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UNIVERSITÀ DEGLI STUDI DI MILANO

Multinationals and Industrial Policy

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Based on Barba Navaretti and Venables, Multinationals and Industrial Policy, Oxrep , 2013
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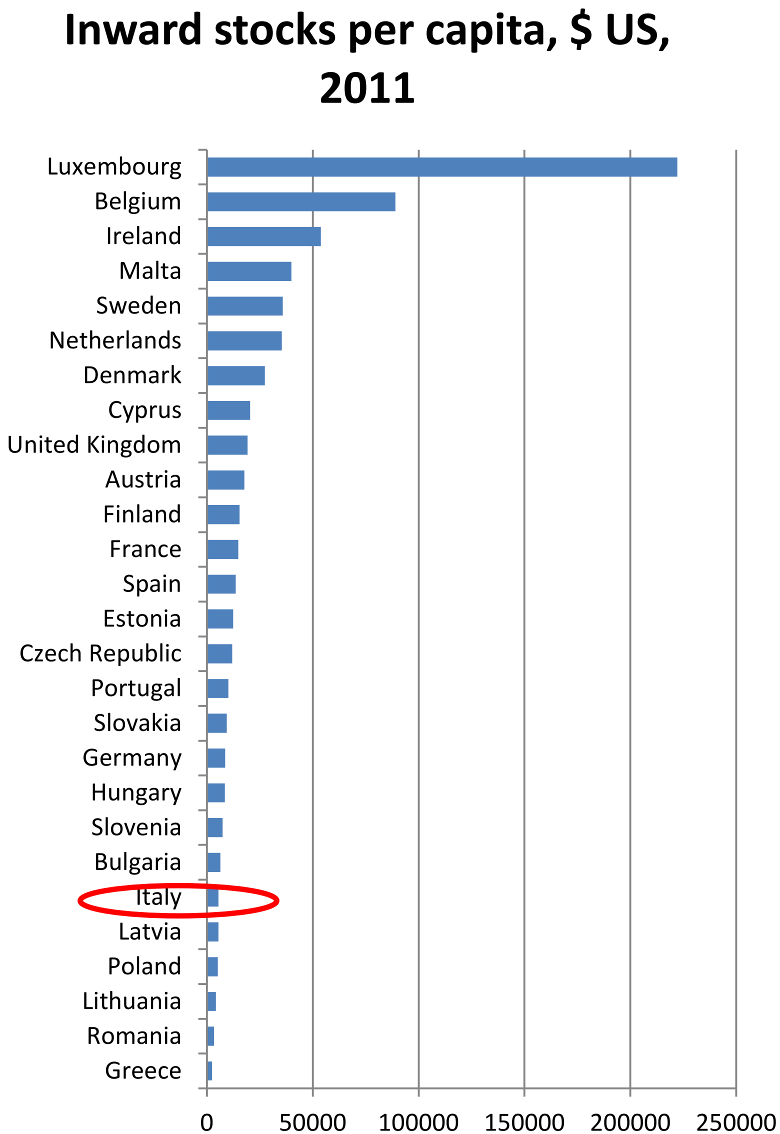
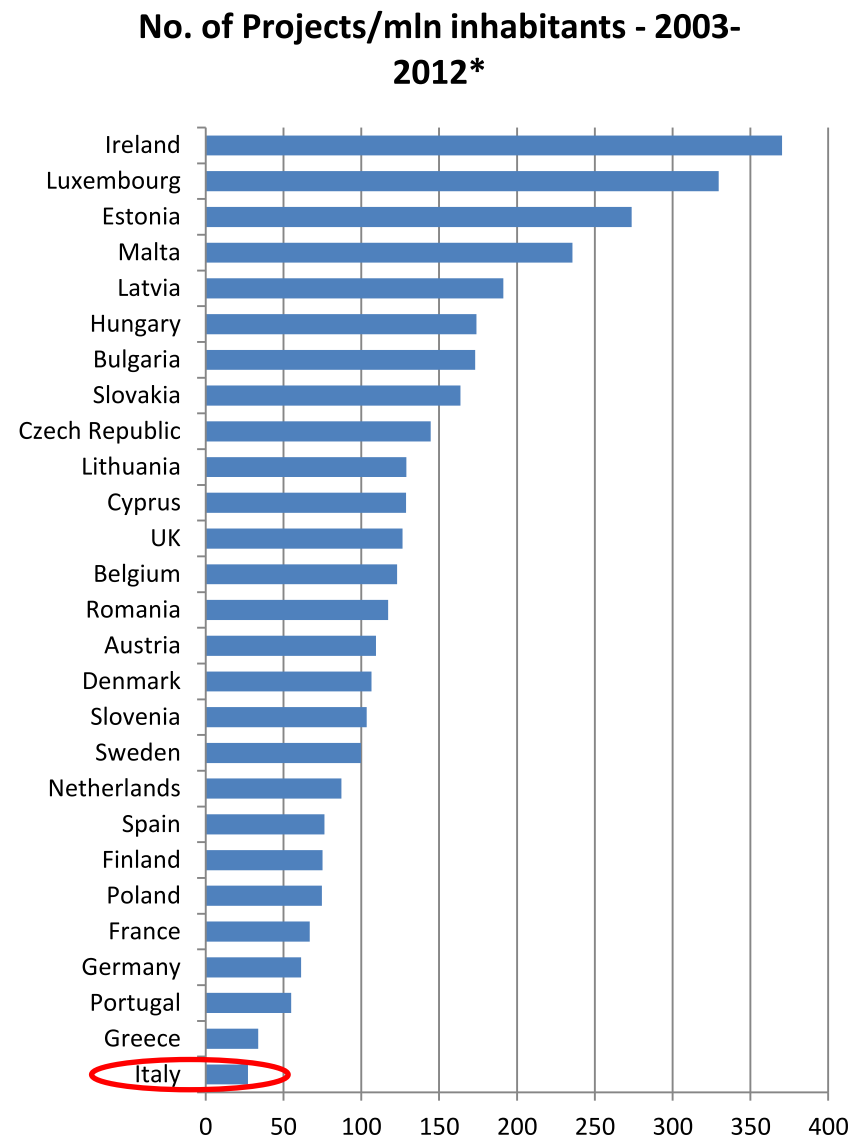
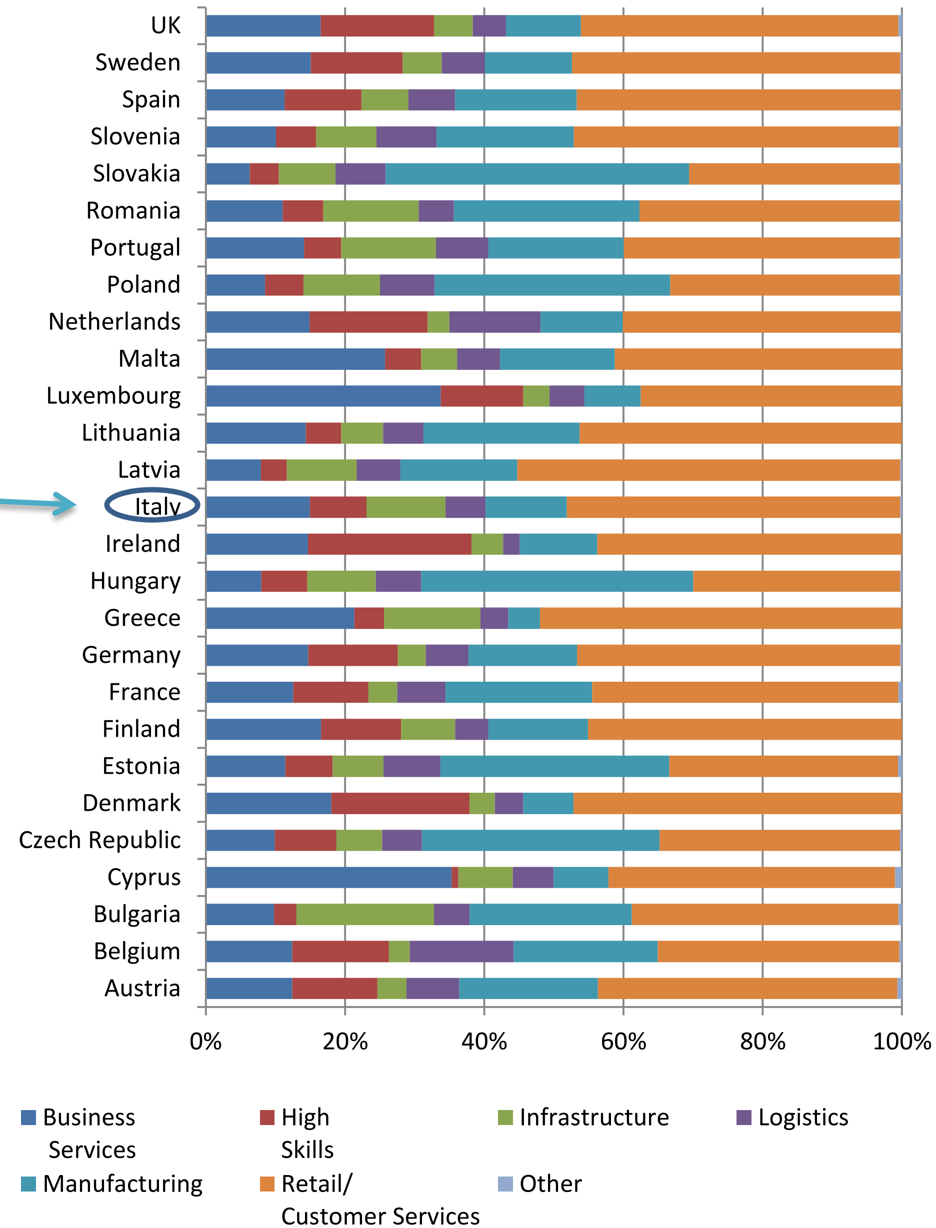
Motivating facts: high and low attractiveness





Source: UNCTAD, FdI Markets and IMF

Motivating facts: composition is very different



Source: FDI Mkts

Issues

Targets?

- Location
- Ownership

Desirability?

- Employment and Wages
- Clusters
- R&D and productivity spillovers
- Regional employment

Policy tools and their effectiveness?

- General instruments
- Selective instruments

Targets

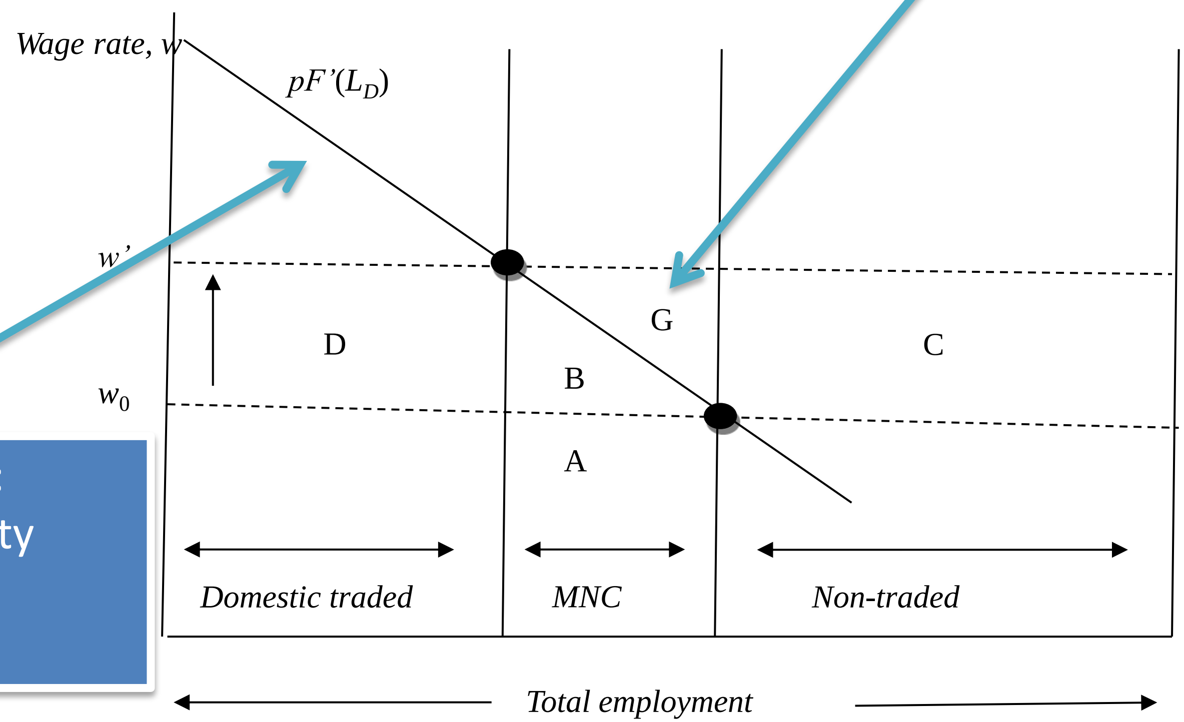
- Location is key:
  - Entry and exit: any mobile plant
  - Tradable *vs.* non tradable

- Ownership
  - 70% of FDI in Europe M&A
  - Different sets of arguments, second order issue

Desirability: labour/wages/productivity

Net real income gain in full employment: terms of trade improvement

Figure 1: Gains from inwards investment



Declining slope:

- Heterogeneity
- Fixed factors
- Price effects

Desirability: Clusters

- Complementarity between foreign and local firms
  - Assemblers and suppliers (Baldwin Venables 2013)
  - Critical mass and loss of a cluster

Desirability: Productivity spillovers

Channels:

- Upgrading quality and productivity of suppliers, especially transition and developing countries (Javorcik, 2004; Javorcik+Spartenau, 2008; Liu, 2008)
- Competition/emulation (productivity 12% higher after 5 ys. Greenstone et al.; Haskel et al 2007)
- Movements of labour (Balsvik 2011)
- Knowledge Spillovers through R&D (Griffith et al 2004)
- Training (Filer et al.

Desirability: Regional employment/unemployment

Employment creation in regions with unemployment:

- Moretti: from 1.59 to 4.9 new jobs in non tardable industries

Careful: small share of FDI in regions with regional aid (2003/7)

- 9% Germany
- 8% Italy
- 3% UK

Policy

ISSUES

- Single country:

  Identifying projects with positive social value and negative economic value (not just difference between the two – market failure)

- Many countries/ many regions:

  Race to the bottom: waste of resources, no effects

TOOLS

- General: reducing cost of operating all firms and sectors
- Selective: aimed at specific firms/industries/areas

General Instruments: structural policies

TABLE 1: EASE OF DOING BUSINESS, SELECTED EU COUNTRIES
Source: WB Doing Business 2013

	Time to Start a Business (days)	Time to Deal with Construction Permits (days)	Time to Get Electricity (days)	Time to Register a Property (days)	Time to Export (days)	Time to Enforce Contracts (days)	Time to Resolve Insolvency (years)
France	7	184	79	59	9	390	1.9
Germany	15	57	17	40	7	394	1.2
Italy	6	284	155	24	19	1210	1.8
Spain	28	182	101	13	9	510	1.5
UK	13	99	105	29	7	399	1.0

Structural horizontal policies uncontrversial

Persisting differences among European countries in competitiveness indicators.

- Why? Unawareness of policy makers? Other factors

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General instruments: taxation

- Effective Marginal Tax Rate (EMTR) for intensive margins
- Effective Average Tax Rate (EATR) for extensive margins

- Meta Analysis Effective Average Tax Rate Matters (1% reduction in EATR, + 5.9% investment flows), De Moij and Edervin

- Effective, but socially valuable?
  - Devereux et al. 2008 find evidence of strategic competition to attract FDI between 1982 and 1999
  - Corporate tax rate keep declining
  - But still large differences, especially between core countries and new acession countries

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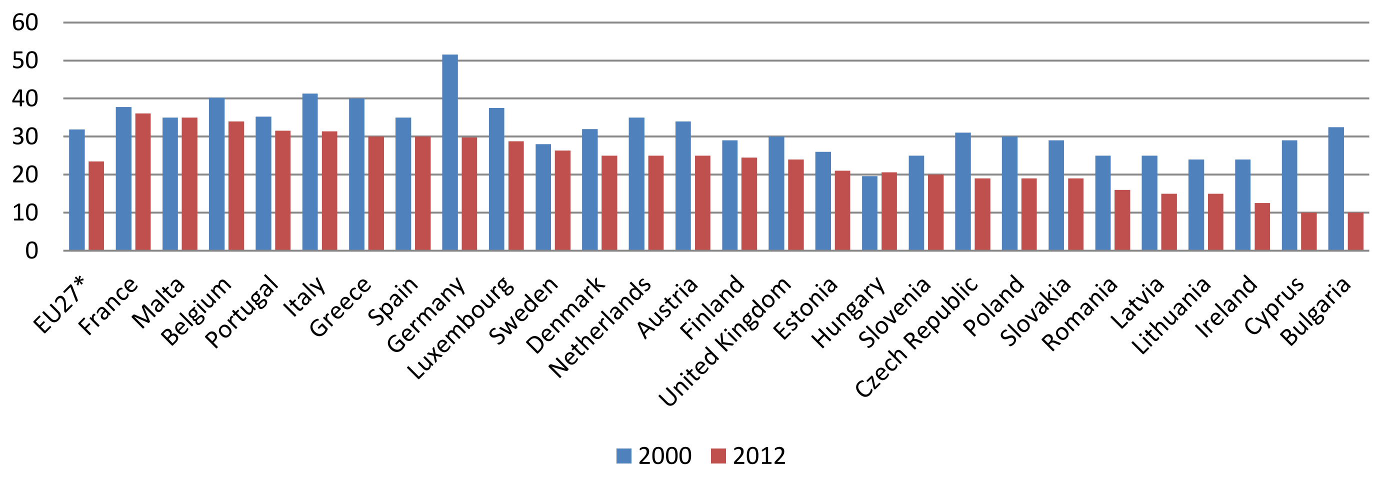
General instruments: taxation

- Large differences across countries. Why?
  - Effectiveness of lower taxation country and context specific
  - DEEP COMPARATIVE ADVANTAGE:
    - Equilibrium tax rate is higher in countries with sunk investments and agglomeration economies *Hanson Olofsdotter, 2010; Konrad Kovenock, 2009; Benassy-Queré et al, 2003*
    - Initial boost ok, but other complementary factors are necessary

Figure 2: Tax on Corporate Income



Selective instruments

Table 2A State Aid, annual average by purpose, mn Euros.	1997-01	2002-06	2007-11
TOTAL	62,101	61,099	57,206
HORIZONTAL	34,624	41,143	48,926
Regional	13,766	10,597	13,469
R&D&I	4,960	6,153	9,848
Environment	4,102	12,306	13,737
VERTICAL	27,477	19,955	8,280
Manufacturing	6,297	4,383	2,292

*Data in million Euro at constant 2000 prices. Excluding agriculture, fish, transport.

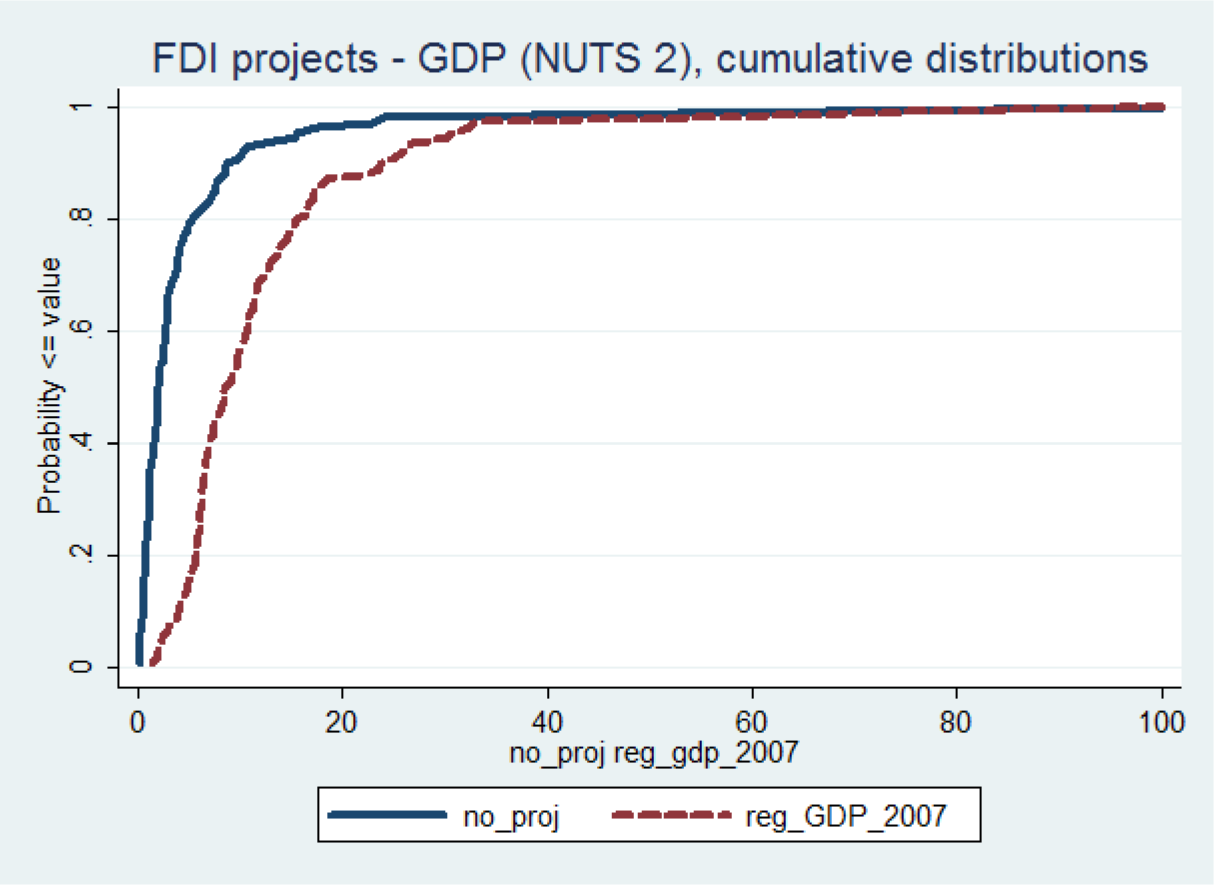
Table 2B State Aid, annual average share of GDP %, by country.	1997-01	2002-06	2007-11
EU Total (*)	0.58	0.54	0.46
Germany	0.88	0.84	0.58
France	0.82	0.38	0.52
Italy	0.54	0.38	0.26
UK	0.16	0.20	0.24
Spain	0.82	0.54	0.38

(*) according to EU membership in the period. Source: European Commission

Selective instruments: questions

- Has policy affected the decision of firms?
- If so, where would have firms located otherwise?
- Has the policy been cost effective?

Selective instruments: FDI very concentrated in few regions



Countries included are: France, Germany, Italy, and UK. FDI projects are cumulated 2003-2007. GD is for 2007.

Selective instruments: effects

- Studies mostly on regional subsidies
  - Effective on location of firms and creation of new jobs but effect depends highly on other correlates like other investors, market potential etc. (Criscuolo et al. 2012; Devereux et al, 2007; Mayer, 2004; Kokko and Gustavsson, 2004)
  - SAME AS FOR TAXATION: attracting FDI in backward regions very costly

- Positive effects on R&D spending
  - Guellec and van Pottelsberghe 2003; parisi Sembenelli, 2003; Bronzini and Piselli, 2013…

- Less on productivity (Buigues Sekkat 2011; Criscuolo et al, 2012)

Selective instruments: diversion

- Key issue in the EU and among regions within countries

- But not strong evidence that incentive base dislocation takes place to a considerable extent.

- The Irish concern… but again succesful backward regions have exploited deeper comparative advantages

Selective instruments: cost effectiveness

- Large evidence of cost ineffectiveness of such instruments (Dewatripoint Seabright, 2006; Buigues and Sekkart 2011):
  - High costs per job created;
  - Short life span of investments

- Deadweight losses (subsidies to privately viable investments)?

Ownership

- Productivity and wages:
  - Mild evidence of real income gains
  - Favourable composition effect, better inputs and more effective use..

- Corporate control
  - Increased contestability of national assets (good competitive effect)
  - Not necessarily less stable employers
  - Building local public goods?
  - Good governance not just a matter of nationality

- Against restricting foreign ownership of assets

Conclusions

- Foreign investors, especially in advanced region, simply require good and stable policy environment
- But special care should be given to agglomeration factors, avoiding depletion of critical mass (in mature economies a matter of divestment more than investment)
- The case for active use of public funds needs to pass a high hurdle:
    - Rigorous supernational framework
    - Restricted to identifiable market failures
    - Effective procedures and ex post assesment necessary
- Most evidence shows this is generally not the case
- Ownership: no region to restrict foreign ownership of domestic assets besides for very limited cases