
Discussion of
“FDI and Development”
by Ted Moran

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Why I admire Ted's work

- Courage to tackle a difficult yet important question
- Accepting that the perfect may be the enemy of the good
 - there are lessons to be learned even from imperfect studies
- Doing a reality check

Outline

1. Summary
2. Survey evidence supports Ted's conclusions that FDI spillovers exist, but their extent differs depending on country conditions
3. Policy implications
4. Extensions

Ted's starting point: Lack of consensus in the literature on FDI spillovers

- Aitken and Harrison (AER 1999) - Venezuelan plant-level data 1976-1989
 - Increase in FDI presence **negatively** affects TFP of local plants in the same sector
 - Magnitude of spillover effect: 20-27% decline in TFP a year

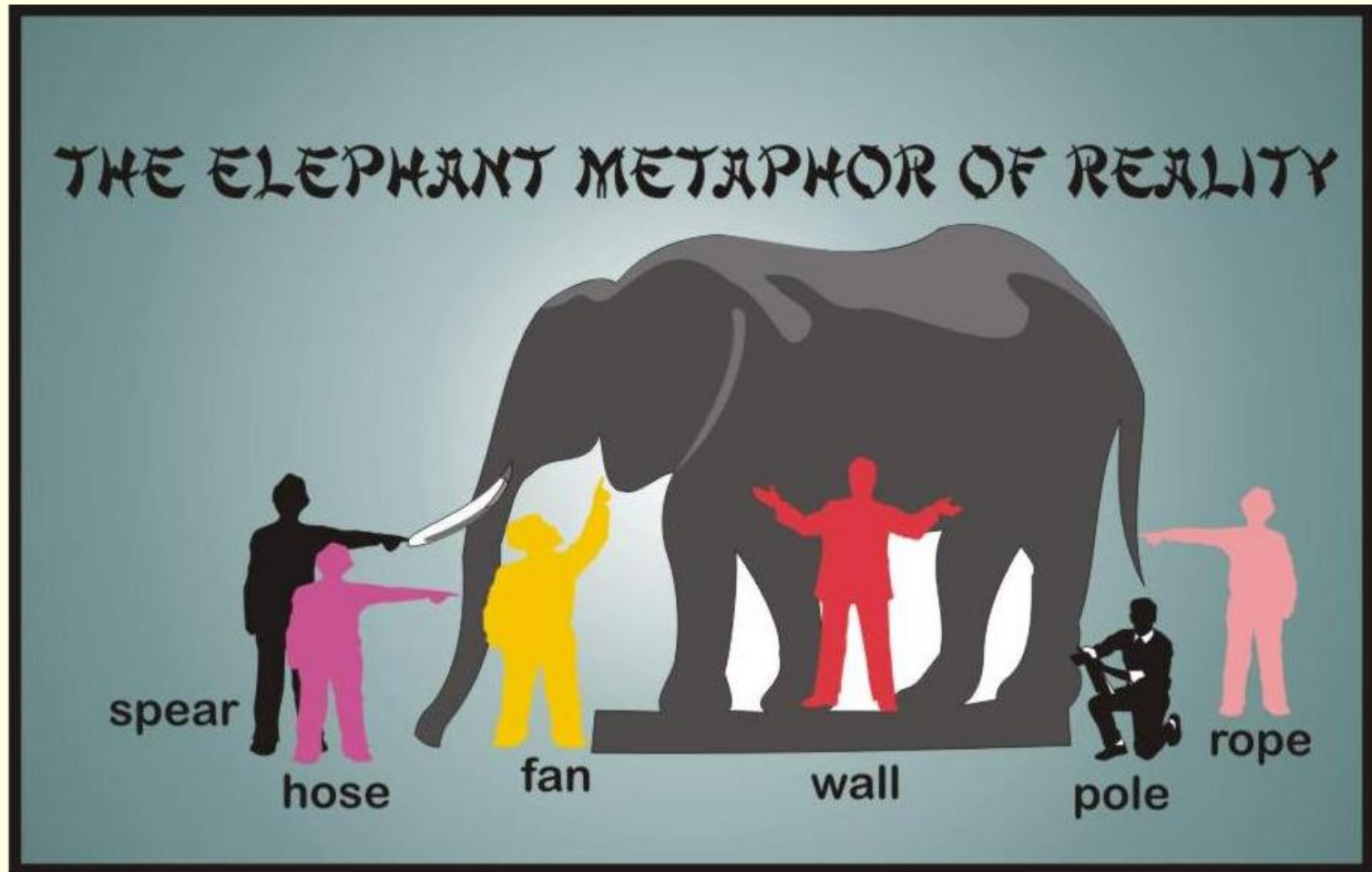
- Haskel, Pereira and Slaughter (NBER WP 2002) - UK plant-level data 1973-1992
 - Increase in FDI presence **positively** affects TFP of local plants in the same sector
 - Magnitude of spillover effect: 10 pts increase in FDI => 0.5% increase in TFP

- Javorcik (AER 2004) - Lithuanian firm-level data 1996-2000
 - **Positive spillovers to supplying sectors**, no evidence of intra-industry effects
 - One-standard-deviation increase in FDI => 15 % increase in TFP of local firms in the supplying industries

Why such different conclusions? Explanations offered so far

- Poor data quality in developing countries may explain why studies based on developed countries are more likely to find positive spillovers (Keller and Yeaple NBER WP 2003)
- TFP is a poor measure of performance unless data on quantities are available (Katayama, Lu and Tybout WP 2003)
- The standard regression is not identified, need IVs or a natural experiment (Hanson IIE volume 2005)

Ted's answer



Ted's answer: search for clues by looking at host country conditions

- Aitken and Harrison (AER 1999) – Venezuela 1976-1989
 - Heavy restrictions on foreign investors, mandatory JVs, import substitution => low incentives for technology transfer to foreign affiliates
 - Increase in foreign equity => increase in TFP only in firms with under 50 employees => little potential for producing knowledge spillovers
 - Easy to 'steal' market share from uncompetitive local producers
- Haskel, Pereira and Slaughter (NBER WP 2002) - UK 1973-1992
 - Highly developed country => limited potential for 'market stealing'
 - Highly developed country => limited room for learning
 - Lesser performers benefit more from spillovers
- Javorcik (AER 2004) - Lithuania 1996-2000
 - Transition from central planning to free market
 - Limited competition and exposure to foreign goods => 'market stealing' effect likely
 - Limited exposure to foreign buyers in the past => potential for spillovers from multinationals to local buyers

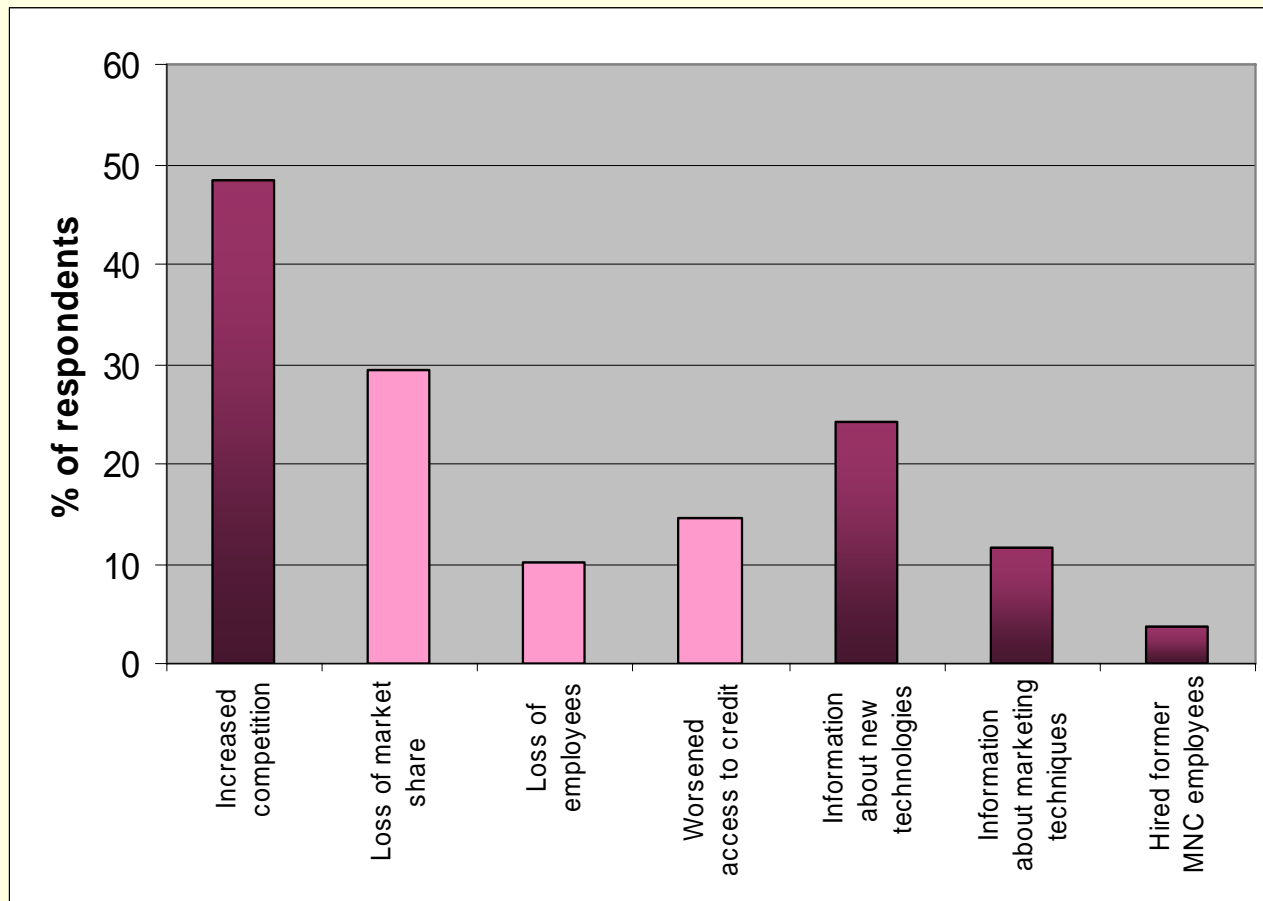
Ted's conclusion

- Don't ask *if*, ask *under what conditions* FDI spillovers exist

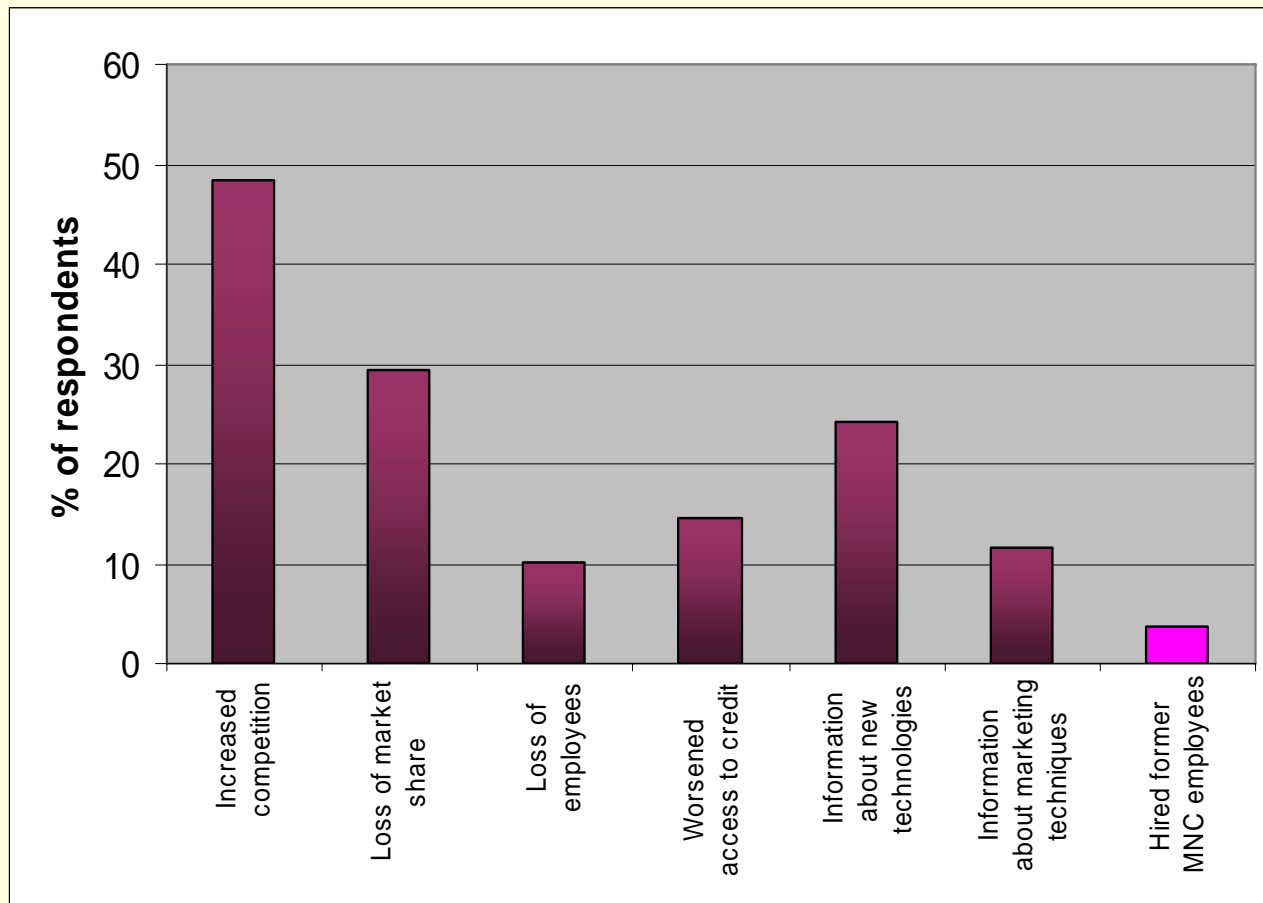
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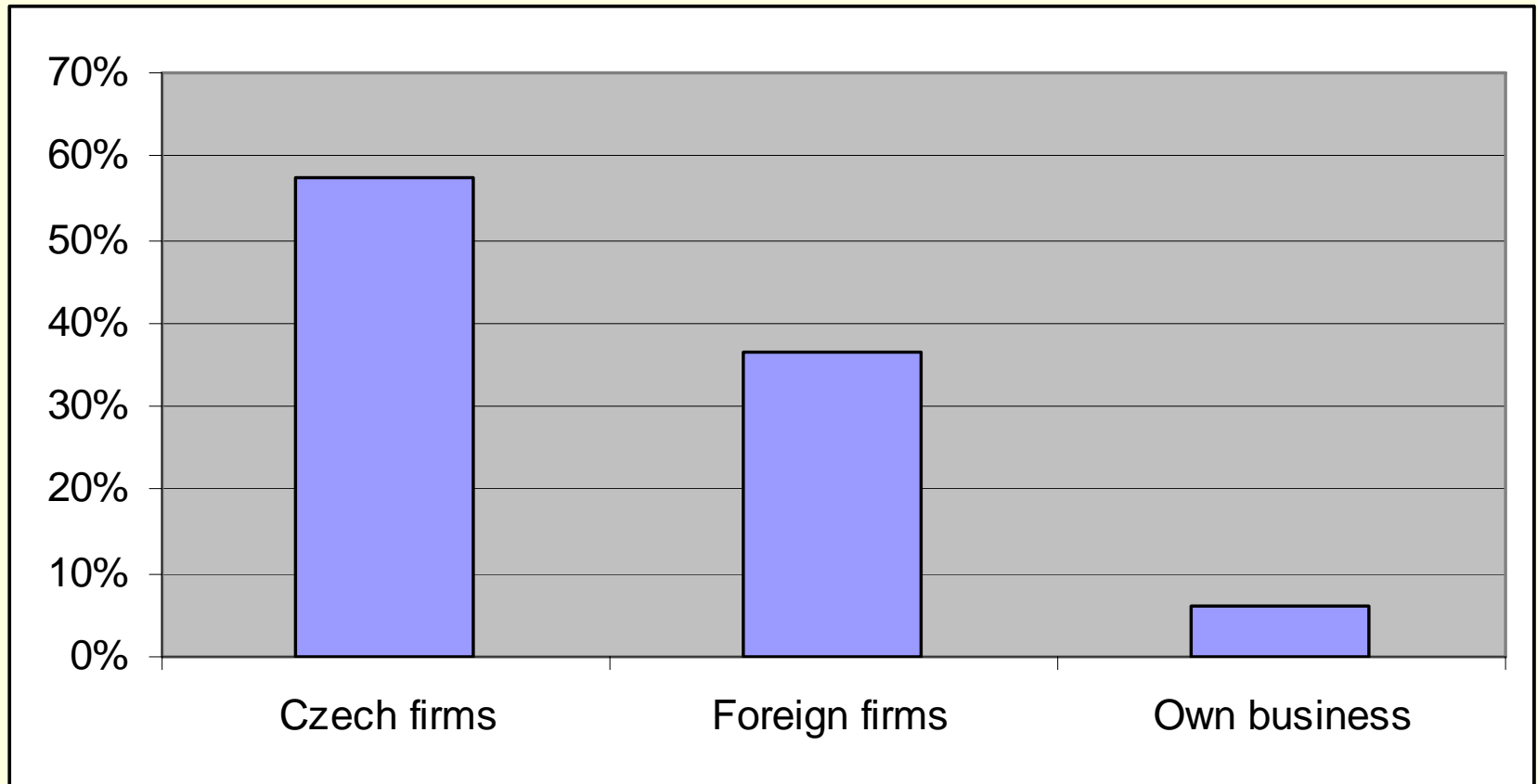
FDI affects local producers through multiple channels (Czech Rep.)



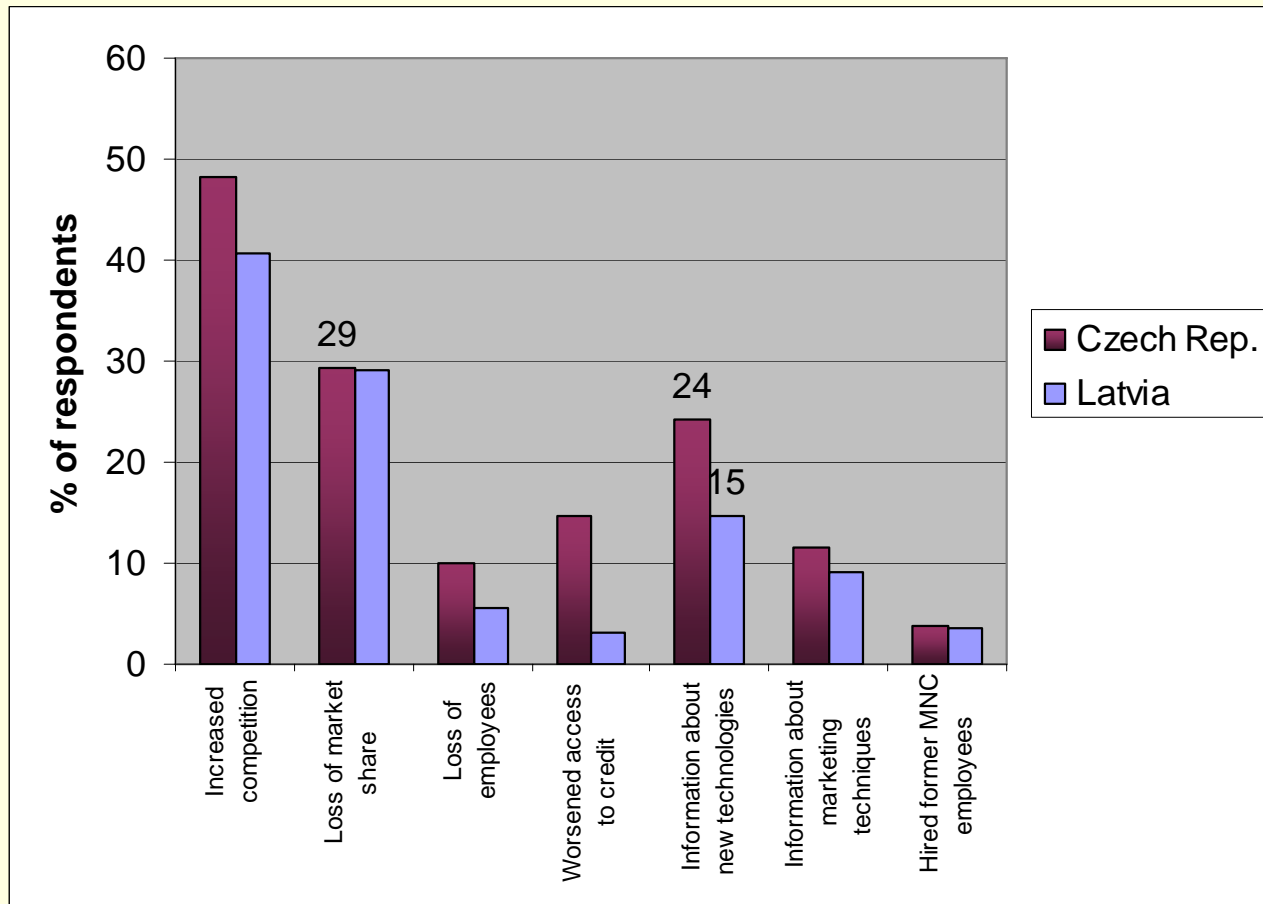
Movement of labor – limited in magnitude



but most employees leaving MNCs go to Czech firms



Relative magnitudes of the effects differ by country



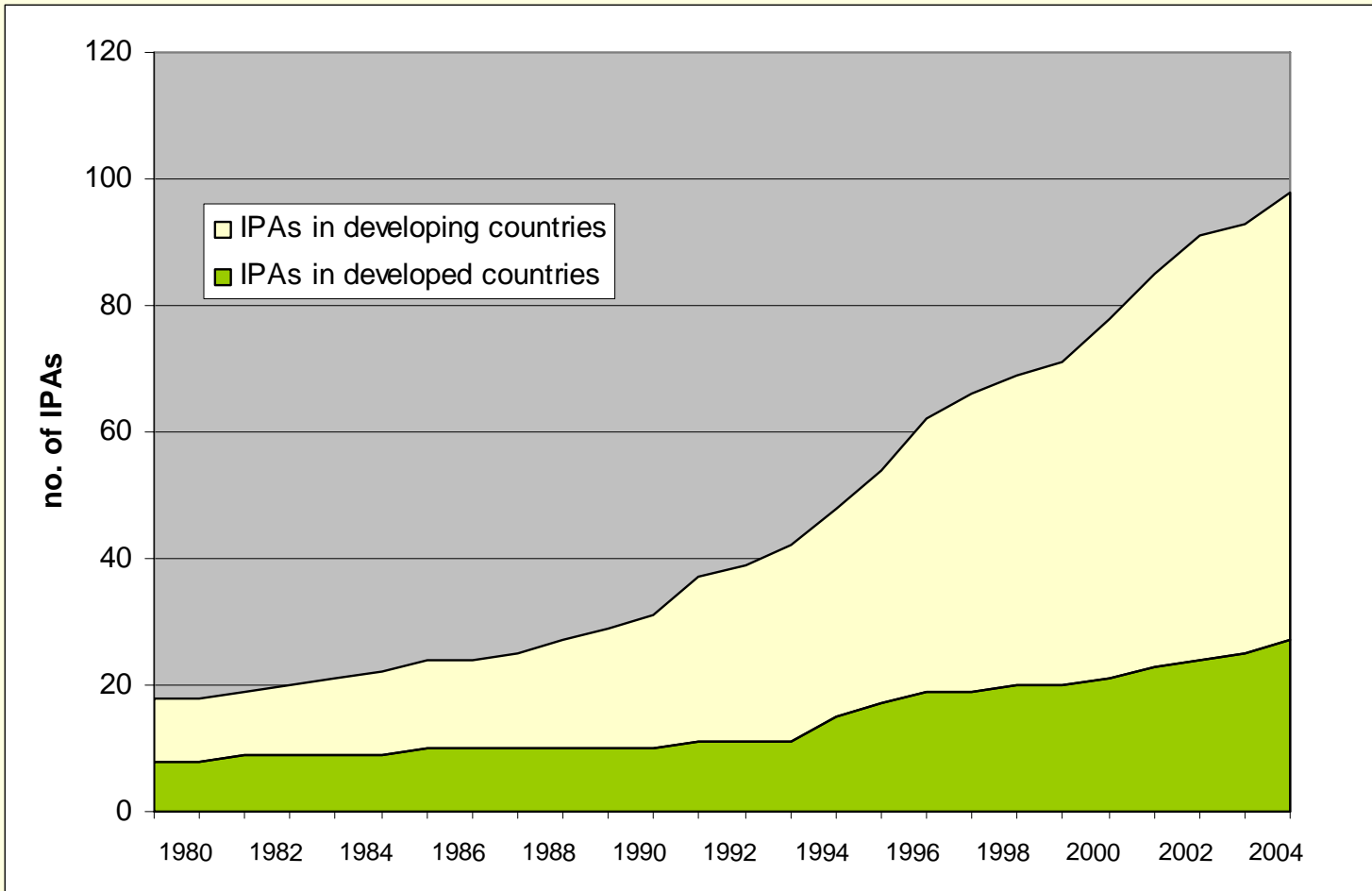
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What do we tell policy makers?

- **Knowledge spillovers** are a justification for FDI incentives
 - Incentives make sense if other conditions are fulfilled
 - but cost may not be worth the benefit (Haskel, Pereira and Slaughter NBER WP 2002)
- **Information asymmetry** as justification for FDI incentives in capital-importing countries (Gordon and Bovenberg AER 1996)
 - It may make sense to subsidize the first flagship FDI project because it will attract other investors
 - Dissemination of information through **investment promotion agencies** (IPAs)
 - IPAs effective in attracting FDI to developed countries (Charlton and Davis 2006)
 - IPAs effective in attracting FDI to developing countries (Harding and Javorcik 2007)
- **Regional competition** in incentives diverts FDI flows (Harding and Javorcik 2007), so there is scope for regional cooperation

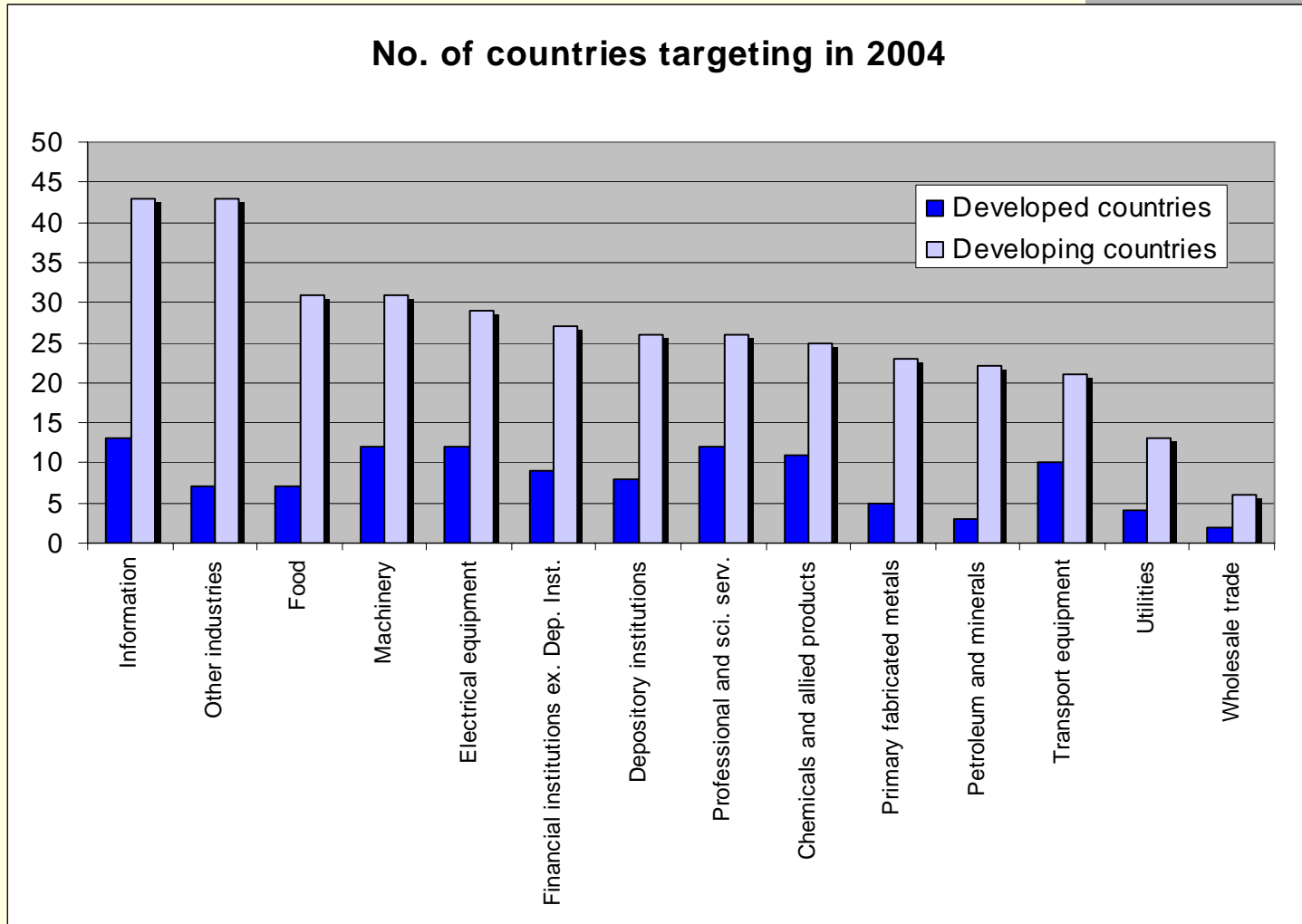
Almost all countries are engaged in FDI promotion



What do we tell policy makers?

- Ted's suggestion
 - “to direct investment promotion efforts toward FDI sectors that common sense suggests might be relatively externality-laden -- sectors that are **higher skill-intensive, higher value-added, promise more local R&D**, or have demonstrated records of extensive local procurement in other developing countries”
- But is a computer chip factory always better than a potato chip factory?

Not all countries think so



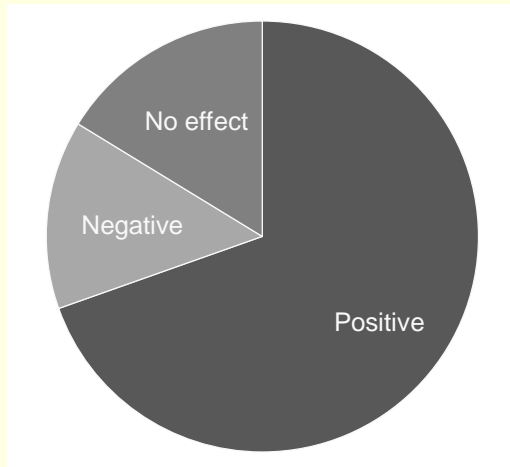
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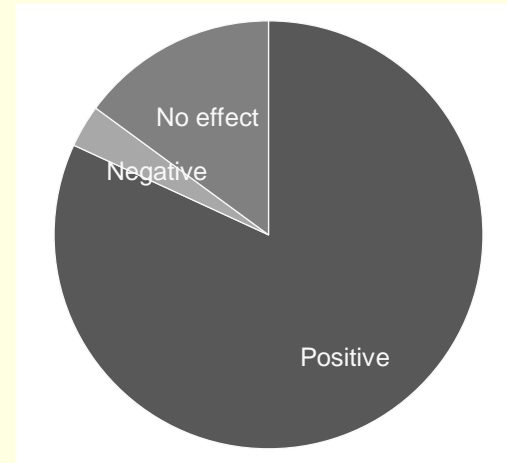
FDI inflows into services sector deserve more attention

- Allowing FDI into services sectors may affect the productivity of manufacturing firms relying on services inputs
 - Services are an important input for manufacturing firms
 - Limited scope for cross-border trade makes the state of country's services providers more important than the state of country's producers of physical inputs
- FDI inflows into banking => better/worse access to financing => access to financing is needed for local firms to benefit from FDI spillovers
 - Alfaro et al. (JIE 2004), Alfaro et al. (WP 2006)
 - Firms with better access to financing become MNC suppliers (Javorcik and Spatareanu 2006)
- Better services may facilitate exports

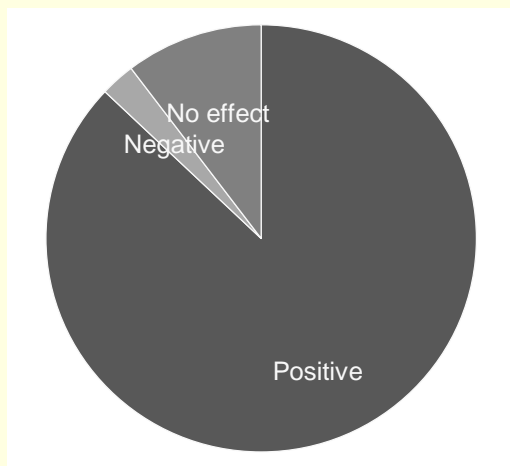
Perceived effects of opening Telecommunications sector to FDI



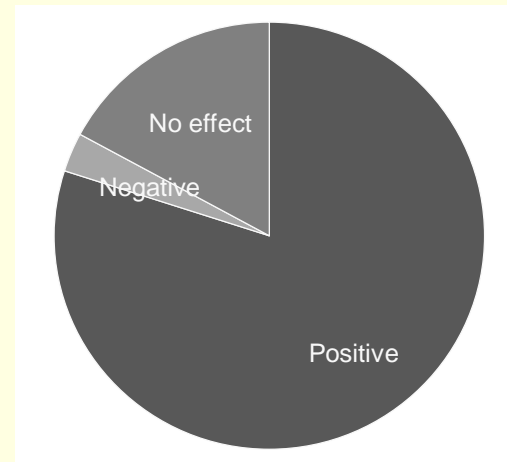
Prices



Quality

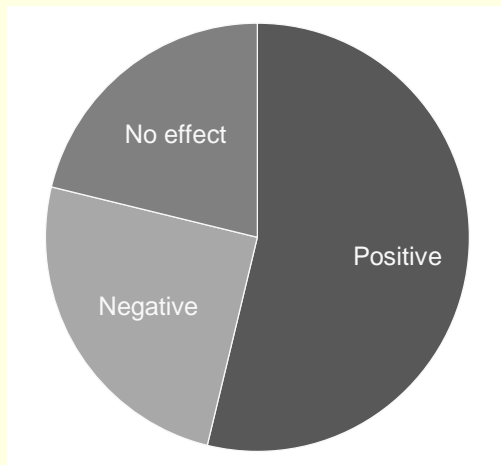


Range of Services offered

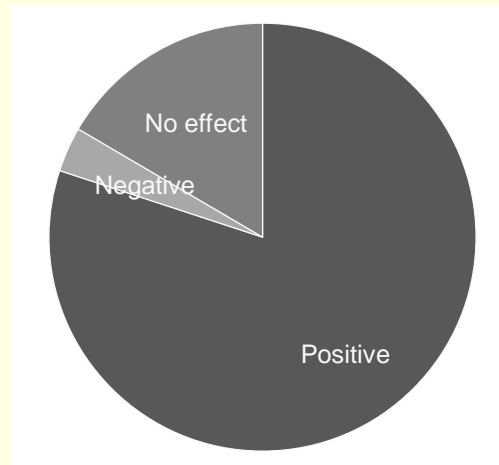


Availability

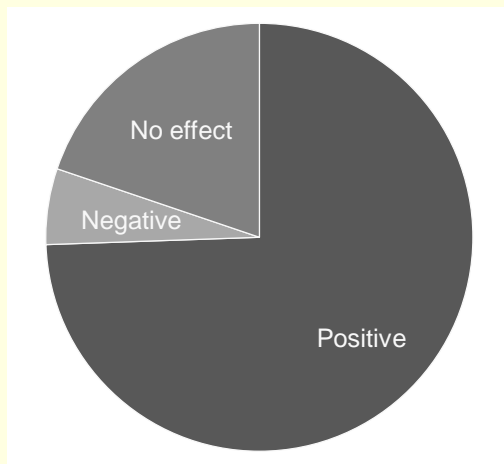
Perceived effects of privatization and foreign entry into Banking



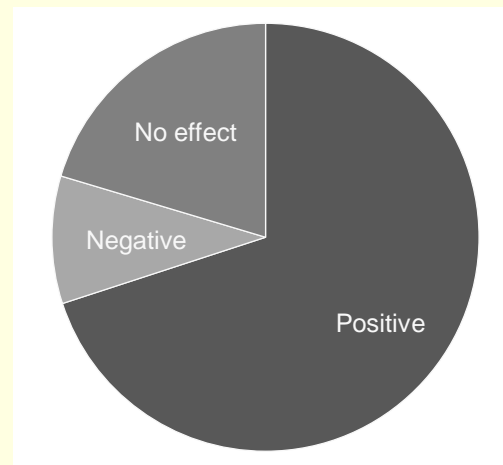
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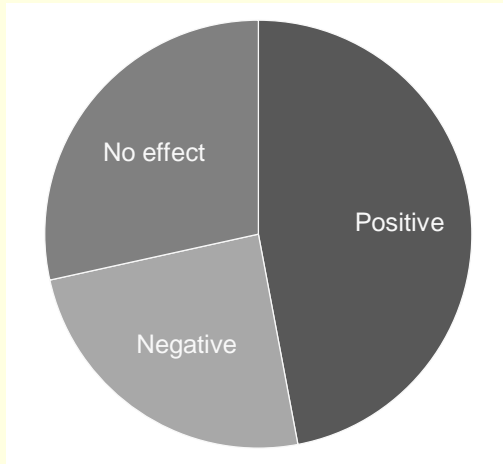


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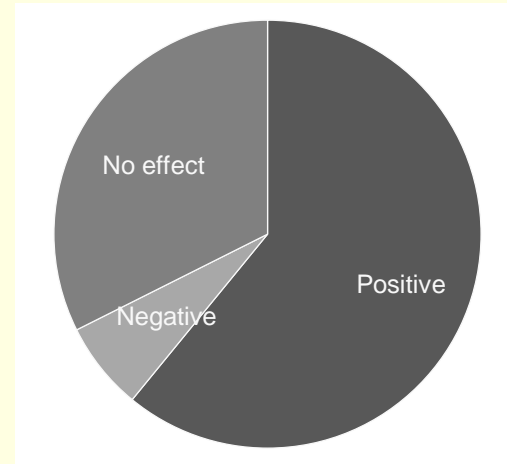


Availability

Perceived effects of opening Transport sector to foreign providers



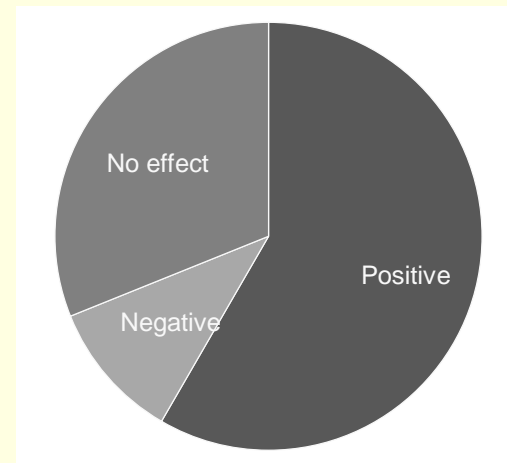
Prices



Quality



Range of Services offered



Availability

Services liberalization benefits manufacturing firms

- Arnold et al. (2007) find a positive relationship between services sector reform and the performance of Czech manufacturing firms relying on services inputs
- Allowing **foreign entry** appears to be the key channel
- A one-standard-deviation increase in FDI in each services sector => a 3.8% increase in the average productivity of Czech firms in downstream sectors

Bottom line

- Nice and useful contribution to the debate on host country effects of FDI inflows