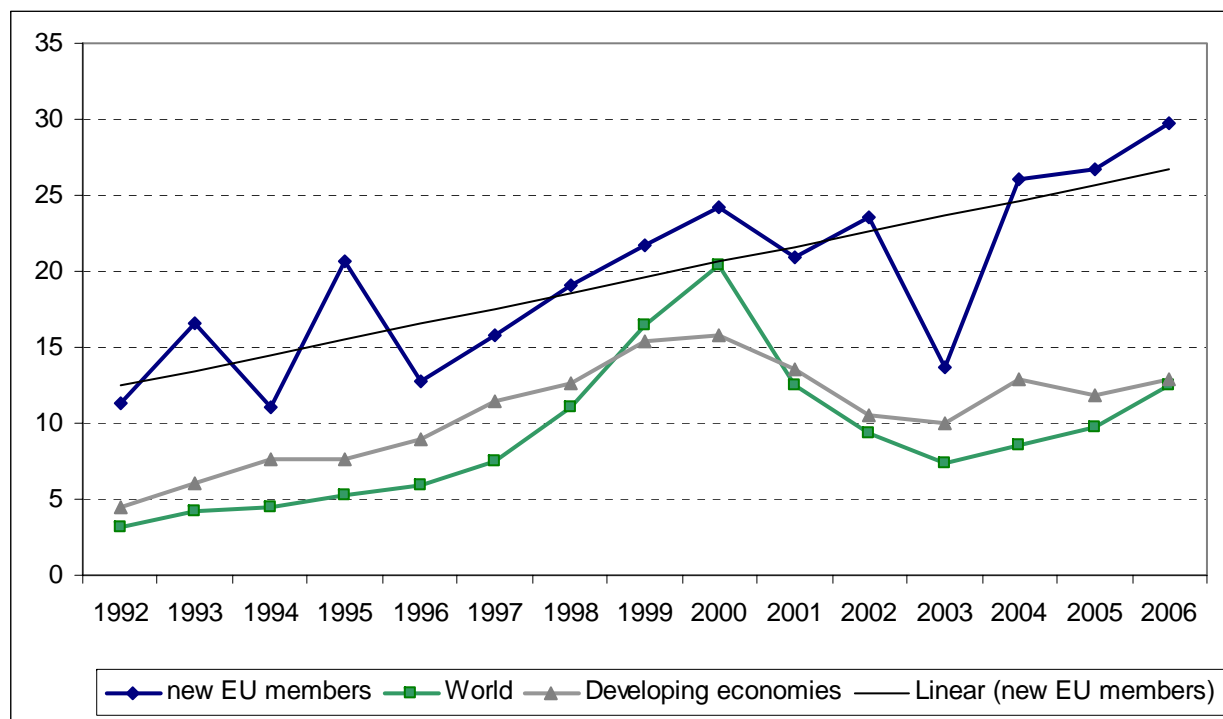- While United States remain stable, France fluctuates a lot;

Source: UNCTAD, FDI/TNC Statistics

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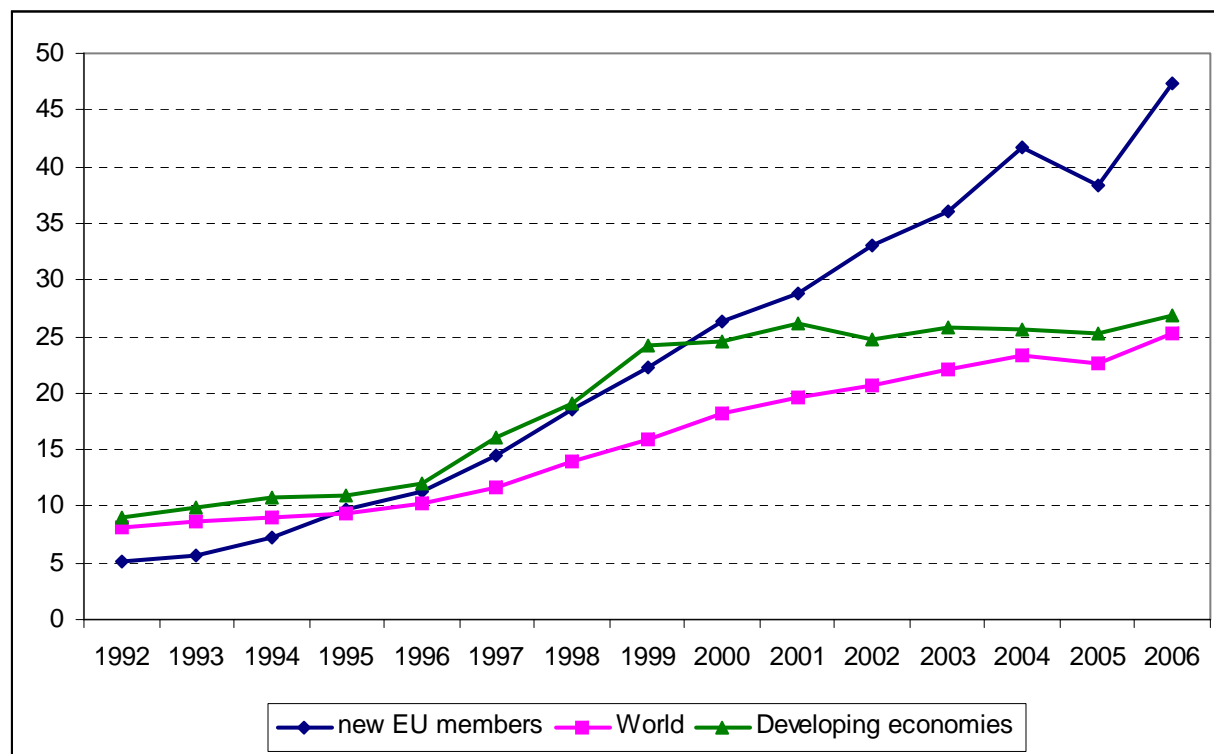# FDI and gross fixed capital formation (GFCF)

Ratio of FDI inflows to GFCF
1992-2006

Source: UNCTAD, FDI/TNC Statistics

Ratio of inward FDI stock to GDP
1992-2006

Source: UNCTAD, FDI/TNC Statistics

FDI performance and potential indices

Performance index

- The Inward FDI Performance Index ranks countries by the FDI they receive relative to their economic size.

- It is the ratio of a country's share in global FDI inflows to its share in global GDP.

$$Ind_i = \frac{FDI_i / FDI_w}{GDP_i / GDP_w}$$

Potential index

- The Inward FDI Potential Index captures several factors expected to affect an economy's attractiveness to foreign investors such as:

  - GDP per capita,
  - The rate of GDP growth over the previous 10 years,
  - The share of exports in GDP,
  - Average number of telephone lines per 1,000 inhabitants
  - Commercial energy use per capita
  - The share of R&D spending in GDP,
  - The share of tertiary students in the population,
  - Country risk
  - The world market share in exports of natural resources,
  - The world market share of imports of parts and components for automobiles and electronic products
  - The world market share of exports of services,
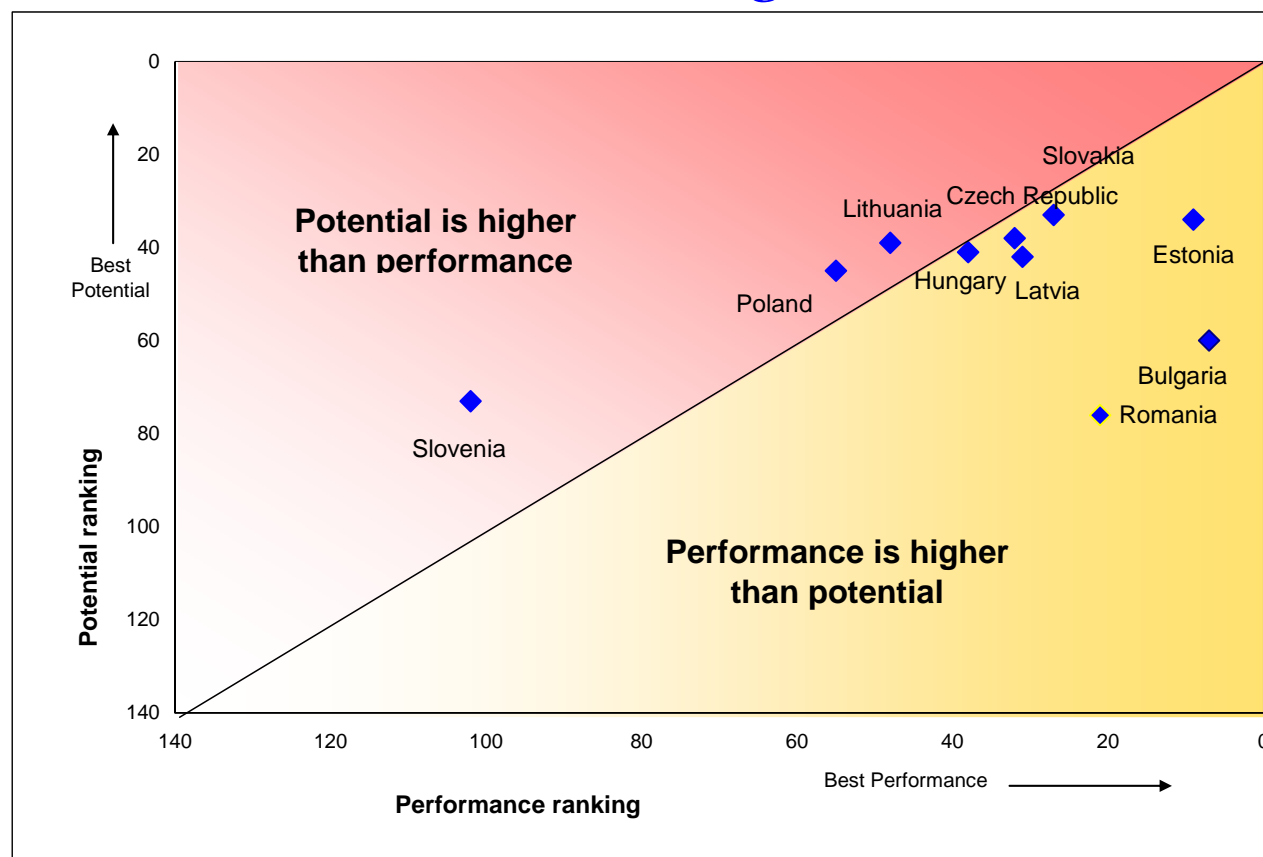 - The share of world FDI inward stock

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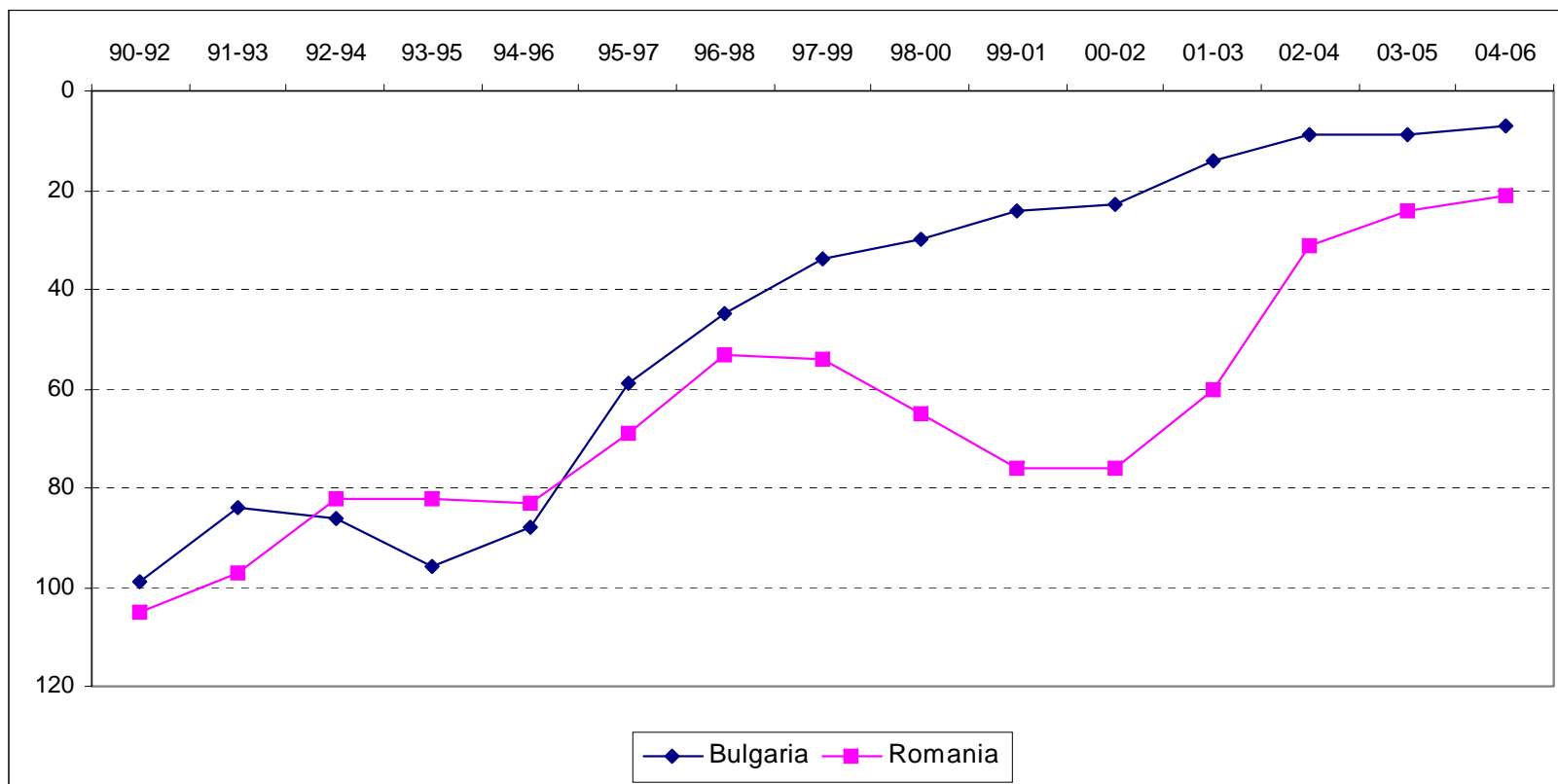# *Inward performance and potential index ranking, 1996*
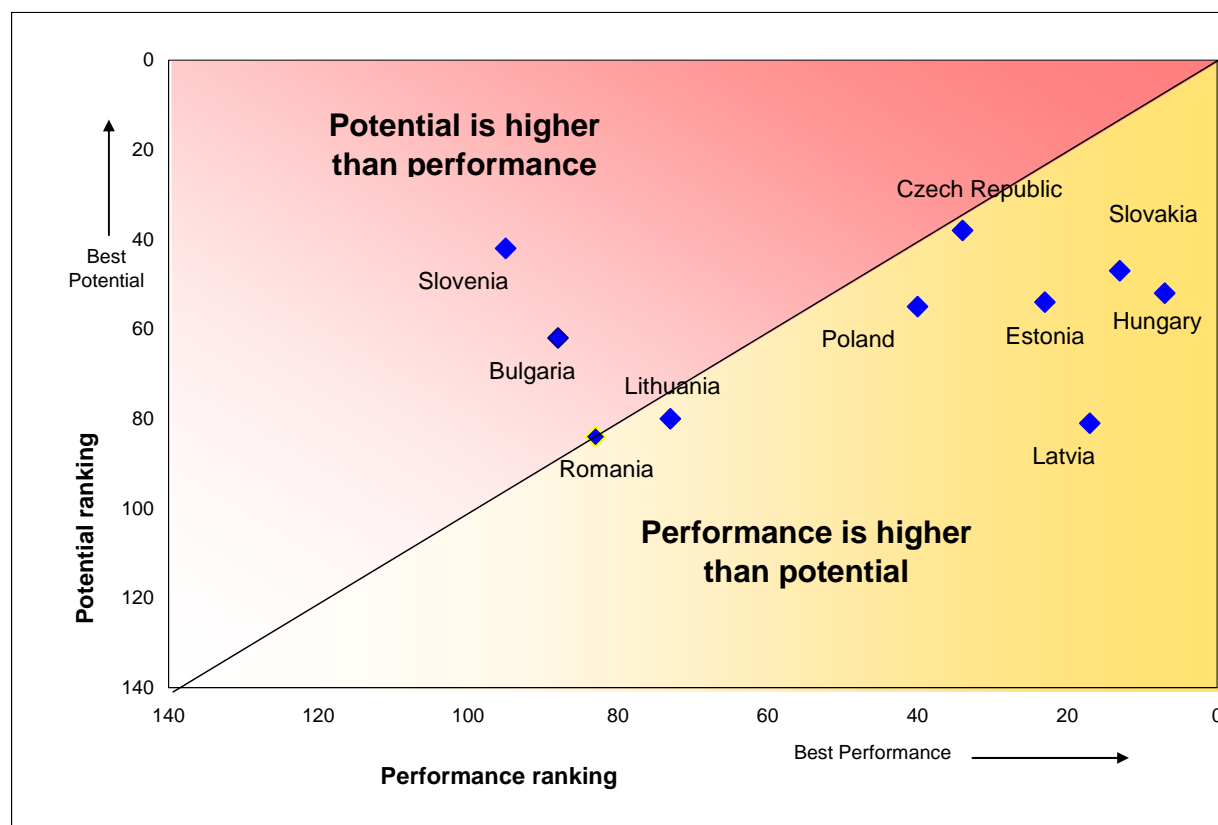
Source: UNCTAD

Inward performance and potential index ranking, 2006

Source: UNCTAD

Inward performance index ranking,

Bulgaria and Romania, 1990-2006

| 90-92 | 91-93 | 92-94 | 93-95 | 94-96 | 95-97 | 96-98 | 97-99 | 98-00 | 99-01 | 00-02 | 01-03 | 02-04 | 03-05 | 04-06 |

Bulgaria ◆ Romania ■

Source: UNCTAD

Econometric analysis

Hypotheses

- Market size-larger economies attract more FDI (market seeking)

- Distance – increase transactions cost (vertical or horizontal FDI) ?

- EU accession – reform anchor

Empirical results of previous studies

- Studies in the early phase of transition relied on surveys (short time series) – Lankes & Venables (1996)

- FDI inflows were affected by labour cost, trade linkages and proximity to EU – Holland and Pain (1998)

- Gravity factors (home and host GDP, distance) and unit labour cost were significant for FDI flows – Bevan & Estrin (2004)

- Market variables such as population and GDP per capita – Resmini (2000), but also privatization methods, as well as country risk affect the volume of FDI – Carstensen and Toubal (2004)

- Labour cost, natural resource abundance and institutions are important on FDI inflows – Kinoshita and Campos (2004)

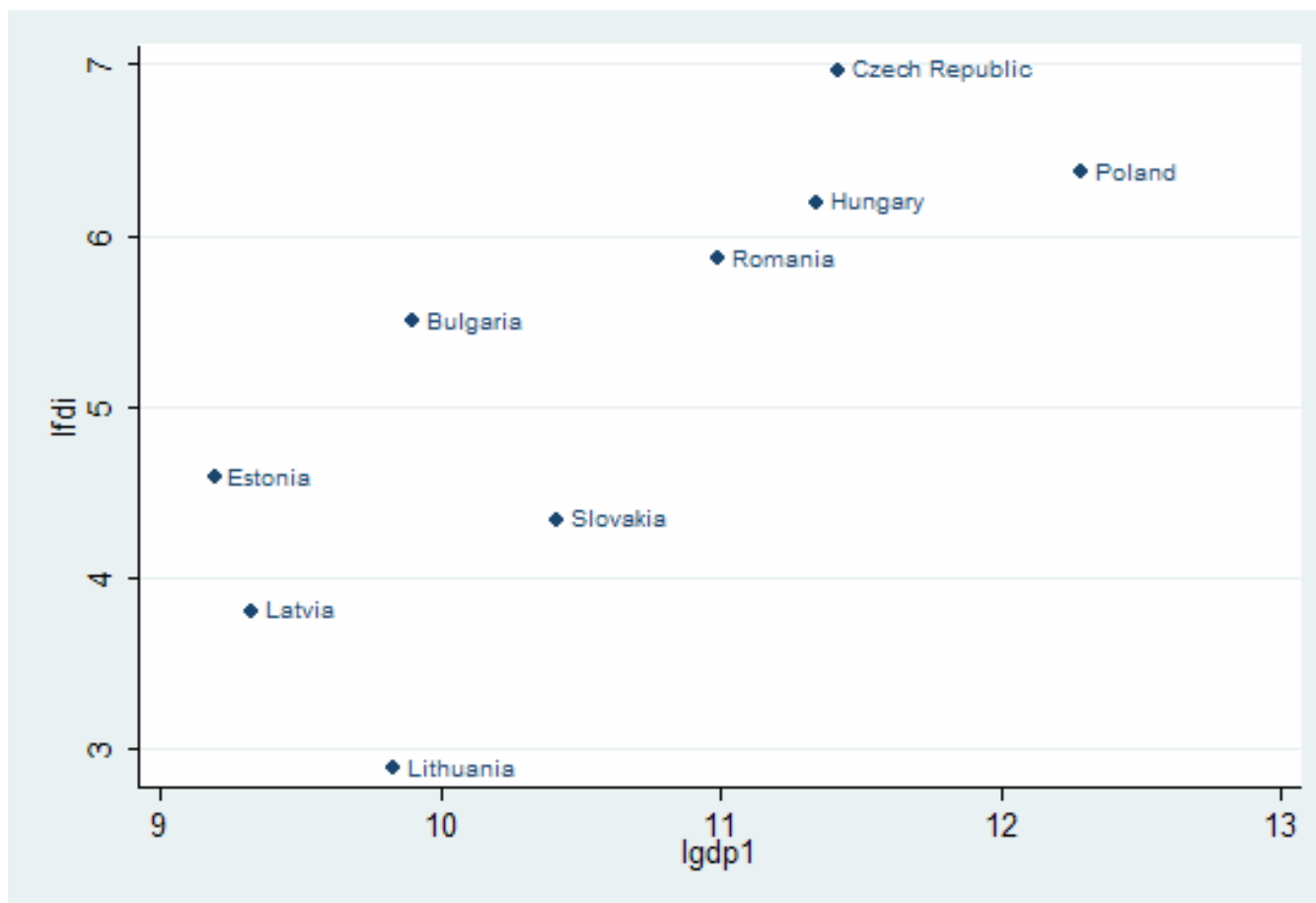# *Size matters: gravity model*
Home country Germany, 1999
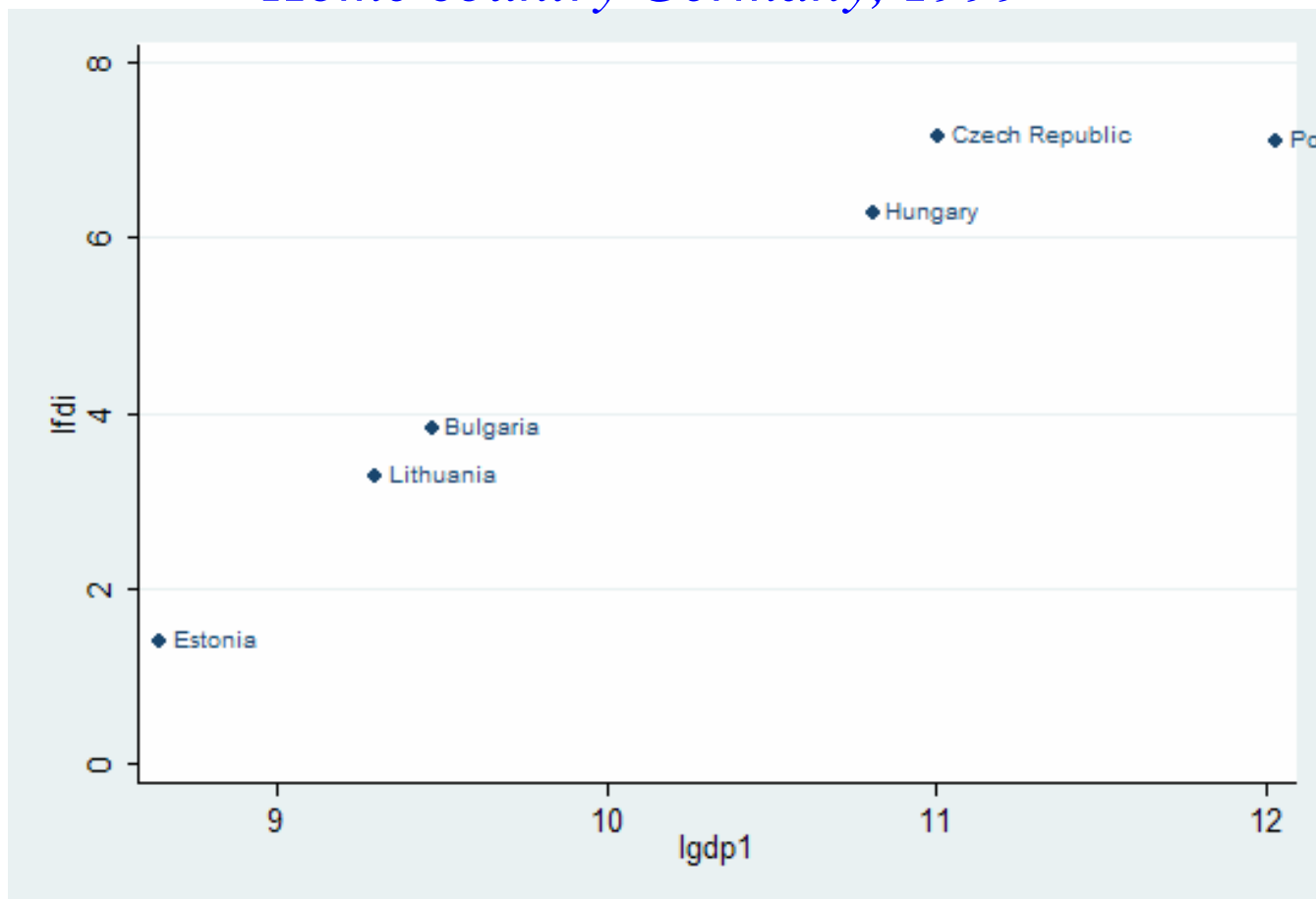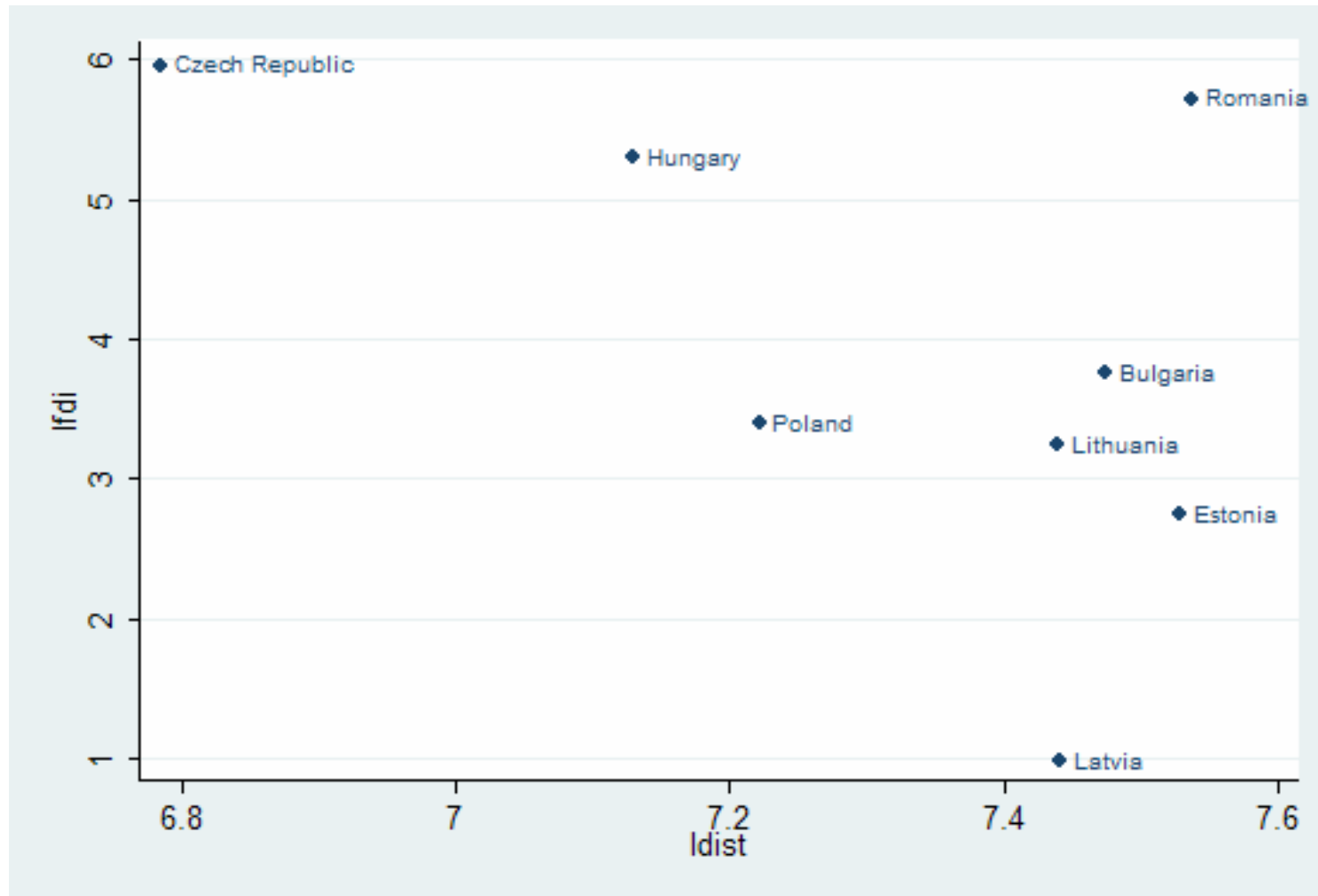
Size matters: gravity model
Home country the Netherlands, 2003

Distance: gravity model

Home country France, 2005

Gravity factors matter

log(gdp1)	0.95	0.59
	0.0***	0.0***
log(gdp2)	1.54	1.51
	0.0***	0.0***
log(pop1)	-0.11	0.24
	0.05**	0.0***
log(pop2)	-1.1	-1.2
	0.0***	0.0***
ldist	-0.92	-0.98
	0.0***	0.0***
contig	0.74	0.73
		0.05**
eu_host	-0.18	
	0.21	
EU_announcement		0.29
		0.0***
No. Obs	2272	2272
No. Groups	315	315
R2 Within	0.24	0.24
Between	0.58	0.58
Overall	0.46	0.46

Note : EU announcement is 2001 for eight countries and 2003 for Bulgaria and Romania.

Time varying distance
Is that the EU effect?
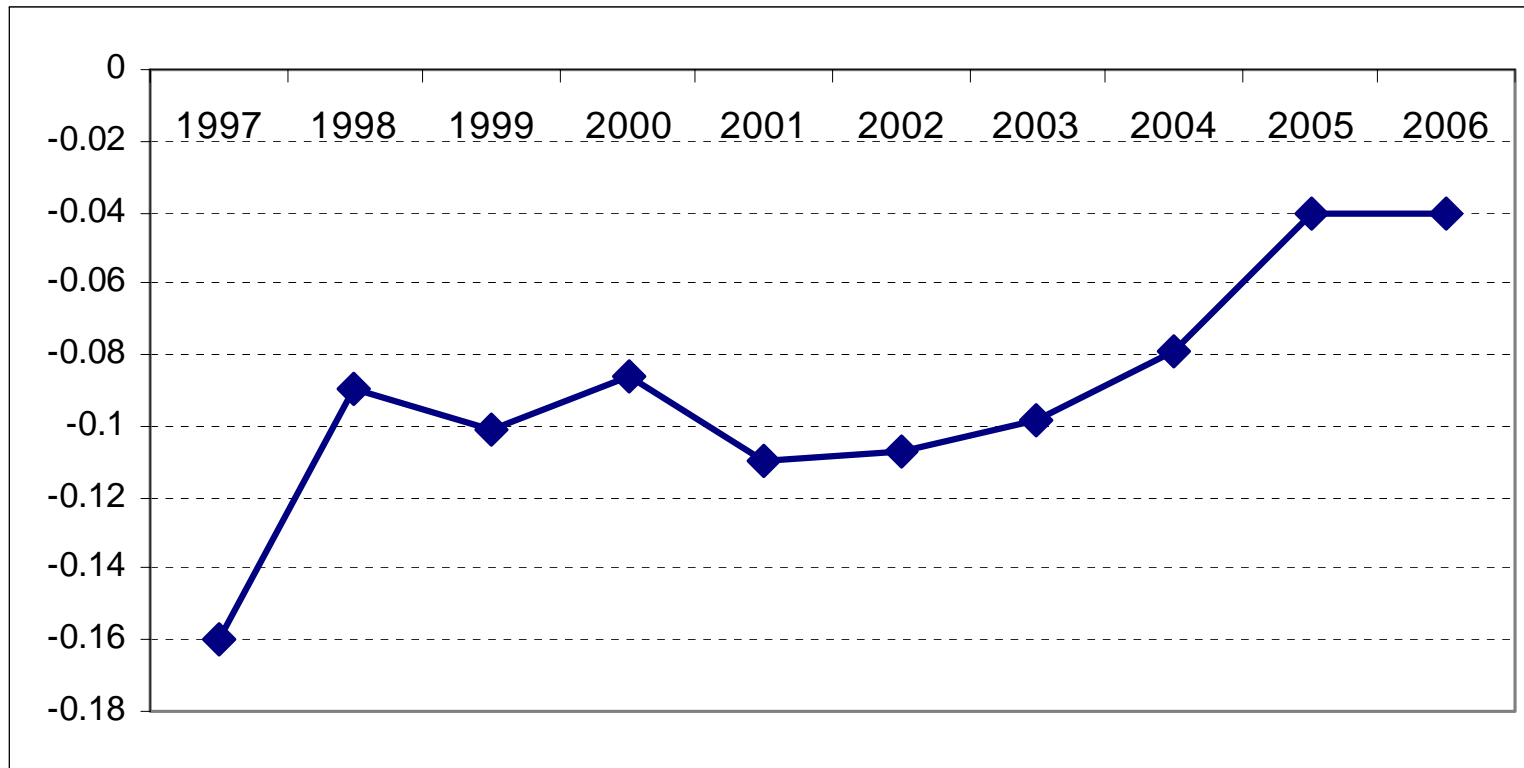
The elasticity of bilateral FDI flows to distance, 1997-2006

Results

- The EU membership has changed the dynamics of FDI flows

- FDI patterns, potential and performance indices, as well as preliminary econometric analysis point in that direction

- While the date of EU membership is not important (statistically) the announcement had a major impact.

- Distance is losing importance in the recent years.

Thank you

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