

Non-Trade Provisions in Trade Agreements and FDI¹

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Motivation and Context

Preferential Trade Agreements (PTAs) have become long and complex:

- ▶ PTAs regulate cross-border issues related to investment, competition, services, technical and sanitary standards, IPR, etc.

More recently, PTAs have increasingly featured provisions on **non-trade related issues** (Lechner, 2016, 2018; Raess and Sari, 2018; Carrère et al., 2021) such as:

- ▶ Civil and Political Rights (CPR)
- ▶ Economic and Social Rights (ESR)
- ▶ Environmental Protection (EP)

For example, the EU has included human rights provisions as *essential elements* in all its trade agreements since 1995:

- ▶ A violation of human rights provisions could lead to the suspension or termination of the PTA (also in the recent EU-UK TCA)

This paper

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The impact of NTIs on FDI could be:

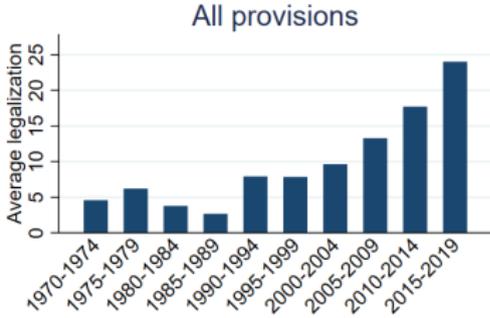
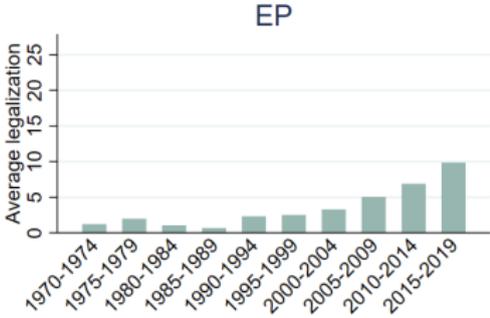
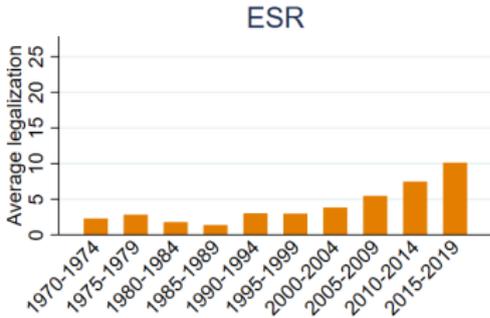
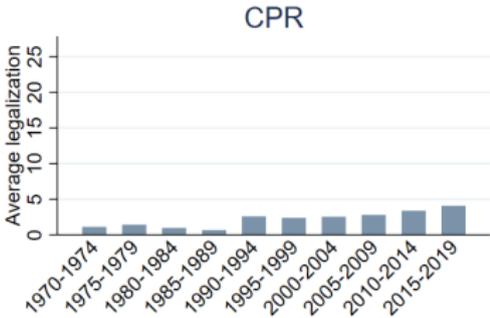
- ▶ **negative:**
 - ▶ FDI can be stimulated by asymmetries in domestic regulations, as investors seek destinations with lower standards than at home
 - ▶ stronger international commitments on labour and environmental protection, which reduce asymmetries and **increase operation costs**, can hinder multinational enterprises entry.
- ▶ **positive:**
 - ▶ progress on NTIs may reflect progress on governance and strength of institutions, hence a **safer business environment**
 - ▶ Lower uncertainty in regulatory framework
- ▶ **nil:** if ineffective, or if NTIs have the function to prevent the worsening of certain minimum standards

Data

- ▶ **FDI:** Financial Times *fDi Markets* database:
 - ▶ Count of all greenfield investments.
 - ▶ Value of investments is mostly imputed - not useful
 - ▶ 172 destinations, 147 sources; 2003-2017 period
- ▶ **NTIs in PTAs:** Lechner's (2016) data:
 - ▶ Legalization score in 3 areas: Civil and Political rights (CPR); Economic and Social rights (ESR); Environmental Protection (EP)
 - ▶ Legalization score is defined across 3 dimensions:
 - ▶ Obligation: extent to which parties are legally bound (e.g. is a clause in main text).
 - ▶ Delegation: degree of authority of third parties (e.g. are experts or int. org. consulted)
 - ▶ Precision: unambiguity of rules (e.g. reference to int. treaty)
- ▶ **Preferential Trade Agreements:** DESTA (Dür et al., 2014)
- ▶ **Bilateral Investment Treaties:** UNCTAD (2019)

Descriptives -1

Evolution of Non-trade Issues, by type



Descriptives -2 FDI



Methodology

We exploit the PPML estimator of Correia, Guimarães, Zylkin (2019):

- ▶ Large fraction of zeros (approx. 50% of estimation sample)
- ▶ Small countries might exacerbate heteroscedasticity issues
- ▶ Count of greenfield bilateral FDI on LHS

$$FDI_{i,j,t} = \exp(\beta \ln NTI_{i,j,t} + \gamma' z_{i,j,t} + \mu_{i,t} + \delta_{j,t} + \lambda_{i,j}) + \varepsilon_{i,j,t}$$

where $NTI_{i,j,t}$ is the (log) of NTI legalization in a PTA between i and j

$z_{i,j,t}$ is a set of pair-wise time-varying policy variables:

- ▶ PTA Depth - Desta index; Bilateral investment treaty; investment chapter in PTA; EU pair.
- ▶ Proxy for internal investment flows
- ▶ Yearly FDI data (2- and 3-year FDI averages for robustness)
- ▶ Two-year lags of policy variables (1-y and 3-y lags for rob)
- ▶ Conservative 2-way clustering (separately at origin and destination level) of standard errors

RESULTS

Main results

Table: NTI and FDI

	(1)	(2)	(3)	(4)
	Yearly FDI flows			
	All FDI		Manufacturing	
Ln(ESR)t-2	-0.096***		-0.133**	
Ln(ESR)t-2 * NN		-0.052		-0.161*
Ln(ESR)t-2 * SS		-0.241***		-0.152*
Ln(ESR)t-2 * SN		0.040		0.037
Ln(ESR)t-2 * NS		-0.095*		-0.092
Ln(EP)t-2	-0.063*		-0.068	
Ln(EP)t-2 * NN		-0.015		-0.039
Ln(EP)t-2 * SS		-0.267***		-0.216*
Ln(EP)t-2 * SN		0.141*		0.261
Ln(EP)t-2 * NS		-0.052		0.003
Ln(CPR)t-2	-0.144***		-0.185***	
Ln(CPR)t-2 * NN		-0.155***		-0.275**
Ln(CPR)t-2 * SS		-0.242***		-0.219**
Ln(CPR)t-2 * SN		0.194**		0.162
Ln(CPR)t-2 * NS		-0.174***		-0.148*
<i>N</i>	27684	27684	13775	13775
Destination-year FE	Yes	Yes	Yes	Yes
Origin-year FE	Yes	Yes	Yes	Yes
Destination-Origin FE	Yes	Yes	Yes	Yes

Note: Results are robust to exploiting 2- and 3-year FDI averages, contemporaneous and three-year lagged policy variables. Two-way clustered standard errors (at origin and destination level) in parentheses; * p < 0.1, ** p < 0.05, *** p < 0.01

Difference in overall NTI commitment

We explore whether effects vary by countries' *overall commitment* on NTI.

- ▶ We aggregate NTIs legalization across all PTAs with third parties - “stock of NTIs”
- ▶ We take the difference between destination and the origin “stock of NTIs”
- ▶ Explore effect by quartiles of the difference in “stock of NTIs” distribution.

	All	Manuf.
Ln(ESR)t-2 * Diff.Oth.Q1	-0.113***	-0.157**
Ln(ESR)t-2 * Diff.Oth.Q2	-0.029	-0.059
Ln(ESR)t-2 * Diff.Oth.Q3	-0.014	-0.076
Ln(ESR)t-2 * Diff.Oth.Q4	-0.008	-0.021
Ln(EP)t-2 * Diff.Oth.Q1	-0.094**	-0.096'
Ln(EP)t-2 * Diff.Oth.Q2	-0.008	0.018
Ln(EP)t-2 * Diff.Oth.Q3	0.004	-0.051
Ln(EP)t-2 * Diff.Oth.Q4	-0.024	-0.079
Ln(CPR)t-2 * Diff.Oth.Q1	-0.165***	-0.193**
Ln(CPR)t-2 * Diff.Oth.Q2	-0.110***	-0.154
Ln(CPR)t-2 * Diff.Oth.Q3	-0.039	-0.154
Ln(CPR)t-2 * Diff.Oth.Q4	-0.067	-0.147
<i>N</i>	27684	13775

Note: Country-pair controls and three-way FEs included in all models. Results are robust to exploiting yearly FDI data, 3-year FDI averages, contemporaneous and two-year lagged policy variables. Two-way clustered standard errors (at origin and destination level) in parentheses; ' $p < 0.15$ * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Discussion and conclusion

- ▶ A higher *NTI legalization* in PTAs is associated with a lower number of inward FDI.
- ▶ This effect is found across all types of NTIs (ESR, EP, and CPR) and is robust to exploiting various data aggregations and model permutations.
- ▶ The negative effects appears to be driven by:
 - ▶ FDI directed *South*, and *South-South* investment in particular.
- ▶ ESR and EP provisions might be deterring FDI to countries with laxer regulation, and therefore “harm” their comparative advantage.
 - ▶ particularly for FDI from stricter- to laxer-regulation countries.
- ▶ For CPR provisions, the negative impact could be due to MNEs preference for lower levels of democracy and civil liberties, once property rights are protected.

Discussion and conclusion

Cost-reducing investments can be stimulated by regulation asymmetries:

- ▶ countries may competitively undercut each other's standards to attract foreign capital, in a *race to the bottom*.

In a *North-South* scenario, countries could push towards alignment of standards and regulations:

- ▶ NTIs in PTAs might help to “close the regulatory gap”.

Non trade provisions seem to be more than a mere decoration of trade agreements:

- ▶ **IF** effective at achieving their stated objective, there is a relevant trade-off to be considered:
- ▶ NTIs are likely to translate into regulation that can deter FDI to developing countries.

Thank you.

Methodology

We exploit a partial-equilibrium gravity model to estimate the impact of NTIs in PTAs on the **flow** of bilateral FDI.

We estimate a model in the spirit of a structural gravity model for trade, as we account for:

- ▶ the main FDI push and pull factors, directly/indirectly linked to GDP
- ▶ bilateral FDI frictions:
 - ▶ absolute frictions: e.g. legal and statutory barriers; other access related policy measures.
 - ▶ relative frictions: e.g. distance; infrastructure; other economic or fiscal factors.
 - ▶ NTIs could increase or decrease both types of frictions.

Methodology

Regressions of FDI on trade agreements can suffer from many forms of endogeneity. Our strategy:

- ▶ Use country-pair fixed effects and country-pair time-varying controls
 - ▶ all time invariant bilateral costs, plus time-varying factors.
- ▶ Country-year fixed effects capture:
 - ▶ time-varying country features (business cycle, labour market policies, etc)
 - ▶ multilateral resistance: decision to invest in one destination is not independent of other destinations (relative attractiveness of alternative countries)
- ▶ Restrict sample to countries in PTAs (*a' la* Carrere, Olarreaga and Raess, 2017)
 - ▶ as we cannot separate vertical and horizontal FDI, we prefer to avoid investigating the PTA-FDI relation, which could be of either sign
 - ▶ we limit the control group to countries in PTAs

Methodology

We include in our model intra-national flows:

- ▶ Control for national non-discriminatory policies (Heid et al., 2020)
- ▶ Provides theoretically consistent estimates of bilateral policies, and accounts for both foreign and domestic distances (Yotov et al., 2016)
- ▶ We proxy intra-national flows with the total number of inward FDI in a year.

FDI do not respond immediately to trade policy changes. With panel data, some authors (Trefler 2004, Olivero and Yotov 2012) advocate the use of data over intervals.

- ▶ we use various lags the policy variables

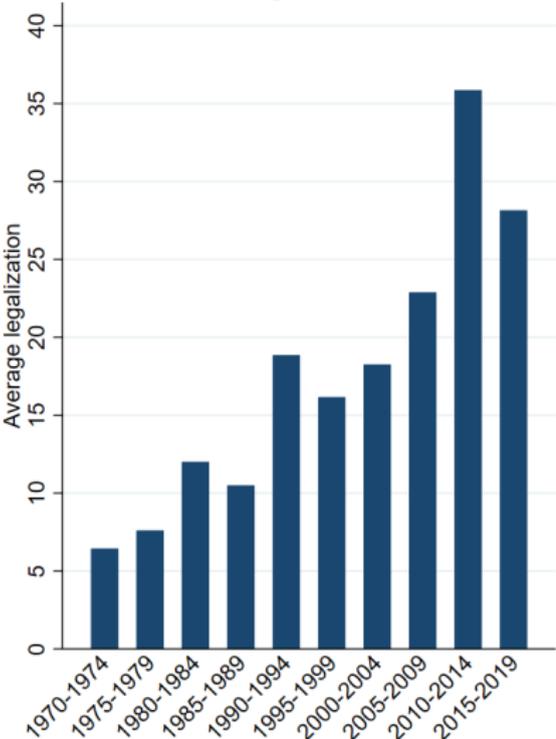
FDI can be quite volatile over time:

- ▶ We average data over 2 year intervals (yearly data and 3-year intervals for robustness)

Descriptives -2

Evolution of Non-trade Issues

EU agreements



Non-EU agreements

