

Econ 340

Lecture 11

Multinationals and International Capital Movements

News: Oct 7-13

- China and US reach "Phase One" deal -- WSJ: [10/12](#) | [Canvas](#) | NYT: [10/11](#) | [Canvas](#) | FT: [10/12](#) | [Canvas](#)
 - China-US trade talks resumed in Washington and they reached a partial deal, said to be "Phase One" of more that will come later. Trump has said he wanted a "whole deal," but that did not happen. This deal will take several weeks to write and will be signed by November.
 - US will postpone tariff increases that were planned for October 15, and China will increase purchases of agricultural products by \$40-50 billion. Other US tariffs planned for December were not postponed.
 - Not yet fully resolved and subject to further negotiations were many other issues: "including China's enforcement of intellectual property rules, U.S. access to Chinese markets, Chinese government support for state-owned enterprises, and the fate of U.S. tariffs on nearly \$360 billion worth of Chinese imports already in place."
- Leaders of China and India meet to discuss trade issues. -- WSJ: [10/12](#) | [Canvas](#) | FT: [10/11](#) | [Canvas](#)
 - President Xi was in India for two days of talks with Prime Minister Modi. The meeting is "likely to be dominated by trade as New Delhi seeks to reduce a huge trade deficit with China."
 - A spokesman for India said "The Chinese will have to figure out ways in which to give India more market access. There are unreasonable non-tariff barriers that China imposes."
 - China wants India to join RCEP, a free trade agreement it is negotiating with other Asian countries.
- Currency news: euro, krona, lira -- WSJ: [10/4](#) | [Canvas](#) | FT: [10/7](#) | [Canvas](#) | FT: [10/7](#) | [Canvas](#)
 - The euro has been falling in US dollar value for more than a year, and reached its lowest in more than two years. Reasons include interest rates (high in US, low in Eurozone), slowing European economy, and concerns about trade.
 - Sweden's currency, the krona, fell against the euro to its lowest in ten years. The krona "is more global trade sensitive than almost anyone else," said an official, who attributes the fall to trade tensions.
 - Turkey's currency, the lira, fell against the dollar to its lowest in more than a month after President Trump threatened to "obliterate" Turkey's economy.

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Treasury Secretary Steven Mnuchin and Chinese Vice Premier Liu He arrived at a trade meeting on Friday. President Trump met with Mr. Liu later in the day. PHOTO: JOSE LUIS

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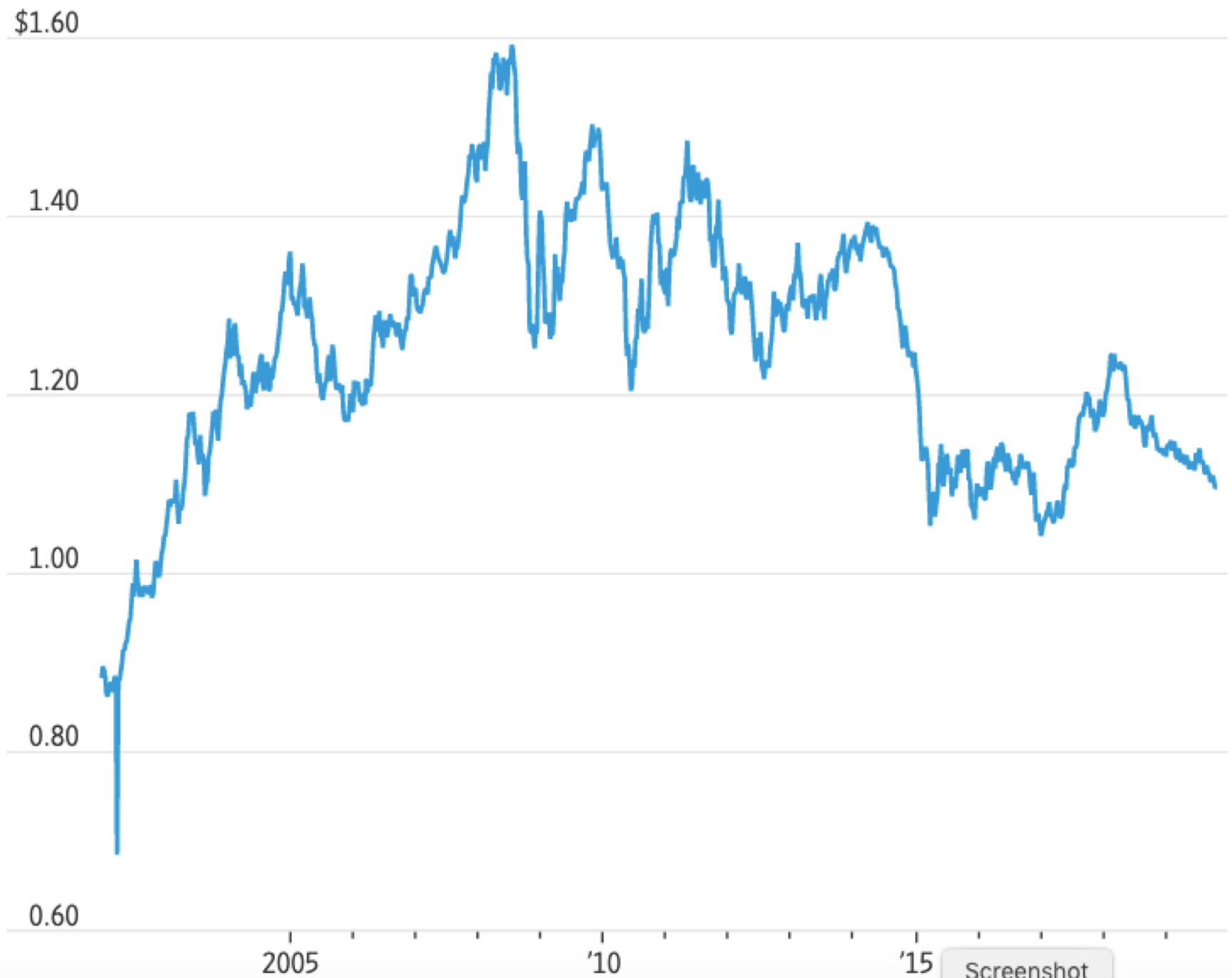


Indian Prime Minister Narendra Modi and Chinese President Xi Jinping chat during their second 'informal' summit, this one held at Mamallapuram in India's south. **PHOTO:** PRESS INFORMATION BUREAU HANDOUT/SHUTTERSTOCK

News: Oct 7-13

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How many dollars €1 buys

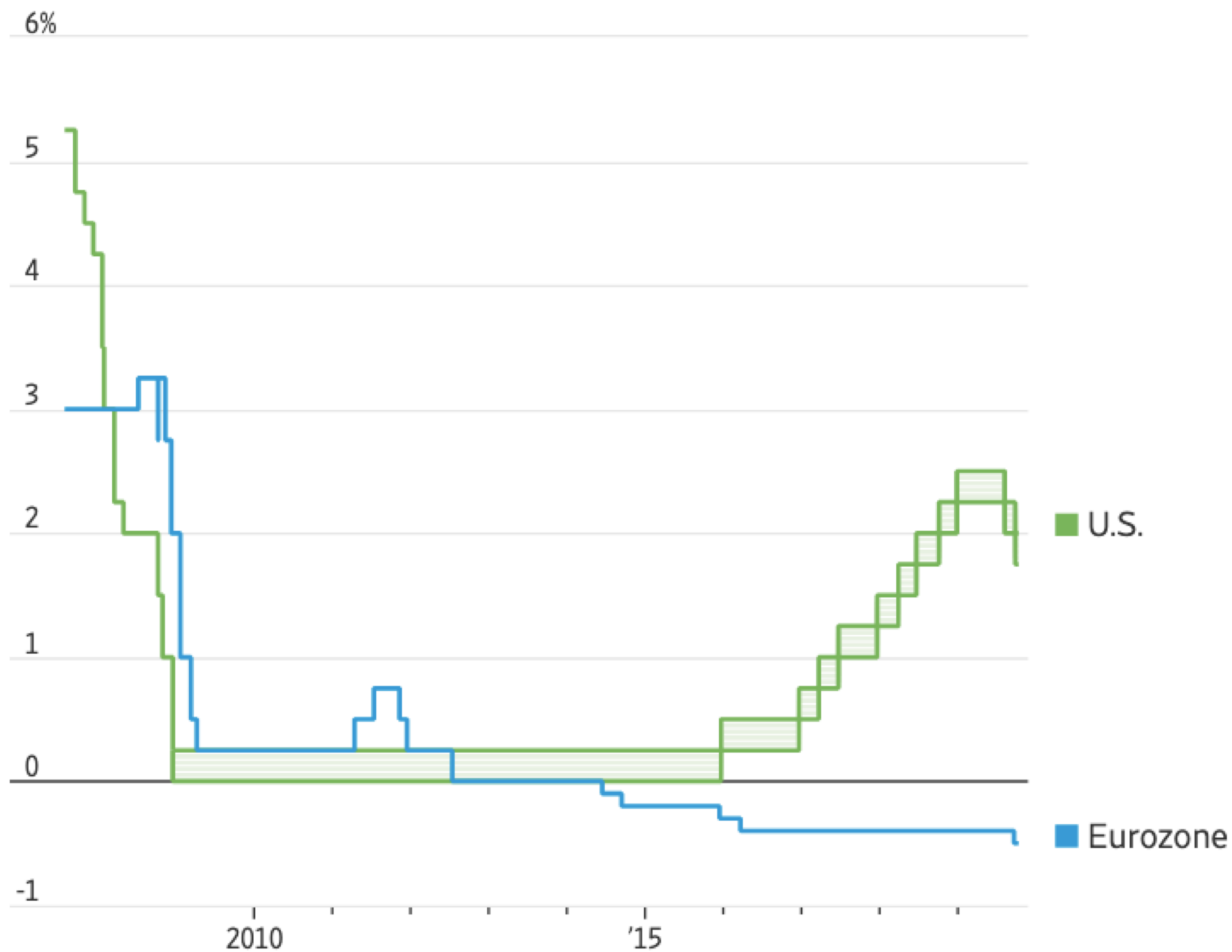


WSJ Dollar Index



Screenshot

Rate benchmarks





SWEDISH KRONA TO EURO GRAPH CONVERTER

13 Oct 2018 00:00 UTC - 13 Oct 2019 20:56 UTC





TURKISH LIRA TO EURO GRAPH CONVERTER

13 Sep 2019 21:00 UTC - 13 Oct 2019 21:00 UTC





Donald J. Trump ✓

@realDonaldTrump

As I have stated strongly before, and just to reiterate, if Turkey does anything that I, in my great and unmatched wisdom, consider to be off limits, I will totally destroy and obliterate the Economy of Turkey (I've done before!). They must, with Europe and others, watch over...

11:38 AM · Oct 7, 2019 · [Twitter for iPhone](#)

<u>Midterm No. 1:</u>	Monday, October 21	8:30-9:50 AM	1120 Weill Hall
<u>Midterm No. 2:</u>	Monday, November 18	8:30-9:50 AM	1120 Weill Hall
<u>Final Exam:</u>	Friday, December 13	1:30-3:30 PM	1120 Weill Hall

Office Hours for the First Midterm Exam

Prof Alan Deardorff

Thu Oct 17, 10-11 AM
Fri Oct 18, 1-2 PM

GSI

Tue Oct 15, 9-10 AM in AHG (Angel Hall, ground floor) Room 144
Wed Oct 16, 10 AM - 12 PM in MLB 2112

GSI Review session:

Sat Oct 19, 3-4 PM in AHD (Angel Hall) Room D

What's Covered on the First Midterm Exam?

NOTE: You will get two points for correctly recording:

- your name and UMID number, both on the exam booklet and on the scantron sheet so that the computer can read it,
- **AND** your **FORM NUMBER** on the scantron so that the computer can read it.

(In other words, you will lose two points if you don't do all of this.)

The first midterm exam covers all of the material since the start of the course through that assigned for October 9, Migration. I intend to give roughly equal treatment to each lecture topic, including the outside readings and assigned news items. Thus, the exam covers:

- The assigned portions of Gerber (see [syllabus](#) on line),
- All of the online readings assigned from Sep 9 through Oct 9, (including the pieces marked as "Other Views" but not those marked as "Optional"),
- You should also be familiar with the **news** that we will have discussed in class, including those items identified on the [Major News Items](#) page for weeks: Sep 9 through Oct 6.

Regarding the emphasis that will be placed on lectures versus readings and on other particular parts of the material, you are responsible for lectures plus *all* of the reading. I intend to make studying all of that worth your while by including on the exam at least a few questions on material ~~that was~~ **not** covered in lecture, both from the text and from the readings.

Screenshot

What to Bring to the Exams:

Do bring something to write with, including #2 **pencils** for answering the multiple choice on computer-graded "scantron" sheets.

Do Not bring **books** or notes.

Do Not bring **blue books**.

You probably *should* bring a calculator, but **DO NOT** bring a **graphing calculator**. Graphing calculators will be confiscated.

You should also **NOT** bring any kind of **computer** (including palm computer) and you should **NOT** bring a **cell phone**, even if you only plan to use it as a clock. Those too will be confiscated. **Do** bring your U of M **ID number**, as it appears on your M-Card. You don't need the card itself, if you know the number.

Screenshot

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)

} FDI

- Financial

- Bonds, loans, bank deposits, currency

- Stocks if less than 10% ownership

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

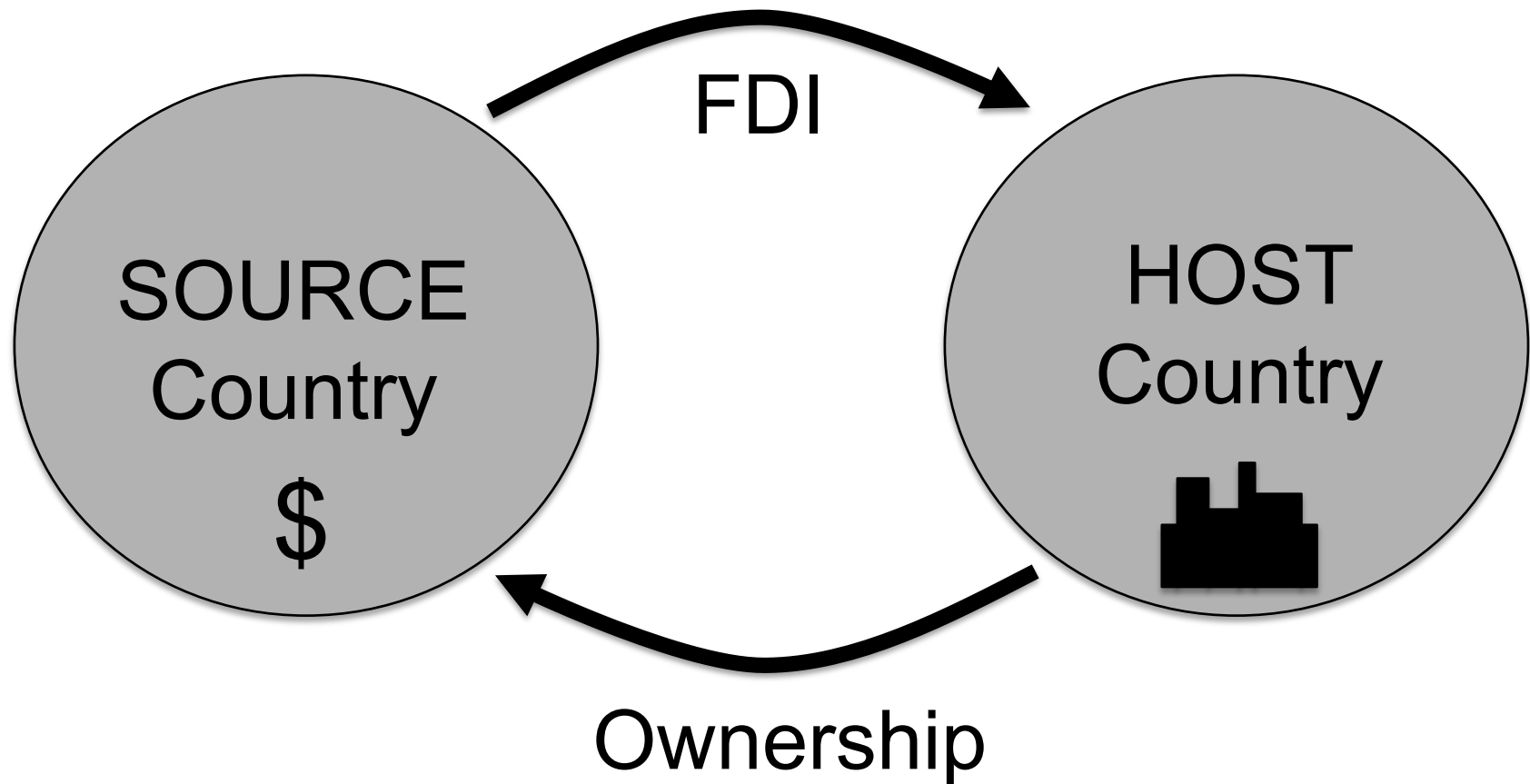
Terminology

- 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



Clicker Question

In which of the following would Japan be the “host country” for FDI?

- a) An American buys the debt of the Japanese government
- b) A Japanese company buys a factory in Germany
- c) A Japanese citizen buy US treasury bills
- d) A Thai corporation borrows from a Japanese bank
- ✓ e) A Saudi prince buys land in Tokyo

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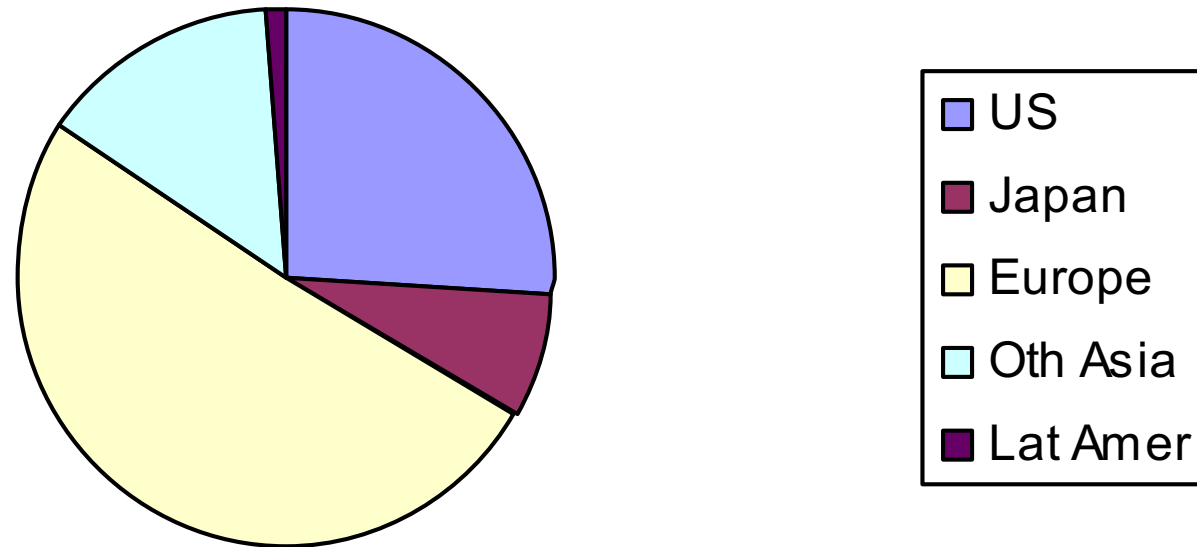
History

- 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

History

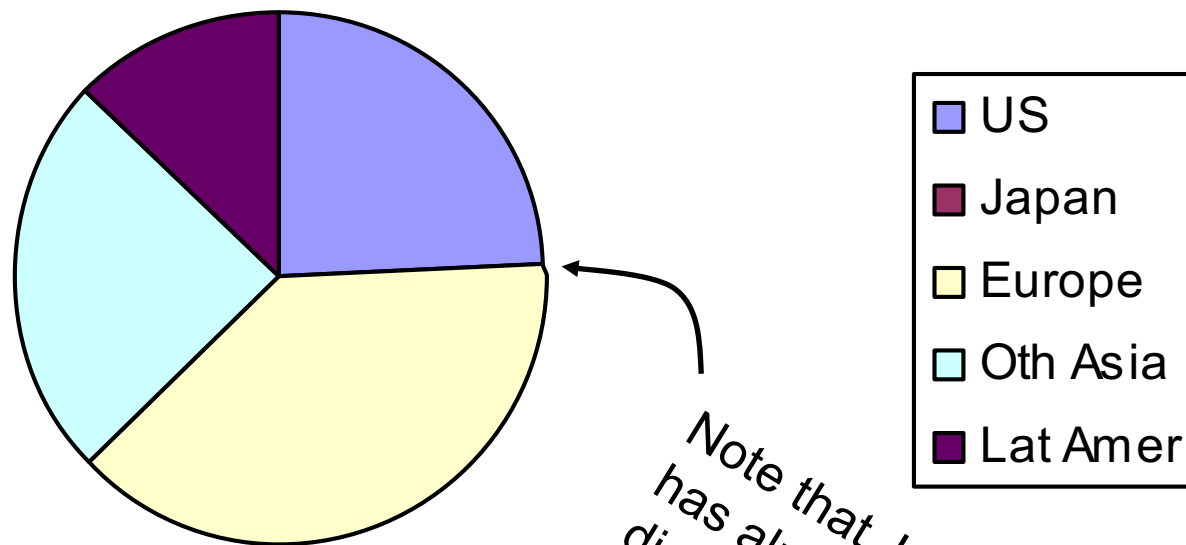
- Starting in 1980s, attitudes began to change
 - Developing countries saw FDI as helping them grow
 - Host countries saw FDI as providing employment
 - Started using policies to attract FDI
 - IMF and World Bank encouraged reforms that would be friendly to FDI
 - US and other countries negotiated Bilateral 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?



Note that Japan
has almost
disappeared here

- Source: Lipsey 2000 (Data for 1996)

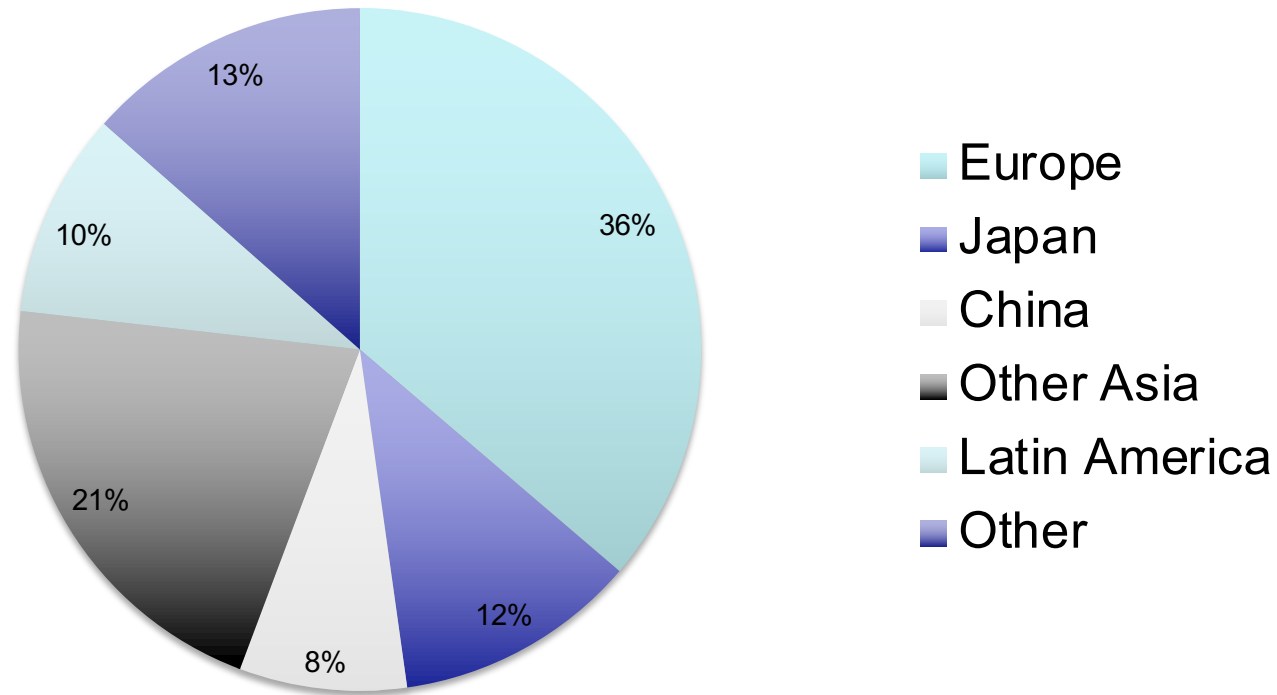
History

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

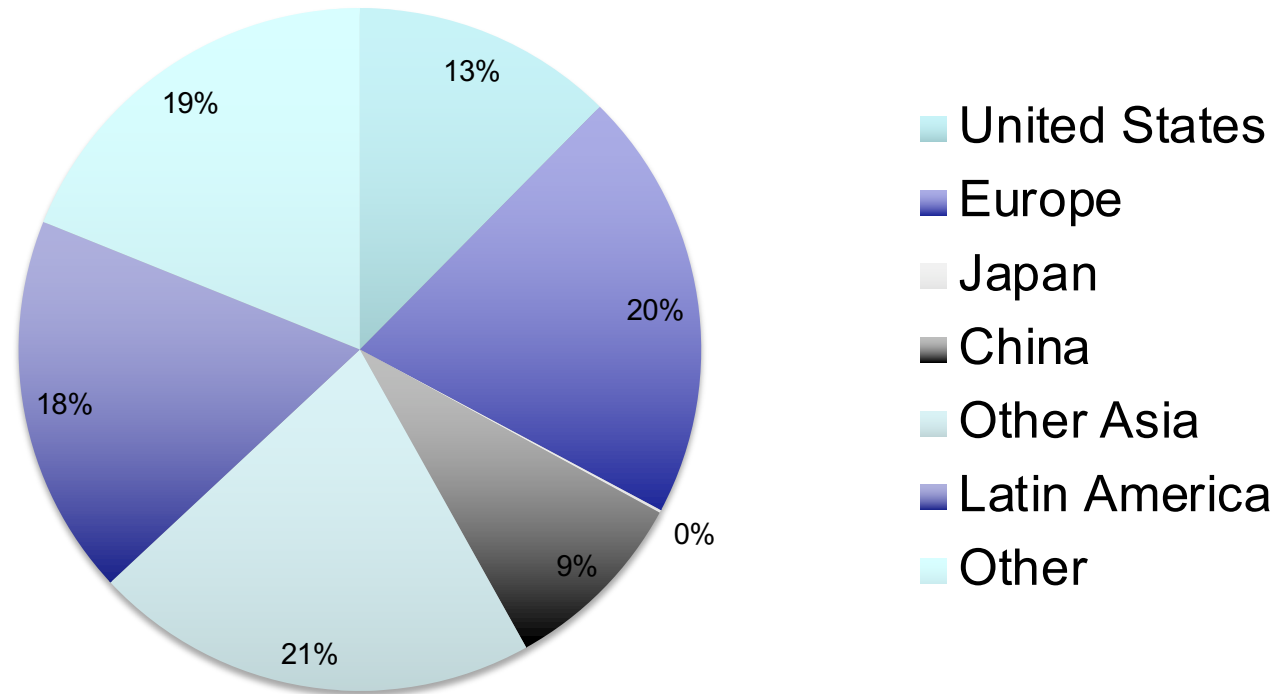
- Source: Lipsey 2000 (Data for 1996)

Who Were Sources of FDI in 2012?



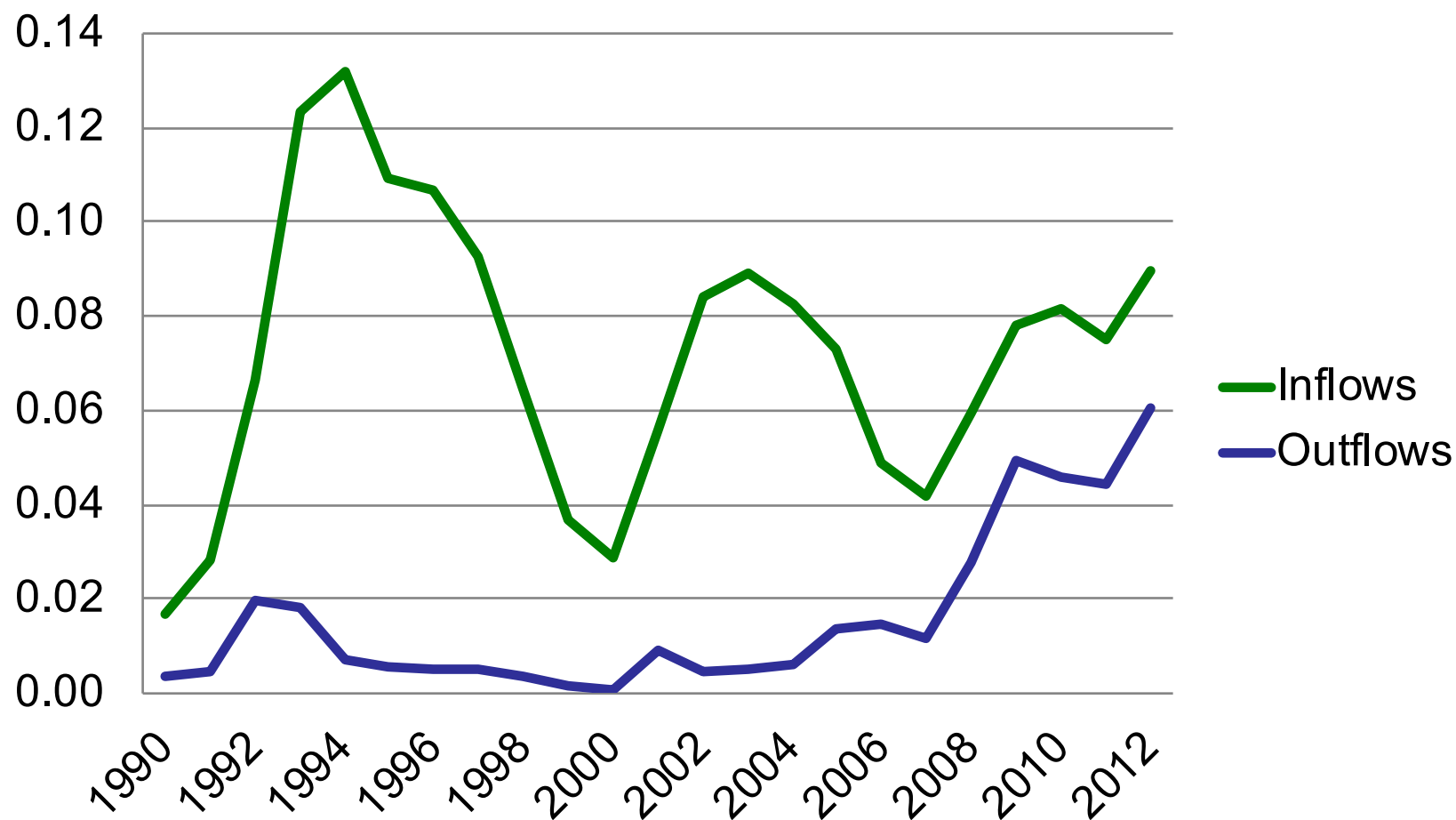
- Source: UNCTAD World Investment Report 2013

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

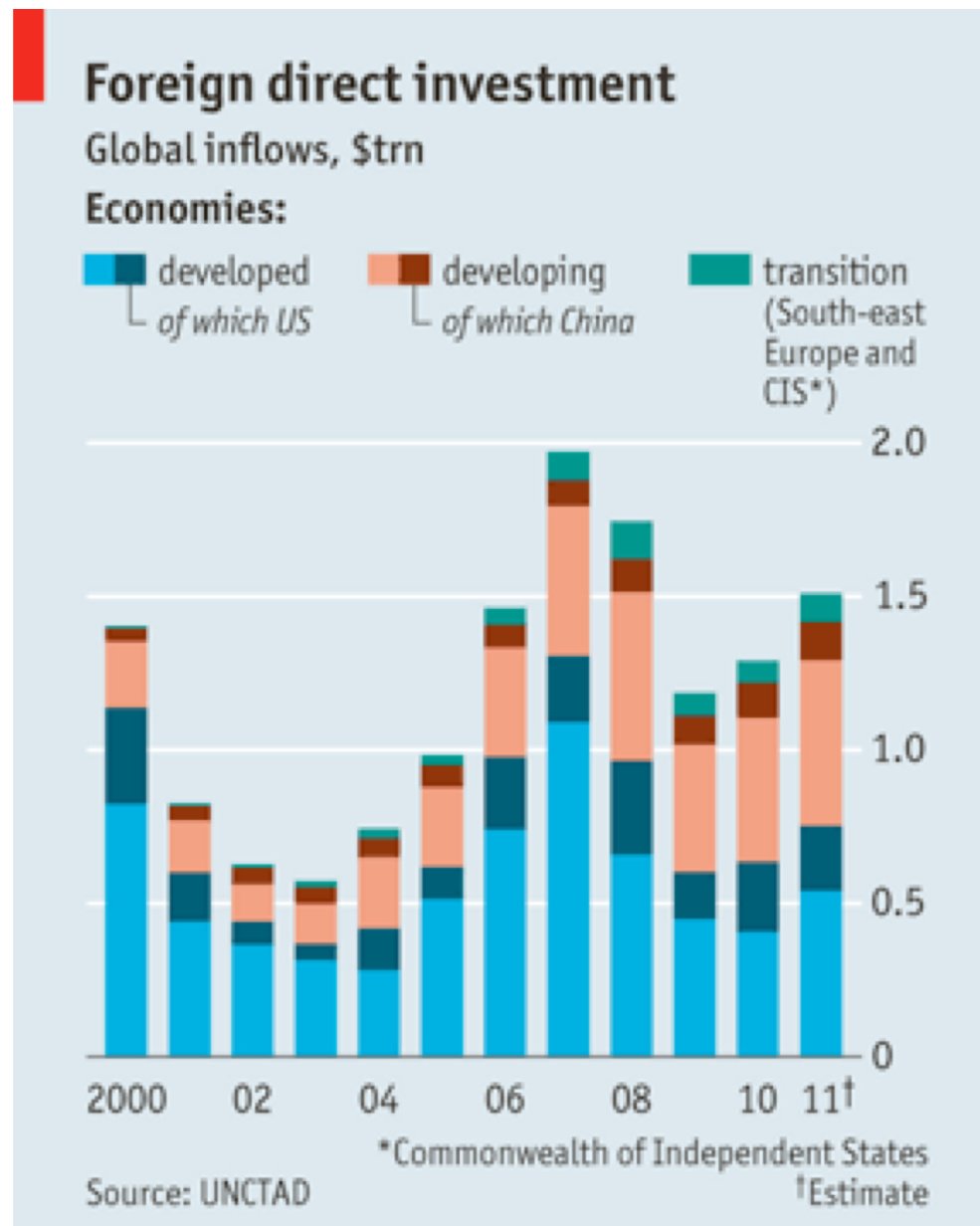
Chinese Investment by State, 2000 - 2016

Legend:

- Less than \$250 million
- \$250 million-\$750 million
- More than \$750 million

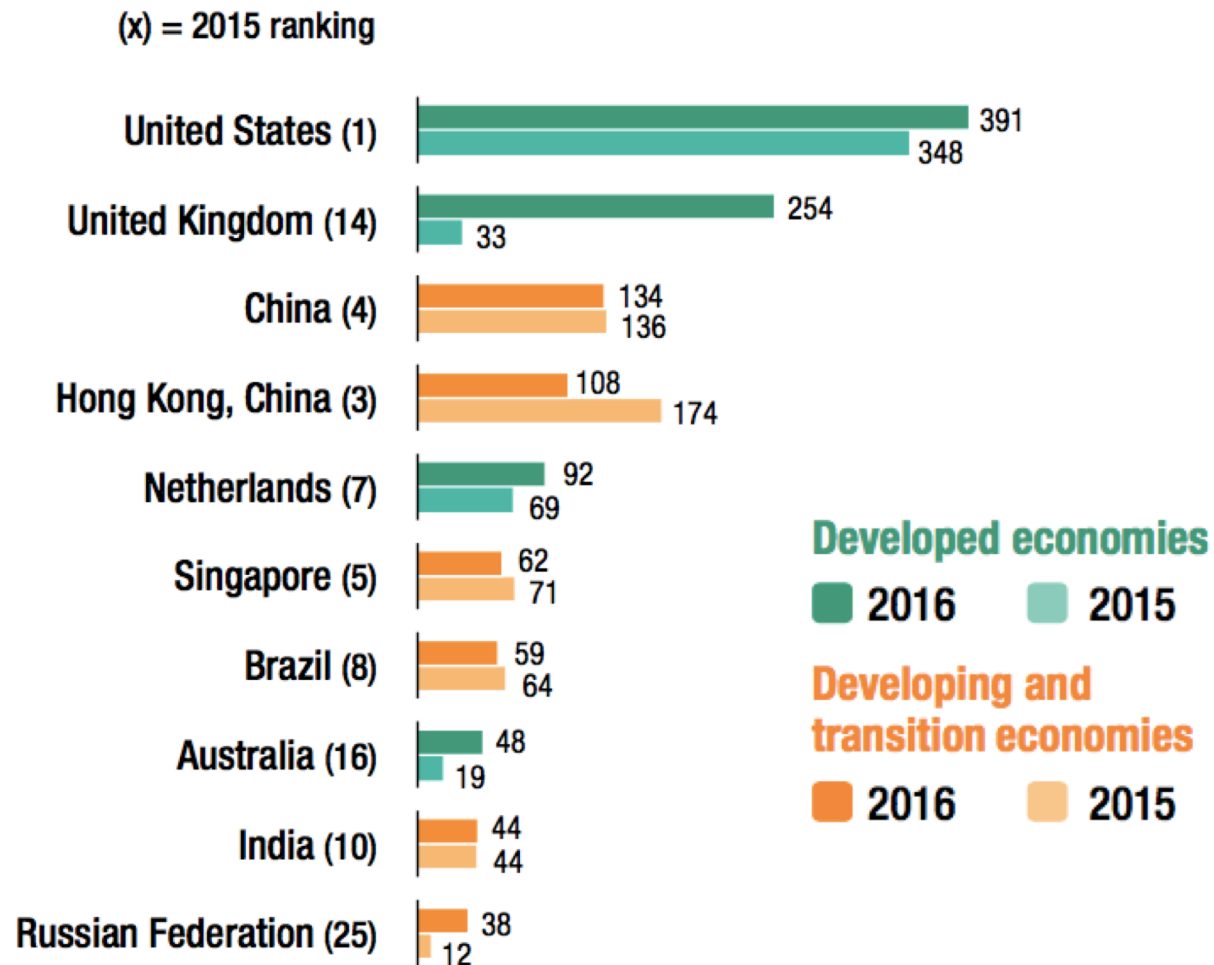
Source: Rhodium Group

Source: Rhodium Group



- Source: *Economist*, Jan 28, 2012

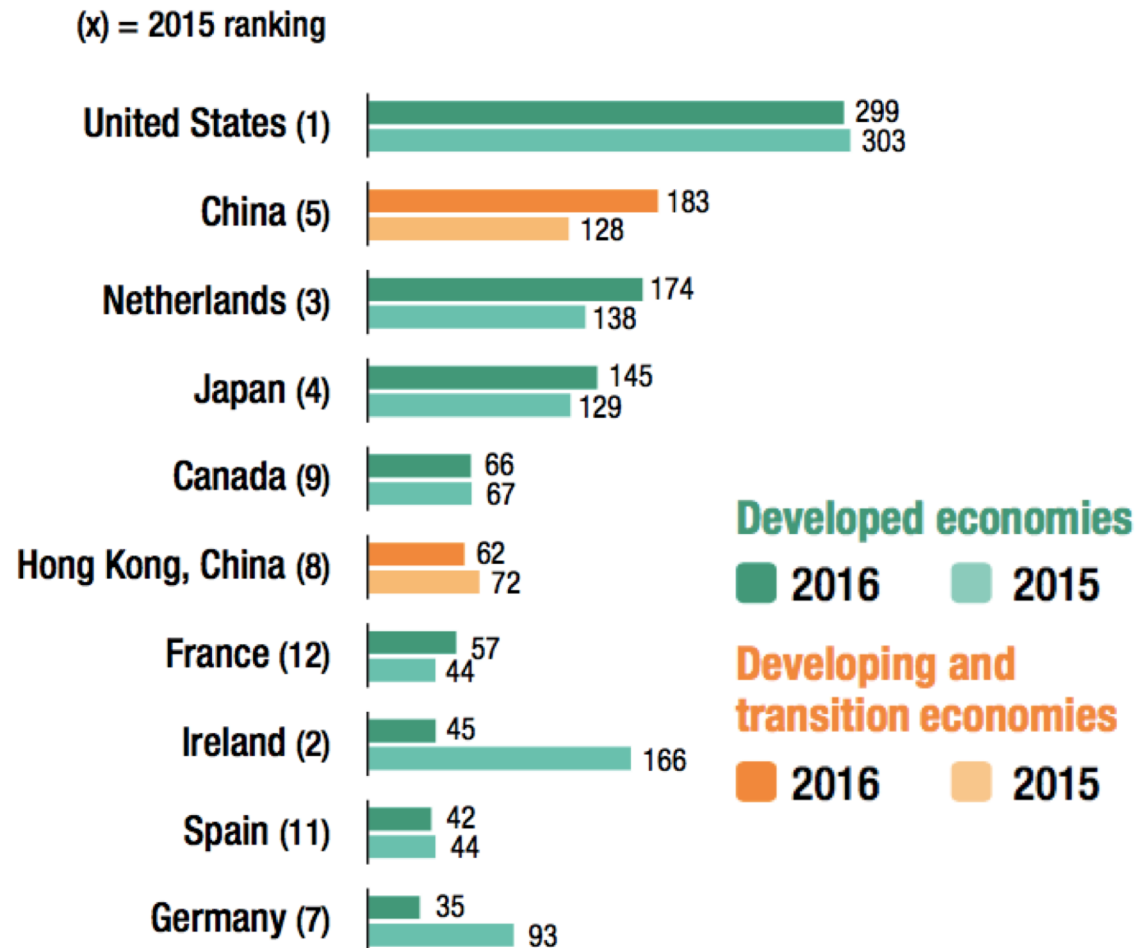
Figure I.11. **FDI inflows, top ~~25~~¹⁰ host economies, 2015 and 2016** (Billions of dollars)



Source: UNCTAD (2017)

Figure I.14. **FDI outflows, top ~~20~~¹⁰ home economies, 2015 and 2016** (Billions of dollars)

(“home” = “source”)



Source: UNCTAD (2017)

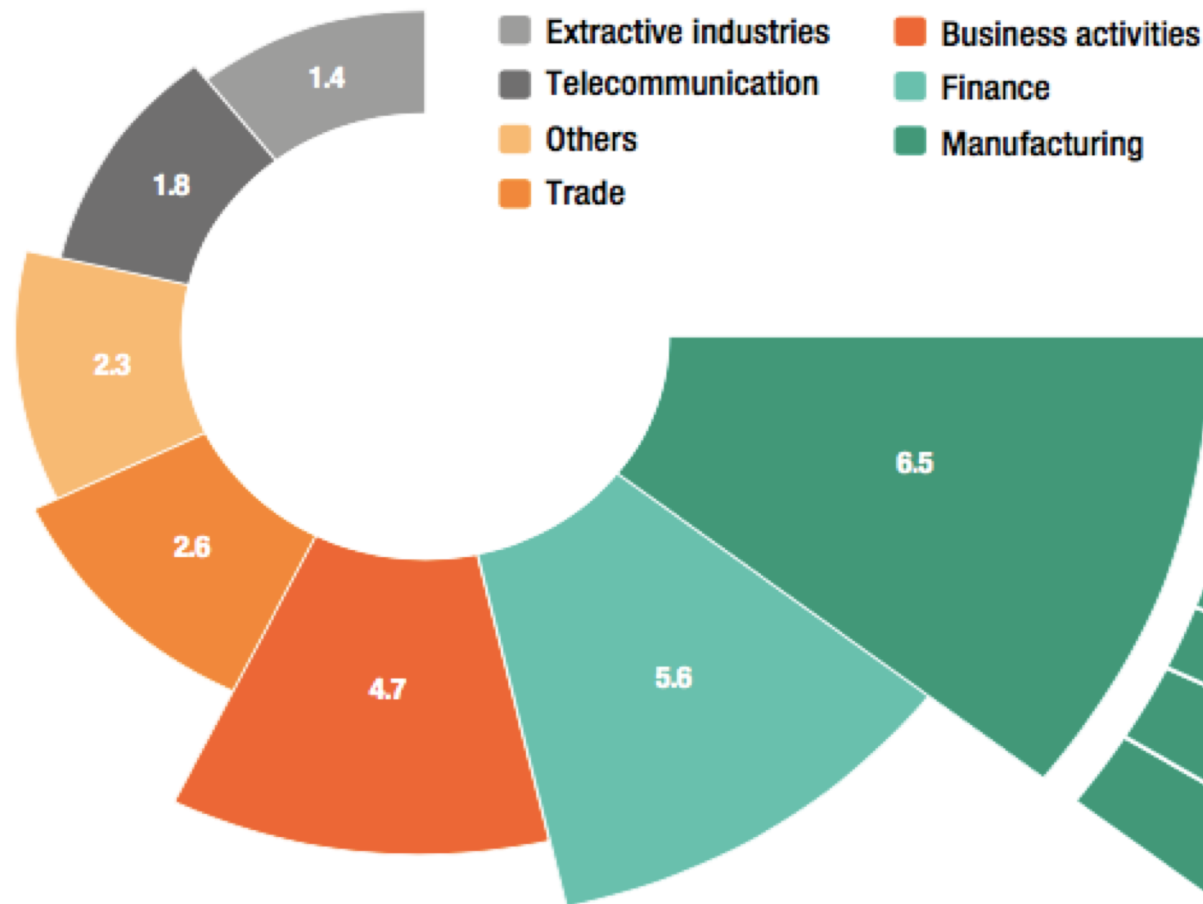
History

- 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

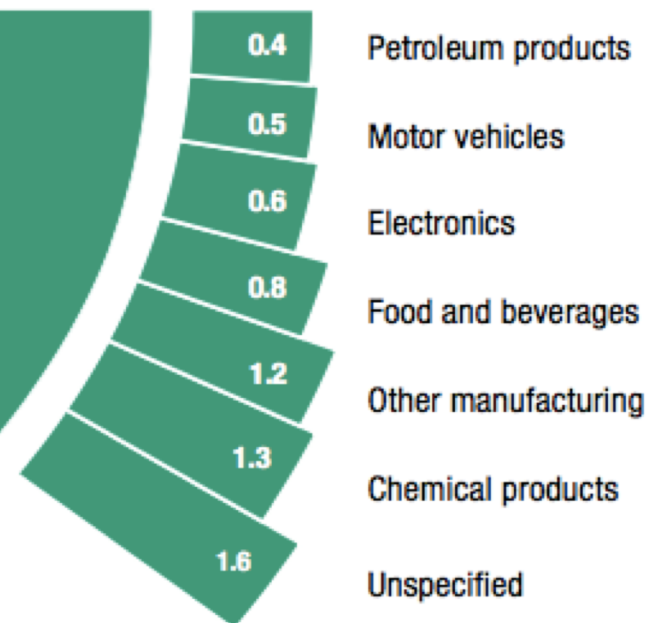
Sectors of FDI

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

a. FDI stock in all sectors



b. FDI stock in manufacturing



Source: UNCTAD (2017)

Clicker Question

What has been the role of Britain (now the UK) in FDI?

- a) It has been a major source of FDI both historically and today.
- ✓ b) It was a major source of FDI in the 19th century, but but not most recently.
- c) It seldom engaged in FDI historically, but has lately become one of the world's biggest sources.
- d) It has never been one of the top sources for FDI.

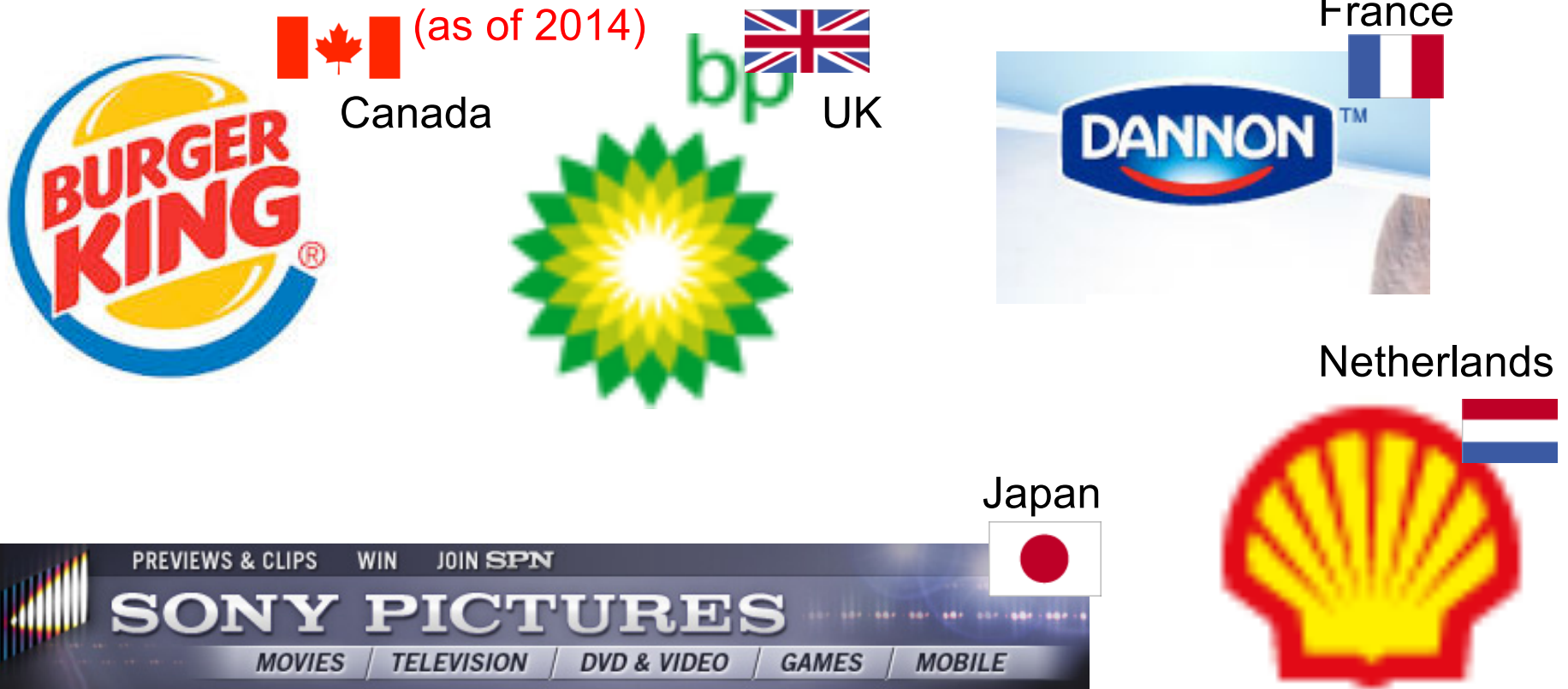
See the top-ten list on the slide above.

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

Germany



CHICAGO SUN-TIMES



suntimes.com

STOP&SHOP



Switzerland



Mexico



Italy



Econ 340, Deardorff, Lecture 11:
FDI





Luxembourg

History



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



Brazil

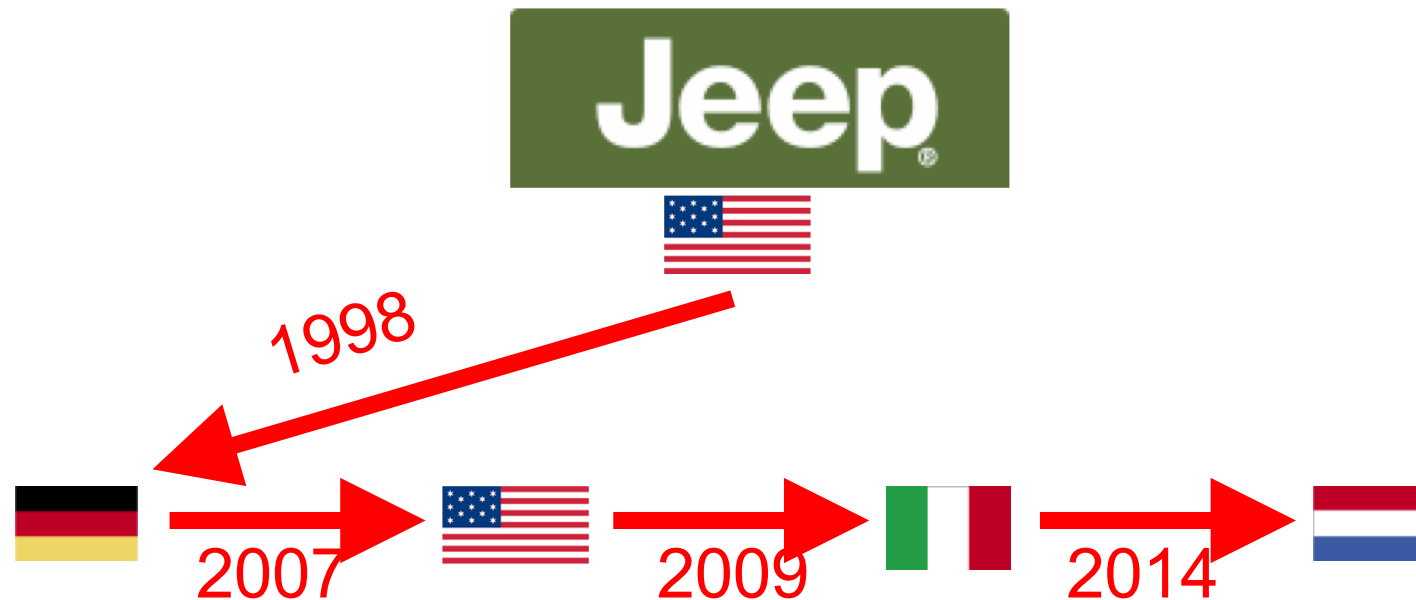


AMC
Theatres



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

Clicker Question

Which of the following companies is **not** Japanese?

- a) 7-11
- b) Denny's
- ✓ c) Trader Joe's German
- d) Sprint

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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)

Clicker Question

How can a tariff cause FDI?

- a) It can't; tariffs apply to imports, not FDI
- ✓ b) A producer invests in the country to which it wants to sell, in order to avoid paying a tariff
- c) If Mexico has a high tariff on beer, its brewers will prefer to produce in the US
- d) A tariff on imports of an important input to an industry will cause foreign producers in that industry to want to produce there

Clicker Question

Which of the following acronyms is **not** related to FDI?

- a) DFI Direct foreign investment
- b) MNE Multinational Enterprise
- ✓ c) MFN Most Favored Nation
- d) MNC Multinational corporation
- e) TNC Transnational corporation

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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

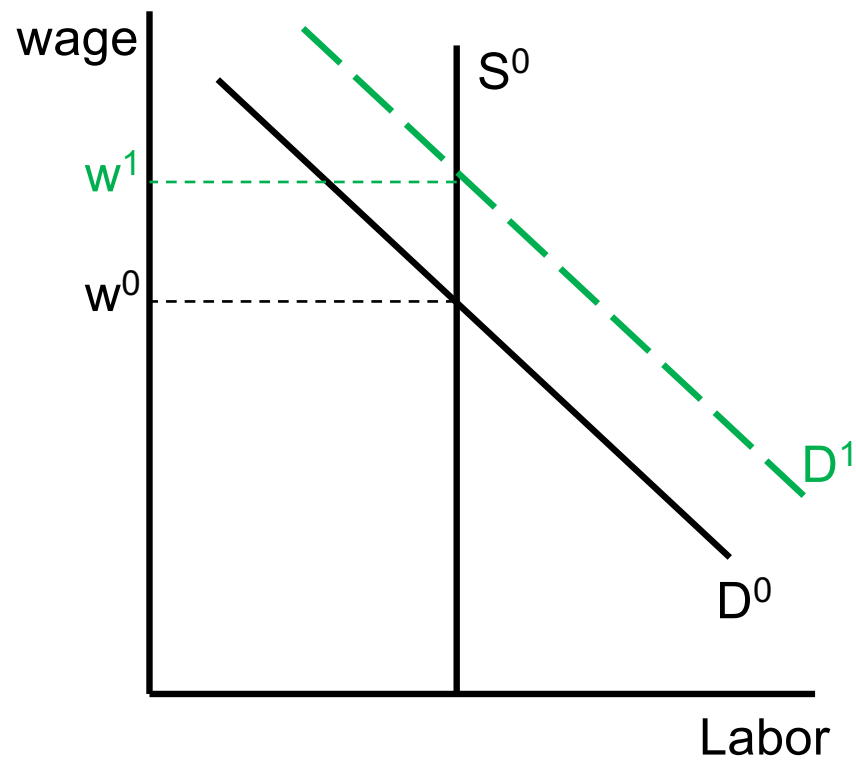
Who Gains and Who Loses

- 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

Clicker Question

The diagram shows supply and demand for labor in a country. Which of these curves will shift, and in which direction, if there is FDI into the country?

- a) Supply shifts right
- b) Supply shifts left
- ✓ c) Demand shifts right
- d) Demand shifts left



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

- **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”

Clicker Question

When a company moves its tax residence to a low-tax jurisdiction, on what portion of its earnings does it pay **less** taxes?

- a) Interest income
- ✓ b) Earnings on intangible assets
- c) Wages in the host country
- d) Wages in the source country
- e) Dividends

This was one of the questions posted for the Economist reading

Next Lecture

(After exam & Sweetland visit):

The Trade Balance

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