DEEP FINANCIAL INTEGRATION AND VOLATILITY

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Abstract
We investigate the relationship between foreign direct ownership of firms and firm- and region-level output volatility using a novel panel data set for European countries. We document a positive, highly robust, relationship between firm-level foreign ownership and volatility of value added. This relationship holds cross-sectionally and in panels with firm fixed effects where the relationship captures within firm variation over time. Considering domestic firms with assets in foreign countries, we document that it is international diversification, rather than the nationality of the owner, that explains this positive correlation. Our results can also be found at the aggregate-level, where we show that region-level volatility is correlated positively with foreign investment in the region. We show that this positive relation between aggregate volatility and foreign investment can be explained by the the granularity of the firm size distribution and the fact that foreign ownership is concentrated among the largest firms. (JEL: E32, F15, F36, O16)