

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

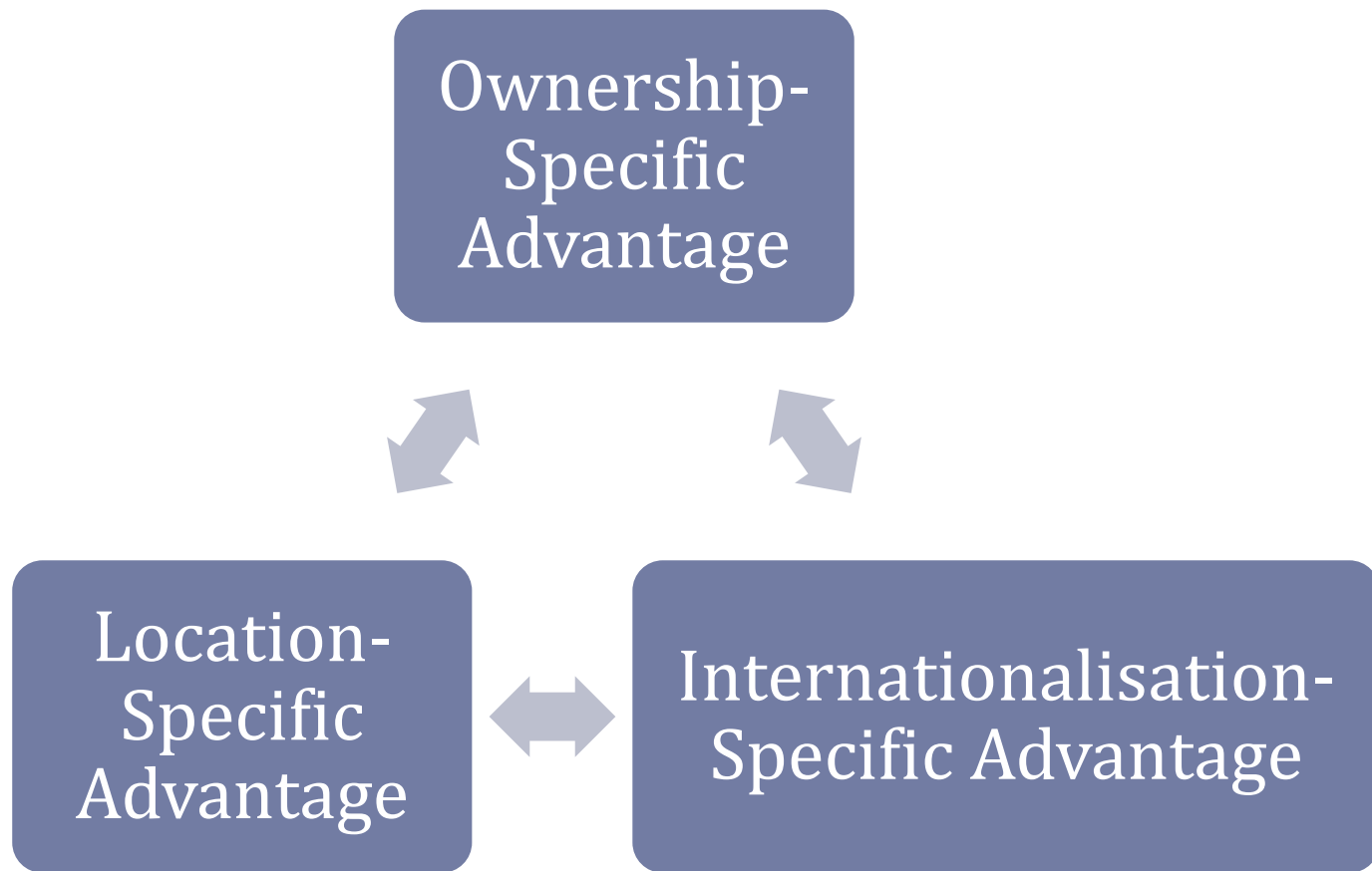
- Expected higher rate of return which can arise from:
 - Positive correlation between GDP (& growth) of a recipient country and FDI flows into that country
 - High per capita income in recipient country
 - Access to mineral or raw materials
 - Trade arrangement/ tariff/ non-tariff barriers (firms can '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	•Ownership of hi-tech resources •Ability to utilise resources in the new market •Mostly oligopoly	•Large market size with impressively high growth •Effective trade protection	Low
Resource-seeking	•Wide access to global market •Potentials to develop vertical integration	•Resource-abundant	Low
Efficiency-seeking	•Ability to utilise resources in new markets + distribute produces around the globe to enjoy economies of scale	•Various government policies available to facilitate foreign investors	High

Theoretical Foundation: Capital Market Equilibrium

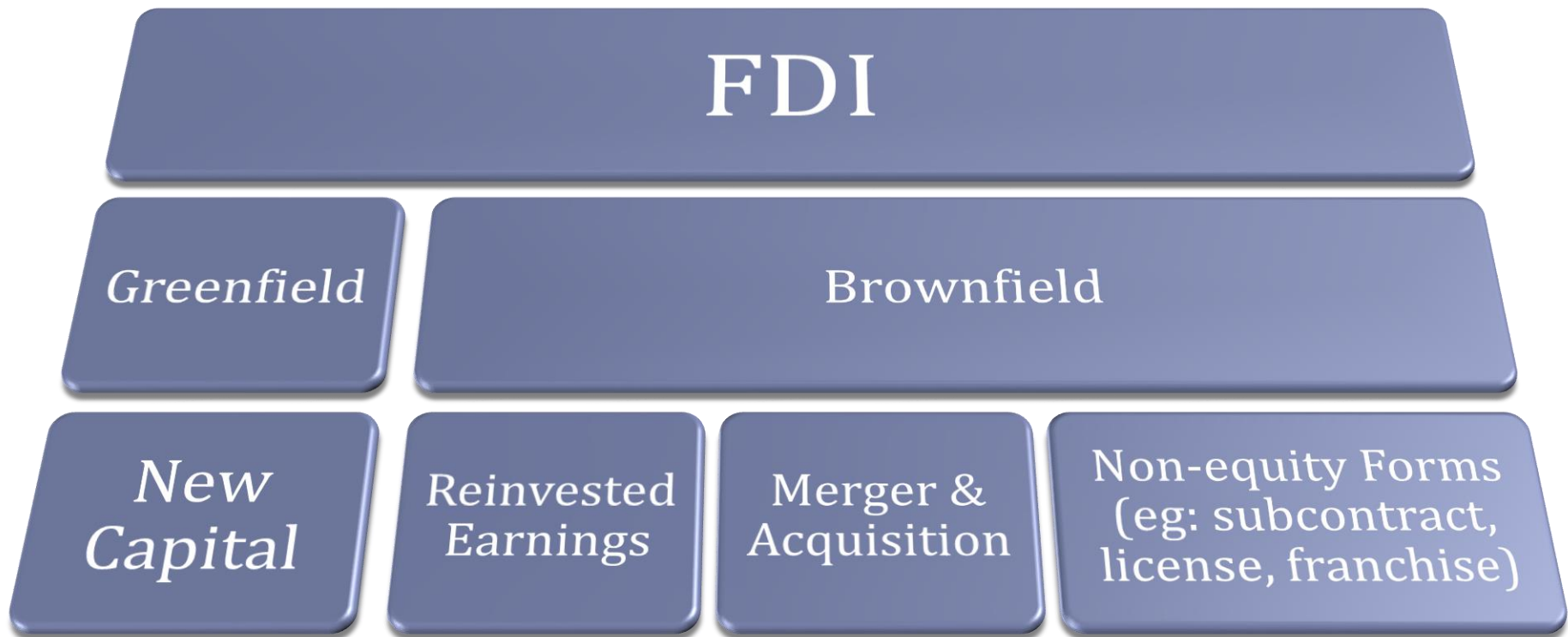
FDI Advantage: OLI Paradigm (Dunning 1988, 1995)



Definition

- The process whereby residents of one country (home) acquire ownership of assets for the purpose of controlling the production, distribution and toher 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

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.