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Integration and Welfare with Horizontal Multinationals

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OBJECTIVES OF RESEARCH

Our main objective is to analyze the link between liberalization policies and individual welfare in presence of foreign direct investments (horizontal multinationals) and asymmetries in the national shares of capital holdings. More precisely we analyse how, in presence of capital mobility and multiplant firms, an increase in the degree of trade integration affect welfare at the national and aggregate level and, also, welfare inequality. We also identify the role of asymmetries in the share of capital holdings at the country level in shaping the previous relationship.

SCIENTIFIC/RESEARCH METHODS

Our objective is pursued by means of a theoretical model of international trade. More precisely, we build a variant of the so-called footloose capital model with two countries, two sectors and two production factors (labor and capital).

POLICY VALUE-ADDED

We believe our results to have significant policy implications. We find that liberalization policies may have negative effects on welfare when horizontal foreign direct investments are taken into account. The sign of this effect crucially depends, among all the parameters, on the degree of markets integration and on the share of world capital owned by each country. More precisely, it can be shown that integration is good for welfare only if the country is rich enough (i.e. it owns a sufficiently high share of worldwide capital holdings) while, by contrast, liberalization policies always reduce the welfare of a sufficiently poor country (i.e. owning a sufficiently low share of worldwide capital holdings). Moreover, we find that prointegration policies always increase welfare inequality between rich and poor countries.

These conclusions may be useful to provide some policy insights concerning debate on the economic and social interactions between the EU and its neighbouring countries (NCs), which has recently attracted the attention of EU policy-makers as witnessed by the European Neighbourhood Policy (ENP). According to this set of policy action plans, "through its European Neighbourhood Policy (ENP), the EU works with its southern and eastern neighbours to achieve the closest possible political association and the greatest possible degree of economic integration". Our model, however, predicts that, when multinational firms are taken into account, achieving the "greatest possible degree of economic integration" may not be a welfare-improving policy objective. More precisely, if we consider the EU countries as the set of "rich" countries and the NCs as the set of "poor" countries, our model suggests that any liberalization policy will unambiguously increase welfare inequality between EU and NC and might, for some degree of economic integration, actually reduce the prosperity of NCs. For these reasons, we think that our conclusions and the economic mechanism that leads to it should not be ignored by EU policy makers and that any ENP policy would be better designed if the economic mechanism highlighted by our model would be taken into account. As a matter of fact, if the mechanism we highlighted is strong enough in actual economies, then policy makers should be aware of the fact that one of main aims of the ENP ("achieving the greatest degree of economic integration") might be incompatible with economic and social cohesion between EU and Neighbouring countries.