

Multinationals and the Globalization of Production

FDI and the host country

Penn State // Fall 2016

Administrative things

- ▶ Arkaive.com course code: 3D0Y
 - ▶ Please sign in
- ▶ Problem set #3
 - ▶ Solutions posted online
 - ▶ Graded problem sets on Tuesday
- ▶ Problem set #4
 - ▶ Due end of class Thursday 10/27
 - ▶ Posted on course web later today

Guest speaker

- ▶ Tuesday 10/25, half class/half speaker
- ▶ Baroness Joanna Shields (Penn State 1984)
- ▶ Currently the U.K. Minister for Internet Safety and Security
- ▶ Background in multinational management
 - ▶ Managing director, Google Europe, Middle East, Africa
 - ▶ VP & Managing director, Facebook Europe, Middle East, Africa

Roadmap

- ▶ Past: Motives for firms to produce abroad
 - ▶ Horizontal reasons (market access)
 - ▶ Vertical reasons (factor cost differences)
 - ▶ Some mixture of the two
 - ▶ Focused on the firm

- ▶ Currently: The impact of FDI on the host country
 - ▶ Host country productivity effects of MNEs ✓
 - ▶ Factor market effects
 - ▶ Competition effects
 - ▶ Should governments encourage inward FDI?
 - ▶ Focus on host country

Factor market effects and FDI

- ▶ How will MNEs affect factor market prices?
- ▶ Factor markets: labor markets, capital markets, natural resource markets, utilities
- ▶ Key issue: factor demand by MNEs vs. factor supply in the country

Negative factor market effects

- ▶ If MNEs need factors that are inelastically supplied
 - ▶ Likely to raise factor prices
- ▶ Example
 - ▶ Energy-intensive MNE...
 - ▶ ...in a country with limited electrical capacity
 - ▶ MNE demand for electricity increases price of electricity
 - ▶ Higher electricity prices hurt other firms and consumers

Neutral factor market effects

- ▶ If MNEs need factors that are elastically supplied
 - ▶ Small impact on factor prices
- ▶ Example
 - ▶ Unskilled-labor intensive MNE...
 - ▶ ...in a country with lots of unskilled labor
 - ▶ MNE demand for unskilled labor changes unskilled wage little
 - ▶ Other firms that use unskilled labor unharmed
- ▶ If MNE investment is large enough, can eventually matter
 - ▶ Rising Chinese wages → MNEs look to Vietnam

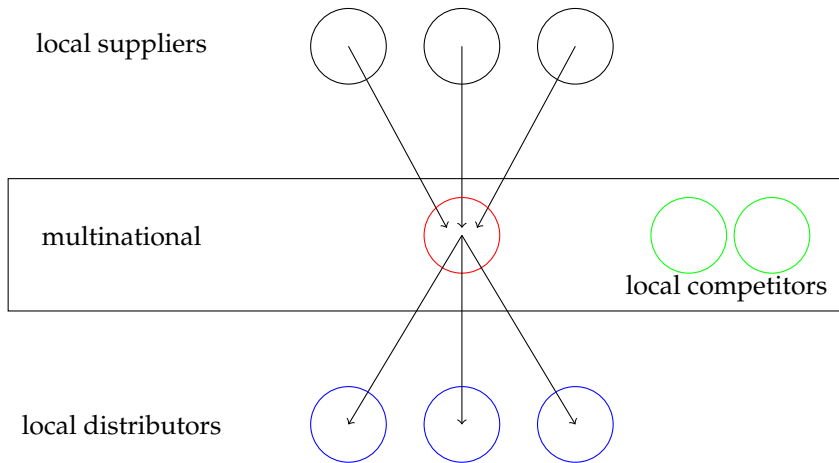
Factor market effects and FDI

- ▶ How will MNEs affect factor market prices?
- ▶ Factor markets: labor markets, capital markets, natural resource markets, utilities
- ▶ Key issue: factor demand by MNEs vs. factor supply in the country
 - ▶ If MNEs need inelastic factors → likely negative effects
 - ▶ If MNEs need elastic factors → likely small effects

Competition effects of FDI

- ▶ Will the MNE improve competition?
- ▶ Is there an established local industry?
 - ▶ How competitive is the local industry?

MNE interactions with other firms: flow of goods



Competition effects of FDI

- ▶ If local firms have market power
 - ▶ MNE provides competition
 - ▶ Decreases markups, lowers prices
 - ▶ Good for consumers, downstream firms

- ▶ Can it go too far?
 - ▶ If MNE drives local firms out of business
 - ▶ Potentially less competition in the market
 - ▶ Higher markups and prices
 - ▶ Bad for consumers, downstream firms

The impact of FDI on the host country

- ▶ Ways FDI affect host countries
 - ▶ Host country productivity effects of MNEs ✓
 - ▶ Factor market effects ✓
 - ▶ Competition effects ✓
 - ▶ Others...

- ▶ Evaluating foreign investment projects

- ▶ Should governments encourage inward FDI?

Evaluating potential FDI

- ▶ Policy makers faced with potential FDI projects
- ▶ Who are the winners and the losers?
- ▶ A framework of questions
 1. Is the investment likely to raise production costs for local firms?
 2. Are there local firms that compete directly with the MNE?
 3. Are there local firms that will likely benefit from the MNE?
- ▶ Often this a local (region/state/city) analysis
- ▶ Depends on how “big” markets are

Is the investment likely to raise production costs for local firms?

- ▶ Factor market competition
- ▶ What factors do the MNE need?
- ▶ How abundant are those factors?

Are there local firms that compete directly with the MNE?

- ▶ Competition effects: Are there other firms in the MNE's market?
- ▶ How competitive are the markets?

Are there local firms that will likely benefit from the MNE?

- ▶ Improved inputs for downstream firms
- ▶ Spillovers to upstream/downstream firms

In-class case study

- ▶ General Motors investment in Brazil
- ▶ The Blue Macaw project
- ▶ Assembly of **small, low cost car** for S. American market
- ▶ Located in **Gravatá, Brazil**
 - ▶ Chile, Argentina, Uruguay highest GDP/capita S. America
 - ▶ Brazil is part of the customs union Mercosur

In-class case study: GM in Brazil

- ▶ Read the background on Blue Macaw
- ▶ What are GM's FDI motivations?
 - ▶ Horizontal, vertical, etc.
 - ▶ Why? What does GM gain?
 - ▶ Why Rio Grande do Sul and not Sao Paulo?
- ▶ Evaluate the project using the framework we developed
 1. Is the investment likely to raise production costs for local firms?
 2. Are there local firms that compete directly with the MNE?
 3. Are there local firms that will likely benefit from the MNE?
- ▶ Who are the winners and losers?

In-class case study: GM in Brazil

- ▶ Read the article I handed out
- ▶ Write “notes” that you would use to form answers
- ▶ Think about how you would present this to an interviewer

- ▶ Take 20 minutes to read and form your answers
- ▶ Then we will discuss the issues

In-class case study: GM in Brazil

- ▶ What are GM's FDI motivations? What do they gain? Why?
- ▶ Why Rio Grande do Sul and not Sao Paulo?

In-class case study: GM in Brazil

1. Is the investment likely to raise production costs for local firms?

In-class case study: GM in Brazil

2. Are there local firms that compete directly with the MNE?

In-class case study: GM in Brazil

3. Are there local firms that will likely benefit from the MNE?