

New Perspectives on Foreign Direct Investment

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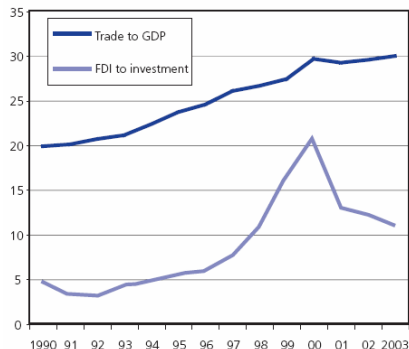
Harvard University

January, 2008

Background

- International trade and foreign direct investment have been among the fastest growing economic activities around the world.

Ratio of world trade to GDP and ratio of global FDI flows to world fixed investment, 1990-2003
(Percentage)

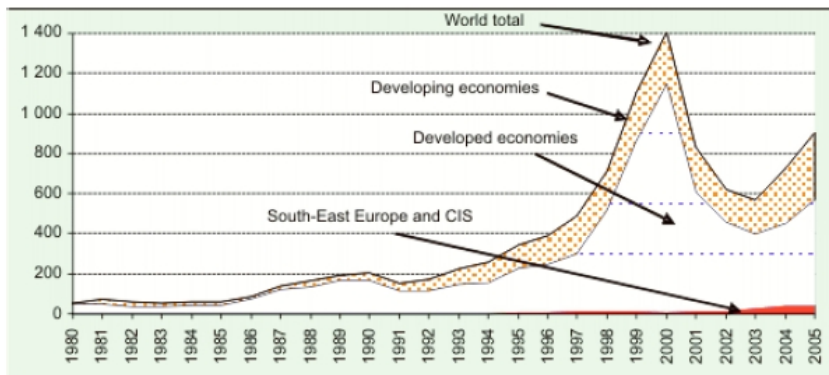


Source: World Bank, World Development Indicators; UNCTAD, World Investment Report and WTO estimates.

Background (continued)

- Trade and FDI are concentrated in the industrial countries:

Figure I.1. FDI inflows, global and by group of economies, 1980–2005
(Billions of dollars)



Source: UNCTAD, based on its FDI/TNC database (www.unctad.org/fdi statistics).

Background (continued)

Table I.1. Distribution of FDI by region and selected countries, 1980-2005
(Per cent)

Region	Inward stock				Outward stock			
	1980	1990	2000	2005	1980	1990	2000	2005
Developed economies	75.6	79.3	68.5	70.3	87.3	91.7	86.2	86.9
European Union	42.5	42.9	37.6	44.4	37.2	45.2	47.1	51.3
Japan	0.6	0.6	0.9	1.0	3.4	11.2	4.3	3.6
United States	14.8	22.1	21.7	16.0	37.7	24.0	20.3	19.2
Developing economies	24.4	20.7	30.3	27.2	12.7	8.3	13.5	11.9
Africa	6.9	3.3	2.6	2.6	1.3	1.1	0.7	0.5
Latin America and the Caribbean	7.1	6.6	9.3	9.3	8.5	3.4	3.3	3.2
Asia and Oceania	10.5	10.8	18.4	15.4	2.9	3.8	9.5	8.2
West Asia	1.4	2.2	1.1	1.5	0.3	0.4	0.2	0.3
South, East and South-East Asia	8.8	8.5	17.2	13.8	2.5	3.4	9.3	7.8
South-East Europe and CIS	..	0.01	1.2	2.5	..	0.01	0.3	1.2
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

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- A remarkable feature of this growth has been an unprecedented expansion of trade and FDI in services.
- Moreover, the nature of trade and FDI have changed dramatically: there is growing trade in intermediate inputs, including services, and the growth in input trade takes place within and outside the boundaries of the firm.

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- A third of the volume of world trade is accounted for by transactions in which multinational firms are in one of the two sides of the exchange

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 - Complex: Assembly and components production can generate interdependence between horizontal and vertical FDI, as well as third market effects.
- MNEs decide on location and the extent of **control**: internalization versus outsourcing.

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- Emphasizes the tradeoff between:
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- Moreover, in the data there is a lot of within industry heterogeneity, with multinationals being larger and more productive than all other firms.

Sorting into Exporting and FDI

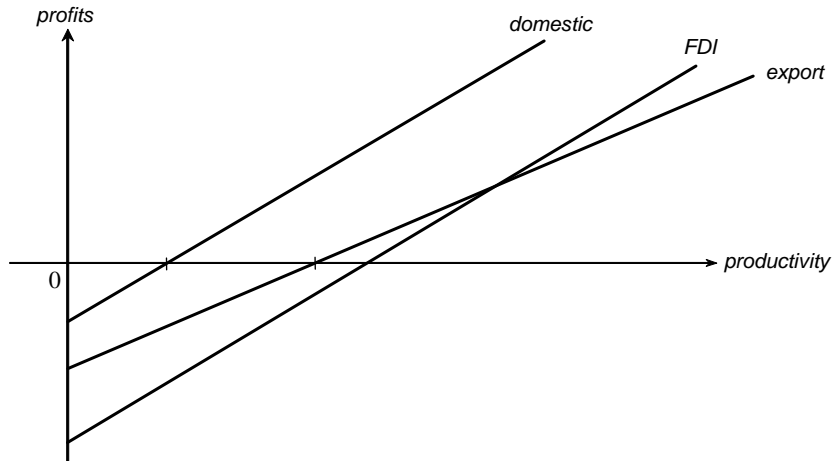


TABLE 1—PRODUCTIVITY ADVANTAGE OF MULTINATIONALS
AND EXPORTERS

Multinational	0.537 (14.432)
Nonmultinational exporter	0.388 (9.535)
Coefficient difference	0.150 (3.694)
Number of firms	3,202

Notes: *T*-statistics are in parentheses (calculated on the basis of White standard errors). Coefficients for capital intensity controls and industry effects are suppressed.

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 - decreasing in productivity dispersion.

Dispersion is as important as trade costs and plant scale economies

TABLE 4—“BETA” COEFFICIENTS: NARROW SAMPLE WITH CONTROLS

	Mean	Standard deviation	“Beta” coefficient
Dependent variable	-0.595	2.375	
FREIGHT	1.863	0.653	-0.271
TARIFF	2.015	1.020	-0.205
FP	3.321	0.785	0.325
U.S. s.d.	1.749	0.316	-0.312
Europe s.d.	1.198	0.276	-0.250
France s.d.	1.224	0.375	-0.325
Europe reg.	1.260	0.333	-0.210
France reg.	1.257	0.336	-0.211

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- More recent theories, based on contractual frictions, yield new insights. They predict:

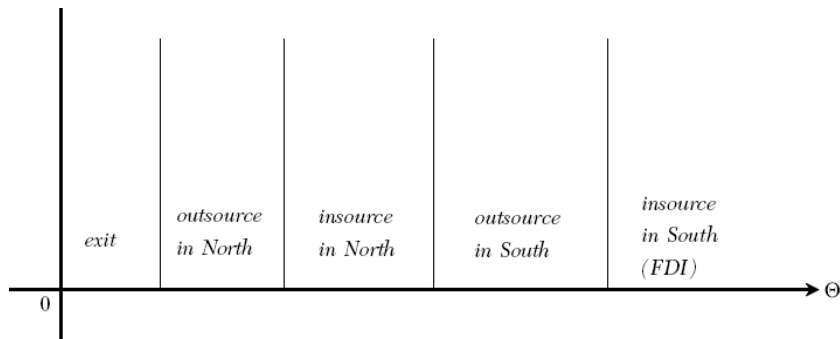
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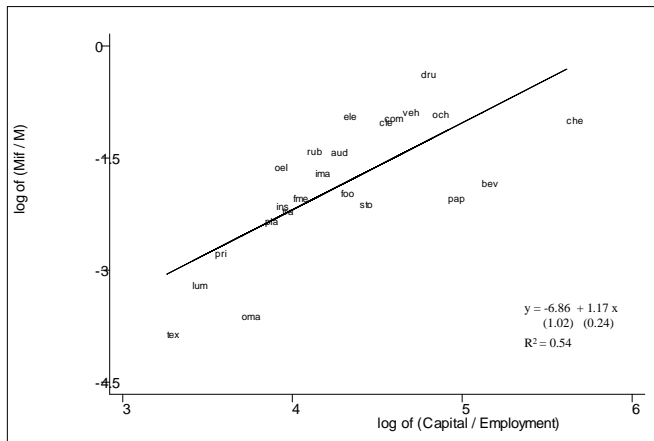
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 - Larger shares of intrafirm trade in more headquarter-intensive sectors.
 - Larger shares of intrafirm imports from countries that are well endowed with inputs that are intensively used in headquarter services.

Sorting Pattern

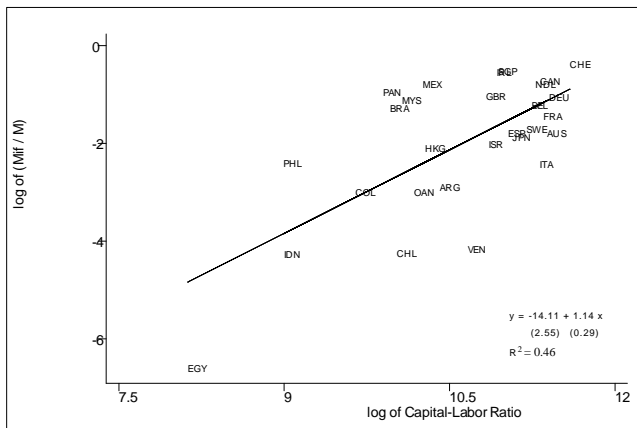


Evidence 1



Notes: The Y-axis corresponds to the logarithm of the share of intrafirm imports in total U.S. imports for 23 manufacturing industries averaged over 4 years: 1987, 1989, 1992, 1994. The X-axis measures the average log of that industry's ratio of capital stock to total employment, using U.S. data. See Table A.1. for industry codes and Appendix A.4. for data sources.

Share of Intrafirm U.S. Imports and Relative Factor Intensities



Notes: The Y-axis corresponds to the logarithm of the share of intrafirm imports in total U.S. imports for 28 exporting countries in 1992. The X-axis measures the log of the exporting country's physical capital stock divided by its total number of workers. See Table A.2. for country codes and Appendix A.4. for details on data sources.

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 - ① The larger the share of headquarter services (R&D intensity).
 - ② The larger productivity dispersion.
 - ③ Intrafirm trade is largest where headquarter inputs are important and productivity is high.
 - ④ Internalization rises with improved contractibility of the supplier's inputs.