



OFDI in the EU8+2: Patterns and Effects

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Structure of the Presentation

- I. OFDI in the EU8+2: Facts and Trends**
- II. The Effects of OFDI on the Home Economies**
- III. Policies and Challenges**



I. OFDI in the EU8+2: Facts and trends

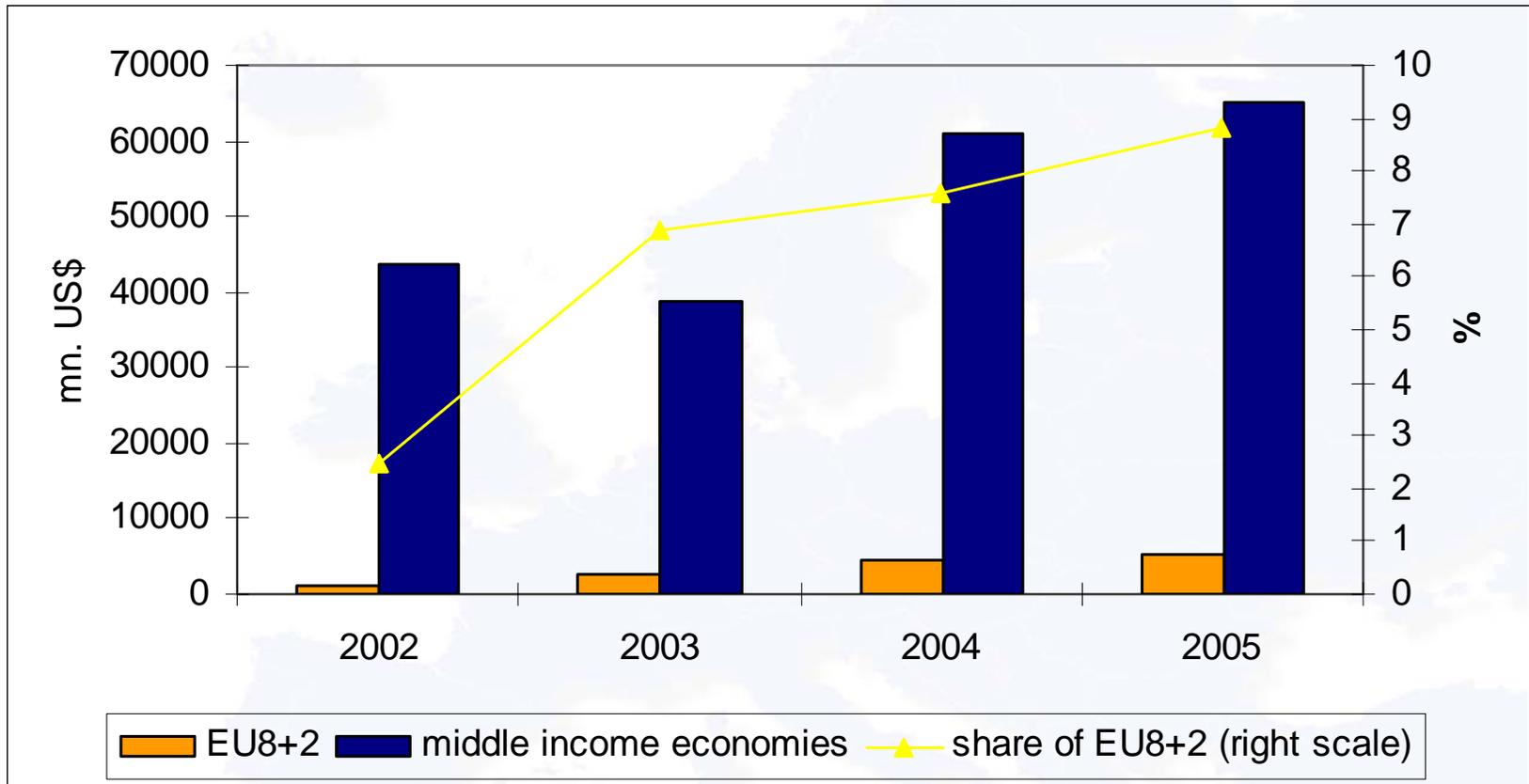


Why is it interesting to study OFDI from EU8+2?

- Low value of OFDI in global scale but high in relative terms and rising fast
- Still middle income countries but EU Member States
- Fast institutional and structural changes affecting OFDI
- Rising OFDI is accompanied with high net inward FDI
- OFDI related policies may have broader relevance

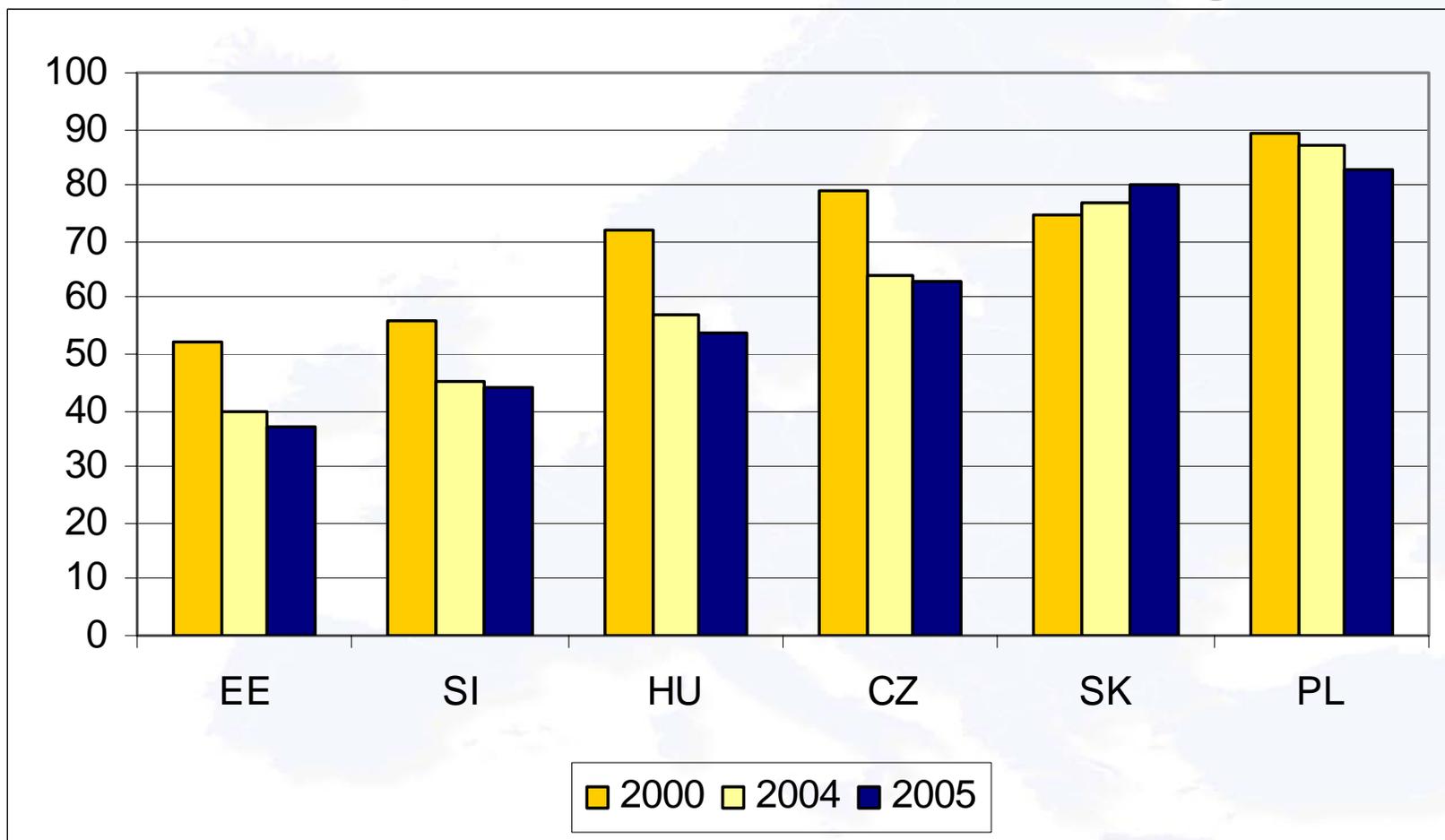


OFDI from EU8+2 in global comparison



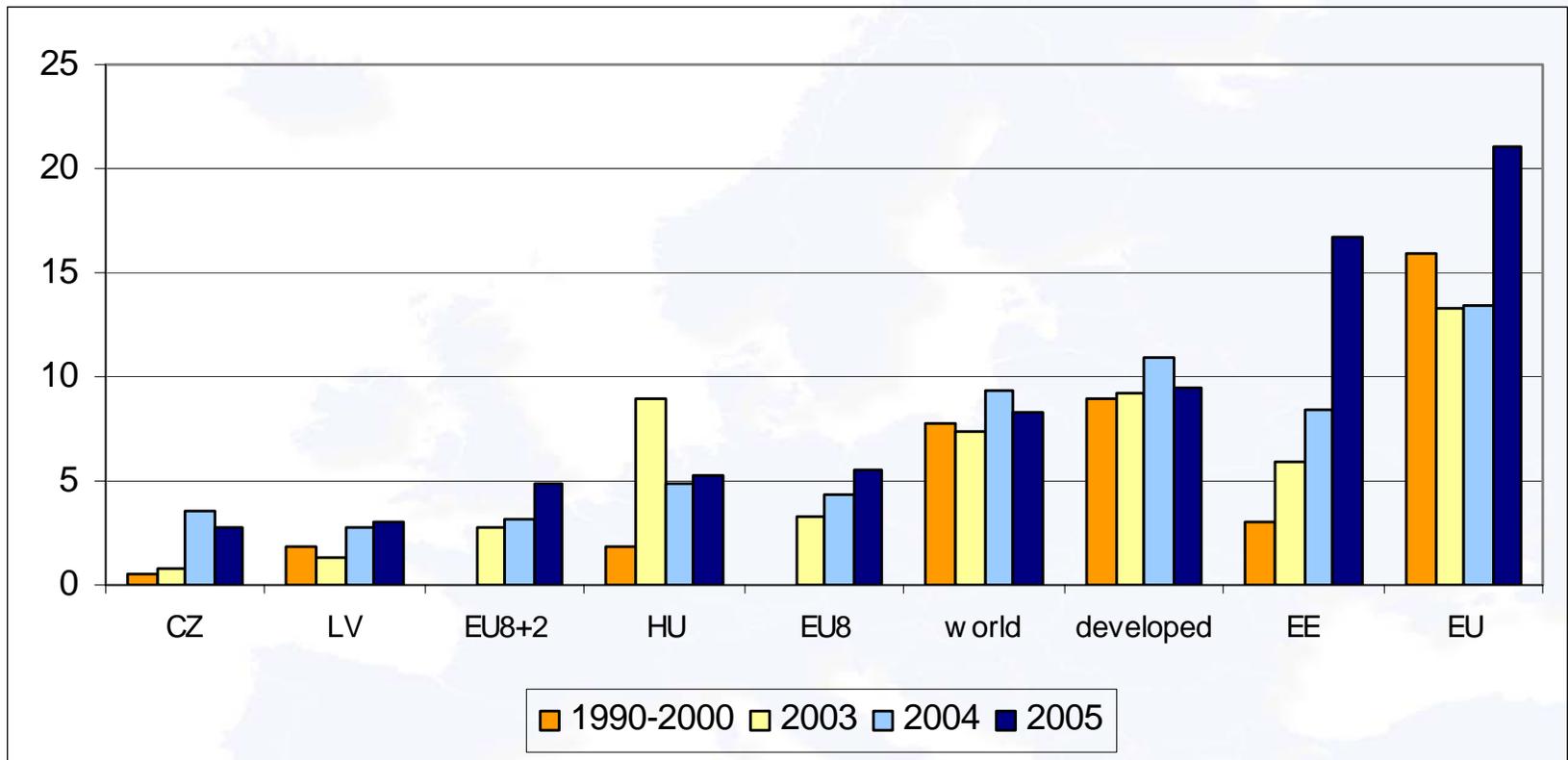


Improving position on OFDI performance index rating



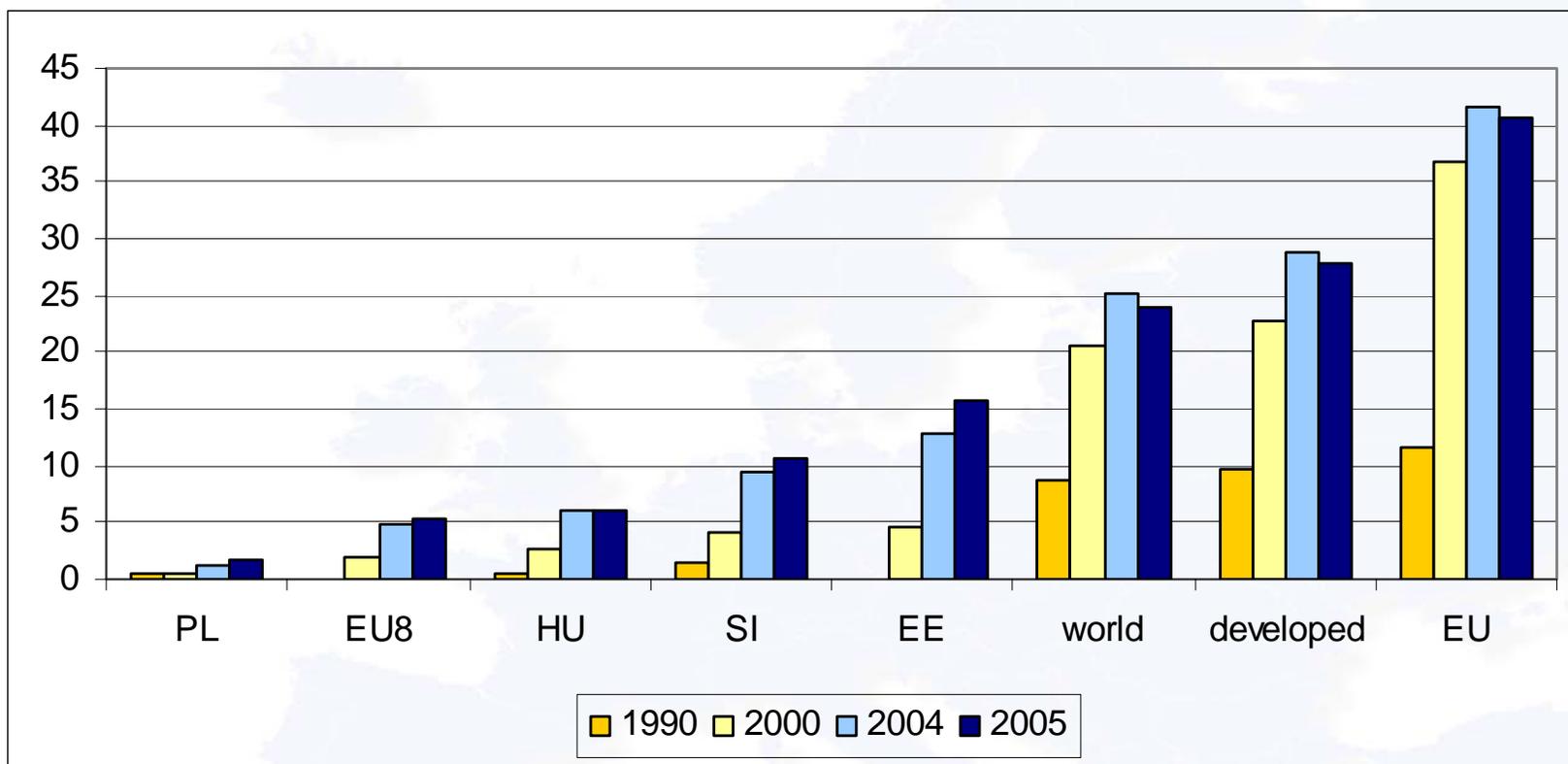


Rising OFDI/GFCF rates





Big difference in OFDI stock/GDP ratios





Trends of OFDI

- OFDI equally important for manufacturing and services
- OFDI dominated by horizontal investments
- OFDI towards countries with similar or lower income level: middle income-middle income country type of flows
- Strong regional concentration
- High company concentration spreading towards SMEs



Factors driving OFDI

- Economies of scale and the productivity pressure
- Price and cost competitiveness, profitability considerations
- Trade and integration
- Privatisation in and opening of host countries
- Maturation of local companies



II. The Effects of OFDI on the Home Economies



Is OFDI beneficial for EU8+2?

Two aspects:

- Disputed home country effects: supply of factors of production (employment and investment effects), labour and total factor productivity, exports, structural effects and economic growth
- Specific EU8+2 features: current and expected productivity levels and their change, strong restructuring at sector and company levels, current employment rates, which may modify mainstream home country effects



Home country employment effects

Background:

- Substitution vs. complementarity effect
- Shift in the labour demand in the home country : Lipsey (2002) no negative link between OFDI and home employment, Konings (2004) and Konings and Murphy (2003) employment shifts only between high wage locations
- But employment effects depend:
 - horizontal (+) versus vertical (-) investments
 - income gap between home and host country (Kokko, 2006)
 - differences in factor intensities (Braconier and Ekholm, 2000) and size of the parent company (Pennings, 2000)

EU8+2:

- Minor impact so far
- Complementarity effect may be stronger due to the OFDI structure



Home country investments effects

Background:

- Theoretical models: negative link between OFDI and domestic investment rate
- Empirically ambiguous: Feldstein (1994) negative for US, confirmed by Desai, Hones and Foley (2005), Blomström and Kokko (2004) for Sweden, but no negative link found by European Commission (2005)
- Reasons for negative effect:
 - Horizontal vs. vertical investments behave differently
 - Rising debt of investing companies
 - Funding hierarchy hypothesis
- But financial deepening and capital market integration may change the relationship

EU 8+2:

- Relatively low investment levels
- High returns on investments
- Fast financial deepening but sustainability of productivity increase



Home country export effects

Background:

- While the Heckser-Ohlin theory implies perfect substitution, some empirical analyses find positive links (Lipsey (2002), Andersen - Hainaut(1998), Blomström - Kokko (2004), Kim (1998)), some are neutral (Frank and Freeman (1978), Barba Navaretti - Castellani(2004))
- Overall: slightly positive effect on exports, but strong differences between horizontal and vertical OFDI (Markusen-Marcus (2001))
- New phenomenon is the OFDI and trade in services

EU8+2:

- OFDI dominated by horizontal investments
- High share of service OFDI



Structural effects of OFDI

Selected structural effects of sustained OFDI:

- Rise in openness and in the share of tradables sector
- Structural effect: shift in the share of sectors with higher value added
- Employment effect: shift in the demand for labour with higher human capital

EU8+2:

- Already very open
- Growing up along the value added ladder
- Employment patterns differ strongly among the countries



Productivity and growth effects

Productivity effect:

- Similar to inward FDI, TFP may rise due to access to advanced technology (Barba Navaretti et al. (2001)) access to advanced technology and economies of scale effect

Growth effect:

- Overall positive on employment and labour supply
- Demand side: exports vs. investment demand
- Rise in productivity
- Regionalisation and agglomeration effects

EU8+2:

- Productivity levels still low but rising fast, driving economic growth
- Growth contribution from other factors (L,I) where OFDI has less role to play



III. Policies and Challenges for OFDI in EU8+2



Policies

Background:

- OFDI support in advanced countries, less in middle income
- Instruments are diverse: agencies, information, training, SME support

EU 8+2:

- Investment insurance, information provision, financial support
- Country differences: investment promotion agency (HU vs. CZ)

Policy issues:

- Sound framework policies and background
- Differentiate in approach among SMEs and others
- No direct, distortive fiscal support for OFDI



Challenges for OFDI in EU8+2

- Balancing out horizontal and vertical OFDI
- Creating overall investment friendly environment
- Balancing out OFDI towards middle and high income countries
- Balancing out SME support and maintenance of non-distortive environment



Conclusions

- OFDI importance is rising but significant differences among EU8+2
- Horizontal investments, high share of services, strong regional geographical orientation of outflows
- Considering the driving factors further OFDI increase is expected
- Home country effects may be early to assess but altogether positive
- Sound framework policies and non-distortive indirect support may be helpful for OFDI



Thank you for your attention!

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