Multinationals and Industrial Policy

Giorgio Barba Navaretti,

University of Milan
and
Centro Studi Luca d’Agliano

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

Inward stocks per capita, $ US, 2011

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

Figure 1: Gains from inwards investment

- **Wage rate,** $w$
- **$pF'(L_D)$**
- **$w_0$**
- **$w'$**

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

Declining slope:
- Heterogeneity
- Fixed factors
- Price effects

Total employment: Domestic traded, MNC, Non-traded
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>
<thead>
<tr>
<th></th>
<th>Time to Start a Business (days)</th>
<th>Time to Deal with Construction Permits (days)</th>
<th>Time to Get Electricity (days)</th>
<th>Time to Register a Property (days)</th>
<th>Time to Export (days)</th>
<th>Time to Enforce Contracts (days)</th>
<th>Time to Resolve Insolvency (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>7</td>
<td>184</td>
<td>79</td>
<td>59</td>
<td>9</td>
<td>390</td>
<td>1.9</td>
</tr>
<tr>
<td>Germany</td>
<td>15</td>
<td>57</td>
<td>17</td>
<td>40</td>
<td>7</td>
<td>394</td>
<td>1.2</td>
</tr>
<tr>
<td>Italy</td>
<td>6</td>
<td>284</td>
<td>155</td>
<td>24</td>
<td>19</td>
<td>1210</td>
<td>1.8</td>
</tr>
<tr>
<td>Spain</td>
<td>28</td>
<td>182</td>
<td>101</td>
<td>13</td>
<td>9</td>
<td>510</td>
<td>1.5</td>
</tr>
<tr>
<td>UK</td>
<td>13</td>
<td>99</td>
<td>105</td>
<td>29</td>
<td>7</td>
<td>399</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Structural horizontal policies uncontroversial

Persisting differences among European countries in competitiveness indicators.

- Why? Unawareness of policy makers? Other factors
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 accession countries
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-Quéré et al, 2003*
    - Initial boost ok, but other complementary factors are necessary

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**Figure 2: Tax on Corporate Income**

![Tax on Corporate Income Chart](chart_image)
## Selective instruments

### Table 2A State Aid, annual average by purpose, mn Euros.

<table>
<thead>
<tr>
<th>Purpose</th>
<th>1997-01</th>
<th>2002-06</th>
<th>2007-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>62,101</td>
<td>61,099</td>
<td>57,206</td>
</tr>
<tr>
<td>HORIZONTAL</td>
<td>34,624</td>
<td>41,143</td>
<td>48,926</td>
</tr>
<tr>
<td>Regional</td>
<td>13,766</td>
<td>10,597</td>
<td>13,469</td>
</tr>
<tr>
<td>R&amp;D&amp;I</td>
<td>4,960</td>
<td>6,153</td>
<td>9,848</td>
</tr>
<tr>
<td>Environment</td>
<td>4,102</td>
<td>12,306</td>
<td>13,737</td>
</tr>
<tr>
<td>VERTICAL</td>
<td>27,477</td>
<td>19,955</td>
<td>8,280</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>6,297</td>
<td>4,383</td>
<td>2,292</td>
</tr>
</tbody>
</table>

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

### Table 2B State Aid, annual average share of GDP %, by country.

<table>
<thead>
<tr>
<th>Country</th>
<th>1997-01</th>
<th>2002-06</th>
<th>2007-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU Total (*)</td>
<td>0.58</td>
<td>0.54</td>
<td>0.46</td>
</tr>
<tr>
<td>Germany</td>
<td>0.88</td>
<td>0.84</td>
<td>0.58</td>
</tr>
<tr>
<td>France</td>
<td>0.82</td>
<td>0.38</td>
<td>0.52</td>
</tr>
<tr>
<td>Italy</td>
<td>0.54</td>
<td>0.38</td>
<td>0.26</td>
</tr>
<tr>
<td>UK</td>
<td>0.16</td>
<td>0.20</td>
<td>0.24</td>
</tr>
<tr>
<td>Spain</td>
<td>0.82</td>
<td>0.54</td>
<td>0.38</td>
</tr>
</tbody>
</table>

(*) 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; parisì 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 successful 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 assessment 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