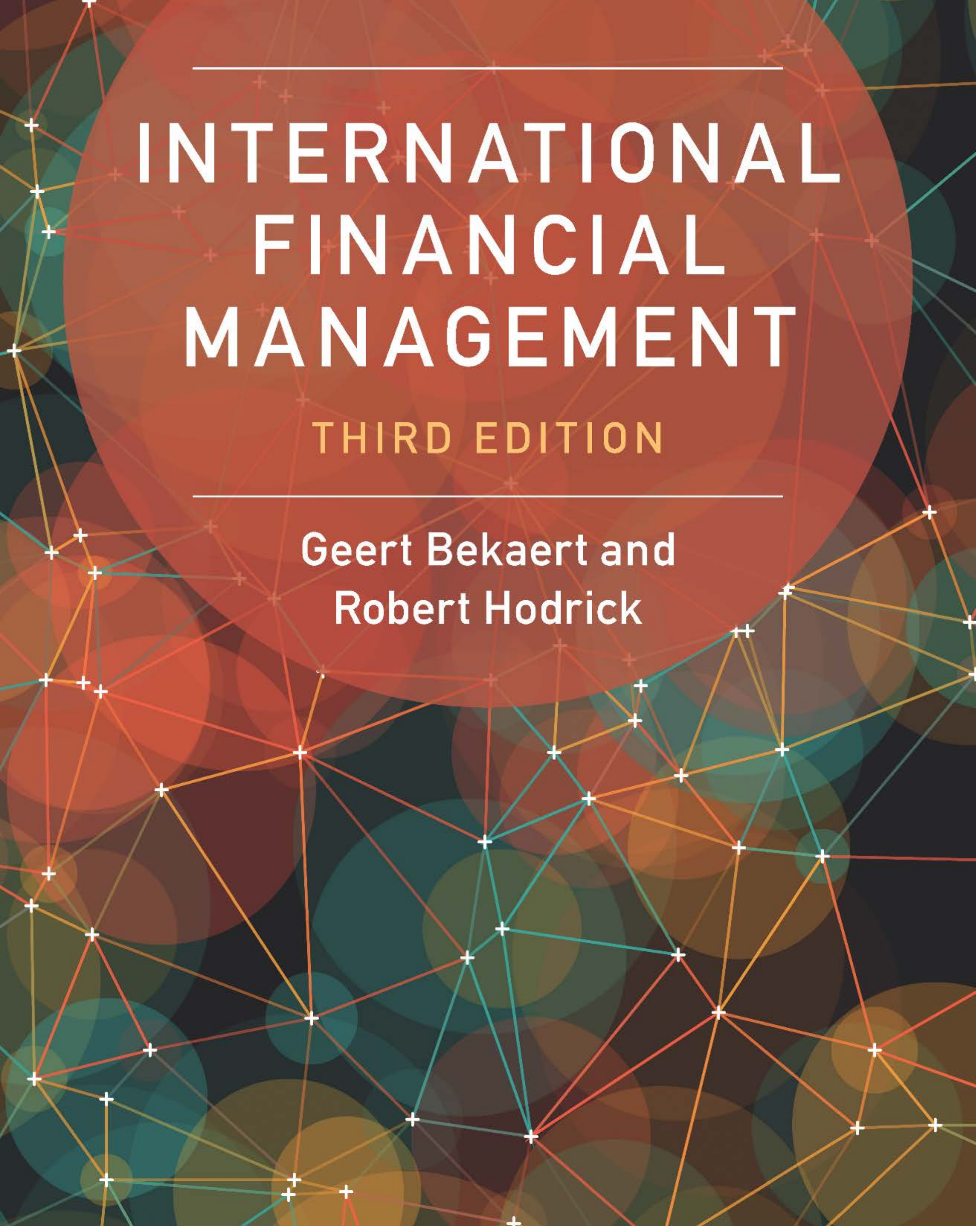



# Chapter 1

## Globalization and the Multinational Corporation

# 1.1 Introduction

- Globalization
  - Increasing connectivity and integration of countries and corporations and the people within them in terms of their economic, political, and social activities
- Multinational corporations
  - Produce and sell goods or services in more than one nation
  - BRIC countries (Brazil, Russia, India and China) offer a lot of opportunities for expansion
- International scope creates opportunities but also challenges
  - Recent crisis

# 1.2 Globalization and the Growth of International Trade and Capital Flows

- The growth of international trade
  - Trade liberalization so countries can specialize at production of goods for which they have a comparative advantage
    - 1960s only 20% of countries were open
    - By 2000, over 70% of countries were open
    - Free Trade agreements
      - GATT (1947)
      - WTO (1986)
      - Regional Trade agreements (European Union, NAFTA, ASEAN)
  - Outsourcing
    - Shifting of non-strategic functions to specialist firms

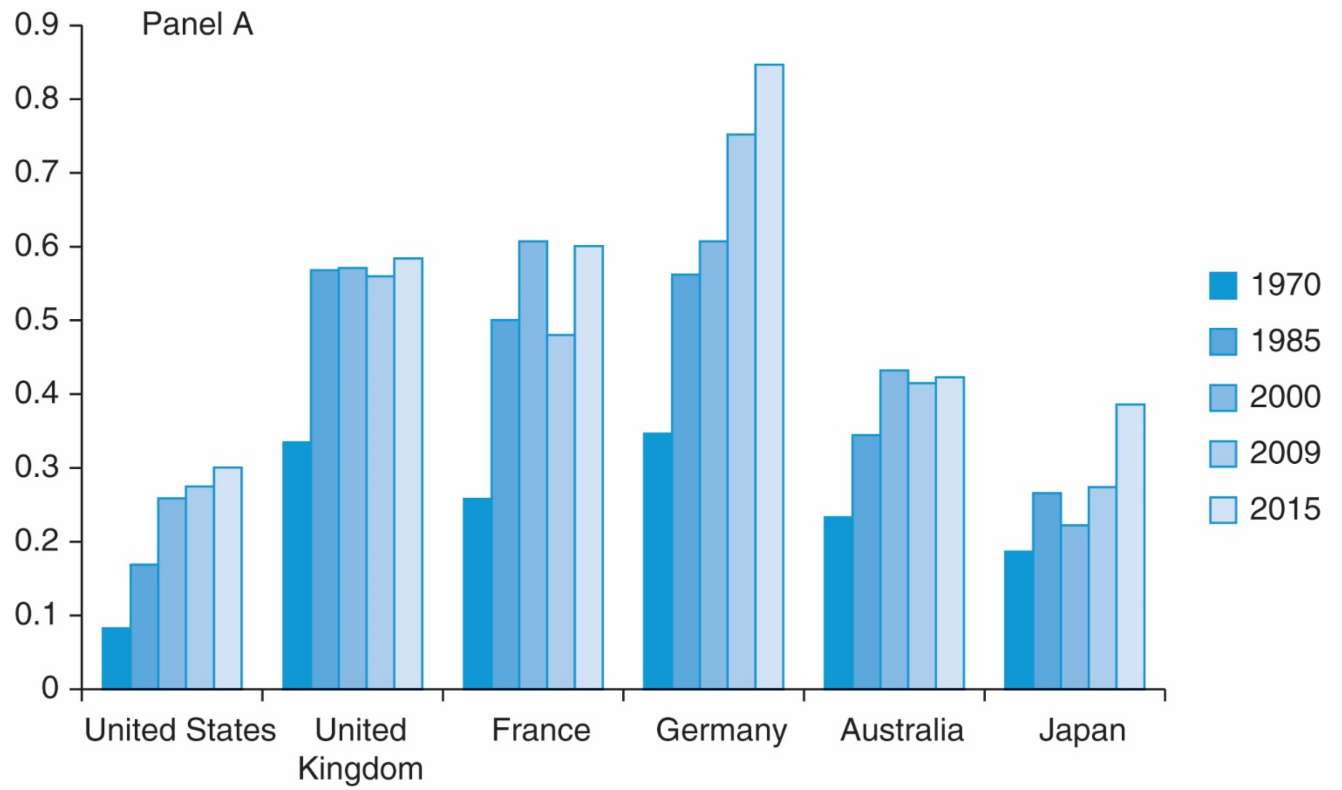
# 1.2 Globalization and the Growth of International Trade and Capital Flows

- The growth in trade
  - Germany is most open, United States is least open
  - China’s trade jumped due to trade reforms
  - Countries that border oceans tend to trade more
  - Large countries tend to trade less than small

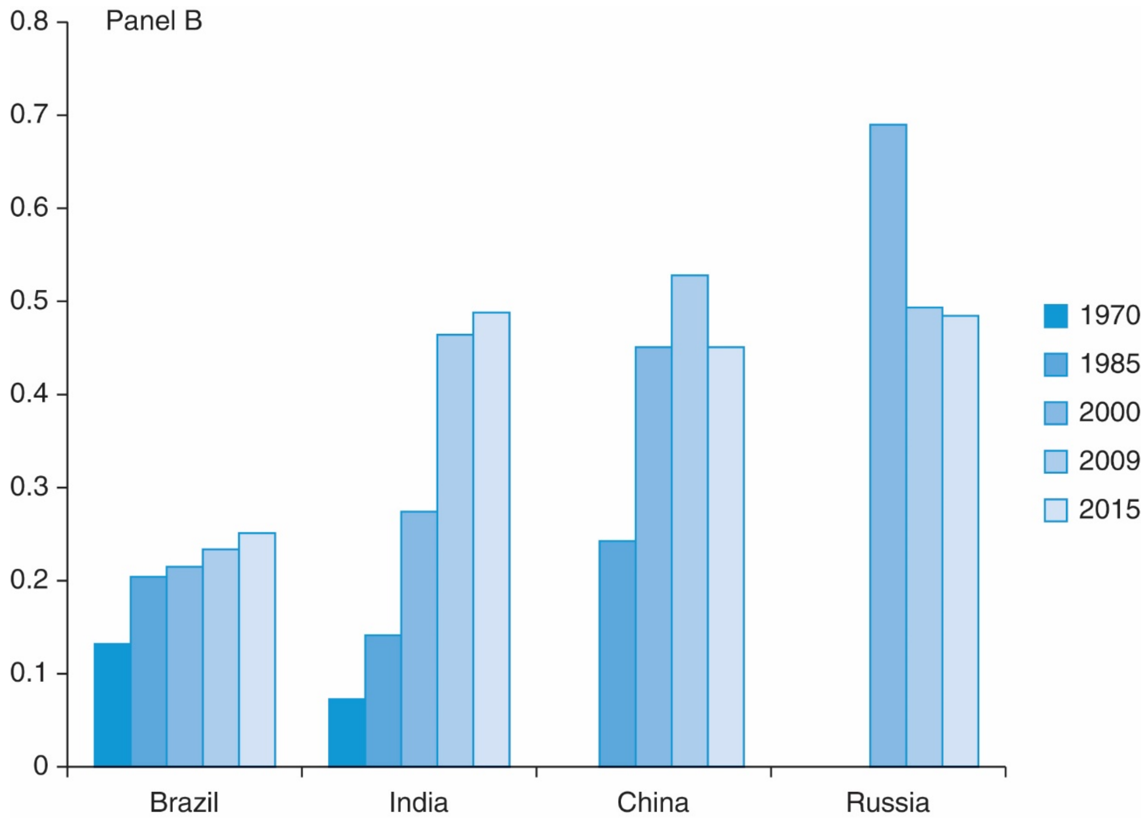
# 1.2 Globalization and the Growth of International Trade and Capital Flows

- Incredible growth in MNCs after WWII
  - 37,000 MNCs in 1990
  - 82,053 in 2010
  - More than 50% of international trade occurs within MNCs
- Globalization of financial markets
  - Trends in financial openness
    - Countries began to allow foreigners to invest in their markets (1980s)
    - Creation of new asset class – emerging markets
  - New financial landscape – derivatives
    - An investment whose payoff over time is derived from the performance of underlying assets (futures, forwards…)
    - Securitization – repackaging of “pools” of loans or other receivables to create a new financial instrument

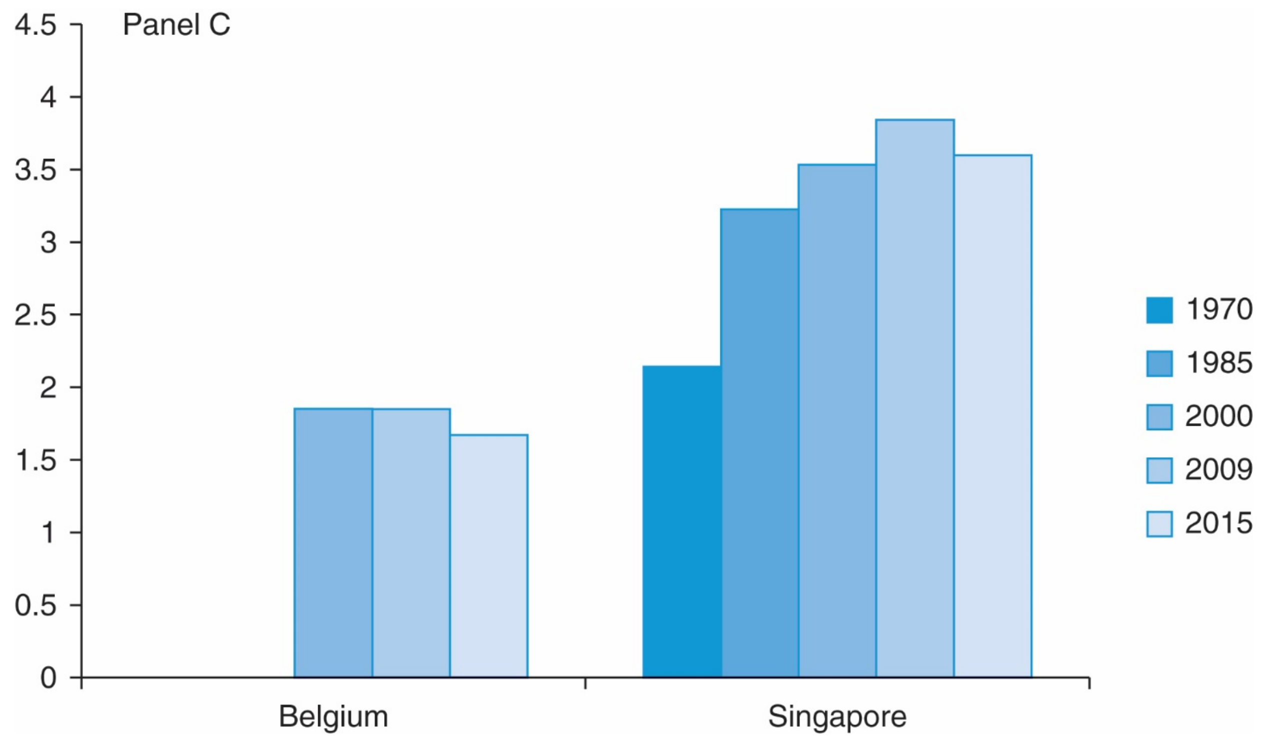
# Exhibit 1.1 (Panel A) International Trade as a Percentage of GDP



# Exhibit 1.1 (Panel B) International Trade as a Percentage of GDP



# Exhibit 1.1 (Panel C) International Trade as a Percentage of GDP



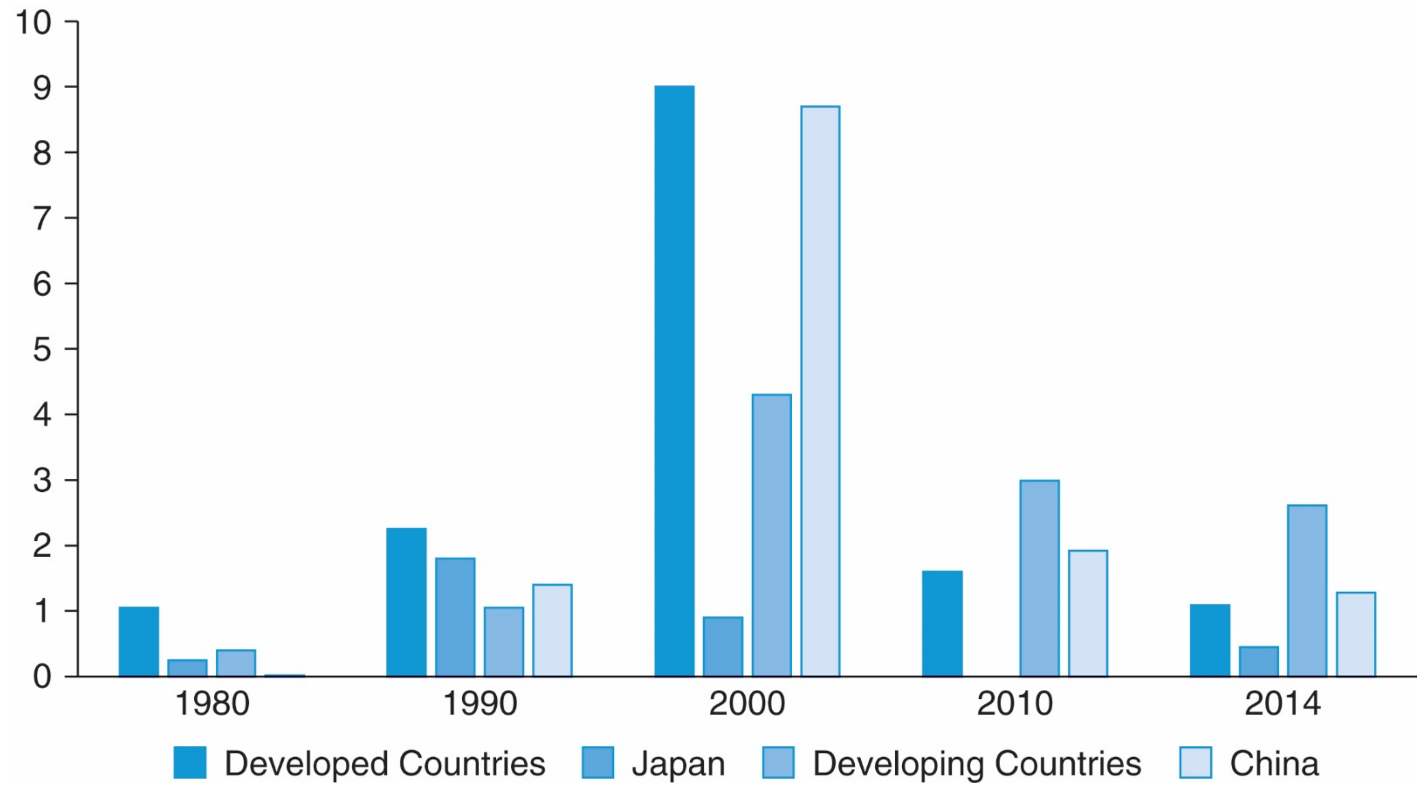
# 1.2 Globalization and the Growth of International Trade and Capital Flows

- Globalization of financial markets
  - Pros and cons of development
    - Pro – banks (and companies) could hedge against risk
    - Cons – smart financiers exploit differences in country-specific regulations and complexity of instruments created opaqueness in the financial system
      - Global Financial Crisis – 2008 – 2010
        - Started in U.S.
        - Longest and deepest in the postwar era
        - Scale and depth of crisis raises deep issues about the functioning of the global financial system

# 1.3 Multinational Corporations

- Foreign Direct Investment (FDI)
  - When a company from one country buys at least 10% of a company in another country
  - Has grown from $7.5 trillion in 2000 to $25.0 trillion in 2015
  - Mergers and acquisitions (M&A) play a huge role in this trend

# Exhibit 1.5 Foreign Direct Investment as a Percentage of GDP



# Exhibit 1.6 Cross-Border Mergers and Acquisitions, 2000–2015 (in millions of dollars)

**Exhibit 1.6** Cross-border mergers and acquisitions, 2000–2015 (in millions of dollars)

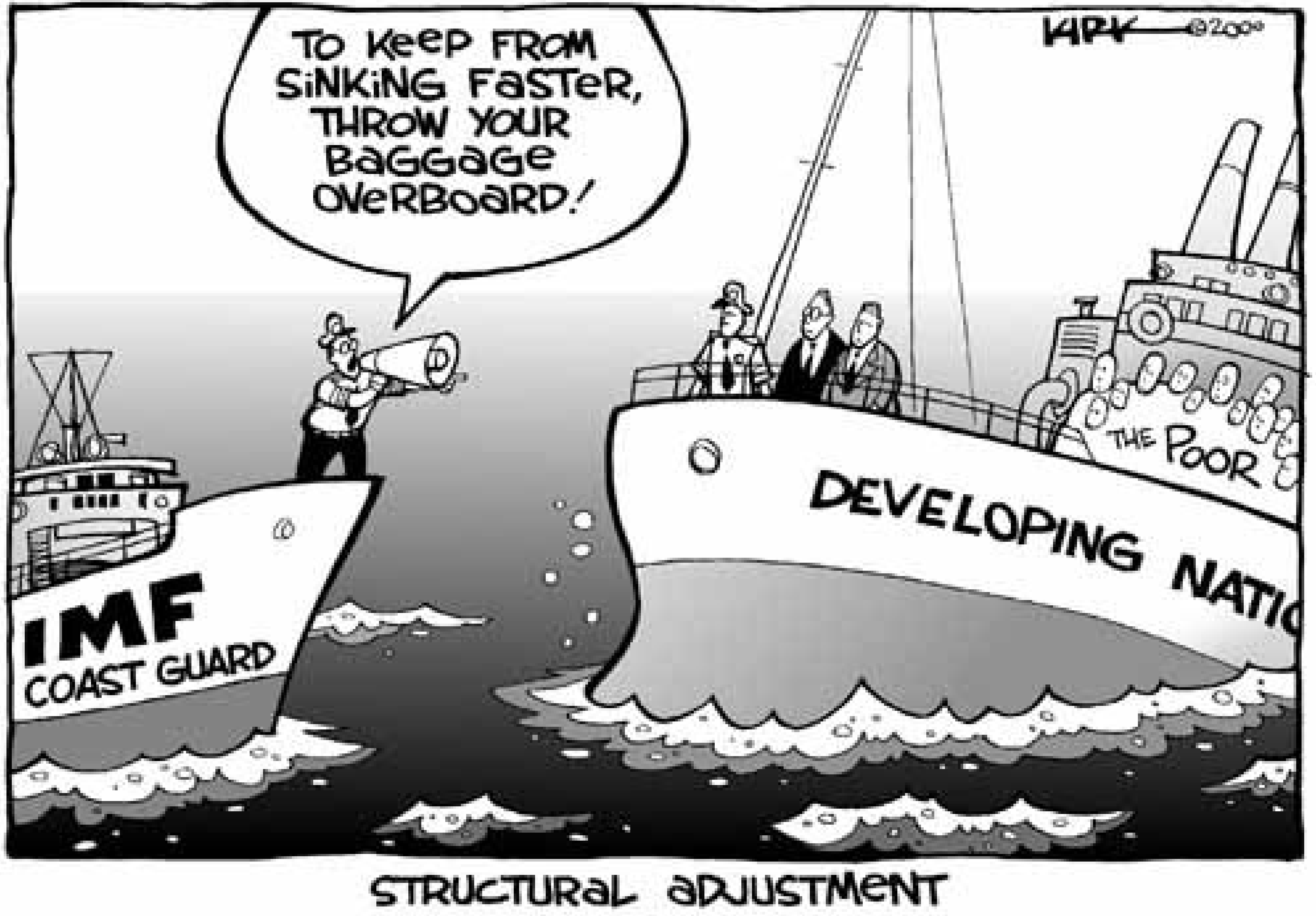
| | By purchaser | | | By seller | | |
|---|---|---|---|---|---|---|
| Region/Economy | 2000 | 2010 | 2015 | 2000 | 2010 | 2015 |
| World | 959,681 | 347,094 | 721,455 | 959,681 | 347,094 | 721,455 |
| Developed economies | 894,982 | 224,759 | 585,860 | 870,099 | 259,926 | 630,853 |
| Europe | 724,478 | 44,262 | 318,047 | 507,745 | 127,458 | 295,090 |
| France | 154,785 | 6,180 | 23,506 | 33,579 | 3,573 | 44,104 |
| Germany | 9,737 | 7,025 | 46,669 | 232,578 | 10,515 | 14,604 |
| Ireland | 5,985 | 5,124 | 97,480 | 3,665 | 2,127 | 48,049 |
| Italy | 18,439 | (5,190) | 3,101 | 11,300 | 6,329 | 14,269 |
| Luxembourg | 492 | 1,558 | 17,352 | 26 | 2,138 | 13,558 |
| Netherlands | 33,604 | 16,418 | 20,275 | 28,779 | 4,162 | 15,540 |
| Spain | 36,495 | 2,898 | 16,715 | 20,095 | 10,348 | 9,665 |
| Switzerland | 59,786 | 12,928 | 39,971 | 5,765 | 1,321 | 17,416 |
| United Kingdom | 339,546 | (3,851) | 34,955 | 112,160 | 60,826 | 71,047 |
| North America | 150,430 | 120,717 | 207,851 | 332,885 | 97,616 | 313,368 |
| Canada | 39,032 | 35,614 | 87,826 | 79,944 | 13,272 | 14,629 |
| United States | 111,398 | 85,104 | 120,024 | 252,941 | 84,344 | 298,739 |
| Other developed economies | 20,074 | 59,779 | 59,963 | 29,469 | 34,853 | 22,396 |
| Australia | 3,441 | 15,629 | 11,527 | 8,861 | 27,172 | 9,091 |
| Japan | 3,107 | 31,271 | 50,381 | 11,439 | 7,114 | 3,203 |
| Developing economies | 60,810 | 100,378 | 119,057 | 88,971 | 83,072 | 81,181 |
| Africa | 2,938 | 3,792 | 3,358 | 2,387 | 7,493 | 20,414 |
| South Africa | 2,934 | 1,619 | 549 | 352 | 3,653 | 20,969 |
| Asia | 53,181 | 79,865 | 110,342 | 52,771 | 37,723 | 46,398 |
| China | (398) | 29,828 | 43,653 | 37,875 | 6,758 | 9,660 |
| Hong Kong, China | 39,865 | 13,318 | 17,916 | 1,472 | 12,684 | 23,832 |
| Korea, Republic of | 1,286 | 9,952 | 563 | 6,345 | (2,063) | (3,649) |
| Kuwait | (480) | (10,793) | 731 | 0 | 460 | 868 |
| Qatar | 2 | 626 | 8,838 | 0 | 12 | 0 |
| Singapore | 7,504 | 8,963 | 21,130 | 1,397 | 3,859 | 4,977 |
| Latin America and the Caribbean | 4,323 | 16,725 | 5,340 | 33,811 | 29,013 | 12,134 |
| Brazil | 239 | 9,030 | (1,654) | 12,981 | 10,115 | 2,719 |
| Mexico | 4,031 | 2,896 | 2,393 | 4,528 | 7,989 | 4,765 |
| Russian Federation | 294 | 3,875 | 4,338 | 411 | 2,882 | 6,677 |

# 1.4 Other Important International Players

- International banks
- International institutions
  - International Monetary Funds (IMF)
    - Member organization whose goal is to ensure the stability of the international monetary and financial system through surveillance and technical assistance
  - The World Bank
    - Member organization whose goals are development, poverty alleviation and advising
      - IBRD – middle-income countries
      - IDA – poorest countries
      - IFC – grow private sector of developing nations

# International Monetary Fund

- The IMF monitors and regulates the international monetary system
- One of its main functions is to provide advice and policy recommendations to emerging markets and LDCs
- It also monitors the financial systems in member countries
- It provides loans to countries that have difficulties repaying sovereign debt
- It usually imposes “conditions” on policy goals in return for making these loans.


KIRK ©2000
TO KEEP FROM SINKING FASTER, THROW YOUR BAGGAGE OVERBOARD!
IMF
COAST GUARD
DEVELOPING NATIO
THE POOR
STRUCTURAL ADJUSTMENT

# World Bank

- The World Bank borrows on international financial markets, and makes loans to middle-income and developing countries.
- Many loans to developing countries are at subsidized rates.
- There are also a number of regional lenders, or “multilateral development banks”, such as the Inter-American Development Bank or the Asian Development Bank
- A new multilateral lender sponsored by China is the Asia Infrastructure Investment Bank


World Bank

# 1.4 Other Important International Players

- Multilateral development banks
  - Regional development banks (including World Bank and regional banks in Africa, Asia and Europe) who provide financing and grants
- World Trade organization (WTO)
  - Mediates trade disputes
- Organization for Economic Cooperation and Development (OECD)
  - Examines, devises and coordinates policies across 34 relatively wealthy nations to foster sustainable economic growth and employment, rising standards of living and financial stability
- Bank for International Settlements (BIS)
  - Fosters international monetary and financial cooperation – central banks' central bank

# World Trade Organization


- The WTO is a forum for negotiating international trade agreements
- Developed from GATT – the General Agreement on Tariffs and Trade.
- The key principle is the Most Favored Nation clause
- There is a WTO court for settling trade disputes
- The WTO vs. regional trade agreements
- The WTO vs. bilateral trade agreements


PAX AMERICAN
WTO

# Organization for Economic Cooperation and Development

- The OECD is an organization of “rich” countries
- It coordinates economic policy and provide a forum for policy discussions

# Bank for International Settlements

- The BIS is a forum for international financial regulation
- It hosted the meetings that established the Basel Accords
- The same building hosts the Financial Stability Board that monitors macro-financial risks in member countries
- The BIS also manages reserves for central banks around the world that don’t have the capabilities of doing that themselves.

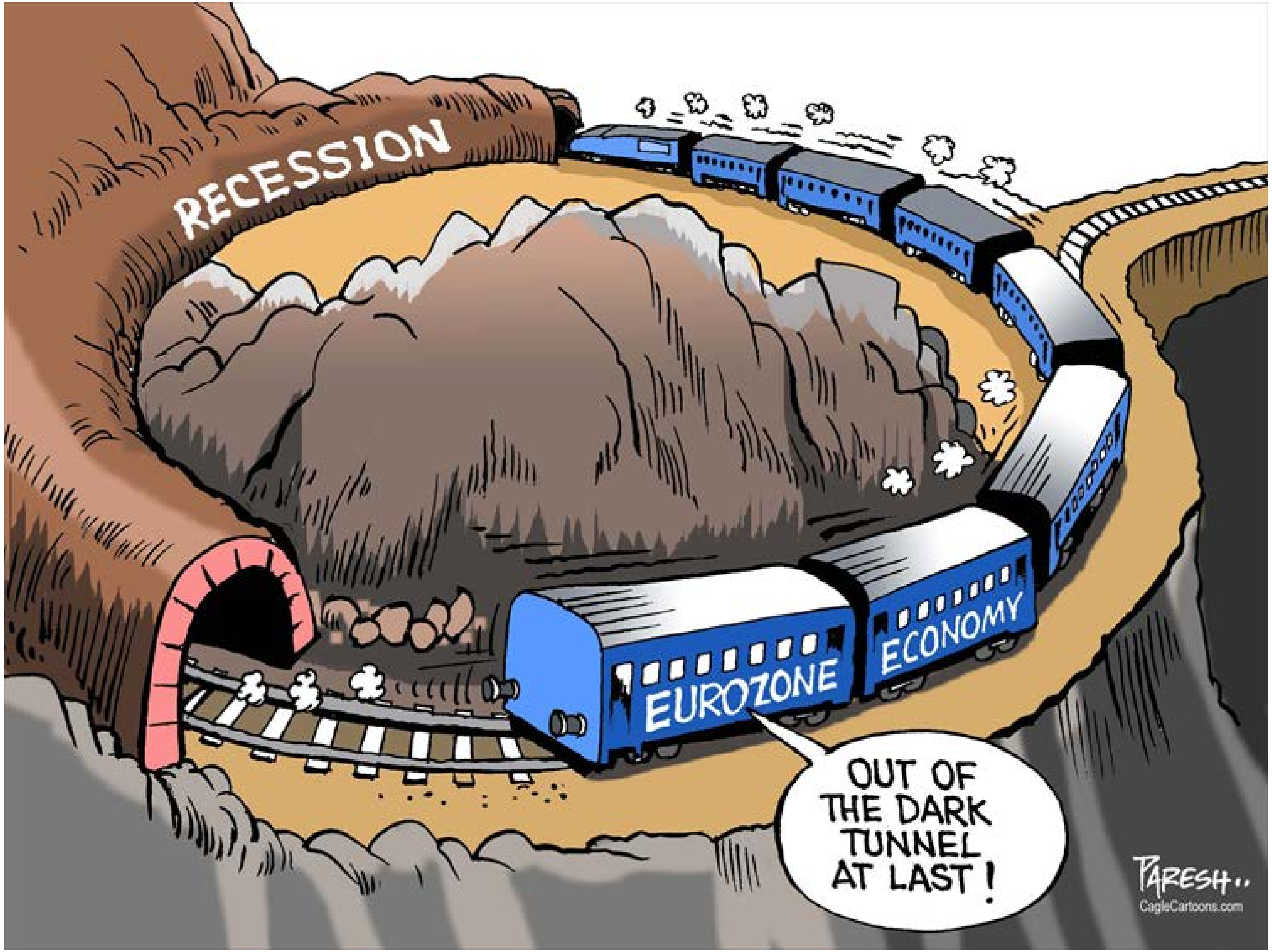
# 1.4 Other Important International Players

- European Union (EU)
  - Cooperation among countries in this region and (in most cases) the adoption of the same currency to promote international business
  - Economic and monetary union (EMU)
- Governments
- Individual investors
- Institutional investors
- Sovereign wealth funds
  - Government-run investment pools
- Hedge funds
- Private equity funds

let's take our country back
Vote Leave
CAN I TAKE MY VOTE BACK?
Brexit CHAOS
Brexit: THEY LIED
OMG!
CHAPPATTE
International New York Times

# European Central Bank

- The ECB sets monetary policy for member of the European Monetary Union (EMU), and in particular, the euro area
- 19 countries in Europe use the euro as their currency
- Pros and cons of a single currency


RECESSION
EUROZONE
ECONOMY
OUT OF THE DARK TUNNEL AT LAST!
PARESH..
CagleCartoons.com

# 1.5 Globalization and the MNC: Benefactor or Menace?

- Countries who had opened their markets to foreigners subsequently fell into crisis
- Benefits of openness
  - Channels savings to most productive uses
  - Sharing of risk beyond what is possible domestically
  - Domestic recessions can be buffered through borrowing
  - Cost of capital decreases
- Costs of openness
  - Sometimes capital is not used wisely
  - Foreign capital can leave quickly causing financial volatility
  - Difficulty in taxing profits – MNCs shift to avoid
  - Capital control effectiveness decreases

# Capital Mobility

Much of the analysis of the textbook assumes capital flows freely across borders

However, many countries have restrictions both on capital inflows and outflows.

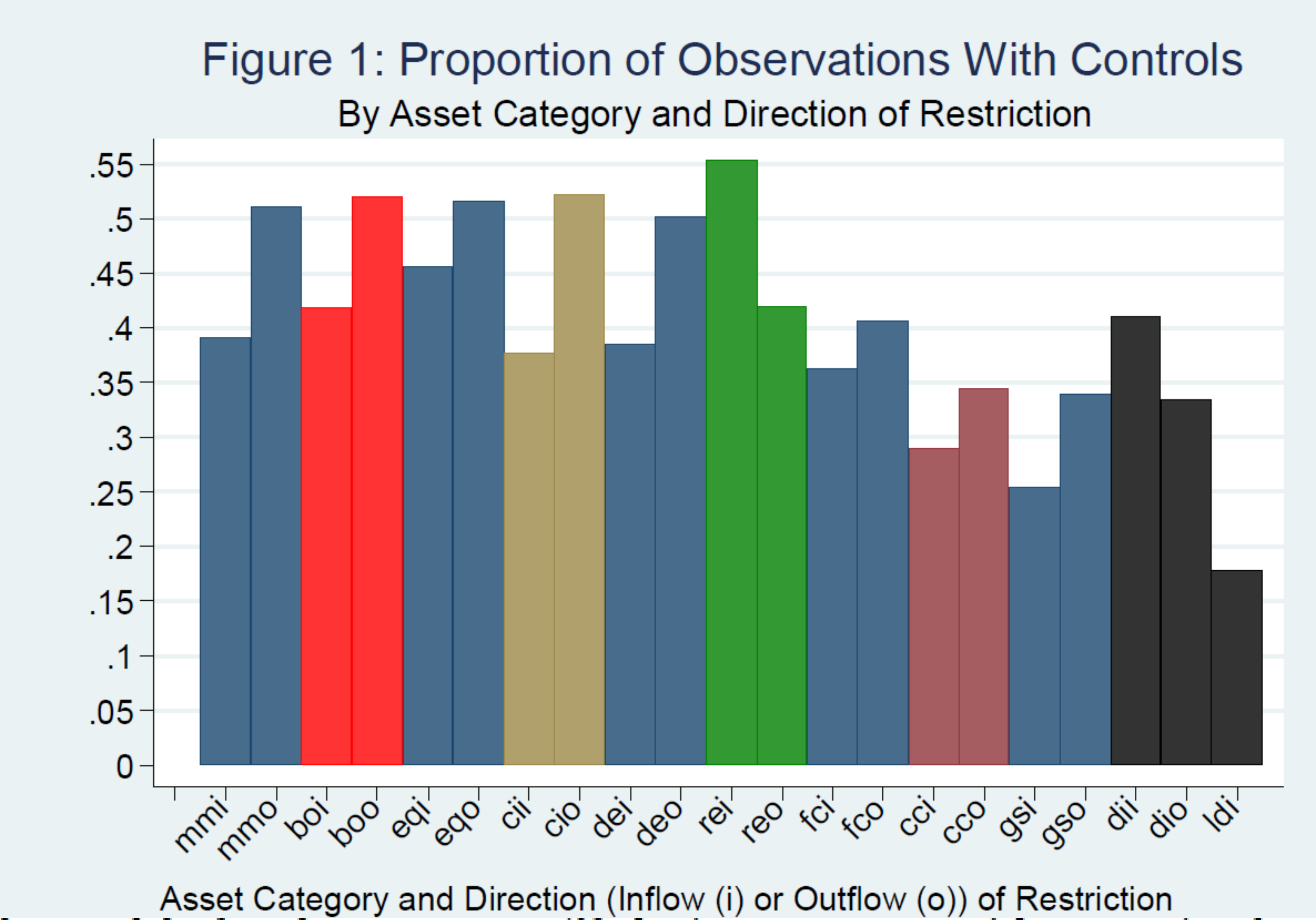
- Capital inflows are foreign investments into a country – loans, purchases of equity, etc.
- Capital outflows are domestic investments into another country
- Capital inflows include repatriation by domestic investors of foreign investments
- Capital outflows include repatriation by foreign investors of domestic investments

We can get some sense of capital controls from the Fernandez et al. paper

| Table 2: Countries In Data Set, By Income Groups, With Open/Gate/Wall Category | | | | | |
|---|---|---|---|---|---|
| High (42) | | Upper Middle (26) | | Lower Middle & Low (32) | |
| Australia | Gate | Algeria | Wall | Bangladesh* | Gate |
| Austria | Open | Angola | Wall | Bolivia | Gate |
| Bahrain | Gate | Argentina | Gate | Burkina Faso* | Gate |
| Belgium | Open | Brazil | Gate | Cote d'Ivoire | Wall |
| Brunei Darussalam | Open | Bulgaria | Gate | Egypt | Open |
| Canada | Open | China | Wall | El Salvador | Open |
| Chile | Gate | Colombia | Gate | Ethiopia* | Gate |
| Cyprus | Gate | Costa Rica | Open | Georgia | Open |
| Czech Republic | Gate | Dominican Republic | Gate | Ghana | Gate |
| Denmark | Open | Ecuador | Gate | Guatemala | Open |
| Finland | Open | Hungary | Gate | India | Wall |
| France | Open | Iran | Gate | Indonesia | Gate |
| Germany | Gate | Jamaica | Gate | Kenya* | Gate |
| Greece | Open | Kazakhstan | Gate | Kyrgyz Republic | Gate |
| Hong Kong | Open | Lebanon | Gate | Moldova | Gate |

| | | | | | |
|---|---|---|---|---|---|
| Iceland | Gate | Malaysia | Wall | Morocco | Wall |
| Ireland | Open | Mauritius | Open | Myanmar* | Gate |
| Israel | Gate | Mexico | Gate | Nicaragua | Open |
| Italy | Open | Panama | Open | Nigeria | Gate |
| Japan | Open | Peru | Open | Pakistan | Wall |
| Korea | Gate | Romania | Gate | Paraguay | Open |
| Kuwait | Gate | South Africa | Gate | Philippines | Wall |
| Latvia | Open | Thailand | Gate | Sri Lanka | Wall |
| Malta | Gate | Tunisia | Wall | Swaziland | Wall |
| Netherlands | Open | Turkey | Gate | Tanzania* | Wall |
| New Zealand | Open | Venezuela | Gate | Togo* | Wall |
| Norway | Open | | | Uganda* | Gate |
| Oman | Open | | | Ukraine | Wall |
| Poland | Gate | | | Uzbekistan | Wall |
| Portugal | Gate | | | Vietnam | Gate |
| Qatar | Open | | | Yemen | Open |
| Russia | Gate | | | Zambia | Open |

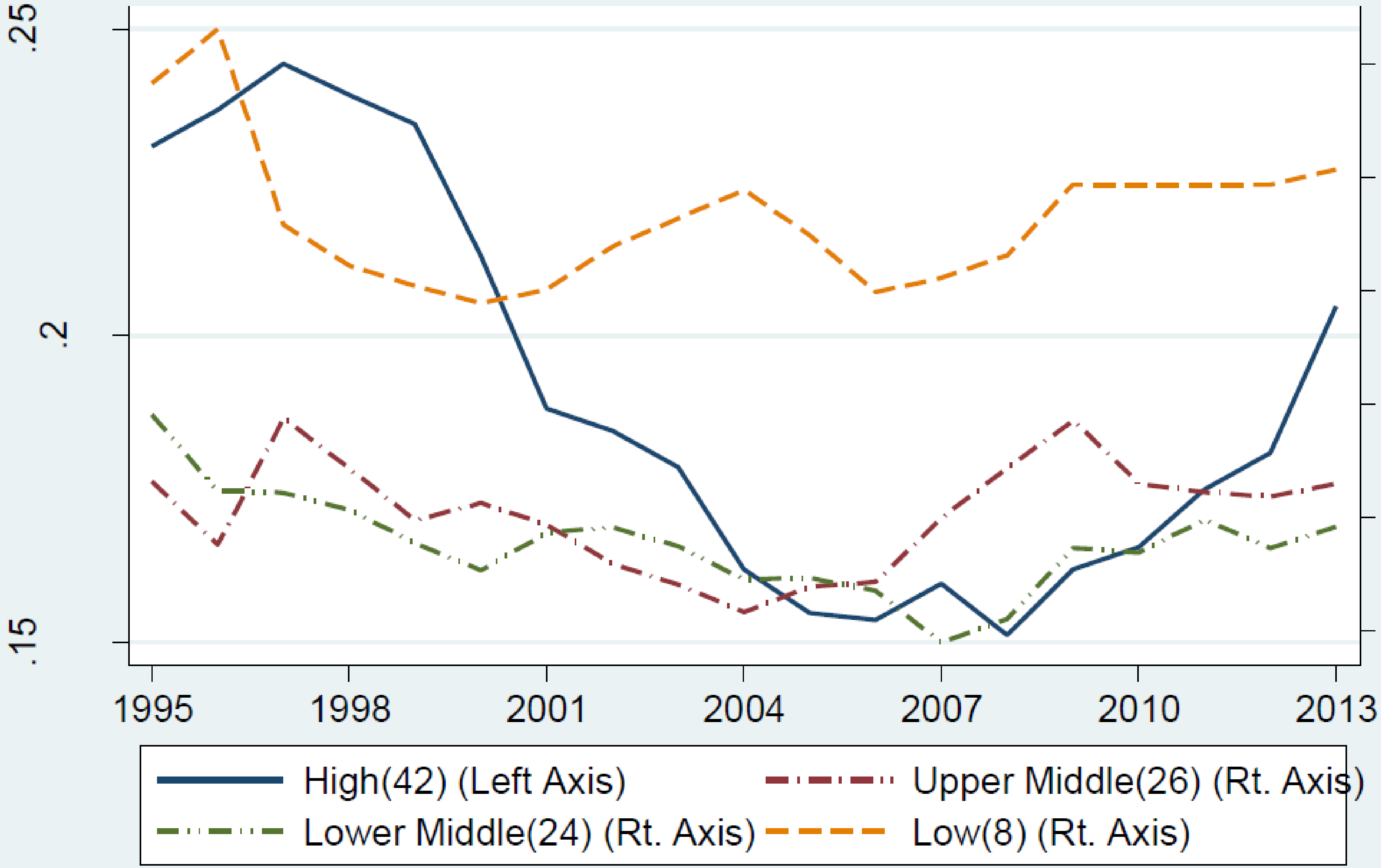
| | | | |
|---|---|---|---|
| Saudi Arabia | Gate | | |
| Singapore | Open | | |
| Slovenia | Gate | | |
| Spain | Open | | * = Low Income rather than Lower Middle Income |
| Sweden | Open | | |
| Switzerland | Gate | | |
| U.A.E. | Gate | | |
| United Kingdom | Open | | |
| United States | Open | | |
| Uruguay | Open | | |
| Open (36) / Gate (48) / Wall (16) | | | |
| 24 / 18 / 0 | | 4 / 17 / 5 | 8 / 13/ 11 |




mm – Money Market Instruments (Debt instruments with maturity 1 year or less)
bo – Bonds (Debt instruments with maturity greater than 1 year)
eq – Equities ci – Collective Investments de – Derivatives re – Real Estate
fc – Financial Credits cc – Commercial Credits gs – Guaranties & Sureties
di – Direct Investment ldi – liquidation of direct investment

# Figure 2a: Average Controls on Inflows by Income Group

Averages Across 10 Asset Categories



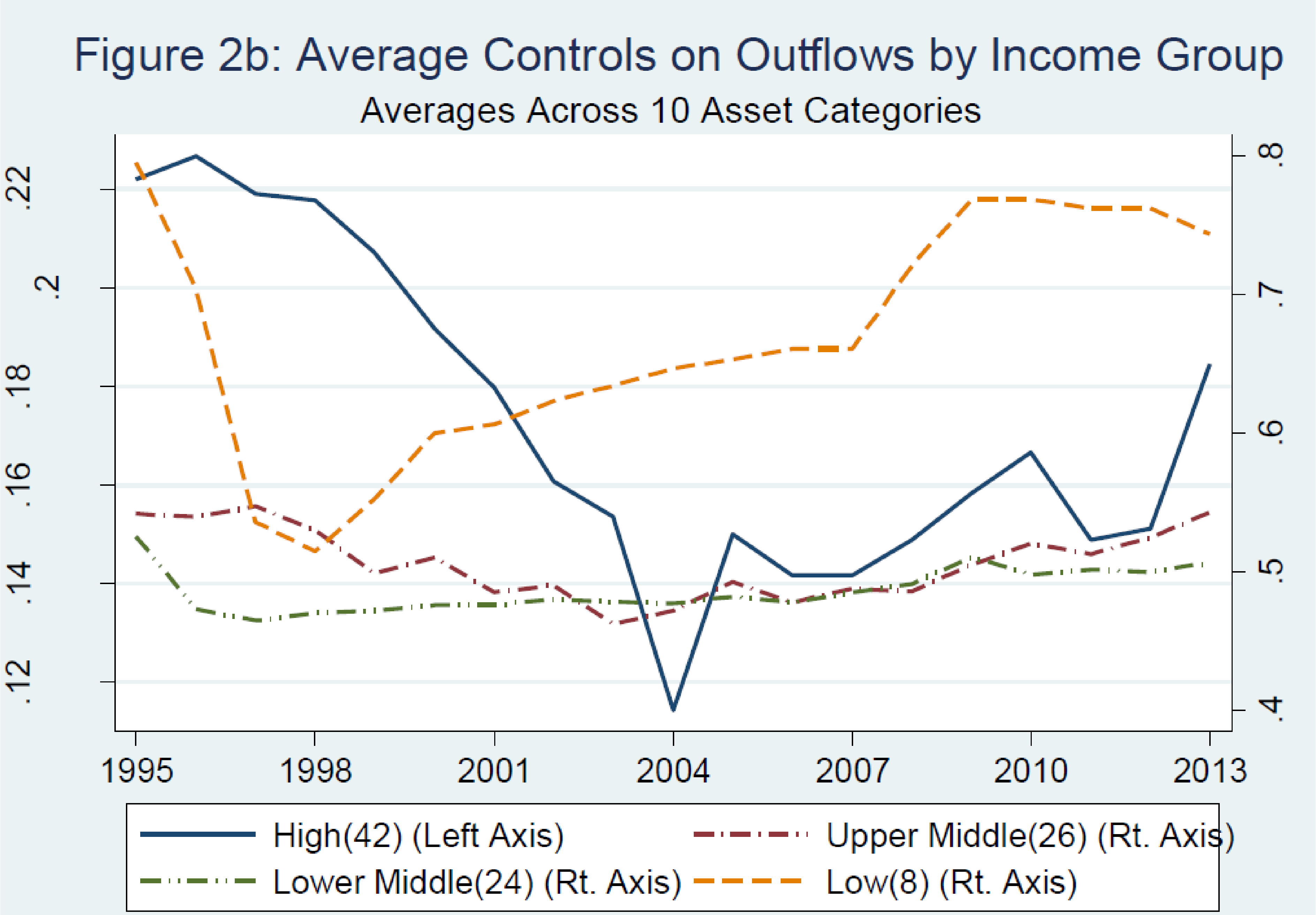


Figure 2b: Average Controls on Outflows by Income Group
Averages Across 10 Asset Categories
.12
.14
.16
.18
.2
.22
.4
.5
.6
.7
.8
1995
1998
2001
2004
2007
2010
2013
High(42) (Left Axis)
Upper Middle(26) (Rt. Axis)
Lower Middle(24) (Rt. Axis)
Low(8) (Rt. Axis)

# Figure 3: Inflow Controls vs. Outflow Controls

Countries' Average Values for all Ten Assets, 1995 - 2012