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

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
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

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”)

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
### Terminology

```
SOURCE Country
$  

FDI

HOST Country
Ownership
```

### 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

### 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
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

Who Does FDI?

- Source: Lipsey 2000 (Data for 1996)

Who Gets FDI?

- Source: Lipsey 2000 (Data for 1996)

Note that Japan has almost disappeared here
Sources and Destinations of FDI, 1996, $ billions

<table>
<thead>
<tr>
<th></th>
<th>US</th>
<th>Japan</th>
<th>Europe</th>
<th>Other Asia</th>
<th>Latin Amer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td>87.8</td>
<td>23.4</td>
<td>172.1</td>
<td>48.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Host</td>
<td>77.0</td>
<td>0.2</td>
<td>120.1</td>
<td>78.0</td>
<td>40.1</td>
</tr>
</tbody>
</table>

- Source: Lipsey 2000 (Data for 1996)

Who Were Sources of FDI in 2012?

- Source: UNCTAD World Investment Report 2013

Who Were Hosts of FDI in 2012?

- Source: UNCTAD World Investment Report 2013
China's Shares of World FDI

- Source: UNCTAD World Investment Report 2013

Chinese Investment by State, 2000 - 2016

- Source: Economist, Jan 28, 2012
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

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?

History

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

• Some not-so-obvious foreign-owned companies and products in the US
  - Trader Joe’s
  - Chicago Sun-Times
  - Sara Lee
  - Bally
  - Starbucks
  - Nestle
  - Fiat
  - DHL

• More not-so-obvious foreign-owned companies and products in the US
  - Panera Bread
  - Sprint
  - Burger King
  - Cineworld
  - Holiday Inn
  - AMC Theatres
  - Tommy Hilfiger
  - Hong Kong Cement

• Nationalities can change:
  - Jeep

  - Actually (see Economist), Jeep is made by Chrysler, owned by Fiat, an Italian company that in 2014 changed its...
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

Why Do Firms Invest Abroad?

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

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
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

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

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
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

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

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
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)

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

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
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

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

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
• 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

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

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”
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