

EE451

**Chapter 7:  
International Factor Movements**

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# Key Concepts

- Countries can grow by receiving factors from abroad.
- International movement of 'capital'
  - Foreign direct investment (FDI): involves ownership and control
    - Multinational Corporation (MNC)/ Multinational Enterprise (MNE)/ Transnational Corporation (TNC)/ Transnational Enterprise (TNE): production is taking place in plants located in two or more countries (Host) but under the supervision and general direction of the headquarters located in one country (Home).
  - Foreign portfolio investment: involves flows of 'financial', not 'real', capital.
- International movement of 'labour'
  - Migration

# Reasons for International Movement of Capital

- Expected higher rate of return which can arise from:
  - Positive correlation between GDP (& growth) of a recipient country and FDI flows into that country
  - High per capita income in recipient country
  - Access to mineral or raw materials
  - Trade arrangement/ tariff/ non-tariff barriers (firms can 'get behind the tariff wall' by producing within the host country itself)
  - Low wage in the host country
  - Defensive purpose to protect market share
  - Risk diversification
  - Superior management/ important patents of the home country (outperform that of the host)

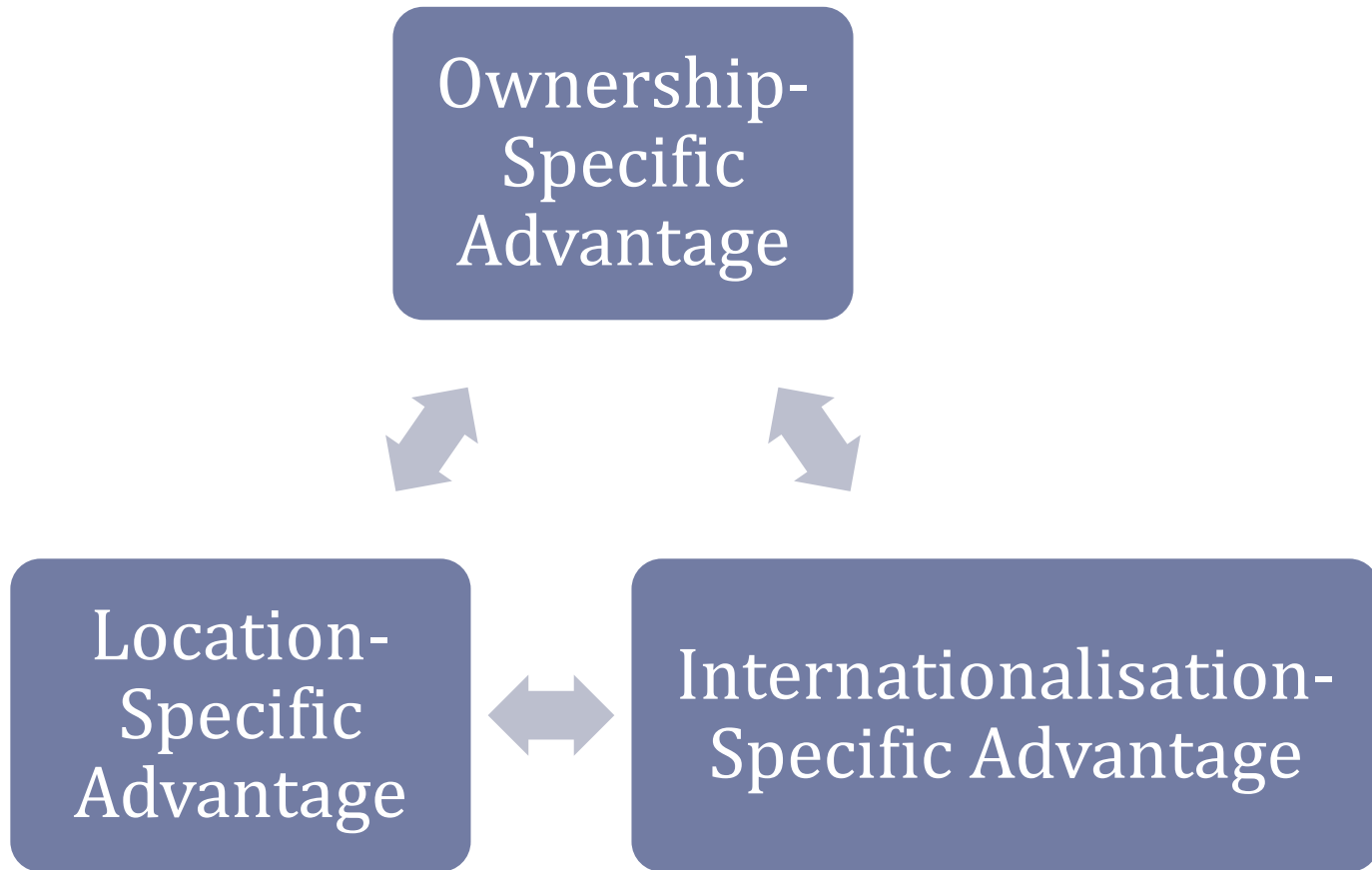
# Type of FDI by Motive

Motives	Form of Investment	Host Characteristics	Tax Responsiveness
Market-seeking	<ul style="list-style-type: none"> <li>•Ownership of hi-tech resources</li> <li>•Ability to utilise resources in the new market</li> <li>•Mostly oligopoly</li> </ul>	<ul style="list-style-type: none"> <li>•Large market size with impressively high growth</li> <li>•Effective trade protection</li> </ul>	Low
Resource-seeking	<ul style="list-style-type: none"> <li>•Wide access to global market</li> <li>•Potentials to develop vertical integration</li> </ul>	<ul style="list-style-type: none"> <li>•Resource-abundant</li> </ul>	Low
Efficiency-seeking	<ul style="list-style-type: none"> <li>•Ability to utilise resources in new markets + distribute produces around the globe to enjoy economies of scale</li> </ul>	<ul style="list-style-type: none"> <li>•Various government policies available to facilitate foreign investors</li> </ul>	High

# Theoretical Foundation: Capital Market Equilibrium

# FDI Advantage:

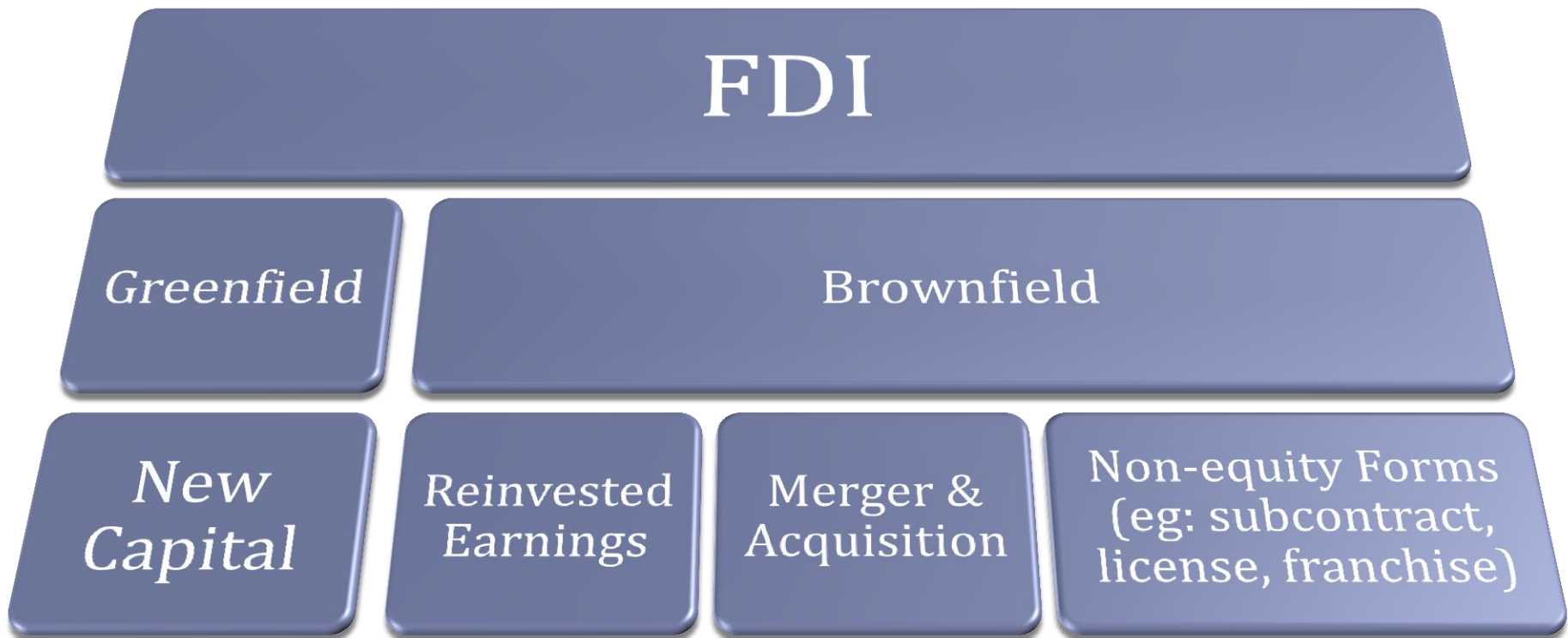
## OLI Paradigm (Dunning 1988, 1995)



# Definition

- The process whereby residents of one country (home) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (host).
- A minimum of 10 per cent shareholding (UNCTAD)

# Type of FDI by Mode of Entry



# Type of FDI by Production Process from the Perspective of the Host

## Vertical FDI

- Exploiting raw materials
- To be nearer to the consumers through the acquisition of distribution outlets

## Horizontal FDI

- To produce similar kinds of goods abroad in the host to those in the home.
- Product differentiation
- To exploit more fully certain monopolistic or oligopolistic advantages (since expansion at home were to violate anti-trust laws)

## Conglomerate FDI

- Horizontal + Vertical
- (M & A)

# Production Process vs Motives

By production process	By motives		
	Market-seeking	Resource-seeking	Efficiency-seeking
Horizontal FDI	X		
Vertical FDI		X	X

Source: Compiled from Jensen (2002)

# What to answer when relocating capital

## Invest?

- Comparison of Marginal Return
- Risks/ Variability of profitability

## When?

- Vernon (1966) product life cycle
- New/ maturing/ standardised

## Where?

- Location decision-making theories eg: Krugman (1991) Fugita et al (1999) Fingleton (2007)

## How?

- Motive/ Mode of Entry/ Product/ Ownership
- Institutional factors

# Potential Benefits of FDI to a Host Country

- Increased output
- Increased wages
- Increased employment
- Increased exports
- Increased tax revenues
- Realisation of scale economies
- Provision of technical and managerial skills and of new technology
- Weakening of power of domestic monopoly

# Kozminski (1995) 8S Formula for Benefits of FDI to MNCs

Size of Market

- Large present market and high future growth imply higher returns to FDI

Strong Margins

- Novelty appeal of western g&s , esp early 90s; some governments awarded exclusive contracts to firm

Stability

- Political, legal, monetary

Skilled Workers

- High educational levels of low wages

Support

- Infrastructure, business services (eg: consulting, auditing, legal, financial)

Suppliers

- Well-developed and privatised suppliers are needed

Safety

- Implies well-developed legal structures (regulations and enforcement)

Springboard

- Use initial FDI as a platform for penetrating other (usu less developed) markets

# Potential Costs of FDI to a Host Country

- Adverse impact on the host country's commodity TOT
- Transfer pricing
- Decreased domestic saving
- Decreased domestic investment
- Instability of BOP and the ER
- Loss of control over domestic policy
- Increased unemployment
- Establishment of local monopoly
- Inadequate attention to the development of local education and skills

# Labour Movement between Countries

- An individual's desire to migrate depends on the expected costs and benefits of the move → expected wage or income differences

# Additional Considerations

- Transfer income
- Temporary worker: A guest worker
- Workers are in fact not homogeneous.