

Regional Integration and FDI in Emerging Markets

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Introduction/ Motivation

- Huge body of literature on (i) FDI determinants and (ii) regional integration...
- ...but still highly contentious whether RIAs provide a stimulus to FDI.
- High expectations (e.g., Brenton et al. in *Empirica* 1999: “important stimulus not only to trade, but also to FDI”)...
- ...often not met:
 - Failure of numerous earlier RIAs to exert any discernible influence on FDI...
 - ...but greater influence of more recent RIAs such as EU, Nafta and Mercosur (UNCTAD WIR 1998)?

Introduction/ Motivation (2)

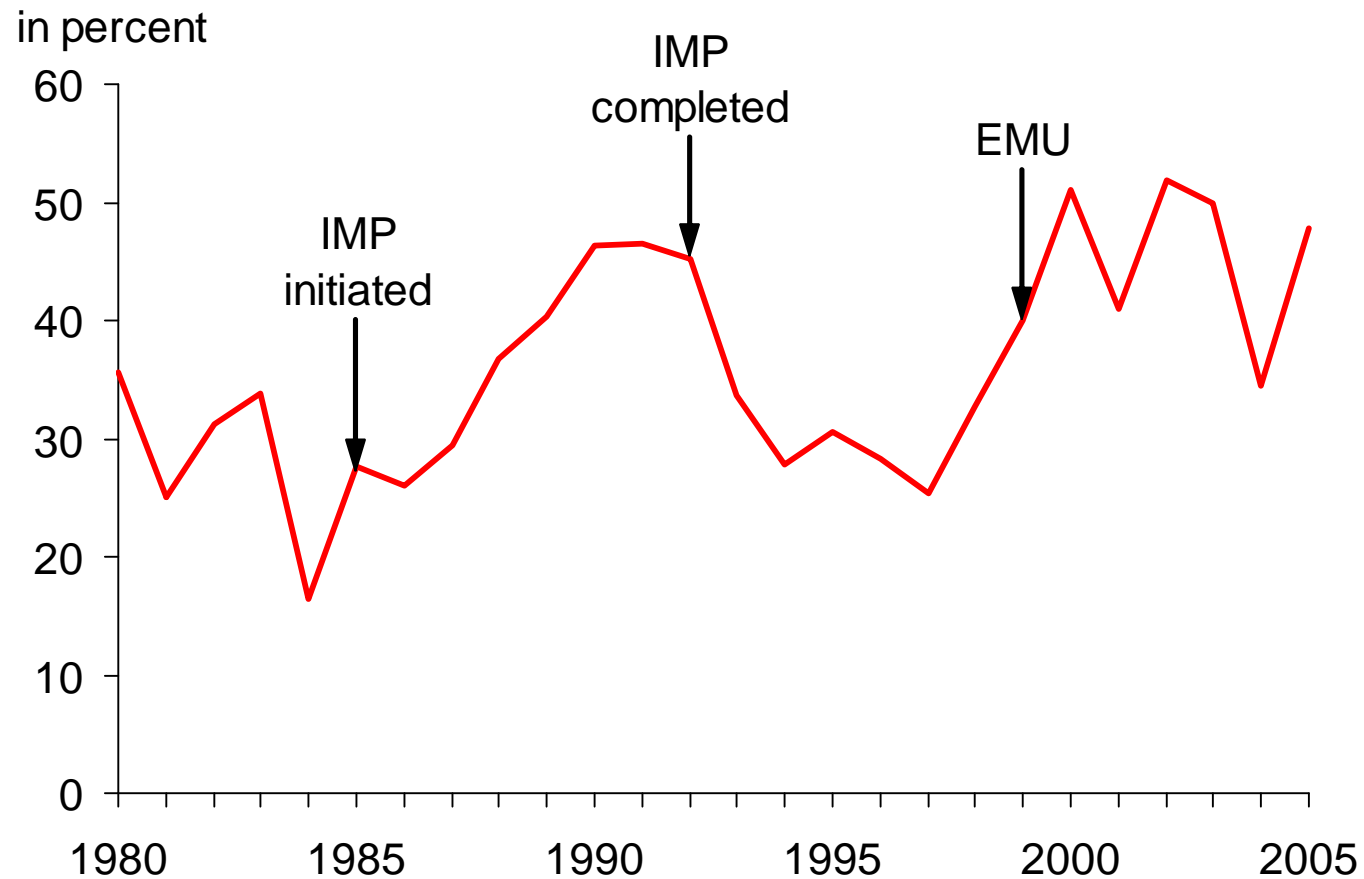
- Reasons to reassess the FDI effects of RIAs in emerging markets (as hosts and sources of FDI):
 - New wave of regional integration,
 - New sources of FDI.
- Focus on major RIAs (important for the particular region and partner countries in the North): Mercosur, ASEAN, SAARC, SADC.
- Questions addressed:
 - Rising inward FDI due to reg. int.?
 - Why not?
 - Benefits shared among member countries? (not really here!)
 - Role of major player in terms of outward FDI in the region.

Analytical background

- FDI effects depend on (i) FDI motives, (ii) FDI sources and (iii) the type and focus of reg.int.
- E.g., horizontal/ tariff-jumping FDI within the RIA may decline due to lower trade barriers.
- Intra-RIA FDI is more likely to increase, however, if trade liberalization promotes vertical specialization.
- If RIA raises external protection level...
 - ...horizontal extra-regional FDI may go up...
 - ...while vertical extra-regional FDI may go down.
- Removal of intra-regional trade barriers may stimulate extra-regional horizontal FDI due to larger effective market,...
- ...but this effect may be counteracted by the “rationalization” of the regional network of affiliates.
- Additional stimulus through explicit investment provisions in RIA – only for intra-RIA FDI?
- Open questions:
 - Importance of dynamic effects.
 - Concentration of FDI within RIA?
- In summary, theoretical ambiguities – even though the net effect is widely believed to be positive.

European integration: the (irrelevant) model (1)

Share of EU-12 in Worldwide FDI Inflows, 1980-2005

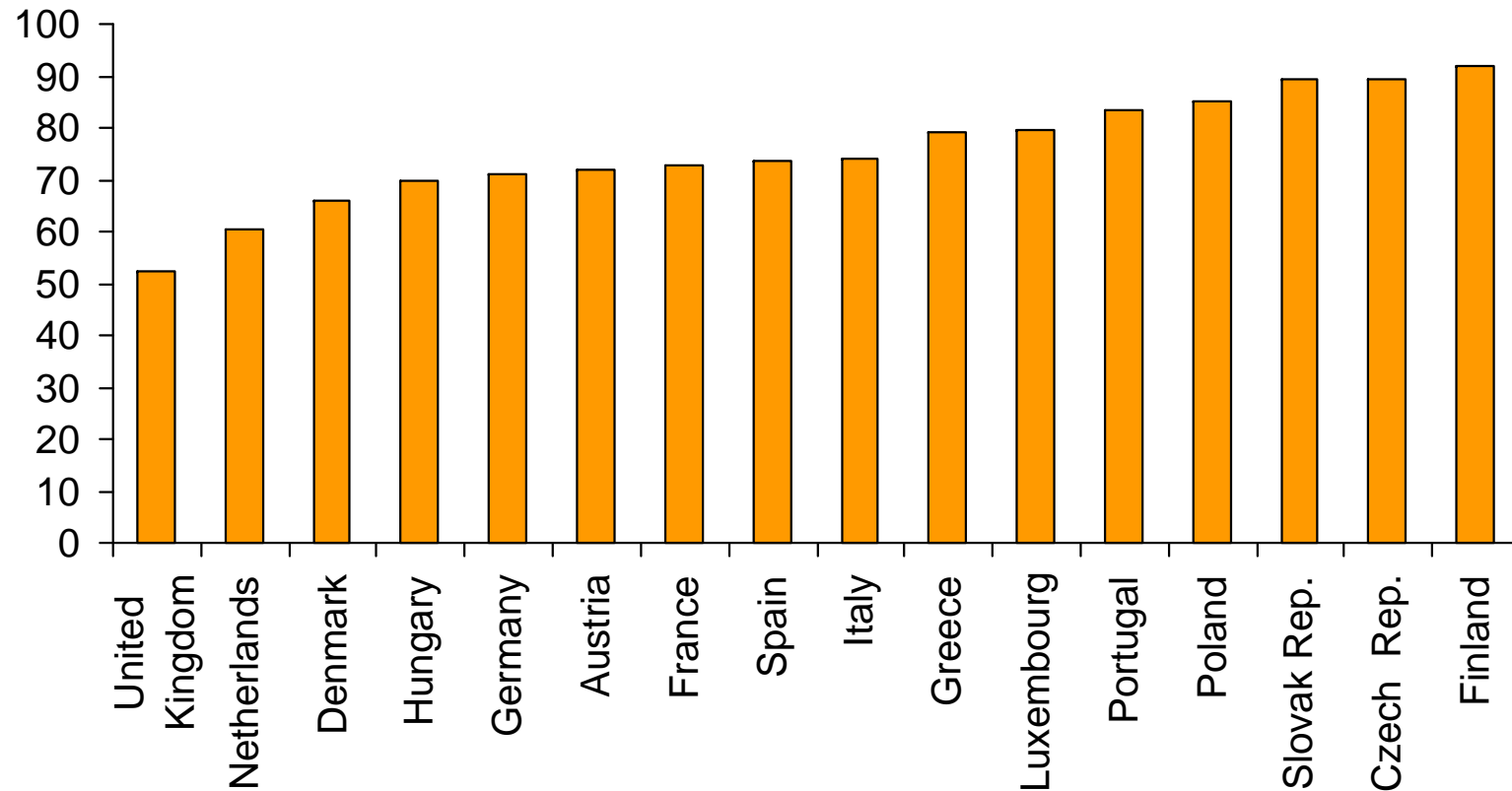


Source: WDI 2007.

European integration: the (irrelevant) model (2)

Share of intra-EU FDI in Total FDI Stocks, Selected Member Countries^a
(most recent year)

in percent



^aComparable data unavailable for member countries not listed.

Source: OECD <http://titania.sourceoecd.org/vl=6333130/cl=18/nw=1/rpsv/ij/oecdstats/16081080/v45n1/s5/p1>

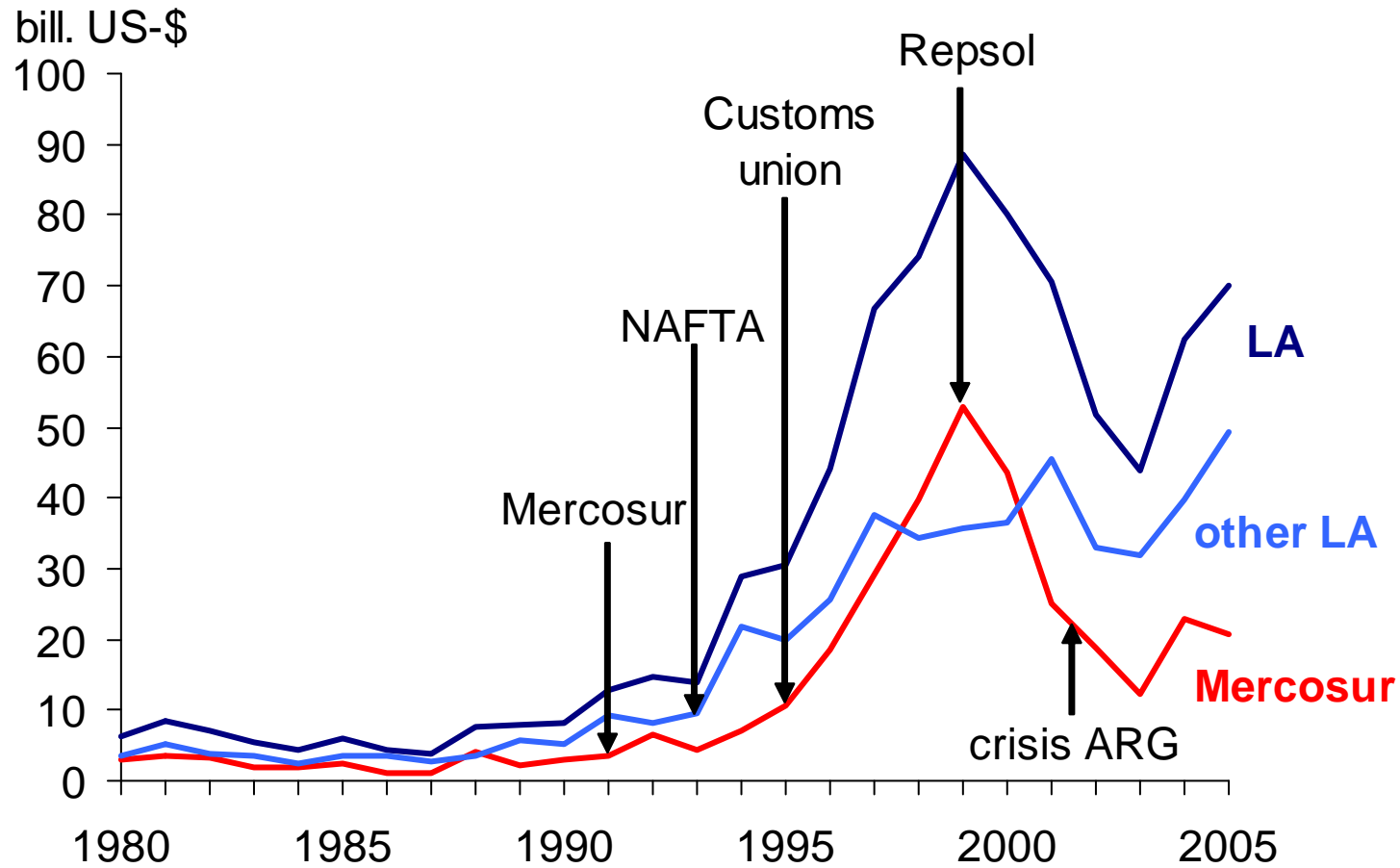
Four Major RIAs: Inward FDI Stocks

	2005/ 1980	Share in FDI stocks in all DCs	
		1980	2005
Mercosur	11.1	17.8	9.8
ASEAN	19.8	14.3	14.1
SAARC	36.7	1.3	2.3
SADC	4.9	16.1	4.0

Source: UNCTAD

Mercosur: FDI Inflows

FDI Inflows: Mercosur in the Latin American Context, 1980-2005



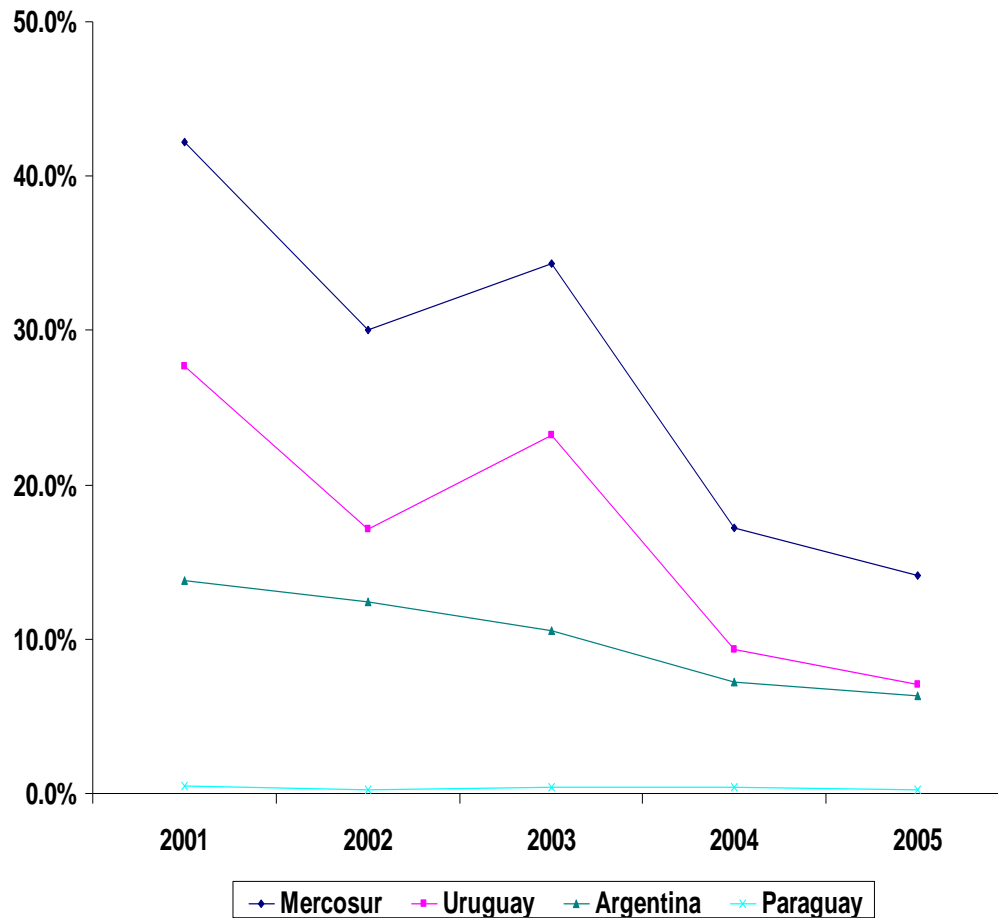
Source: WDI 2007

Mercosur: formal integration alone won't do

- Not particularly successful in attracting FDI, even though institutionalization of RIA more advanced than elsewhere in the 90s (CU since 1995).
- Declining share in all DCs since 1980, no better than other LA.
- Booming FDI in the second half of the 90s, but...
- ...uncertain how much of the reforms should be credited to the formal integration agreement" (Blomström and Kokko 1997), rather than unilateral and multilateral liberalization,
- ...the peak in 1999 is largely due to some exceptionally large acquisitions (notably Spanish Repsol's engagement in Arg. of \$ 13 bill.).
- More generally, FDI-promoting effects of RIA...
 - ...dominated by country-specific boom and bust phenomena,
 - ...limited by serious implementation deficits:
 - "the integration process has virtually come to a standstill" (Preusse 2001);
 - the "common" external tariff still had 800 exceptions in 2004;
 - Paraguay and Uruguay complain that access to Brazils market is "theoretical" (Economist Jan 2006);
 - The Economist (July 2007): "bickering and backsliding"; "rule book riddled with exceptions"; "paralysis."
- Brazil accounts for 77 % of FDI stocks (2005), but is no more attractive than Arg./Uru. in terms of per capita FDI.

Outward FDI from Brazil

Share of Mercosur



- OFCs account for most of Brazil's OFDI, but excluded here;

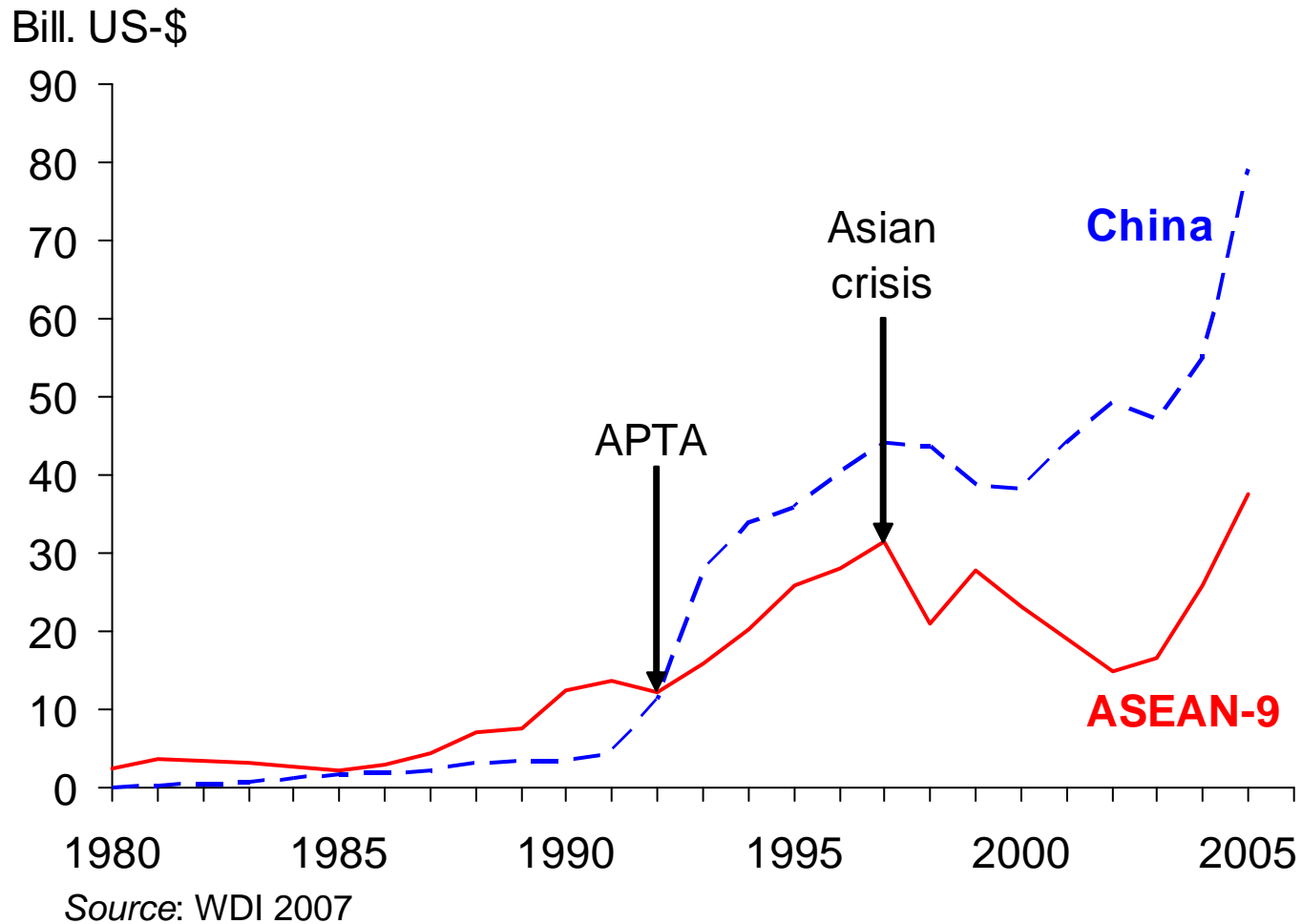
- Mercosur: just 14% of OFDI stocks in 2005, decreasing trend;

- Uruguay and Argentina just make it into Top 10 host countries;

- Paraguay far down the list; but Brazil is second largest investor in P. (after US)

ASEAN and China: FDI Inflows

FDI Inflows: ASEAN (excluding Brunei) and China, 1980-2005



ASEAN: can do without (much of institutionalized) integration?

- ASEAN much more successful than Mercosur in attracting FDI (see table above),...
- ...even though (market-driven) regionalization dominates (institutionalized) regionalization in Asia (Langhammer 2007), suggesting that the latter may not be needed to attract FDI.
- Unlike the EU, reg.int. in Southeast Asia often pushed by external shocks such as recent fears about FDI diversion to China.
- With hindsight such concerns appear largely unjustified (Chantasasawat et al. 2004 show FDI to ASEAN to be positively correlated with FDI inflows to China).
- Arguably, ASEAN could have performed still better if...
 - ...promises had been kept (CSIS: only 30 % of ASEAN's agreements are ever implemented,
 - ...private companies did not regard it to represent 10 separate markets with 10 sets of regulations (US-ASEAN Business Council).

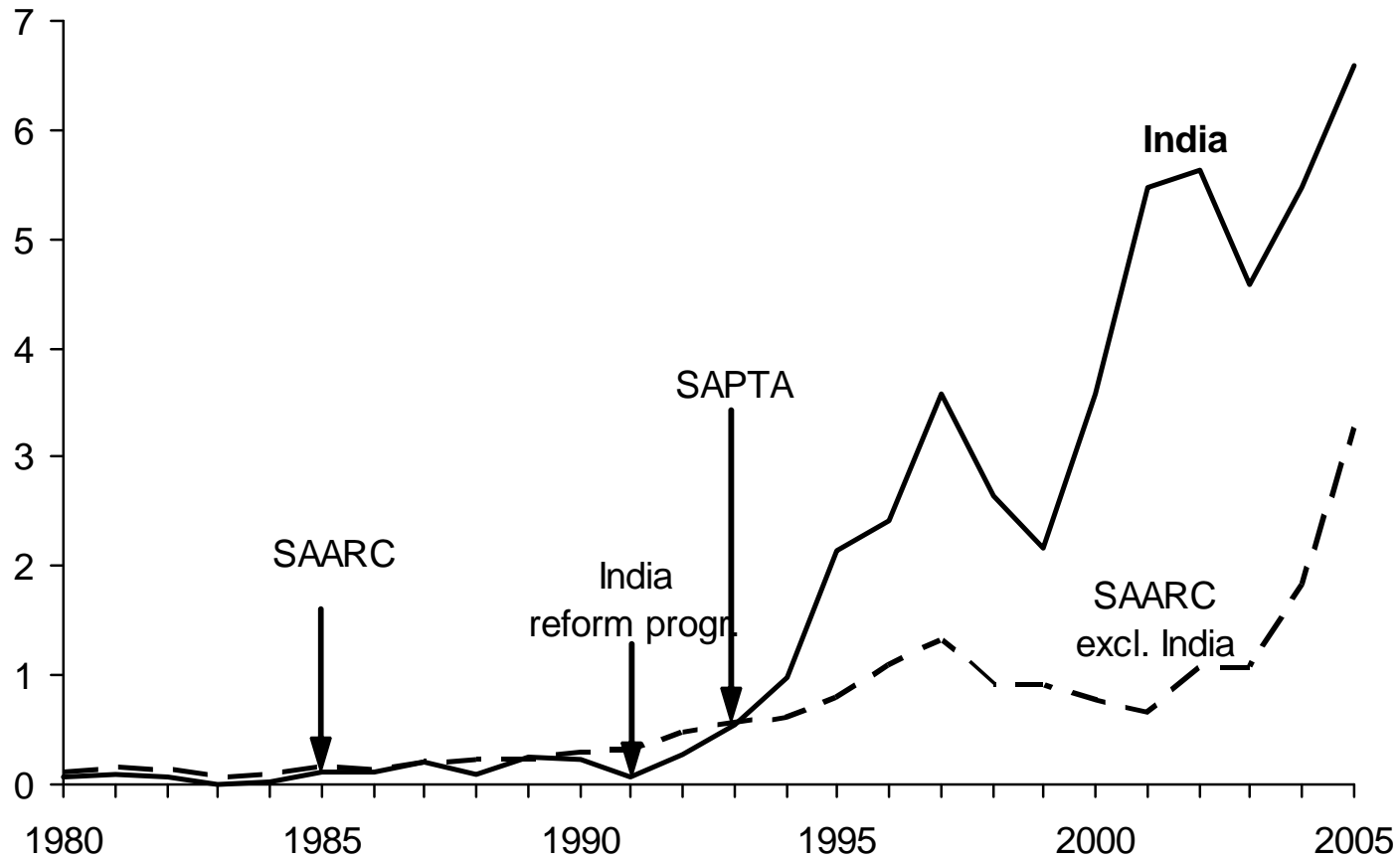
ASEAN: OFDI China/Summary

- Sum 2003-2005: about \$ 20 billion;
- thereof:
 - about 45 % to OFCs
 - about 35 % roundtripping to Hong Kong
- ASEAN(10) got 10-11 % **of the rest**, i.e.:
 - slightly more than the US,
 - about the same as Sudan, Nigeria, and Kazakhstan taken together.
- In summary, China may have pushed ASEAN's attempts at integration somewhat forward (even though concerns about FDI diversion may not be justified), while its FDI activities are rather unlikely to support reg.int.

SAARC: Inflows

FDI Inflows: SAARC

Bill. US-\$



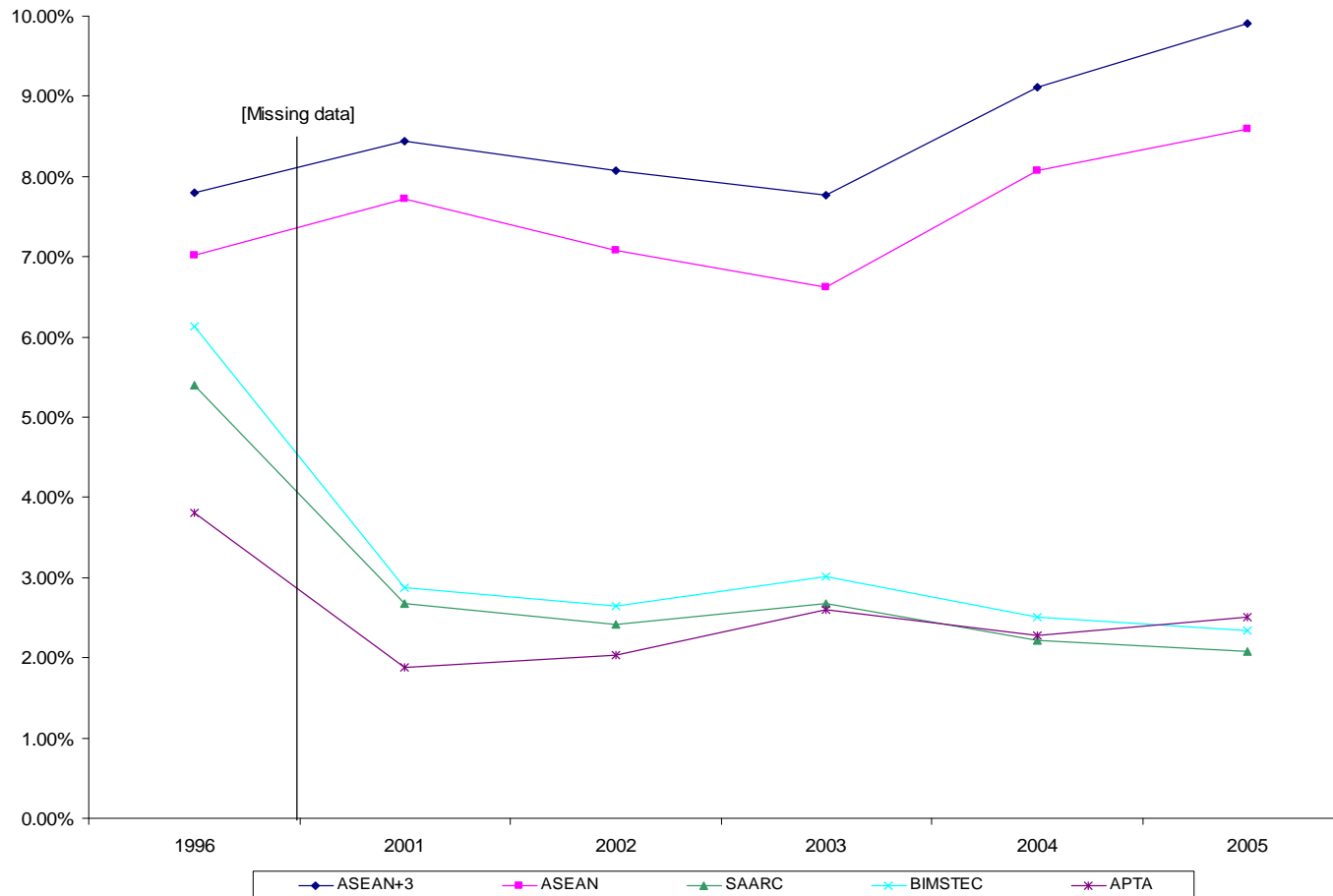
Source: WDI 2007

SAARC: All about India?

- Most striking feature: FDI boom in India
 - 76% of SAARC inflows in 2006
 - Policy reforms of early 1990s and 2001 as major driving force
 - Reg int. hardly mentioned in the literature as possible determinant of FDI in India
- Excl. India, the rest of SAARC accounted for a stagnant share of less than 1% of FDI flows to all low and middle-income countries - regional integration does not appear to have helped.
- Country-specific factors seem to be most relevant for other SAARC members, too: increasing inflows after economic liberalization (Bangladesh vs. Pakistan)

OFDI from India

Regional shares in OFDI stocks



- 43% of OFDI in developed countries (market-seeking)

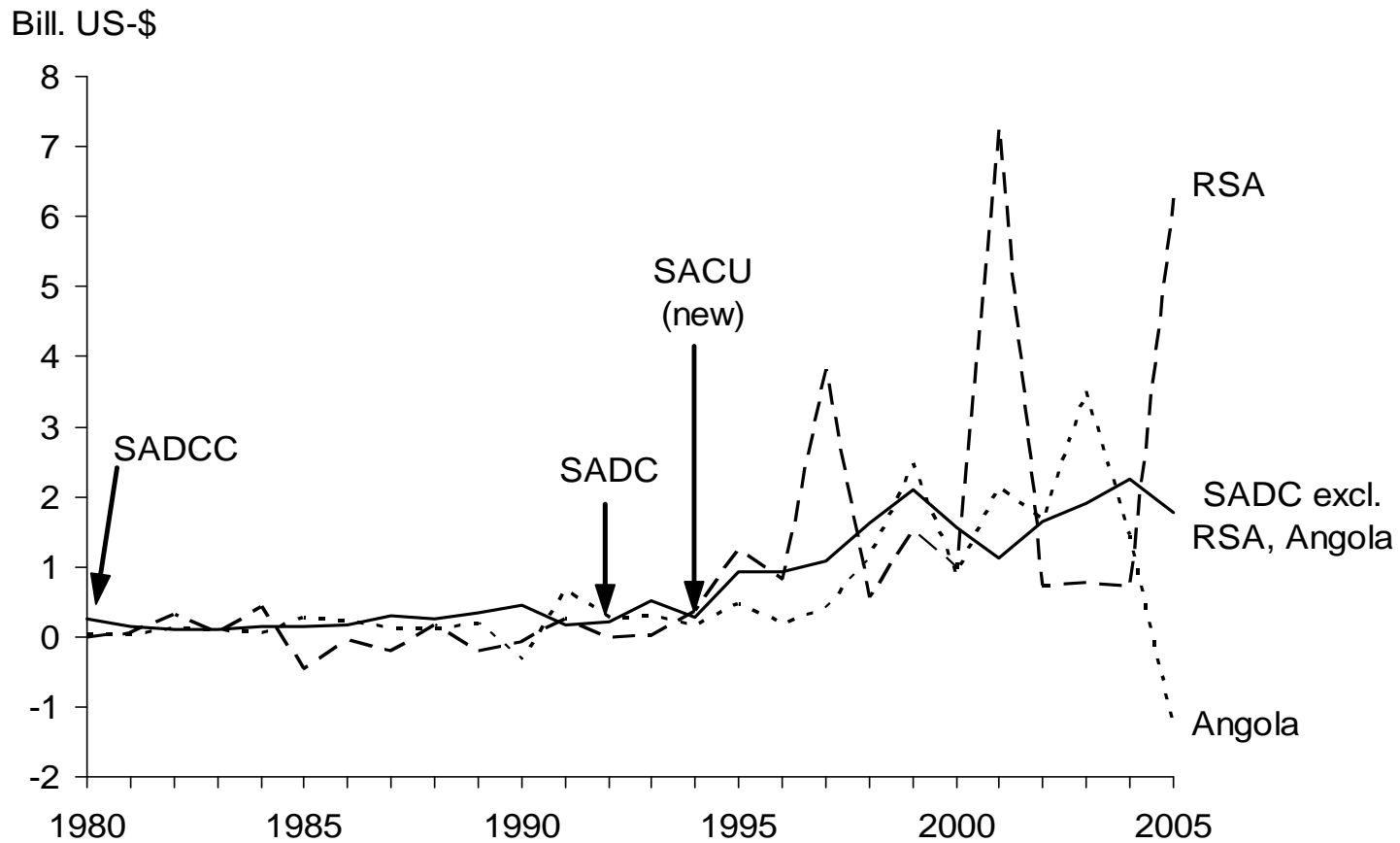
- Within SAARC: >1/2 in Sri Lanka, 1/3 in Nepal

- ASEAN (Singapore) more important than SAARC

- Mainly in manufacturing, IT on the rise

SADC: Inflows

FDI Inflows: SADC



Source: WDI 2007

SADC: The Africa Factor?

- Jenkins & Thomas (2002): Size of local market important motivation for investors in SADC: -> FTA should encourage FDI
- FTA envisaged for 2008, customs union for 2010: Anticipation effects? Why not?
 - Overlapping membership patterns
 - Business climate
- RSA dominates FDI to SADC (66% of FDI stocks, 2005)
- Future role of RSA - magnet for FDI to the region or diverting FDI from other SADC countries?

OFDI from South Africa

- 91% of South African OFDI in developed countries, 8% in Africa
- Yet, RSA important source of FDI for SADC
- Regional and bilateral agreements stimulated investment in SADC to reduce costs, esp. wage costs (Te Velde, 2004)

Conclusions

- FDI effects of RIAs not only theoretically ambiguous, but also the stylized facts are less clear than might be expected.
- Not really surprising, taking into account that...
 - ...RIAs differ with respect to institutionalization, approach (e.g., FTA/CU), openness to outsiders, inclusion of investment provisions, type of FDI attracted, etc.;
 - ...implementation deficits weaken FDI effects (on the other hand, anticipation effects if announcements are credible);
 - ...data leave much to be desired (notably with regard to OFDI by major regional players);
 - ...other factors are more important (RIA neither sufficient nor necessary?);
 - ...RIA effects difficult to be isolated from unilateral lib., BITs, etc.

Overview: Anchor countries and RI

	Regional share in AC's total OFDI	Tendency	Influence of regional integration observable?	AC's share in total IFDI to region	Tendency
China/ ASEAN	13% ¹	→	ambiguous	1% ⁵	→
India/ SAARC	2.1% ²	↘	No		
RSA/ SADC	~7% ³	?	ambiguous	25% ⁷ (2003)	?
Brazil/ Mercosur	14.1% ⁴	↘	??		