

Econ 340

Lecture 11 Multinationals and International Capital Movements

Outline: Multinationals and International Capital Movements

- Terminology
 - FDI, DFI, MNEs, MNCs
 - Real Versus Financial Capital
- History
- Purposes Served by FDI
 - Local Market versus Export
 - Reasons for FDI
- Who Gains and Who Loses?
 - Effects that are Similar to Trade
 - Effects that are Similar to Migration
 - Other Effects

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Terminology

- International Capital Movement
(or “Capital Flow”)
= Acquisition of assets in another country
 - Takes two forms
 - Real
 - Physical assets, land
 - Ownership of companies (stocks: 10% or more)
 - Financial
 - Bonds, loans, bank deposits, currency
 - Stocks if less than 10% ownership

} FDI

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Terminology

- FDI = Foreign Direct Investment
= DFI = Direct Foreign Investment
= Acquisition of real assets abroad
Results in a firm owning assets in more than one country:
- MNC = Multinational Corporation
= MNE = Multinational Enterprise
= TNC = Transnational Corporation
= Firm that operates (and usually owns assets) in more than one country

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Terminology

- FDI does not necessarily involve a net capital flow
 - Reason: acquisition of assets abroad can also be financed locally
- Thus
 - Net capital flows...
 - Are due to unequal savings and investment
 - FDI and MNCs...
 - Are due to business opportunities
 - Both may sometimes also be due to incentives of taxation (see *Economist* on “Company Headquarters”)

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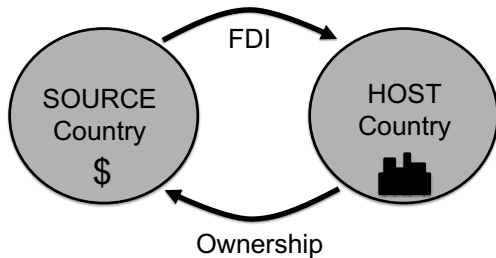
Terminology

- When FDI happens from Country A into Country B,
(That is, when a firm based in Country A acquires assets, perhaps a subsidiary, in Country B)
 - “Source Country” = Country A
 - “Host Country” = Country B

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Terminology



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History

- FDI was very important in US industrialization
 - E.g., British firms built the railroads in the 19th century
 - Not just in U.S. Also in South America
- In 20th century, until the 1980s, FDI was small, and resisted by both source and host countries
 - Governments restricted capital movements and exchange of currencies
 - Developing countries equated FDI with colonialism and imperialism
 - Countries blamed MNCs for interfering in domestic political and military matters

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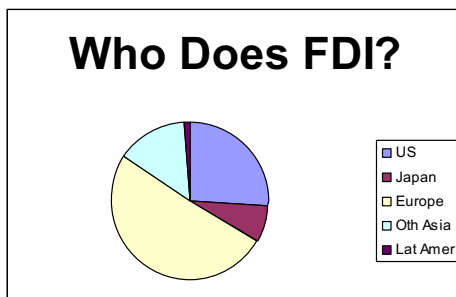
History

- Starting in 1980s, attitudes began to change
 - Developing countries saw FDI as helping them grow
 - Host countries saw FDI as providing employment
 - Started using policies to attract FDI
 - IMF and World Bank encouraged reforms that would be friendly to FDI
 - US and other countries negotiated Bilateral Investment Treaties (BITs)
 - Wikipedia says there are now more than 2500 BITs in force

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Who Does FDI?

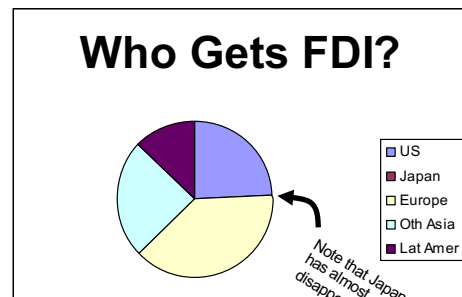


- Source: Lipsey 2000 (Data for 1996)

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Who Gets FDI?



- Source: Lipsey 2000 (Data for 1996)

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History

Sources and Destinations of FDI,
1996, \$ billions

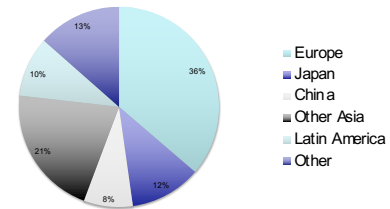
	US	Japan	Europe	Other Asia	Latin Amer
Source	87.8	23.4	172.1	48.0	3.8
Host	77.0	0.2	120.1	78.0	40.1

- Source: Lipsey 2000 (Data for 1996)

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Who Were Sources of FDI in 2012?

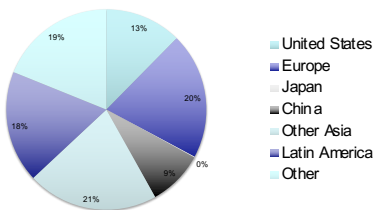


- Source: UNCTAD World Investment Report 2013

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Who Were Hosts of FDI in 2012?

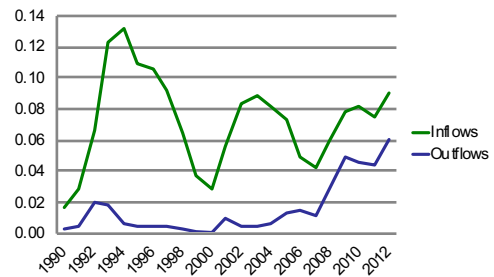


- Source: UNCTAD World Investment Report 2013

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China's Shares of World FDI



- Source: UNCTAD World Investment Report 2013

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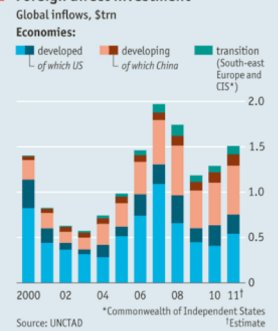
Chinese Investment by State, 2000 - 2016



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Foreign direct investment

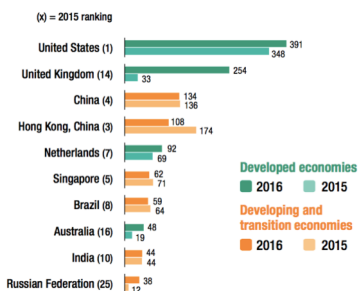


- Source: *Economist*, Jan 28, 2012

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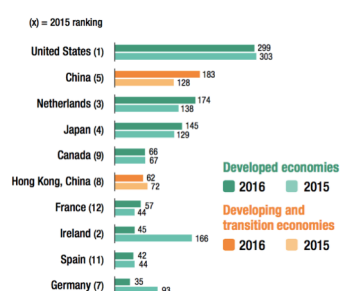
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Figure I.11. FDI inflows, top 20 host economies, 2015 and 2016 (Billions of dollars)



Source: UNCTAD (2017)

Figure I.14. FDI outflows, top 20 home economies, 2015 and 2016 (Billions of dollars)



Source: UNCTAD (2017)

History

- Conclusions about who sends and receives FDI
 - US and Europe are both huge sources and huge hosts
 - (But lots of Europe's FDI is from one to another)
 - Japan is a major source of FDI and hardly hosts any at all
 - Developing Asia, and especially Latin America, are mainly hosts of FDI
 - China has been a large host of FDI, especially in the 90s, and is now growing rapidly also as a source.
 - Africa does not appear significantly as either source or host

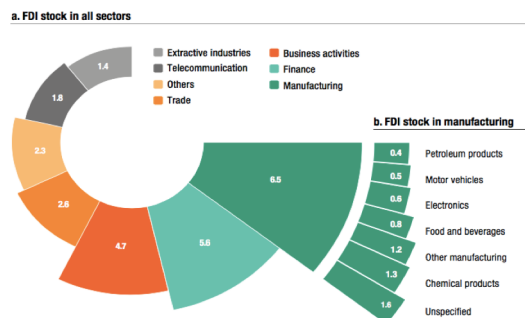
- But that may be changing. China's investment there

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Sectors of FDI

Figure I.18. Estimated global inward FDI stock by major industry, 2015 (Billions of dollars)



Source: UNCTAD (2017)

History

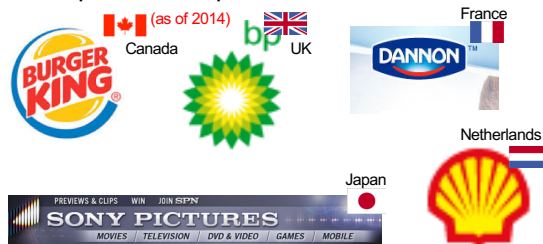
- US has received almost as much FDI as it has sent out
 - That means lots of US assets are foreign-owned
 - What are they?

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History

- Some perhaps obvious foreign-owned companies and products in the US



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History

- Some not-so-obvious foreign-owned companies and products in the US



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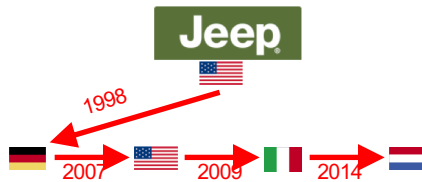
History

- More not-so-obvious foreign-owned companies and products in the US



History

- Nationalities can change:



- Actually (see *Economist*), Jeep is made by Chrysler, owned by Fiat, an Italian company that in 2014 changed its...
 - legal domicile to the Netherlands
 - tax residence to Britain
 - main stockmarket listing to New York

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Why Do Firms Invest Abroad?

- Purposes of FDI
 - To sell to the Host Country
 - To export from the Host country
 - Back to the Source Country
 - To third countries (Host = "Export Platform")
 - To obtain inputs for production elsewhere (Really a special case of #2)

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Why Do Firms Invest Abroad?

- Alternatives to FDI
 - Trade
 - To sell to Host: Export instead of producing there
 - Instead of exporting from Host: Import from independent firms there
 - Licensing, Subcontracting
 - Have an independent firm in Host do production for you

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Why Do Firms Invest Abroad?

- Prerequisites for FDI
 - Reason for an activity in a foreign country
 - Something to sell (to Host-country market)
 - Or something to buy (raw material or factor services)
 - Both require price or cost differences, similar to trade
 - Likely to require that host have comparative advantage (true if trade is nearly free)
 - Reason to produce abroad & own the facility, rather than export, license, or subcontract

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Why Do Firms Invest Abroad?

- Reasons for FDI to Sell to Host
 - Tariff Jumping
 - Common reason for FDI instead of exporting: Trade Barriers (tariffs, quotas, VERs, etc.)
- An import tariff can induce inward FDI, as exporters produce inside the host country to avoid paying the tariff
- Worth doing if extra production cost is less than the tariff

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Why Do Firms Invest Abroad?

- Reasons for FDI to Sell to Host
 - Tariff Jumping
 - Examples:
 - Much FDI in Developing countries;
 - US “Transplant” auto plants
 - » Really “VER jumping”
 - » Not the motive today

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Why Do Firms Invest Abroad?

- Reasons for FDI to Sell to Host
 - Transport Costs
 - Makes FDI more likely for selling to Host market: raises cost of exporting to it

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Why Do Firms Invest Abroad?

- Reasons for FDI to Sell to Host
 - Providing Services
 - Many services cannot be provided from a distance: Service firms must have local providers
 - Example: McDonalds

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Why Do Firms Invest Abroad?

- Reasons for FDI to Sell to Host
 - Firm-specific assets
 - Examples: Proprietary technology, unique business model, expertise of CEO
 - These give firm advantage over competitors, including local host-country firms
 - Control of these assets may require ownership rather than licensing or subcontracting

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Why Do Firms Invest Abroad?

- Reasons for FDI to Export
 - Lower cost, especially labor
 - Access to resources
 - Avoid regulations (e.g., environmental)
 - This is actually not a common reason for FDI
 - Minimize transport costs (in export platforms)

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Who Gains and Who Loses

- Effects that are similar to trade
 - If production shifts to foreign location
 - Some workers at home lose jobs (“exporting jobs”)
 - Same as if production was replaced by imports
 - Other workers have jobs “saved,” if employers use FDI to avoid shutting down completely
 - If FDI is motivated by lower cost
 - Firms and consumers gain from greater efficiency
 - Effects on wages are similar to trade
 - Other firms face increased competition

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Who Gains and Who Loses

- Effects that are similar to migration
 - To the extent that FDI does move capital from country to country
 - Host country gains capital
 - Often an important source of capital growth for LDCs
 - Source country loses capital
 - Changes in capital alter demands for labor
 - Wages rise in host country
 - Wages fall in source country
 - All very similar to what we said of migration

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Who Gains and Who Loses

- Other Effects of FDI and MNCs
 - MNCs typically differ from local firms in same industry
 - Pay higher wages
 - Provide better (though not always “good”) working conditions
 - Use more capital-intensive methods

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Who Gains and Who Loses

- Other Effects of FDI and MNCs
 - Unlike trade, FDI requires the presence of foreign people and establishments in the host country
 - This may cause changes in the host-country society and culture
 - Friction possible between groups

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José Bové

- **José Bové**
 - French farmer and anti-globalization activist who came to fame by dismantling a McDonald's franchise in 1999
 - Now a politician and (since 2009) member of the European Parliament

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Who Gains and Who Loses

- Other Effects of FDI and MNCs
 - MNCs pay taxes in both Source and Host countries
 - Provides revenue for Host country government
 - May be offset by inducements to invest
 - E.g., "tax holidays"
 - Efforts of MNCs to reduce tax burden
 - Shift income to low-tax jurisdiction

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What Determines Company Nationality?

- See *Economist*, "Company Headquarters"
 - National pride
 - When Italian Fiat acquired US Chrysler, taking on the Netherlands as legal domicile was neutral
 - When Burger King merged with Canada's Tim Horton's, it became Canadian to please Tim Horton customers
 - (But later was bought by Brazil's 3G Capital)
 - Legal structure: Netherlands has undemanding laws (like Delaware)
 - Tax laws and tax rates
 - Low corporate tax rate favors Ireland
 - Moving to get a lower tax rate is called "Tax Inversion"

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Next Lecture (After Exam): The Trade Balance

- The Balance of Trade and International Transactions
 - What the trade balance is
 - What it means and doesn't mean

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