Mike Pournarakis Ph. D.
Department of Economics
Athens University of Economics and Business

Inward FDI Activity in the European Union: Integrating or Disintegrating Effects ?

Inward FDI Activity in the European Union : Integrating or Disintegrating Effects ?

ABSTRACT

This paper looks into the effects of FDI activity on European integration As a starting point the importance of transnationals in the context of the globalization - regionalization - mix of the 1990s is discussed. Then the paper concentrates on inward FDIs in the European Union (EU). The discussion draws on the evidence of transnational activity in the EU by the members of the "Triad" (EU, Japan, USA). Given the current FDI policy of the EU, which does not accommodate adequately the regional disparities, the paper concludes that transnational activity in Western Europe could become a source of economic rivalry with disintegrating effects that hinder the objectives of the Maastricht agreement.

Inward FDI Activity in the European Union Integrating or Disintegrating Effects ?

In the last decade international production underwent dramatic changes both at the quantitative and the structural end The role of Foreign Direct Investment (FDI) in this context is becoming increasingly important FDIs experienced a spectacular growth in the second half of the 1980's. Although at a slower rate, FDI outflows continued to grow up to 1990 and despite the decline in 1991, the outward stock world-wide is approaching 2 trillion dollars

Structure-wise, changes in Foreign Direct Investment strategies have been in the center of new developments in international economic relations One such important change is the shifting of global pattern of FDIs from a bi-polar (US,EU) to a tri-polar situation with the three members of the "Triad" (U S, EU, Japan) being the protagonists in the flow of investment both internationally as well as among themselves The Triad accounts for about 75 percent of the world's outflows of FDIs while intra-Triad FDIs represent a very large percentage of the world total

Now, in the current trend towards the coexistence of regionalization and globalisation the FDIs are looked upon as the liaison between national, regional and international production structures The formation of large economic blocs through regionalization is in a cause and effect type of relationship with the happenings in the world of FDIs To be sure, economic economic integration has facilitated the building by Transnational Corporations (TNC) of regionally integrated networks of their affiliates On the other hand, in the case of production - based integration, of the type experienced by the European Community in the late 80's, corporate cross-border activity is expected to facilitate and expedite matters with market unification objectives This argument in the literature [e g U Nations, (1993, ST/CTC/144), The UN Library on Transnational Corporations, Vol 9 edited by P Dobson] is based on allocative efficiency improvements through intra-regional specialization and competitiveness across countries.

This paper looks into the question of possible interaction between corporate integration and regionalization for the case of European Union After reviewing the basic traits of FDI strategies by the "Triad" members, the paper examines the integrating effects of multinationals given the EU* policy on inward foreign investment

Inward Foreign Direct Investment in the European Union
by the Triad Members

The rates of growth of FDI flows into the EU region in the 1980's were particularly impressive. Athough with considerble time lag, US and Japanese transnational corporations, in response to the EC-92 program, sought to position themselves strategically in the EU In the following, we will look into some basic traits of the impressive inward FDI activity in the EC by the Triad Members.

U States Outward Investment in the EU In the case of the United States, its transnationals in the EU have had a strong presence for a long time and, compared with other non-EU transnationals, possess high local content levels. Also, unlike other industrial economies, the United States relies on investment-based exports to the EU

The already strong foreign investment position of the US in the EU explains in a way the relatively low rates of FDI flows in the late 80s and early 90's As expected, priority was placed

*Both EU and EC are used in the paper depending on the chronology referred to in the text.

on adjustments of direct investment to the new regional environment Following market unification and elimination of borders in regional trade, region-based affiliates are expected to continue to engage in large scale realignment of investment activity. Cross-border investment with mergers and acquisitions are expected to characterize corporate restructuring and investmetn in new ventures. [U.N. (1990), (1993)]

In the case of large size US transnationals, of key importance for their globalization strategies is the widely recognized fact, [e g Divinney and Hightower (1991)] that their EU-based affiliates enjoy a definite advantage at this point in that they are better positioned in the Single Market than their Japanese and even their European counterparts. The affiliates of the United States, are in a position to capitalize on their experience and take advantage of the opportunities presented by the market unification to shift their scope of competition from the national to the EU-wide level.

It would seem, therefore, that the United States FDIs in the EU, building on the already existing advantage of early rationalization, could view the EU as the most appropriate member of the Triad to implement their "globalization" strategies. Further regionalization and restructuring of their activities would make the EU (rather than the firm's country of origin) the relevant home base According to this definition of globalization our discussion above suggests that the advancement of the EC to Economic Union will motivate the transnationals of the Triad members to pursue similar operations. Of course, the "regional insiders" of the EC member countries are in an advantageous situation.

The EU Challenge to Japanese FDI's. Japan's importance as a source of FDI outflow has increased dramatically in the 80's with an impressive acceleration during 1985-90. During these years Japan became the single most important overseas investor. After peaking in 1990, Japanese investment outflows followed the general trend of decline in world FDI flows but retained the first position in the next two years

Within the Triad, the pace of Japan's FDI outflow to the EC was even faster When combined with a considerable slow down of Japanese investment in the US, it becomes evident that there is a shift of interest for certain fields of FDIs in favour of the European Community This surge of Japanese investment in the EC, as a recent phenomenon, pauses certain questions and concerns on the part of the other two members of the Triad Of course, the chronological coincidence of the EC-92 program and the dramatic increase in the Japanese FDI is in the middle of the "sensitivity" already exhibited by some EC countries and the occasional concerns voiced by US business.

No doubt, in the case of Japanese FDI inflow in the EU, the challenge is big considering that penetration of Japanese products to EC is primarily exports - based Japanese affiliates in the EU, up to very recently, supplied only 20 percent of their country's sales while the remaining 80 percent came from exports [United Nations (1990)] In recent years Japanese firms have exhibited a tendency to converge to the U S prototype with more investment-based exports to the EC (Encarnation, 1993)

The relevant question, is whether Japan, like the United States, has chosen the EC as the appropriate location to implement a long run globalization stradegy or the surge of investment is more of a temporary phenomenon triggered and sustained by the "Fortress Europe" syndrome Predicting the future position of Japanese FDI in the Triad is particularly difficult considering that the parameters involved are many and do not converge in a consistent manner to help base objectively sustainable reasoning As a result the opinions expressed so far in the literature differ widely

<u>The Intra-EU Foreign Direct Investment</u> The abrupt shift of EC from trade policy-led

to production-based integration via the EC-92 program in 1985 was attributed primarily to the fact that the early 1980's found Europe lagging behind in the technological race of the members of the Triad. The external economic threat in the middle of the information technology revolution put Europe's industries under pressure Europe was overdue to reap the benefits of a truly integrated market with a single regulatory structure in order to cope with the current realities of international economic life It was at that point that the motto "Europe for Europeans' gave rise to concerns by the non-EC countries for discriminatory policies that could lead to "Fortresse Europe".

In the years that followed it became evident that regional rather than national economic policies on trade and investment would dominate intra-EC economic activity An unprecedented level of intra-regional foreign direct investment in the second half of the 1980s led to the "regionalization" of EC - owned industry. Many EC transnational firms regionalized their activities in their effort to prepare themselves to move up from "national champions" to "EC-champions" Corporate strategies aimed at rationalizing operations on a regional scale with massive merger and acquisition activity In short, EC corporations have been going through a period of restructuring with intense cross-border activity following the EC-92 program.

FDIs and Distribution Effects of EU Integration

It makes sense to look into the effects of FDI inflow in the EU from the point of view of distribution of benefits among the member countries. The issue is very topical given the persistent divergencies among member states and the regional disparities in terms of per capita GDP. The slow tempo of convergence in the European periphery, especially Creece and Portugal, and the lack of balanced growth in the EU countries are couses of concern, especially in view of the Maastricht Treaty requirements and deadlines to be met.

Of course, the issue of the regional impact of FDI on the EU is based on the premise of the potential positive relation between inward investment and economic growth. If this is so then persistent imbalances in the geography of transnational activity in the EU could be detrimental to the convergence process.

In approaching the above questions let us start with the observation that capital flows in the EU are destined to play a role of crucial importance in pursuing convergence, a prerequisite for the attainement of the Maastricht targets [Panic (1993)] In terms of benefits to the host countries, the experience so far with the United Kingdom, the largest recipient of inward investment, shows significant gains (UK Department of Trade and Industry 1993)

The heavy concentration of transnational activity in England and the rest of the central core of the Community is in the center of the many concerns voiced by the periphery of the Union In the recent literature on the subject, these concerns point to the fact that corporate integration does not necessarity support regional integration in the absence of active and consistant policies on FDI flows in the EU. In fact, regional disparities may be accentuated in view of the anticipated large-scale restructuring and realignments of FDIs in the EU [e g. Young and Hood (1993)]. Following the unification of the EC market, massive adjustments in locational advantages are expected by the FDIs in the EU The cost of this FDI redistribution in terms of job losses, loss of high value added production and other components of economic growth, will be born primarily by the periphery.

Recent Trends in Inward Foreign Direct Investment in the EC by the Triad Members

As we saw earlier the massive inward foreign investment in the EC in the 1980's was positively influenced by the developments that led to the EC-92 program. It would seem that, on the basis of the available evidence so far, realigment and rationalization of FDIs rather that new, greenfield investment will be the priority in the 1990's. The statistics of recent investment activity by the Triad members in the EC in the early 90's support this thesis.

A U S Direct Investment in the EU

The overall slowdown of the growth rate in U.S foreign direct investment charactirizes also the US inward FDI in the EC for the year 1991. The U.S. International Trade Commission (USITC, 1993) attribuites this primarily to an expected "levelling off of the rush to gain presence in the EC before 1992 and the shifting of priorities by US investors due to NAFTA" Equally remarkable, however, is the fact that the category of investment referred to as "equity capital outflows" or "new" investment in the EC was very low in 1991, the lowest compared to U States FDIs in other parts of the world. It should be added here that large-scale restructuring of U S investment in the EC was already under way in 1988 and 1989 (UN. 1990). Consistent with the above are the persistent centripetal tendencies exhibited by the geography of US investment as shown in Table 1.

B. Japanese Transnationals in the EU

In the case of Japanese investment in the EU, Table 2 shows a similar adjustment pattern. Geography wise there is a tendency for a more balanced distribution among the more advanced countries but, with the exception of Spain, no centrifugal tendencies are exhibited.

Despite the slow down of 1991 and 1992, Japan continues to "externalize" its competitive advantage away from its secure national environment. Breaking away from their insistence in the past for greenfield foreign investment, Japanese firms engaged in a variety of strategic alliances, acquisitions and joint ventures. This type of investment activity was directed primarily to the new

Single Market in the context of implementing a policy of "Europeanization" of Japanese firms Dunning (1992) estimated that, in 1988-90, 40% of the value of new Japanese investment in the EC took place in the form of acquisitions and mergers

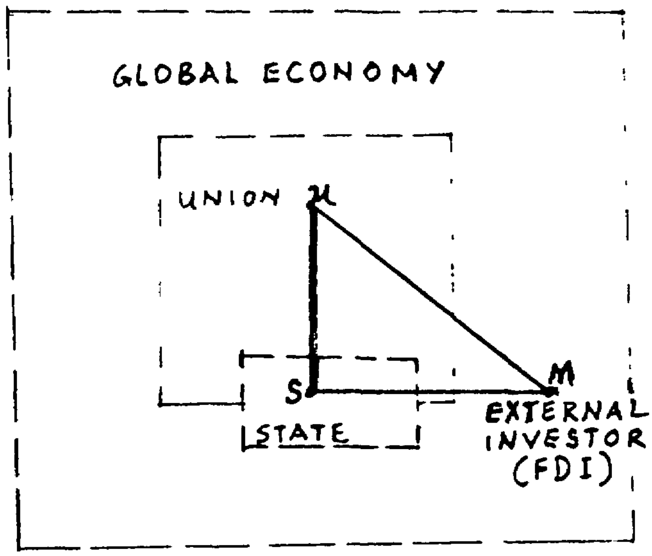
C Intra - EC Investment

Tables 3 and 4 cover inward and Intra-Community foreign investment by member States The data come from the latest available study by Eurostat on FDIs in Europe The tables show that FDI investment inside the EU borders exceeds EU inward investment Intra-Community direct investment underwent a spectacular increase between 1988-89 In terms of geography allocation, it is clear that, both, insiders and outsiders investing in the EC, exhibit preferences for closeness to the center

Table 5 shows a recent compilation of data by the EC Commission on mergers and acquisitions in the EC between 1986 and 1991 The data point to the boom of mergers and acquisitions since 1986 at the national, intra-EC and international level The increasing trend of "big" mergers and acquisitions levelled-off somewhat in 1990-91 It remains to be seen whether this is temporary, reflecting the general slowdown in the EC, or merger activity will return to more moderate levels Unofficial data for 1992 show a comeback of the flurry of the previous years (USITC, 1993) As expected, the big States France, Germany and U K are the portagonists in the EC merger activity while among the foreign buyers the United States and Japan were the most active countries Finally, as the chart shows, the international part of merger activity, as a percentage of total is in an increasing trend despite the slow down of 1990-91

The Need for a Comprehensive FDI Policy in the EU

Our discussion above suggests the need for a comprehensive FDI policy in the EU At the same time one can appreciate the complexity of the issue in the case of inward investment to the Union. As shown in the diagram below, the very nature of an integration scheme with a Single Market suggests potential conflict of interest from three sources : the State, the Union and the external investor.



To begin with, at the FDI - National Government level of interaction, the problem arises from the complete lack of a comprehensive regulatory framework on FDI activity in the global economy. Unlike the fields of international trade and finance, international investment activity does not have to obey any general principles of a comprehensive agreement. It makes sense that the lack of an institutional framework to facilitate the needs of the global economy can explain the usual tactics by foreign investors to circumvent economic policies of national governments. On the other hand, the current reality of international economic life suggests that proposals for such a comprehensive agreement [e.g. Kline (1993)] cannot materialize in the foreseable future.

Based on our discussion above, it goes without saying that a supranational FDI policy at the level of economic union, emerges as a <u>sinc qua no</u> prerequisite for successful integration Again, given the differences in the nature and magnitude of economic problems faced by the member states, potential conflict between national sovereignty and a supranational authority, in the perceived role of FDIs in economic development, is expected to arise. The presence of a supranational policy for inward investment in the EU could reduce the size and dimensions of the problem faced by the national states, members of the EU.

At the Union - FDI level of interaction (line UM in the dragram below) a union-wide FDI policy could act as a shock absorber in this triangular conflict. Active and consistent policies could address the important issues of market imperfections at the union level and provide the prototype for a global approach to the issue of foreign investment activity. Currently, the EU lacks such a consistent and well coordinated policy on FDIs. At best, and in its implicit form, such a policy could be viewed us an extention of the more general EC target to secure competitiveness and "equal treatment" of "insiders" and new comers under the proviso that "reciprocity" is observed by the outside world. In practice, however, due to the lack of an explicitely stated common policy on FDI inflow, individual states often resort to begger-thy-neighbor practices with frequent use of increased national subsides in order to recruit the type of multinationals that suit their developmental needs.

The EC statistics of inward new FDIs as well as of restructuring activity prove the existing EC policy inadequate and/or inoperative. For the case of the FDI restructuring, in the last years the existing policy regulations aim at implementing the Articles 85 and 86 of the Rome Treaty which promote competition and guard against "excessive" concentration. The EC-92 program created the need to widen the scope of these policy measures so that the issue of mergers and acquisitions could be accomodated in a way that market efficiency and rationalization of cross-border investment activity could materialize. The EC Regulation No 4064 of 1989 and the Major Control Regulation of 1990 reflect the spirit of the globalization process and emphasize market efficiency in the framework of strengthening competition policy

The inadequacy of EC foreign investment regional policy is more obvious and in part responsible for the uneven regional distribution of new inward investment and cross-border restructuring. Obviously the less developed areas in the Union have not been able to capitalize on the EC policy measures instituted to bring the periphery's competitive bidding for new FDIs up to parity and avoid present large scale dislocations

Conclusions

In the global economy of the 90's, transnationals are destined to play an increasingly important role The formation of large economic blocs raises the interesting question of the interaction between corporate integration and regionalization The two are in cause and effect type of relationship. Integration schemes which involve market unification of the member states are expected to lead to regionally integrated FDI activity. On the other hand, with an active and consistent policy of regional authorities, transnationals could facilitate the process of market unification

In the case of the European Union, its FDI policies are characterized by a relative atrophy compared to other policy areas. Due to insufficient focus and lack of consistency, regional FDI policy does not guard against unbalanced developments that can accentuate regional disparities The reduced competitive bidding for FDI attraction by the periphery of the EU is not offset by an accommodating regional policy of incentives. Furthermore, large-scale cross border restructuring entails dislocation costs due to the centripetal preferences of investors. As a result, widely divergent policies of the member states lead to frequent resort to beggar-thy-neighbor practices To the extent that these persistent asymmetries imply lack of concensus of central EU authorities on the primacy of regional over national FDI policies, one can see why, in the final analysis, foreign investment activity in EU could be the source of serious economic rivalry with disintegrating rather than integrating effects that hinder the objectives of the Maastricht agreement

Bibliography

Burgenmeier and Muchielli, Multinational Firms and European Intergration, London, Routledge, 1991

Divinney and W. Hightower, European Markets after 1992, Lexington Books, 1991

J Dunning and J. Cantwell, "Japanese Direct Investment in Europe" in Burgenmeier B ed, Multinational Firms and European Integration 1992 London, Routledge, 1991

------ Multinational Enterprises and the Gloabal Economy Workingham, England Addison wesley 1993

J Kline, "International Regulation of Transnational Business : Providing the Missing Leg of Global Investment Standards". Transnational Corporations, vol. 1, 153-164.

D. Encarnation, "A common Evolution ? A Comparison of United States and Japanese Transnational Coorporations" "Transnational Corporations, vol 2, Feb.1993, pp. 7-32.

M. Panic, National Management of the International Economy, London: Mcmillan, 1992.

U.K. Department of Trade and Industry· A Study into the Knock-on Effects of Inward Investment in English Regims, 1991.

United Nations, World Investment Report, 1991,1992.

United Nations, Regional Economic Integration and Transnational Corporations in the 1990s, Series A, No 15, July 1990.

------ From the Common Market to EC 92, ST/CTC/144 1993

------ World Investment Report, 1993, NY, 1993

US Department of Commerce, International Trade Administration, Europe Now, A Report, January 1993

US International Trade Commission, The Effects of Economic Integration within the European Community and The United States, Washington DC April, 1992 and follow up Reports 5th and 6th January, 1994.

S Young and N. Hood "Inward Investment Policy in the European Community" Transnational Corporations, vol 2 August 1993, pp. 35-60

TABLE 1

U.S. Direct Investment Position Abroad 1990 and 1991, European Community

(Million dollars)

Partner	1990	1991
United Kingdom	68,224	68,261
Germany	27,259	32,942
Netherlands	22,658	24,711
France	18,874	20,495
Italy	13,117	13,825
Belgium	9,050	8,838
Spain	7,704	7,712
Ireland	6,880	7,450
Denmark	1,597	1,835
Luxembourg	1,390	1,455
Portugal	598	893
Greece	288	291
Total, EC	177,642	188,710

Source : U S Department of Commerce, BEA Statistics, 1992

Table 2

Japanese Direct Investment in the European Union by Countries (millions of U.S $).

Fiscal Year			
Country	1990	1991	1992
U.K.	6.806	2.948	2.553
Netherlands	2.744	1.960	1.144
Luxemburg	1.242	1.115	1.371
Germany	224	266	68
Denemark	1.257	817	456
France	854	223	295
Spain	320	378	332
Belgium	367	222	281
Ireland	49	102	113
Italy	217	322	216
Portugal	68	10	12
Greece	4	1	-
Total	13.369	9.004	6.766

Source, Ministry of Finance, Japan.

TABLE 3

Intra-Community direct investment receiving countries

million ecu

year / receiving countries	1984	1985	1986	1987	1988	1989	Annual averages (%) 84-89	87-89	84-86
UEBL	-1051	-504	-959	-1182	-3816	-5330	14	15	12
DK	-8	6	-72	177	-136	-523	1	1	0
D	-632	-612	-595	-425	-1367	-4815	9	10	9
GR	-15	-107	-136	-102	-86	-254	1	1	1
E	-570	-592	-1164	-1519	-1889	-3406	10	10	11
F	-1216	-1233	-1435	-1349	-4424	-3864	15	14	18
IRL	-140	-281	-62	-160	-301	-1051	2	2	2
I	-971	-489	-1106	-770	-1278	-2355	8	6	12
NL	2802	-700	-2800	-1283	-3791	-4532	12	14	3
P	-82	-188	-114	-192	-313	-681	2	2	2
UK	-1899	-1614	-2829	-5237	-2566	-7555	24	23	29
not allocated	-271	81	-65	-321	-303	-977	2	2	1
total EUR 12	-4053	-6233	-11336	-12634	-20269	-35344	100	100	100

Source: EUROSTAT

TABLE 4

Extra-Community inward investment by Member States

million ecu

year	1984	1985	1986	1987	1988	1989	Annual averages (%) 84-89	87-89	84-86
UEBL	63	507	151	693	1282	1868	6	7	4
DK	48	159	157	150	422	640	2	2	2
D	115	295	246	215	-382	1437	3	2	3
GR	-27	134	207	87	64	90	1	0	2
E	1417	1327	1075	1338	1799	2127	12	9	20
F	1387	1677	1387	2056	1813	2101	14	11	23
IRL	-29	330	2	327	174	399	2	2	2
I	927	30	-456	1745	3063	291	7	9	3
NL	138	507	938	664	854	2586	8	7	8
P	135	123	48	97	212	365	1	1	2
UK	1995	623	3365	4846	6802	16035	45	49	31
total EUR 12	6169	5711	7119	12217	16102	27939	100	100	100

Source EUROSTAT

TABLE 5

Mergers and acquisitions in the EC, Involving the top 1,000 European firms by industries, fiscal years, 1987-91

Sector	1986-87	1987-88	1988-89	1989-90	1990-91
Manufacturing					
Food	52	51	76	102	71
Chemicals	71	85	107	148	100
Electrical and electronics	41	36	49	46	48
Machinery	31	38	55	52	25
Computers	2	3	4	2	7
Metal manufacturing	19	40	35	64	47
Vehicles	21	15	14	32	21
Wood, paper and furniture	25	34	61	79	49
Mining	9	12	19	19	13
Textiles and apparel	6	14	20	13	12
Construction	19	33	39	39	47
Other manufacturing	7	22	13	26	15
Distribution	49	57	58	52	38
Banking	35	78	83	113	75
Insurance	28	40	33	46	28
Total	415	558	666	596	596

Source: EC Commission XXIst Report on Competition Policy.