ANALYSIS

Perspectives on the Economic Effects of FDI and Investment Screening

2022

Summary

A Government Inquiry has proposed that in a future Swedish investment screening mechanism it will become mandatory for the Inspectorate of Strategic Products (ISP) to consult with the National Board of Trade. A key role for the Board will be to provide ISP with analysis regarding the degree of importance of the potential investment for the economy and the investment climate.

We note a gap in the literature in the sense that most of the economic analysis of foreign direct investment (FDI) focus on the economic effects of production-oriented activities. While the economic analysis is focused on economic effects of FDI, the security-oriented discourse tends to cover issues related to the ownership of infrastructure, hospitals and questions related to the ownership of technology.

It is well known that uncertainty impedes FDI, and unclear investment screening rules are no exception. To minimise uncertainty and the potential FDI dampening effects of an investment screening regulation, the range of affected sectors should be narrowly defined, accompanied by a swift and transparent review process that provides predictability to the transaction parties. Important is also that the process should guarantee confidentiality to the transaction parties.

Inward FDI in general and high-tech investments in particular benefit innovation, stimulate investment, promote skills upgrading, improve resource allocation, sharpen competition, create high-wage jobs and increase economic growth. In short, existing evidence suggests that R&D and technology-intensive investments may be especially beneficial to the host country. Tracing the economic effects of FDI are however challenging. The literature has shown that many of the positive effects of FDI are in the form of spillover effects that are difficult to measure directly.

Because of the national wide benefits of being destination of FDI, many countries use various measures to attract FDI. Reviewing the literature, we have found that many best practices that attract FDI include general policies rather than selective measures.

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1 The proposed future Swedish investment screening mechanism

A recent amendment to the Swedish Protective Security Act gives the state the opportunity to screen transfer of ownership of certain operations deemed to be of importance to Swedish national security.[1] However, this does not amount to a classic investment screening mechanism.

A government inquiry (Screening of foreign investments, SOU 2021:87[2]) was handed over to the Government Offices in November 2021.[3] The inquiry proposes that the Inspectorate of Strategic Products (ISP) will be the government agency responsible for the screening of inbound direct investments. The ISP is the national contact point requesting and sending information about foreign direct investments (FDIs) between the different EU Member States and the EU Commission, as required by the EU Investment Screening Regulation.[4] The inquiry proposes that the ISP will screen both transfer of stock above ten percent (brownfield investments) and also start-ups of new companies (greenfield investments).[5] It is the sector to which a company belongs that will determine whether the company will be screened, not the size of the company.

Already before this assignment, the ISP was an agency tasked with dealing with issues related to Swedish security and for this reason the inquiry deemed it most fit for the purpose. Against this background, it is very likely that Parliament will give the ISP the proposed role as the agency responsible for investment screening.

The inquiry presumes that the bulk of inbound investments will be considered non-problematic and, according to the proposal, in these cases the ISP will not conduct an in depth-investigation. Instead, applications will be automatically approved after a certain period. The period will start from the date the ISP receives an application.

In cases in which the ISP finds reason to look at specific applications in more detail, it will conduct an in-depth-investigation. According to the

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[1] Chapter 4, Paragraph 13–20, Protective Security Act (2018:545)
[2] Granskning av utländska investeringar, SOU 2021:87
[3] In the following we will assume that the Government/Parliament follows the suggestions of the inquiry.
[4] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.
[5] As opposed to mergers and acquisitions (brownfield), a greenfield is a type of FDI in which a parent company creates a subsidiary in a different country, building its operations from the ground up.

inquiry, when conducting an in-depth investigation, the ISP needs to consult the appropriate government agencies and, in some cases, also regional agencies. Which agency depends on the specific investment. However, it has also been proposed that it will be mandatory for the ISP to consult with four agencies, no matter what kind of investment is seeking approval.

The Swedish mandatory consultation authorities are the Secret Service (Säpo), the Swedish Defence Forces (in practise, MUST), the Swedish Civil Contingencies Agency (MSB) and finally, the odd bird, the National Board of Trade.

In the first instance, Swedish investment screening will not be conducted by the Government Offices such as is the practise in most other countries, but will instead be conducted by the government agency, the ISP, assisted by other agencies. The Swedish constitution generally prohibits the Government from influencing decisions taken by government agencies in individual cases. For this reason, when the ISP initially handles a case, the Government is not allowed to influence whether a specific investment should be allowed or not. However, a decision taken by the ISP, including a rejection/condition, may be appealed by the investor to the Government. This will supposedly make a (future) Swedish investment screening mechanism more transparent compared to countries in which decisions are taken directly by the Government. A major reason for the potentially increased transparency is that Swedish agencies need to submit their opinion in writing to the ISP.

So, what is the role of the National Board of Trade role in this? Bearing in mind that the three other obligatory consultation authorities are all security-oriented, we might expect that the National Board of Trade would be given a different role and indeed this is what the inquiry proposes:

According to SOU (2021:87), it has been proposed that “the National Board of Trade can offer analysis regarding the importance of an investment for the economy and the investment climate.”[6] Furthermore, it has been proposed that all applications should be sent to the mandatory consultation authorities and that these authorities will be given the opportunity to share information with the ISP on its own initiative. It is stated that:

[6] Author’s translation of ”Granskning av utländska investeringar”, SOU 2021:87. p 35

"*The assessment of the National Bord of Trade of the significance of an investment, from, among other things, an economic and political perspective, may be required as a basis for the review authority when balancing different legitimate interests*."[7]

With the National Board of Trade as part of a future investment screening mechanism, structural considerations that will complement security issues, covered by other agencies, when assessing whether to admit, reject or condition a foreign direct investment.

2 The need for an economic perspective

In many, if not most, countries, investment screening is conducted by the Government Offices. The investment screening process is in these cases often led by ministries such as the Ministry of Justice or the Ministry of Economy, or equivalent.

The EU Regulation 2019/452 on investment screening, which was adopted in March 2019 and has been in force since October 2020, states that if an investment poses a threat to state security or public order, it may either be forbidden or subject to conditions. If no such threat is identified, the investment will be allowed.

This starting point, focusing solely on security concerns, may lead to a situation in which little or emphasis is attached to the wide array of benefits associated with inward FDI. More precisely, in their respective deliberations, the ministries may not put an economic price on a situation in which a screened investment is stopped or subject to conditions.

A potential rationale to downplay the economic benefits of FDI is that the governments does not wish to give an investor argument as to why a negative decision should be revoked by either the courts or other governmental bodies, depending on who acts as the appellate body.

A diligent decision maker should ask how the home state may be affected by the stopping or conditioning of an investment. On the one hand, we may presume that there are situations in which the perceived security threat is of such a magnitude that other societal costs for stopping or conditioning the investment is irrelevant. On the other hand, we might also presume that there are situations in which the economic cost of stopping an investment is too high to revoke or condition an investment, when taking into account the (low) level of threat that a specific investment may pose.

[7] Author's translation of "Granskning av utländska investeringar", SOU 2021:87. p 456

So how do we identity and distinguish between such situations? To start with, the state needs to admit that such situations may occur and provide institutional rules accordingly. It could be argued that in states in which screening is conducted by the Ministry of Economy, economic arguments are probably more successful than in cases in which the Ministry of Justice or the Ministry of Defence are in charge.

The question that arises is how do you analyse the economic effects of a planned investment? This is not an easy task since it is inherently difficult to predict future effects, especially of greenfield investments. There is, however, a large body of literature that has investigated the economic effects of FDI. In addition, as the government inquiry for a Swedish screening mechanism proposes that only investments in certain sectors should be screened, we may at least work on the premise that only certain sectors need to be covered by a National Board of Trade analysis. Even with this limitation, screening will require the collection of a significant amount of information, especially since a screened sector may comprise multiple sub-sectors. To have an overview of the economic effects of FDIs, we need to know the volume of FDIs, the general effects of FDIs, the mechanism behind these effects and the empirical challenges. This will all be helpful as an initial guide.

Below we present an overview of the factors that a decision maker needs to take into account when assessing the potential effects of a future investment. The complexity of such tasks shows how difficult it is for a state to put a hypothetical economic value on an investment. This may, in turn, explain why this aspect is rarely mentioned in connection with investment screening.

3 FDI flows and localisation

Over the last 20 years, FDI has increased rapidly. Between 2000 and 2016 the share of the FDI stock in global GDP increased from 22 to 35 percent.[8] Following a decline during the financial crisis, mergers and acquisitions recovered, peaking at a record value of USD 1.2 trillion in the first quarter of 2018. During the first year of COVID-19, global foreign direct investment fell by one third to USD 1 trillion, which is well below the low point reached after the financial crisis. Greenfield investments in industry and new infrastructure investment projects in developing countries were particularly impacted but recent data from the OECD has

[8] Carill-Caccia and Pavlova (2018).

shown that there was a remarkable recovery in 2021,[9] when global FDI flows grew by 88 percent, reaching 37 percent above pre-pandemic levels. This growth was mainly driven by investments in OECD countries in which inward and outward FDIs reached their highest levels since 2005. In 2001, the top global destinations were the United States and China. The current war in Ukraine and distortions in global supply chains make the future economic outlook highly uncertain.[10]

3.1 Localisation theory

There are many theories that aim to explain why multinational enterprises invest abroad. Surveys of theoretical and empirical literature include but are not limited to: Blonigen (2005), Iršová and Havránek (2013), Donnelly (2014), Paul and Singh (2017) and Teixeira, Forte, and Assunção (2017).

An early FDI theory was proposed by MacDougall (1958), who built his analysis on a perfect competition model in which the driver of FDI was cross-country differences in the return to capital. Along similar lines, Kemp (1964) showed how capital moves from capital-abundant to capital-scarce countries. The equilibrium outcome is that the return to capital will equalise across countries. Since this time, new FDI models have evolved that look beyond cross-country differences in the price of capital to explain investment patterns. The new FDI theories take a firm-decision based approach, and we will briefly touch upon two of them.

Hymer (1960) developed an FDI model and stated that multinational enterprises (MNEs) must have some kind of "firm-specific" advantage. The idea is that domestic firms possess several home-market advantages in terms of knowledge of culture, language, legal system, etc. To compensate for this, Hymer (1960) stated that foreign firms must have some form of market power to compensate for these local factors. The Hymer (1960) hypothesis has gained support from many researchers (Lemfalussy 1961; Kindleberger 1969; Knickerbocker 1973; Caves 1974; Dunning 1974; Vaitsos 1976). However, one weakness with Hymer's model is that it fails to explain in which locations FDI takes place.

In the mid-1970s, a more general theory of the determinants of FDI was developed. Building on the assumption of imperfect competition and markets, in a series of papers, Dunning (1977, 1979 and 1988) and

[9] Unctad (2022).
[10] OECD, investment statistics.

Dunning and Lundan (2008) presented what has become known as the eclectic theory of FDI, or the OLI theory. Dunning defines three groups of determinants of FDI (O-L-I), in which "O" stands for ownership, "L" stands for location, and "I" stands for internalisation. Starting with O, Dunning states that to invest abroad a firm must possess an ownership advantage. The "O" is therefore closely related to the firm-specific advantage discussed by Hymer (1960). This ownership, or firm-specific advantages allow firms to overcome the costs of operating in a foreign country. Examples of firm-specific advantages include, but are not limited to, brand-name, marketing, and organisational practices. The "L" or location advantages proposed by Dunning focus on where MNEs choose to locate. Hence, the localisation part encapsulates a series of country-specific advantages to which a firm gain access when investing abroad (cheap labour, raw materials, etc). Finally, the "I" or internalisation advantages explain how and why firms choose to operate autonomously in a foreign country rather than outsource or license production to a firm outside the own corporation. The motivation here includes the risk of technological leakage and other firm-specific knowledge. Hence, there is a close link between internalisation, technology, Intellectual Property Rights (IPR) and the rule of law. Today, parts of the OLI paradigm have become integrated into the new economic geography (Fujita et al., 1999), the knowledge-capital model (Carr et al., 2001), etc. In addition to OLI, there are other factors that play a role in determining inward FDI. Table 1 follows Minakshee (2020) and presents four broad motives behind FDI.

Table 1. Motives for FDI

Motive	Description
Market-seeking FDI	Closeness to customers. - relates to horizontal FDI, tariff jumping.
Efficiency seeking FDI	Exploits the benefits of specialisation along the value chain, - relates to vertical FDI and fractionised value chains.
Asset-seeking FDI	Exploits technological advantages such as skilled labour, know-how and R&D. - associated with inward FDI in highly developed countries.
Resource-seeking FDI	Aims to exploit (natural) resources in host countries. - relates to resource-based comparative advantage.

Source: Minakshee (2020).

3.2 Localisation – the evidence

Using the theory of FDI as a background, this section aims to review the empirical evidence of host-country determinants of inward FDI. The review begins with Table 2 and survey-based findings. In the survey, firms and experts were asked about FDI and localisation. The respondents were asked to rank the determinants of FDI with. It should be noted that while foreign direct investors in certain cases may value a highly educated work force, other investors may prioritise access to cheap labour. Hence, for specific investments, the ranking of determinants can deviate from the average view.

Table 2. Determinants of inward FDI – survey evidence.

Rank	Variable	Note
1	Economic growth rate	Expected revenue
2	Market size	Scale
3	Expected profit	Expected revenue
4	Political and social stability	Uncertainty
5	Educational attainment of the labour force	Factor supply
6	Rule of law and IPR	Uncertainty
7	Infrastructure	Transportation costs
8	Local supply of goods and services	Factor supply
9	Wage level	Cost factor
10	Access to advanced technology	Technology
11	Financial market development	Other/mix
12	(Fear of) protective measures against import	Other/mix
13	Access to raw materials	Factor supply

Source: United Nations (2001), International Investment: Towards the Year 2001. Based on a survey targeting 311 firms and experts around the globe from June–October 1996.

The survey-based findings are followed by a review of the econometric evidence. While the survey ranks the determinants of FDI, the econometric evidence divides the variables into four categories:
(i) Macroeconomic variables
(ii) Industry attributes and infrastructure
(iii) Openness to trade and investment, and
(iv) Resources.
Each variable is then marked as “positive”, “negative” or “mixed”, depending on its statistical significance as a determinant of inward FDI.

Table 3. Determinants of inward FDI – econometric evidence

Variable	Relationship to FDI	Note
Macroeconomic variables		
Market size	Positive	Scale
Exchange rate	Mixed	Cost factor
Economic growth rate	Positive	Expected revenue
Per capita income	Mixed	Cost/level of development
Inflation rate	Negative	Uncertainty
Exchange rate stability	Positive	Uncertainty
Industry attributes and infrastructure		
Competitive conditions	Mixed	Other/mix
Productivity growth	Positive	Uncertainty
Socio-political stability	Positive	Uncertainty
Protection of property rights	Positive	Uncertainty
Government efficiency	Positive	Uncertainty
Physical infrastructure	Positive	Transportation/ information costs
Openness to trade and investment		
Investment protection	Negative	Uncertainty
Restrictions to foreign ownership	Negative	Obstacles
Investment promotion agencies	Positive	Obstacles
Subsidies	Mixed	Cost factor
Requirements	Mixed	Obstacles/uncertainty
Openness to trade (trade/GDP)	Positive	
Tariffs and other barriers to trade	Mixed	Obstacles
Resources		
R&D-intensity	Positive	Cost factor
Educational attainment	Positive	Factor supply
Total employment	Positive	Scale
Wage level	Negative	Cost factor
Unionisation	Mixed	Other/mix
Large, liquid stock markets	Positive	Other/mix
Interest rate	Negative	Cost factor

Note: “Mixed” means that the positive and negative results for the variable in question were roughly equal in number, and/or most of the results for the variable in question were not statistically significant.

Source: Globerman and Zitian (2010).

A comparison of the survey-based evidence and econometric evidence revels the following remarks to be made.

I. Economic growth and market size are important factors for attracting FDI. The size of the market is closely related to market-seeking FDI while vertical FDI, in which the production chain is split up, normally attaches more importance into factor prices and conditions for production.

II. There are several factors related to the degree of uncertainty. These include but are not limited to: The quality of institutions such as rule of law, IPR, and labour market conditions.

    Hence, since uncertainty is harmful to FDI it is plausible to assume that unclear rules about investment screening can be a deterrent to FDI.

III. It is notable that on average, wage level and per capita income rank relatively low. This can partially explain why subsidies fail to significantly impact the attractiveness of FDI. However, it would appear that investment promotion agencies can be effective instruments to encourage inward FDI, particularly if they focus on mitigating the administrative costs and delays that confront foreign investors.

4 Economic effects

For many countries, FDIs are a key component of their growth strategy. Accordingly, there are a range of policies designed to attract and stimulate inward FDI. Numerous papers have shown that FDI can support economic growth, enhance capital accumulation (Alfaro et al. 2004), boost productivity, both horizontally (within industries) (Haskel et al. 2007) and vertically, up and down supply chains (Javorcik 2004). FDI can also stimulate innovation (Bransletter 2006), increase competition (Mastromarco and Simar 2015) and promote new management practices (Bloom et al. 2012). In addition, we have employment generated by FDI.

4.1 Employment

As an indication of the importance of inward FDI for Swedish employment, it can be noted that in 2019, out of 5.1 million employees, 683,149 were hired by foreign-owned firms. Of these 683,149, 64 percent were hired by investors originating from the EU single market. Comparing the share of employment between investors from the EU single market and investors from third countries, we note that in the

manufacturing sector, 52 percent of workers were hired by firms that originated from the EU single market, while the corresponding employment share for the service sector was 68 percent (Table 4).[11]

The attractiveness of Sweden as a destination for FDI was further recognised in a survey conducted by Business Sweden (2021) in which Sweden ranked number 14 in terms of attractiveness for FDI, meaning Sweden is ranked as one of the world's most attractive destinations for FDI.[12] One explanation for this attractiveness is Sweden's membership. Of the EU. According to Bruno et. al (2020), because of single market integration, external inward FDI to the single market has increased by 60 percent and internal FDI across member state countries has increased by around 50 percent. Nevertheless, it would appear to be clear that the FDI-promoting effect of EU membership outperforms the impact of any other free trade agreement, including NAFTA, EFTA, and Mercosur.

Table 4. Inward and outward FDI, Sweden 2019.s

	Inward FDI		Outward FDI	
Sector	**# Employees in foreign-owned firms**	**Single market share[(a)] %**	**Division of outward FDI**	
Manufacturing	204,705	52%	Total employment abroad	1,421,879
Service	447,258	68%	Single market employment	699,567
Other	31,186	88%	Single market, employment share, %	49%

Source: Tillväxtanalys. Utländska företag - Tillväxtanalys (tillvaxtanalys.se)

[11] Looking at Swedish outward FDI, in 2019, Swedish owned multinational enterprises had 1.4 million workers hired abroad, of which 49 percent were located in the EU single market.
[12] Business Sweden (2021). [(a)] Share of total number of employees working in foreign-owned firms hired by firms originating in the single market.

4.2 Documented growth effects

As a brief overview of the recognised effects of inward FDI, Marchick and Slaughter (2008) give a brief survey of a series of evaluations of the economic effects of inward FDI. Below we present the survey findings by Marchick and Slaughter (2008) and some Swedish experience. These findings are quite representative of the body of literature of inward FDI in developed economies.

Sweden.
- Firm R&D increases after foreign acquisition.[13]
- Firm exports increase after foreign acquisition.[14]
- Firm employment increases after foreign acquisition.[15]
- Firm skill upgrading occurs after foreign acquisition.[16] [17]
- After an acquisition, skills upgrading is particularly strong in small and medium-sized non-MNEs that are active in the service sector.[18]
- Foreign acquisitions are associated with increased productivity, skills upgrading, increased average wages and reduced job security.[19]

Denmark. The relative performance of firms acquired by foreign parents improved after takeover.[20]
Finland. Foreign ownership raised the productivity of the acquired firms by an average of around 10 percent, and workers' wages by around 4 percent.
Indonesia. Large increases in average wages after foreign takeovers.[21]
Italy. Foreign acquisitions raised the labour productivity of the targeted firms, and these gains were not attributable to employment reductions.[22]
Norway. Foreign owners tended to reverse a negative trend in productivity and employment in the acquired plants, and employment increased.[23]
Portugal. Wages rose after foreign acquisition by 3–12 percent.[24]
United Kingdom. Acquired firms experienced increased employment.

[13] Bandick et al. (2014).
[14] Bandick et al. (2014).
[15] Bandick et al. (2014).
[16] Bandick et al. (2014).
[17] Bandick et al. (2014).
[18] Bandick et al. (2014).
[19] Bandick et al. (2014).
[20] Bandick et al. (2014).
[21] Bandick et al. (2014).
[22] Bandick et al. (2014).
[23] Balsvik (2006).
[24] Almeida (2003).

4.3 Spillovers and FDI

A signature feature of the economic effects of FDI is that they largely come in the form of technology spillover. *Spillover effects* refers to effects that are not included in the price mechanism, i.e., the actors involved in the investment contribute to an effect that goes beyond the private return of the investment and, in the presence of technology spillover, the market solution tends to underinvest in R&D activities. Technology spillover has also been shown to be localised, suggesting that the largest benefits of FDI occurs geographically close to the investment. The diffusion of FDI spillovers has been categorised to be transferred through five mechanisms:

(i) the demonstration effect
(ii) labour mobility
(iii) the competition effect
(iv) trade and
(v) backward and forward linkages.

The demonstration effect is arguably the most obvious spillover channel (Wang and Blomström, 1992). The idea is that utilising new technology can be both costly and risky for small domestic firms. If, however, a technology is used by a multinational firm, this will encourage domestic firms to adopt to the new technology.

Spillovers by *labour mobility.* The range of which labour mobility can act as a vehicle for the transmission of new technology is closely related to commuting distance (Fosfuri et al., 2001). The labour mobility argument can also negatively impact local firms in that multinational firms may attract the best workers (*brain drain*), thereby negatively affecting the competitiveness of local firms (Sinani and Meyer, 2004). Related to the brain drain argument and competition for skilled labour is the general impact on *competition* that results from inward FDI. The idea is that local firms with low productivity either exit the market or increase their efficiency as competition increases. This leads to overall increased productivity and overall higher wages (Markusen and Venables, 1999). This kind of change may not always be appreciated since the exit of firms is associated with a structural change that can be costly and painful for the individual workers and affected firms.

Several studies have established that multinational firms have a positive impact on the *export capacity* of domestic firms (Kokko et al., 2001). One channel behind this export spillover effect is the knowledge of

export procedures, the establishment of distribution networks, transport infrastructures, and even knowledge of consumer preferences in foreign markets that can be transferred from foreign to local firms (Greenaway et al., 2004).

One feature that has received increased attention is the impact of global value chains (GVC) and forward and backward linkages (Markusen and Venables, 1999). Multinational firms may directly benefit local suppliers through increased demand. Local suppliers can also benefit from technical support, labour training, help in creating different types of infrastructure, etc. (Lall, 1980). On the user side (forward linkages), local firms benefit from the supply of higher quality inputs from foreign investors. A behind-the-scenes feature of the GVC argument is that bilateral trade diminishes with distance. Hence, having an international high-quality supplier at arms' length distance is beneficial to spillovers (Markusen and Venables, 1999).[25]

4.4 Spillover effects and investment quality

It is well-known that the diffusion of technology does not occur automatically. Apart from being a source of knowledge from which to draw, the diffusion of technology requires the recipient to have the capacity to absorb the technology (Lapan and Bardhan, 1973; Wang and Blomström, 1992; Perez, 1997, Kinoshita, 2001). Thus, the size of the technology gap between the sender and receiver becomes relevant. One lesson learned is that domestic firms must not have too large a large technology gap vis-à-vis foreign investors. The results by Flôres et al. (2002) suggest that spillover effects are maximised when the average level of domestic productivity is between 50–80 percent of the corresponding productivity level of foreign firms.

The concept of "absorptive capacity" not only comprises the technological level of local firms but also other factors that enhance the transfer of knowledge, such as local infrastructure, communication and financial systems (Hermes and Lensink, 2003). Also, linkages between local suppliers and customers matter in terms of how much local markets benefit from inward FDI (Rodríguez-Clare, 1996). There is also a difference between greenfield investments and mergers and acquisitions. When FDI takes place through greenfield investment, the introduction of the new technology is instantaneous (Braconier et al., 2001). If, however,

[25] Efficiency-seeking and strategic asset-seeking motives predominate inward FDI to the EU (Kaloty 2006). The Single Market may stimulate FDI from both within and outside the EU.

FDI takes place through a merger or acquisition, the MNE, due to its prior integration into the local economy, is expected to establish wider cross-sectoral linkages with domestic firms (Scott-Kennel and Enderwick, 2001; Belderbos et al., 2001).

It is evident that a series of factors are involved in the diffusion of investment spillovers. Even though it is week known that spillovers exist, only a limited number of studies have analysed what determines the quality or the economic benefits of inward FDIs on the host county, i.e., what determines the magnitude of technology or productivity spillovers? Table 5 builds on Globerman and Zitian (2010) and summarises the empirical literature on the magnitude of spillovers.

Table 5. Factors that determine the degree to which FDI has positive spillover effects

Variable	Impact	Note
R&D	Strongly positive	Technology
Education and skills level	Weakly positive	Technology
Linkages to foreign firms	Mixed	Expected positive
Domestic competition	Mixed	Unrelated
Geographic density	Strongly positive	Agglomeration effects
Export orientation	Mixed	Market seeking vs. resource seeking
Openness	n.a	More studies needed
Regulation of foreign affiliates	n.a	More studies needed

Note: “Mixed” means that the positive and negative results for the variable in question were roughly equal in number, and/or most of the results for the variable in question were not statistically significant. “n.a.” indicates only a small number of studies reported results for the variable in question, meaning no reliable inferences about the variable could be drawn.

Source: Globerman and Zitian (2010).

Table 5 shows thar the strongest spillover effects occur in tandem with high-tech and R&D-intensive production. It is also noted that a dense environment promotes spillovers. Jointly, this suggests that technology-intensive investment in R&D clusters such as Silicon Valley in the USA and Kista in the Stockholm region creates a good environment for positive FDI spillovers.

4.5 Policy and the evaluation problem

When analysing the effects of FDI, it is motivated to consider the potential synergy effects, and the economic literature provides compelling evidence that know-how and technology are spread through FDI. However, recent studies have often concluded that the impact of FDI on the host country is weaker when the analysis is performed at the micro rather than the macro level (Gunby et al., 2017). The evidence gap between the micro and macro level has very different policy implications. If FDI promotes national development, as the macro view suggests, policies should aim to achieve openness and inflows of FDI. If, however, the operations of foreign investors have no impact on local firms, more neutral FDI policies might be appropriate.

There are several reasons why there may be differences between the macro and micro perspective. While spillover estimates using aggregated data aim to detect the effects of FDI on the regions or sectors being investigated, micro analyses examine the effects at the firm level. Since firm-level estimates are rarely weighted by firm size, and “average” and relatively small firms may have a minor impact on industry totals, estimate results may indicate insignificant spillovers, even if the largest and most important firms manage to learn from foreign investors.

Moreover, spillovers may originate in both horizontal and vertical relationships with foreign investors. Capturing vertical spillovers is challenging in micro-level studies, but less of a problem for macro studies in which the unit of analysis is a geographic region. These observations suggest that the evaluation of a specific investment project is challenging, one reason being that the benefit of a single investment is relatively insignificant compared to the total stock of FDI and therefore easily becomes obscured by other factors.

In brief, the specific effects and spillover channels from a single investment are difficult to capture.

5 FDI policy – days of future past

5.1 Classic FDI policy

To reap the benefits of FDI, it is common for governments to offer incentives to foreign firms to invest in their countries. The incentives can be regarded as incentives that attract FDI, and policies intended to maximise the economic benefit of an investment.

At the macro level, studies have identified several host-country characteristics associated with attracting foreign investors. The most frequently investigated determinants include market size, government policies affecting entry costs, cost of local production, wages, and the quality of infrastructure. Other measures that attract FDI are tax concessions, low interest loans, grants and subsidies (Blonigen, 2005, Blonigen and Piger, 2014).

In a survey study of the effectiveness of FDI policies, Globerman and Zitian (2010) note that many best practices attracting FDI include general policies. Hence, factors such as a well-functioning legal system, a well-educated workforce, well-functioning infrastructure (transportation and telecommunication), as well as policies that stimulate innovation are regarded as factors that promote inward FDI. However, Globerman and Zitian (2010) suggest that subsidies and tax breaks that specifically target foreign investors are not necessarily the best ways of attracting investment. According to Globerman and Zitian (2010), such policies could even reduce the productivity effects, particularly if the subsidies and tax breaks result in FDI that geographically disperses industrial and scientific capacity (mitigating market-driven agglomeration effects). Recent research has also investigated policy tools that leverage collaboration between firms, the evidence from policy induced collaboration incentives is however mixed.[26]

Reducing information uncertainty is beneficial for inward FDI. Thus, government agencies can be instrumental in informing foreign investors about locational advantages, administrative procedures, etc. In fact, in many countries, investment promotion agencies are now part of national and local government strategies to attract foreign investment.

[26] Crescenzi et al. (2019).

5.2 Recent trends in FDI policy

Despite the seemingly positive picture painted above, many governments are moving in a different direction. In recent years, several large countries have approved or are considering new laws that restrict certain types of FDI. Specifically, the range of sectors and technologies considered to fall within the scope of sensitive sectors in the context of the FDI EU regulation has become broader and is not limited to only include military and defence interests. National security now includes factors such as critical infrastructure, energy, communication assets, advanced technology, and data security.

Commonly used tools to restrict FDI include ownership limitations and performance requirements (Allen et al. 2022). Recent overviews of the FDI policy measures adopted can be found at the United Nations Annual Conference on Trade and Development (UNCTAD), the Global Trade Alert database, and WTO data on trade and trade policy measures.[27] For further information regarding recent trends, see also OECD, Investment policy developments in 62 economies between 16 October 2020 and 15 October 2021.[28]

The (increased) use of FDI screening has led to several deals being blocked or unwound. Examples from 2021 include the new Australian FDI regime and the UK National Security and Investment Act (CFIUS Annual Report to Congress CY2020).

One driver behind stricter FDI policies is the increased inflow of Chinese investments that has been accompanied by complaints of unfair competition, risk of dominant position and threats against national security. For example, all four deals blocked by CFIUS under the Trump administration involved Chinese acquirers. However, China is not the only driver behind the movement towards stricter FDI regulation. In the USA, 85 percent of the acquisitions reviewed by CFIUS in 2020 involved non-Chinese investors.[29]

At the same time as the EU, USA and other major economies have moved towards stricter FDI regulation, some Asian countries have opened parts of their economies to inward FDI. One example from

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[27] WTO Data – Information on trade and trade policy measures Global Trade Alert

[28] OECD, Investment policy developments in 62 economies between 16 October 2020 and 15 October 2021, Freedom of Investment Process, Paris, November 2021 and earlier OECD papers.

[29] CFIUS Annual Report to Congress CY2020. Table I-13, page 36 of the report: Covered Transactions by Acquirer Home Country or Geographic Economy 2018–2020.

January 2020 is the new Chinese foreign investment law. Other countries that have taken measures towards introducing a more FDI-friendly regime include India and Vietnam, who also recorded pre-pandemic record levels of inward FDI (Allen et al. 2022).[30]

Although not all countries are moving in the same direction, the trend regarding national security and FDI is clear. FDI restrictions are likely to increase. However, it is still too early to assess post-intervention estimates of how these new regulations will impact FDI flows.

In summary, it seems reasonable to assume that new FDI restrictions accompanied by an underlying uncertainty about the current and future framework that regulates FDI will have a dampening effect on FDI. Given the importance of FDI for economic growth, a protectionist drift in FDI policy could exacerbate disruptions to capital markets, leading to economically negative consequences for many countries. This therefore raises the urgent question of how to design more stringent FDI policies without causing excess harm?

6 Conclusions and recommendations

From this review it can be concluded that predicting the economic effects of inward FDI can be a daunting task. At the same time, existing evidence can provide some helpful guidelines.

The first thing to recognise is that in several studies, inward FDI has been associated with a series of host country effects, including skills upgrading, increased competition, increased productivity, higher wages and improved resource allocation. The existing evidence suggests that R&D and technology-intensive investments may be especially beneficial to a host country. It has also been recognised that for many countries, including Sweden, employment in foreign-owned firms represents a significant share of total employment.

Thus, a natural question is: what determines whether a destination is interesting for an investor? While some types of FDI require a highly educated labour force, other investments may prioritise access to cheap

[30] Some examples: Interventions have been taken involving digital maps for the automotive industry (*Navinfo/HERE Technologies* (2017)) and digital apps (*Beijing Kunlun Tech Co Ltd/Grindr LLC* (2019) and *Beijing ByteDance Tech Co Ltd/Tik Tok* (2020)). In France, the *Couche-Tard/Carrefour* transaction was prohibited on the grounds of food security.

labour, etc. Despite this heterogeneity, both survey-based evidence and econometric evidence suggest that uncertainty is detrimental to FDI.

Uncertainty comes in many flavours and can, for example, be related to unclear rules and regulations, weak rule of law and IPR, but also high inflation rates and uncertain labour market conditions adds to uncertainty.

As a corollary of the uncertainty paradigm, it becomes clear that if an investment screening mechanism involves additional uncertainty, it hampers inward FDI. Thus, a key challenge is balancing the economic effects of an investment screening mechanism against security concerns.

In accordance with Allen et al., (2022), we adhere to the four principles that can accommodate the need for sharper investment screening while also holding back the negative economic effects of restrictive regulations. The proposed principles are:

(1) Problems to target
The foreign investment review law should be narrowly tailored. Restrictions on foreign investments should be limited to the problems that the market itself cannot solve, such as anticompetitive impacts or threats to national security.

(2) Predictability
The investment screening process should provide predictability to transaction parties and facilitate reviews of the majority of transactions over a brief period of time.

(3) Trust
The investment screening process should guarantee confidentiality to the transaction parties.

(4) Limiting the number of affected sectors
Countries should avoid broad sector-based lists that require investment screening. If sector-based lists are used, such lists should be drawn as narrowly as possible and tailored to those transactions that are at the core of a government's national security interests.

Hence, the goal should be to create a clearly defined investment screening regulation, accompanied by a swift and transparent review process that provides predictability to the transaction parties, while also causing as little friction as possible for potential investors.

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Summary in Swedish

Sammanfattning på svenska

En statlig utredning har föreslagit att det ska bli obligatoriskt för Inspektionen för strategiska produkter (ISP) att samråda med Kommerskollegium inom ramen för en framtida svensk investeringsgranskningsmekanism. En viktig roll för kollegiet kommer att vara att förse ISP med analyser om den potentiella investeringens ekonomiska effekter på svensk ekonomi.

I denna rapport diskuteras ekonomiska effekter av utländska direktinvesteringar och kommerskollegiums roll i en framtida investeringsgranskningsmekanism. Ett grundläggande förhållande som noteras är att det finns ett gap mellan ekonomiska analyser av utländska investeringar och den diskurs som dominerat framväxten av investeringsgranskningsmekanismen. Gapet består i att de flesta ekonomiska analyser av utländska direktinvesteringar visar en rad positiva ekonomiska effekter av att erhålla utländska direktinvesteringar medan den säkerhetsorienterade diskursen omfattas av frågor som rör ägande av investeringar så som infrastruktur, sjukhus, samt ägande av teknik och överföring av immateriella tillgångar.

Även frågan om hur en investeringsgranskningsmekanism kan påverka inflödet av investeringar lyfts. Det är välkänt att osäkerhet i alla dess former bromsar investeringsviljan, och oklara regler för granskning av utländska investeringar är inget undantag. För att minimera osäkerheten som följer av en förordning om granskning av investeringar bör de sektorer som berörs vara snävt definierade och processen åtföljas av en snabb, väldefinierad, och förutsägbar granskningsprocess. Det är också viktigt att förfarandet garanterar konfidentialitet för transaktionsparterna.

Vad gäller de ekonomiska effekterna av utländska inkommande direktinvesteringar visar den vetenskapliga evidensen att utländska direktinvesteringar i allmänhet och högteknologiska investeringar i synnerhet gynnar innovation, främjar kompetenshöjning, förbättrar resursfördelningen, skärper konkurrensen, skapar höglönejobb och ökar den ekonomiska tillväxten. Dessa positiva effekter till trots är det svårt att spåra de ekonomiska effekterna av enskilda investeringar. En orsak till att det är svårt att uttala sig om enskilda investeringar är att många av de positiva effekterna har formen av positiva externaliteter, eller spridningseffekter, som inte är knutna till penningströmmar och därför är svåra att mäta direkt.

Att vara värdland för utländska direktinvesteringar är påvisat gynnsamt och en viktig drivkraft bakom ekonomisk och teknologisk tillväxt. På grund av fördelarna med att vara mottagare av utländska direktinvesteringar använder många länder sig av olika åtgärder för att locka till sig utländska investerare. Vid en genomgång av litteraturen har vi funnit att många av de bästa metoderna för att locka till sig utländska investeringar snarare omfattar allmänna strategier och ett gott ramverk än selektiva åtgärder.

Appendix

Examples of the definition of the expansion of sensitive sectors described by Allen et al., (2022).

- In 2019, the list of ‘sensitive sectors’ in France was expanded to include space operations and research and development (R&D) activities linked to sensitive technologies and activities (cybersecurity, artificial intelligence, additive manufacturing and semi-conductors).
- In 2021, Canada added the acquisition of businesses with access to sensitive personal data, sensitive technology or involvement in producing critical minerals to areas that could raise national security concerns.
- In May 2021, Germany announced a filing obligation that focused on acquisitions of high-technology enterprises, including companies developing automated or autonomous driving functions, specific nano-electronic components and certain smart meter gateways.
- In March 2020, Spain tightened its FDI regime, requiring acquirers who are not from the European Union or EFTA to obtain prior approval for an acquisition of a shareholding of 10 per cent or more, or a management right, in a Spanish company in a broad range of sectors, including critical infrastructure and technology, healthcare, communications, energy and transport, media, the supply of key inputs such as energy, raw materials and food security, as well as any other sector with access to sensitive information (particularly personal data.
- In January 2020, the United Kingdom introduced a new mandatory notification regime (entered into force on 4 January 2022) covering 17 specified sectors including energy, transport, communications, artificial intelligence, data infrastructure and other high-tech sectors.

The National Board of Trade Sweden is the government agency for international trade, the EU internal market and trade policy. Our mission is to facilitate free and open trade with transparent rules as well as free movement in the EU internal market.

Our goal is a well-functioning internal market, an external EU trade policy based on free trade and an open and strong multilateral trading system.

We provide the Swedish Government with analyses, reports and policy recommendations. We also participate in international meetings and negotiations.

The National Board of Trade, via SOLVIT, helps businesses and citizens encountering obstacles to free movement. We also host several networks with business organisations and authorities which aim to facilitate trade.

As an expert agency in trade policy issues, we also provide assistance to developing countries through trade-related development cooperation. One example is Open Trade Gate Sweden, a one-stop information centre assisting exporters from developing countries in their trade with Sweden and the EU.

Our analyses and reports aim to increase the knowledge on the importance of trade for the international economy and for the global sustainable development. Publications issued by the National Board of Trade only reflect the views of the Board.

The National Board of Trade Sweden, October 2022

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