The EU in the Global Economy

Online learning

Document identifier				
Lesson	**Title**	**How to proceed?**	**Time need**	
#7	Foreign Direct Investments	1) **<u>Reading material</u>** 2) Video (Trends) 3) Video (UNCTADStat – EU) 4) Online test	cc. 15 mins.	

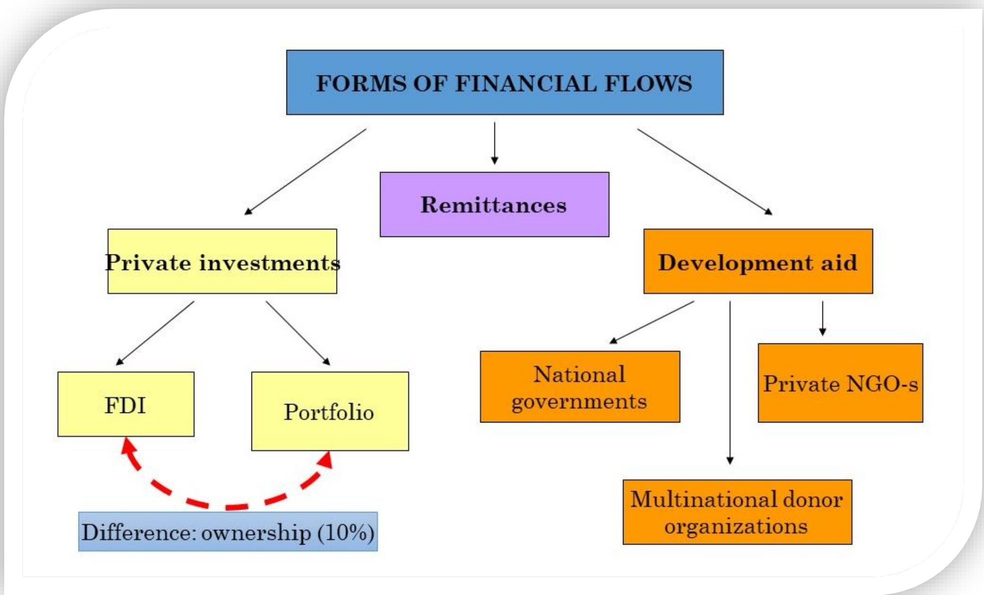
THE EUROPEAN UNION IN THE GLOBAL ECONOMY

1 INTRODUCTION

Basically, there are three types of international financial flows (Figure 1): private investments, remittances and development aid. Private investments can be portfolio investment or foreign direct investment (FDI). In case of FDI, the investor reaches more than 10% ownership, while in the case of portfolio investment, it remains lower. Portfolio investment takes places owing to the liberalization of financial markets, and its main target area is still the middle-income countries. The main aim of portfolio investment to achieve high return – so the shares and related risks are diversified. Higher risk relates to higher return, that's why portfolio diversification is required. Neither portfolio investors, nor FDI-investors are development actors, so in case of economic or political danger in a country, they will leave the country. In this lesson, we are going to detail the FDI.

Portfolio investment: purchase of shares, bonds or trade papers abroad

Figure 1 Types of international financial flows



2 FOREIGN DIRECT INVESTMENTS – BASIC CONCEPTS

When speaking about FDI, we need to be aware of the following concepts:

Host country

The country that attracts FDI and where the afiiliate is opened.

Home country

The country where the headquarter of the parent company is.

Inward FDI

FDI going into a certain country.

Outward FDI

FDI going out from a certain country.

Brownfield investment

With renovation and reutilization, the area can be used.

Greenfield investment

The parent company needs to build up the whole affiliate.

Mergers and acquisitions (M&A)

When two (or more) companies merge into one (merger) or when a company buys another company (acquisition)

3 FDI AND TNC STRATEGIES

Transnational corporations are called many ways: international companies, international cooperation, international monopoly, international trust or multinational corporation.

How to define a TNC?

According to the United Nations, a TNC is a company which operates in two or more countries, has centralized decision-making system and owns a global strategy, while the parent company shares information, resources and equipment with the affiliate. The owners of a TNC are from different countries. There are two types of TNCs: a vertical TNC covers more elements of the supply chain and the affiliates operate in different stages of the production. On the contrary, a horizontal TNC and its affiliates stand at the same level of the supply chain.

The **motivations** of FDI can be grouped in several ways. According to the eclectic theory of **Dunning**, the following motivations lay behind FDI: acquiring advantages; benefitting from current advantages; coping with disadvantages. The advantages that can be acquired be ownership-specific, location-specific and internalization advantages – these are called the elements of the **OLI**-paradigm. Based on these elements and theories, there is a very **similar but more practical grouping**:

A SPECIAL MOTIVATION: ENVIRONMENTAL OUTSOURCING

There are several international attempts to decrease environmental pollution: Paris Agreement, EU strategies, etc. However, FDI enables to reduce environmental pollution in a country with settling the environmental polluting activity abroad, while the products will be imported. According to the New York Times, 13% of the Chinese environmental pollution stems from the production of goods that are produced for other countries and not for China. In India, this rate is 20%.

Acquiring resources	• getting unique and special resources that can result in lower costs and higher quality than its production in the home country • A resource may be natural resource or skill labor force.
Access to market	• avoiding any trade barrier (tariff or non-tariff barrier) imposed on the imports in the host country.
Increasing effectiveness	• a company rationalizes its investments aiming at resources or markets. • For example, economies of scale or diversification of risks.
Strategic advantage	• acquiring such companies that would contribute to the company's long-term strategy or international competitiveness.

4 WHY TO ATTRACT FDI?

Until now we analyzed FDI trends from the point of view of the parent country (home country). Now let's see what are the advantages and disadvantages for a **host country** to attract FDI.

Advantages

- Job creation
- Additional financial resources
- Receiving foreign currency
- Taxes
- Business knowledge and skills
- Better relationship with foreign countries

Disadvantages

- Negative impacts on current account and capital account
- Not more taxes but tax reduction
- Dominant MNC
- Influence on economic policy (and political parties)
- Environmental pollution
- Not job creation but employment of national employees
- Unilateral development of foreign relations

In case we are about to analyze the impacts from the point of view of the **home country**, we can use the list above. In this case, what an advantage for the host country is will be a disadvantage for the home country. For example, there is a company in the United States that would open an affiliate in Mexico. This company opening results in more jobs in Mexico (advantage for the host country), but not in the US (disadvantage for the home country). The new affiliate is going to pay corporate and other taxes in Mexico (advantages for the host country) but in the US, this company will pay less or no tax (disadvantage for the home country). Or: the government of Mexico provides tax reductions for foreign companies to attract more into the country (disadvantage for the host country). This tax reduction is beneficial for the American company and can benefit from the lower costs and can expect more profits (advantage for the home country).

How to assess the impacts on the home country?

This teaching material has been made at the University of Szeged, and supported by the European Union.

Project identity number: EFOP-3.4.3-16-2016-00014

SZÉCHENYI 2020

HUNGARIAN GOVERNMENT

European Union
European Social Fund

INVESTING IN YOUR FUTURE