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A First Look at the Impact of FDI in Services

There is considerable evidence to suggest that trade reform in services—that is, more openness—has a positive influence on long-run growth performance (Mattoo, Rathindran, and Subramanian 2006; Hoekman and Francois 2009; Hufbauer, Schott, and Wong 2010, table 3.1). Research directed specifically at FDI in service industries, however, is only beginning to gain prominence. As suggested from the studies cited in this chapter, the size and importance of FDI in services signal that this is a priority area for next-generation research.

New Investigations

Pioneer researchers in this field, Javorcik and Li (2010), examine how the presence of global retail chains affects firms in supplying industries in Romania. They find that the expansion of global retail investors (Metro and REWE from Germany, Carrefour from France, and Cora from Belgium) leads to a significant increase in total factor productivity in supplier industries. Across all of Romania, the number of direct outlets rose from five in 1999 to 25 in 2001 and 86 in 2005, with total selling space growing tenfold over the period from 43,000 to 463,000 square meters. The presence of outlets in a given region increases the total factor productivity of supplier firms by 15.4 percent. A doubling of the number of chains leads to a 10.8 percent increase in total factor productivity. The impact is particularly pronounced among larger supplier firms (more than 25 employees), with a much smaller impact on small enterprises (fewer than five employees). Data from Javorcik and Li suggest that very small Romanian firms may not have the technology and financial support needed to meet the quality or quantity requirements set by the chains.

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The favorable results seen in the expanded penetration of foreign investors in the retail services industry of Romania are mirrored in the examination of foreign investment in banking, telecommunications, electric power, railway transport, road transport, and water distribution in the Czech Republic. Arnold, Javorcik, and Mattoo (2010) find that foreign-owned service providers in these sectors exhibit higher labor productivity than their domestic counterparts and have a higher propensity to invest. When foreigners acquire Czech service firms in these sectors, the new foreign-owned firms enjoy an increase in productivity and investment, and expand their market share.

Arnold, Javorcik, and Mattoo next investigate the relationship between the liberalization of service sectors and the productivity of domestic manufacturing firms. Their indices of "liberalization" include the extent to which foreign investors have entered the Czech service industries (the share of the industry's output produced by foreign-owned companies), the progress of privatization (the share of an industry's output produced by private companies), and the level of competition (the market share of the four largest providers). Controlling for other impacts on domestic firm productivity—including import tariffs—the authors find a strong independent correlation between service-sector reform and the productivity of local firms that rely on services as intermediate inputs. They conclude that opening service sectors to foreign providers is one of the key channels through which reform in services affects productivity in manufacturing.

Similarly, Arnold et al. (2010) show that reform in the service sector in India has been a relatively neglected factor during the post-1991 growth of the country's manufacturing sector. Conventional accounts focus on liberalization of trade in goods and the opening up of industrial licensing policies. Alongside these explanations, reform of services (banking, telecommunications, and transport) had independent significant positive effects on the productivity of domestic manufacturing firms, both foreign-owned and indigenous. A one standard deviation increase in the aggregate index of service liberalization resulted in a 6 percent productivity increase for indigenous firms and a 7.5 percent productivity increase for foreign affiliates (Arnold et al. 2010).

Clearly more research on FDI in services should be a high priority. As in other areas, econometric investigation can benefit from detailed case studies like the investigation of the impact of Wal-Mart in the Mexican retail sector, which is considered in the next chapter.

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