BSM 933 - International Business

Lecture 2

Sumon Bhaumik

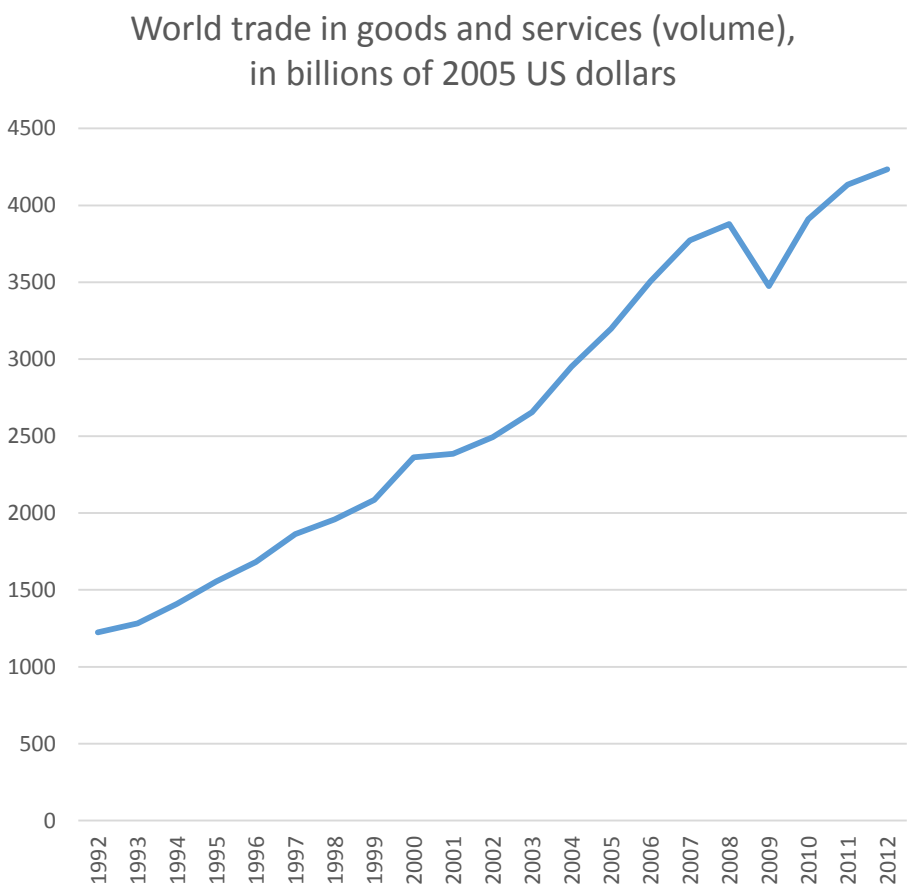
http://www.sumonbhaumik.net

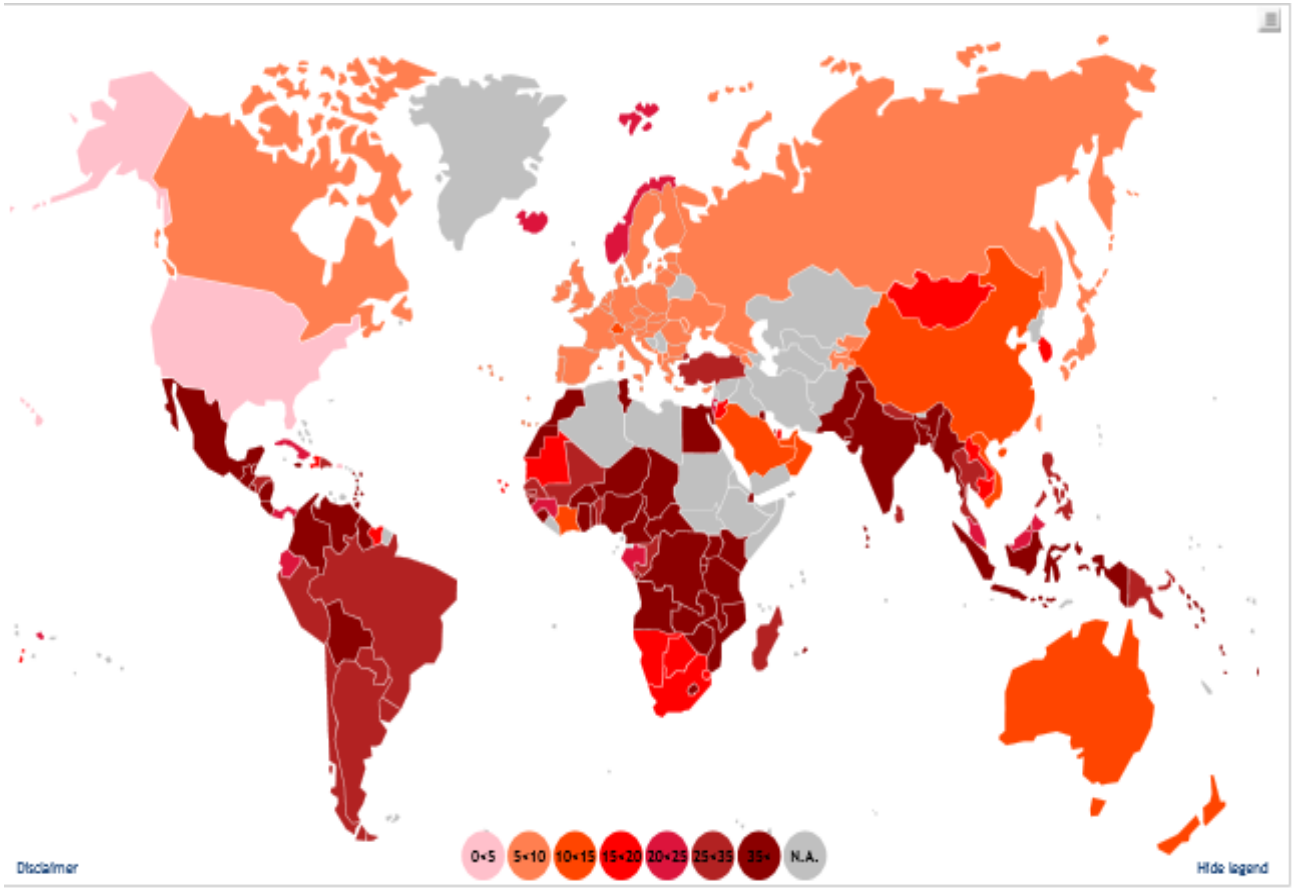
Globalisation

- Trade

- Investment
  - Arms length (e.g., franchises, supply chains)
  - Physical presence (e.g., greenfield projects, joint ventures)
  - Financial (portfolio investment)

International trade
Trade volumes and tariff





Source: OECD *StatExtracts*; World Trade Organisation (International Trade and Market Access Data)

International trade
Non-tariff barriers

Initiation on 26 September 2012 of anti-dumping investigation on imports of bicycles and other cycles (including delivery tricycles but excluding unicycles) from Indonesia, Malaysia, Sri Lanka, and Tunisia (possible circumvention of anti-dumping measures of imports from China imposed in 2011) (HS 87)	26-Sep-12	Indonesia; Malaysia; Sri Lanka; Tunisia
Initiation on 23 October 2012 of anti-dumping investigation on imports of aluminium foil of a thickness of not less than 0.008 mm and not more than 0.018 mm, not backed, not further worked than rolled, in rolls which are not annealed, of a width exceeding 650 mm and of a weight exceeding 10 kg from China (possible circumvention of anti-dumping measures of imports from China imposed in 2009) (HS 76)	23-Oct-12	China
Initiation on 10 November 2012 of anti-dumping investigation on imports of stainless steel tube and pipe butt-welding fittings, whether or not finished from China and Chinese Taipei (HS 73)	10-Nov-12	China; Chinese Taipei
Initiation on 16 February 2013 of anti-dumping investigation on imports of seamless pipes and tubes of iron or steel, other than of stainless steel, of circular cross-section, of an external diameter exceeding 406.4 mm from China (HS 73)	16-Feb-13	China
Initiation on 28 February 2013 of anti-dumping investigation on imports of solar glass from China (HS 70)	28-Feb-13	China
Initiation on 10 April 2013 of anti-dumping investigation on imports of open mesh fabrics made of glass fibres, with a cell size of more than 1.8 mm both in length and in width and weighing more than 35 g/m^2 from India and Indonesia (possible circumvention of anti-dumping measures of imports from China imposed in 2011) (HS 70)	10-Apr-13	India; Indonesia

Source: World Trade Organisation

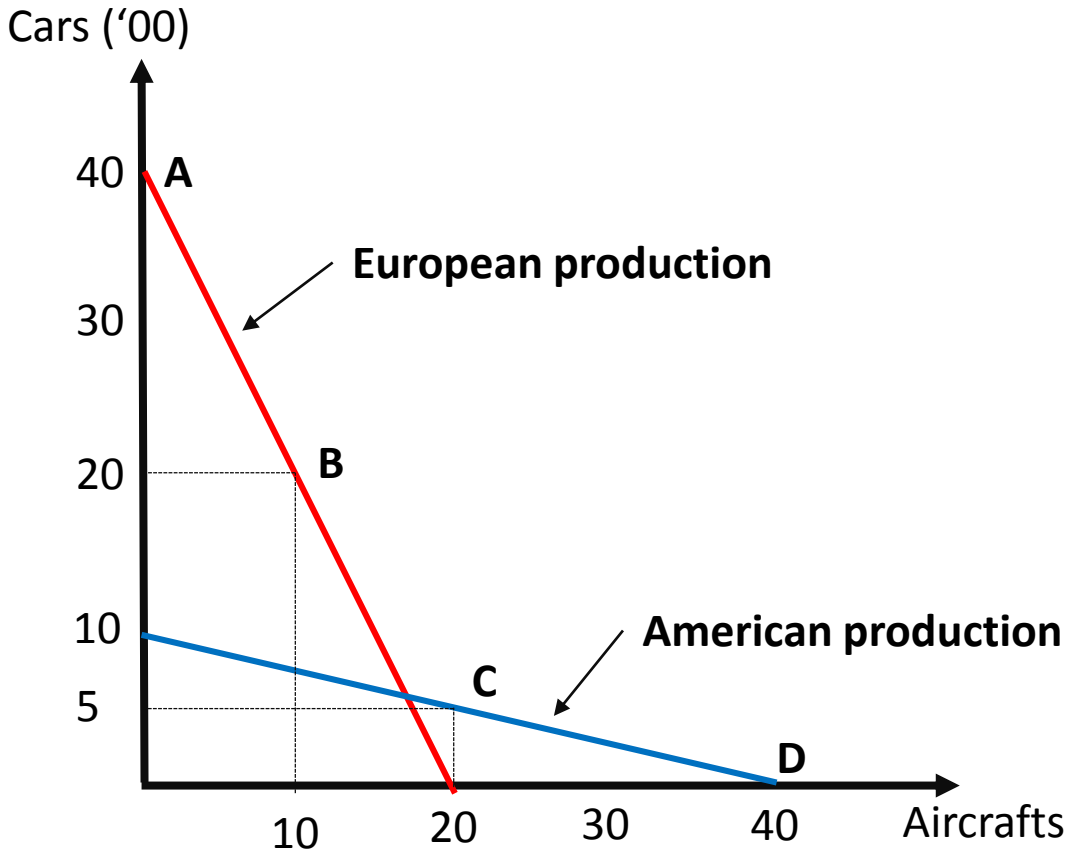
International trade
Why do countries trade?

Mercantilism (Colbert, 1600s – 1700s)	International trade is a zero sum game – trade deficit is dangerous	Forerunner of modern day protectionism	Inefficient allocation of resources
	Governments should protect domestic economies and promote exports		Reduces the wealth of nations in the long run
Absolute advantage (Smith, 1776)	Nations should specialise in economic activities in which they have an absolute advantage and trade with others	Forerunner of free trade movement	When one nation is absolutely inferior to another, the theory is unable to provide any advice
	By specialising and trading, each nation produces more and consumes more, wealth increases		When there are many nations, it may be difficult to find an absolute advantage
Comparative advantage (Ricardo, 1817; Heckscher, 1919; Ohlin, 1933)	Nations should specialise in economic activities in which they have comparative advantage and trade with others	More realistic guidance to nations (and their firms) interested in trade but having no absolute advantage	Relatively static, assuming that comparative advantage does not change over time
	Even if one nation is absolutely inferior to another, the two nations can still gainfully trade	Explains patterns of trade based on factor endowments	
	Factor endowments underpin comparative advantage		

Source: Peng and Meyer (Chapter 5, Table 5.4)

International trade
Absolute advantage

- "Model"
  - Two "countries" (Europe and America)
  - Two goods (cars and aircrafts)
  - Resource endowment (each country has 800 units of resources)
- Absolute advantages
  - America can produce an aircraft using 20 units of resources, Europe needs 40 units
  - Europe can produce 100 cars using 20 units of resources, America needs 80
  - How do we see that in the graph?
- Autarky outcome
  - America produces 500 cars and 20 aircrafts (**B**)
  - Europe produces 2000 cars and 10 aircrafts (**C**)
- Trading outcome
  - America produces 40 aircrafts (**D**)
  - Europe produces 4000 cars (**A**)
  - Global production and consumption is higher



Source: Peng and Meyer (Chapter 5; Figure 5.2)

International trade
Comparative advantage – the concept

	Potential output		Actual output		Consumption	
	Person 1	**Person 2**	**Person 1**	**Person 2**	**Person 1**	**Person 2**
Good A	10	10	5	10	15	0
	or	**or**	**and**	**and**	**and**	**and**
Good B	10	5	5	0	0	5

Opportunity costs:

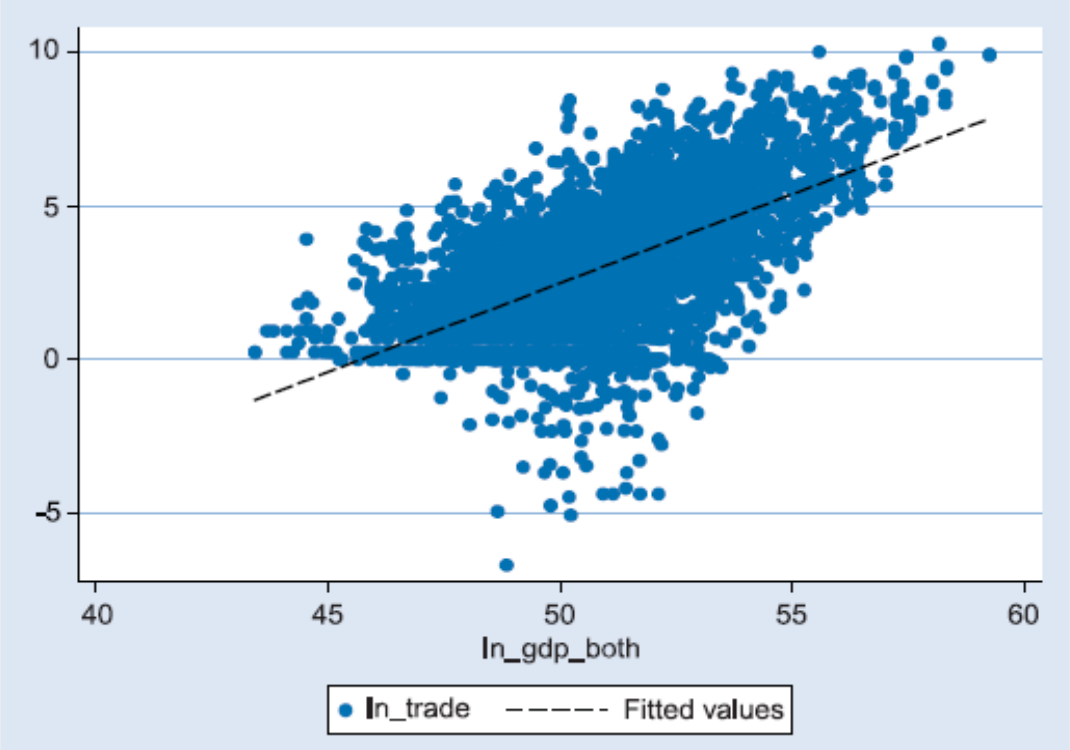
Person 1, Good A = 1 unit B
Person 1, Good B = 1 unit A

Person 2, Good A = 0.5 unit B
Person 2, Good B = 2 unit A

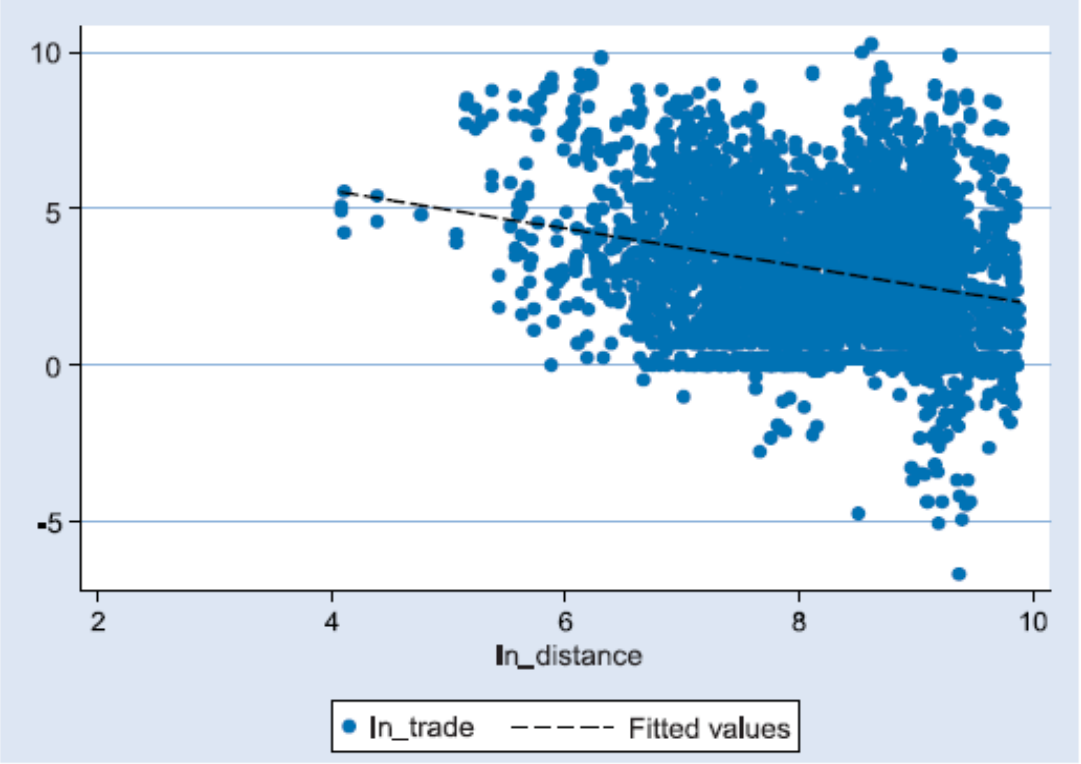
1. Given available resources, Person 1 can produce either 10 units of Good A or 10 units of Good B; she prefers to consume Good A
2. Given the same resources, Person 2 can produce either 10 units of Good A or 5 units of Good B; she prefers to consume Good B
3. At least one of them would gain if they specialise in the production of one good and trade, without reducing the consumption of the other
4. Specialisation and trade is the only way to efficiently use limited resources, as human demand expands continually

International trade
Drivers of bilateral trade – gravity model – I

Size of the trading countries



Distance between the countries



Source: Shepherd, B. (2013). *The gravity model of international trade: A user guide*, UNESCAP.

International trade
Drivers of bilateral trade – gravity model – II

- Problems with the basic gravity model
  - If there is a preferential trade agreement between countries *i* and *j*, then it will affect trade with country *k*
  - If there is a decline (or increase) in transportation cost across the board – e.g., on account of more fuel efficient transportation – then the relative prices (say, between internal and external trade) will be unchanged

- Extensions of the basic gravity model take into consideration factors such as whether the countries have a common border (e.g., Mexico and the USA), whether they share a common language, whether one of them had colonised the other (e.g., India and UK) or whether they share the same colonising power (e.g., Francophone Africa)

Digression
Primer on linear regression models

- Model:

  $y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \varepsilon$

- Output:
  - Estimates of β_0, β_1 and β_2
  - Estimates of standard errors

- Statistical significance:
  - The ratio of a β and its corresponding standard error (t-statistic) should be high (roughly, > 2)

International trade
Drivers of bilateral trade – gravity model – III

Linear regression

Number of obs	= 3884
F(7, 2151)	= 442.01
Prob > F	= 0.0000
R-squared	= 0.5431
Root MSE	= 1.5281

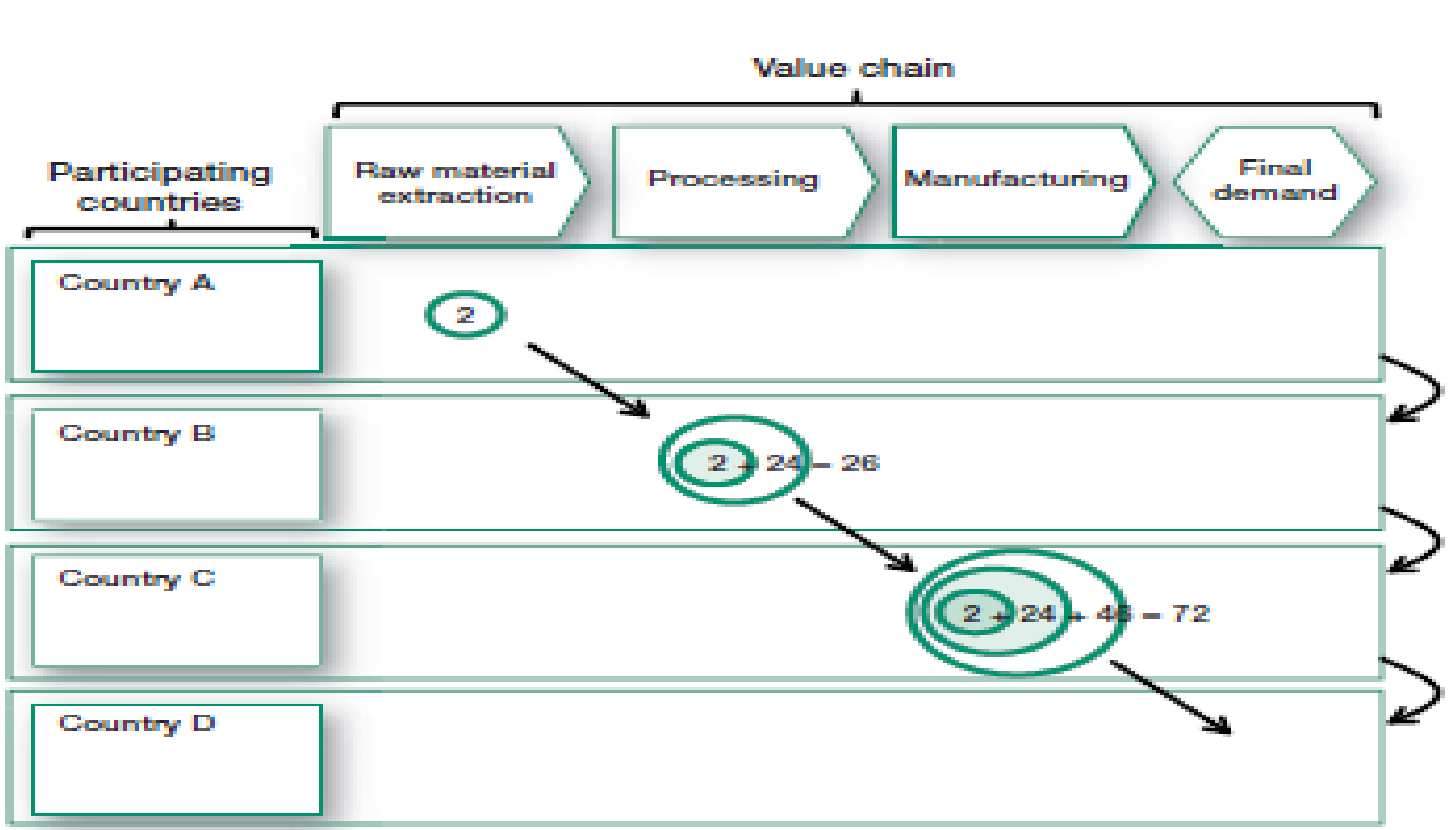
(Std. Err. adjusted for 2152 clusters in dist)

ln_trade	Coef.	Robust Std. Err.	t	P>|t|	[95% Conf.	Interval]
ln_gdp_exp	.6011672	.0132209	45.47	0.000	.5752401	.6270942
ln_gdp_imp	.6176062	.0142666	43.29	0.000	.5896284	.6455839
ln_distance	-.7385146	.03536	-20.89	0.000	-.8078579	-.6691714
contig	.3989524	.1829276	2.18	0.029	.0402191	.7576858
comlang_off	.8861328	.0993078	8.92	0.000	.6913835	1.080882
colony	1.202965	.1201971	10.01	0.000	.9672503	1.43868
comcol	-.0245067	.2018195	-0.12	0.903	-.4202883	.371275
_cons	-22.03706	.671738	-32.81	0.000	-23.35438	-20.71974

Source: Shepherd, B. (2013). *The gravity model of international trade: A user guide*, UNESCAP. (Table 2)

International trade
Global value chains – double counting

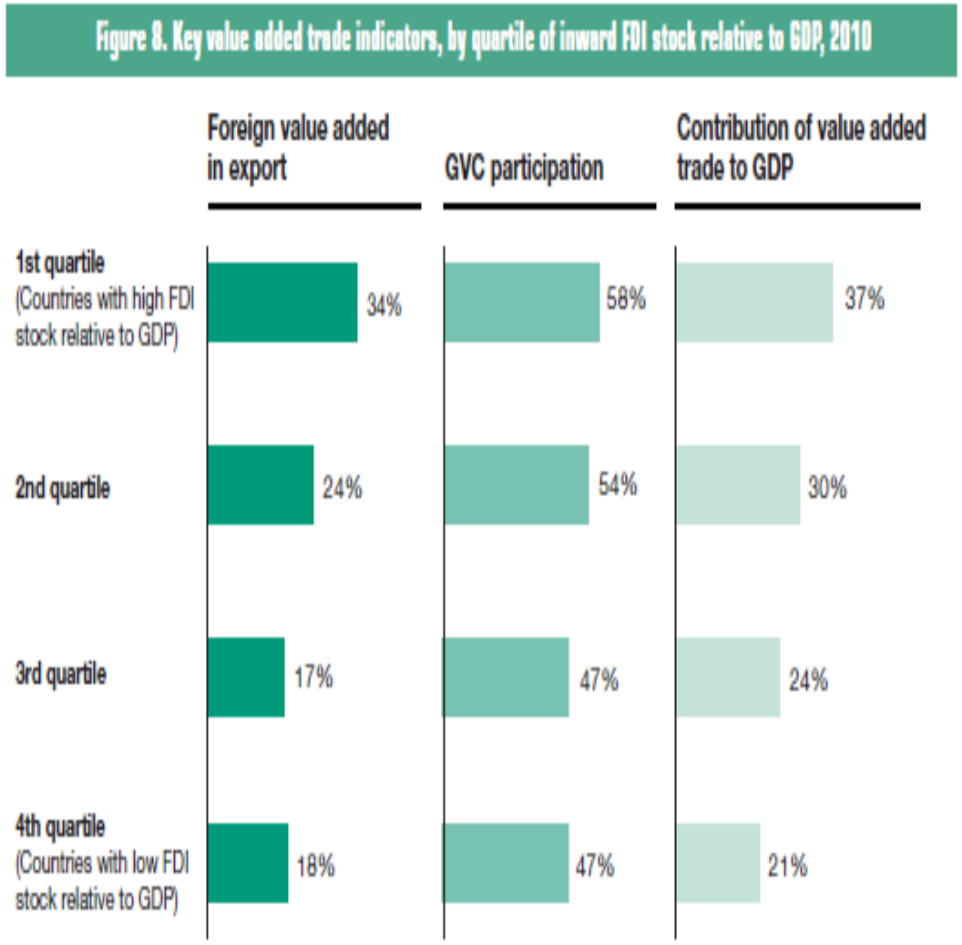
Figure IV.1. Value added trade: how it works

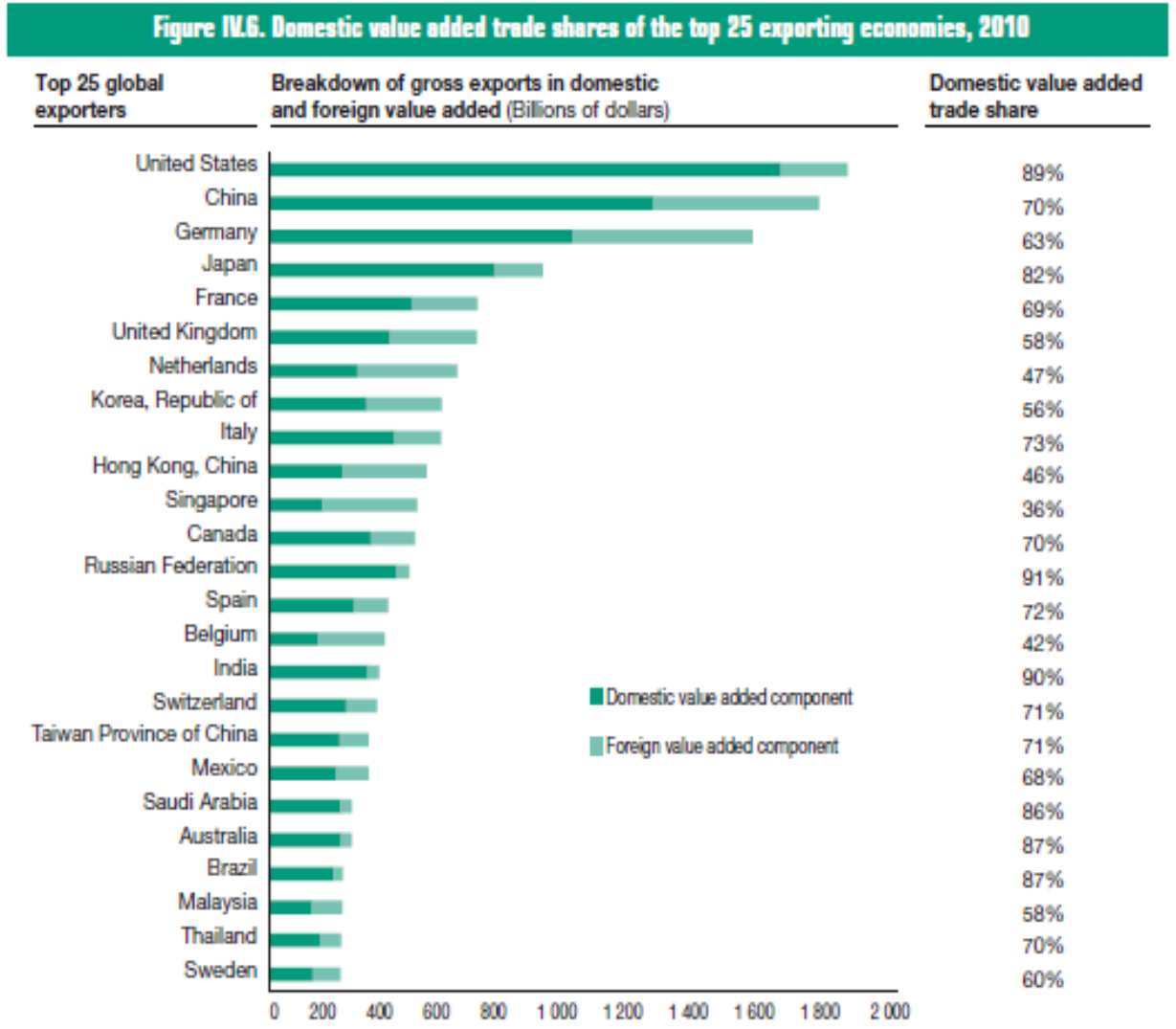


	Gross exports	Domestic value added	Double counting
	2	2	0
	26	24	2
	72	46	26
Σ	100	72	28

Source: *World Investment Report 2013* (Figure IV.1)

International trade
Global value chains – statistics





Source: *World Investment Report 2013* (Figures 8 and IV.6)

Foreign direct investment
Evolution of FDI in the 19th and 20th centuries

- Initial emphasis on natural resources
- Post-1914 increasing share of manufacturing with strong cross-country differences
- Bias towards countries that are “close” in terms of geography and language/culture
  - Theories about strategic decisions about multinational investment in other countries
- FDI from emerging market economies
  - First wave directed to developing economies and generally labour intensive
  - Second wave with greater diversification between developed and developing

Foreign direct investment
Early multinationals

Company	Nationality	Product	No. of foreign factories in 1914	Location of foreign factories
Singer	USA	Sewing machines	5	UK, Canada, Germany, Russia, Austria-Hungary
J&P Coats	UK	Cotton thread	20	USA, Canada, Russia, Austria-Hungary, Spain, Belgium, Italy, Switzerland, Portugal, Japan, Brazil
Nestle	Swiss	Condensed milk, baby food	14	USA, UK, Germany, Netherlands, Norway, Spain, Australia
Saint-Gobain	France	Glass	8	Germany, Belgium, Netherlands, Italy, Spain, Austria-Hungary
Bayer	Germany	Chemicals	7	USA, UK, France, Russia, Belgium
Ericsson	Sweden	Telephone equipment	8	USA, UK, France, Austria-Hungary, Russia

Source: Jones, G.M. (2005). *Multinationals and Global Capitalism: From the Nineteenth to the Twenty First Century*, Oxford Scholarship Online

Foreign direct investment
Determinants and advantages to host countries

Determinants

- Economic conditions
  - Market size
  - Growth prospect (institutions?)
  - Human capital and labour cost
  - Infrastructure
  - Macroeconomic stability
- Host country policies
  - FDI-trade policies and regulations
  - Financial development
  - Legal framework
  - Bureaucratic quality
  - Perception of country risk

Advantages

- Resource transfer
  - Early models of economic growth
- Technology transfer
  - Solow growth model
- Skill transfer
  - New growth models
- Competition
  - Evidence about impact on productivity
- Employment
- Balance of payments

http://www.adbi.org/discussion-paper/2006/11/28/2066.fdi.south.asia.policy.trends/impact.and.determinants.of.fdi/

Foreign direct investment
Statistics – “home” and “host” countries

Figure 2. Top 20 host economies, 2012
(Billions of dollars)

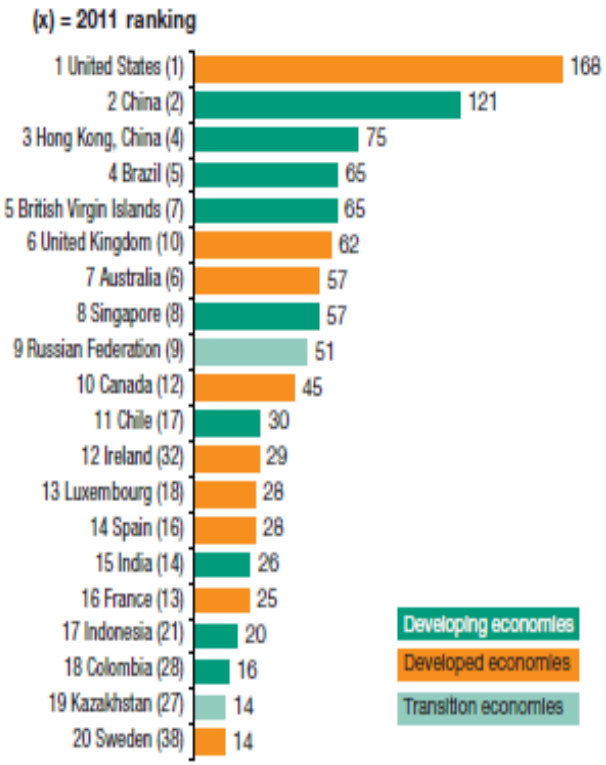
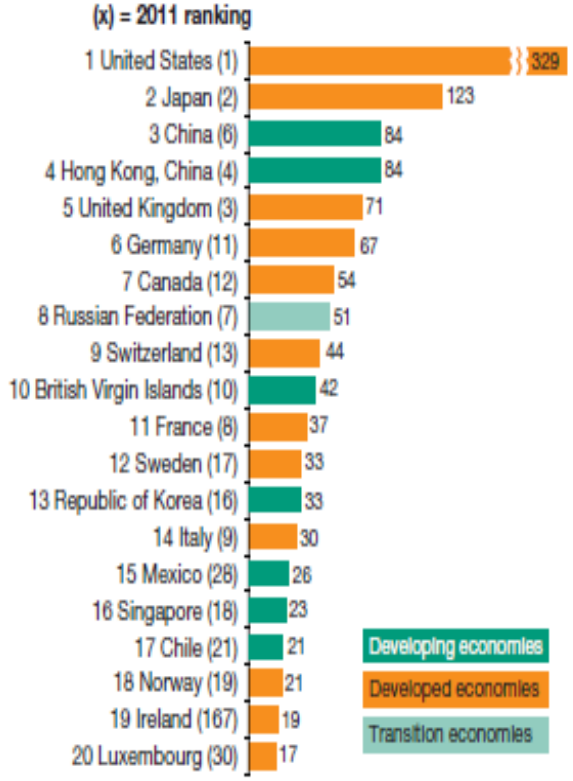
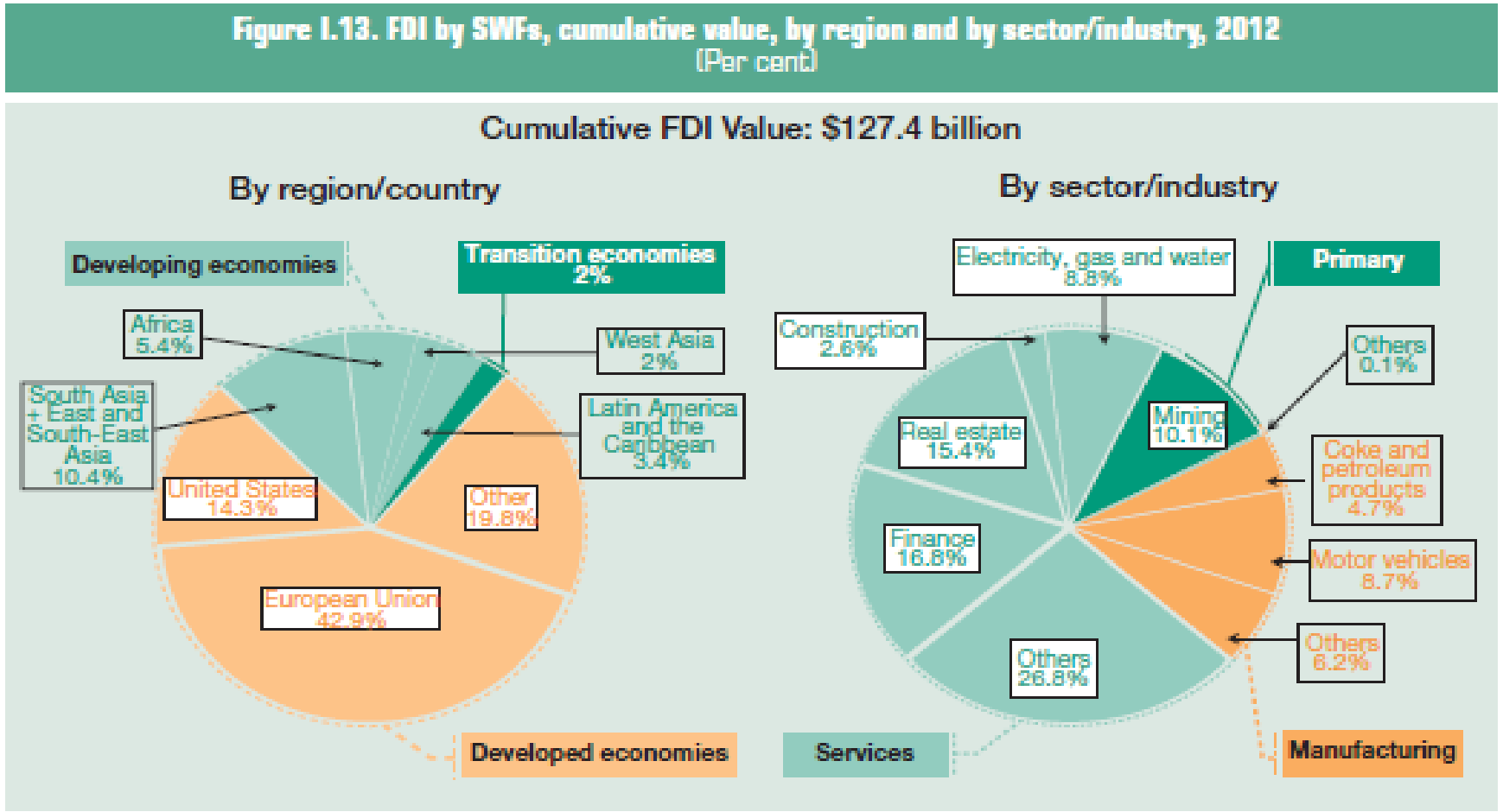


Figure 3. Top 20 investor economies, 2012
(Billions of dollars)



Source: *World Investment Report 2013* (Figures 2 and 3)

Foreign direct investment
Statistics – sovereign wealth funds



Source: *World Investment Report 2013* (Figure I.13)

Foreign direct investment
Statistics – cross border M&A by PE firms

Table I.2. Cross-border M&As by private equity firms, 1996–2012
(Number of deals and value)

	Gross M&As				Net M&As			
	Number of deals		Value		Number of deals		Value	
Year	Number	Share in total (%)	$ billion	Share in total (%)	Number	Share in total (%)	$ billion	Share in total (%)
1996	932	16	42	16	464	13	19	14
1997	925	14	54	15	443	11	18	10
1998	1 089	14	79	11	528	11	38	9
1999	1 285	14	89	10	538	10	40	6
2000	1 340	13	92	7	525	8	45	5
2001	1 248	15	88	12	373	9	42	10
2002	1 248	19	85	18	413	13	28	11
2003	1 488	22	109	27	592	20	53	29
2004	1 622	22	157	28	622	17	76	33
2005	1 737	20	221	24	795	16	121	26
2006	1 698	18	271	24	786	14	128	20
2007	1 918	18	555	33	1 066	15	288	28
2008	1 785	18	322	25	1 080	17	204	29
2009	1 993	25	107	19	1 065	25	58	23
2010	2 103	22	131	18	1 147	21	65	19
2011	2 020	19	153	14	902	15	77	14
2012	2 229	23	182	22	1 104	20	51	16

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (www.unctad.org/fdistatistics).

Note: Value on a net basis takes into account divestments by private equity funds. Thus it is calculated as follows: Purchases of companies abroad by private equity funds (-) Sales of foreign affiliates owned by private equity funds. The table includes M&As by hedge and other funds (but not sovereign wealth funds). Private equity firms and hedge funds refer to acquirers as "investors not elsewhere classified". This classification is based on the Thomson Finance database on M&As.

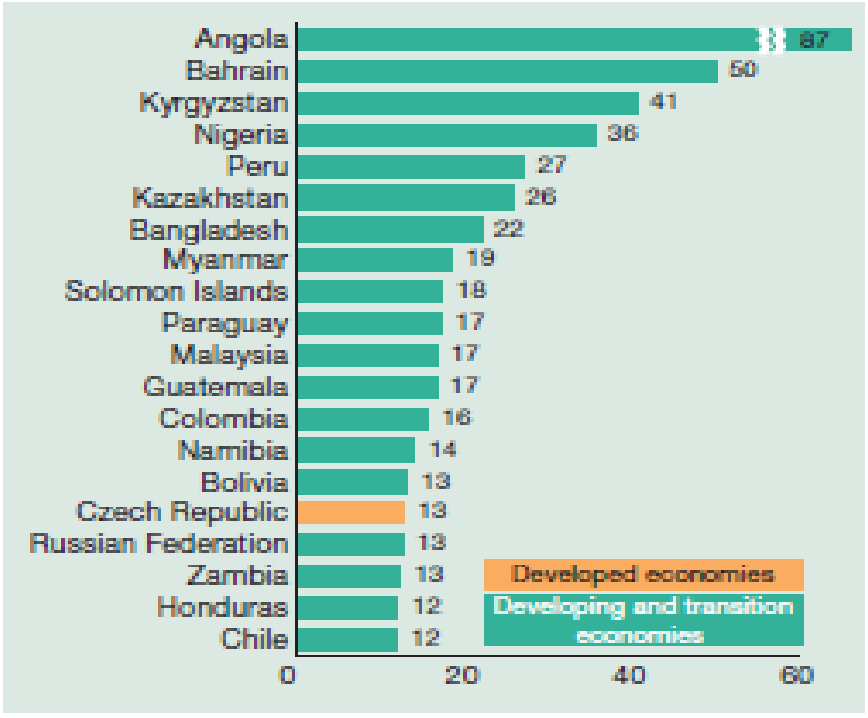
Source: *World Investment Report 2013* (Figure I.2)

Foreign direct investment
Statistics – top destinations vs. rate of return

Figure I.25. TNCs' top prospective host economies for 2013–2015
(Percentage of respondents selecting economy as a top destination)

Source: UNCTAD survey.
Note: Based on 159 company responses.

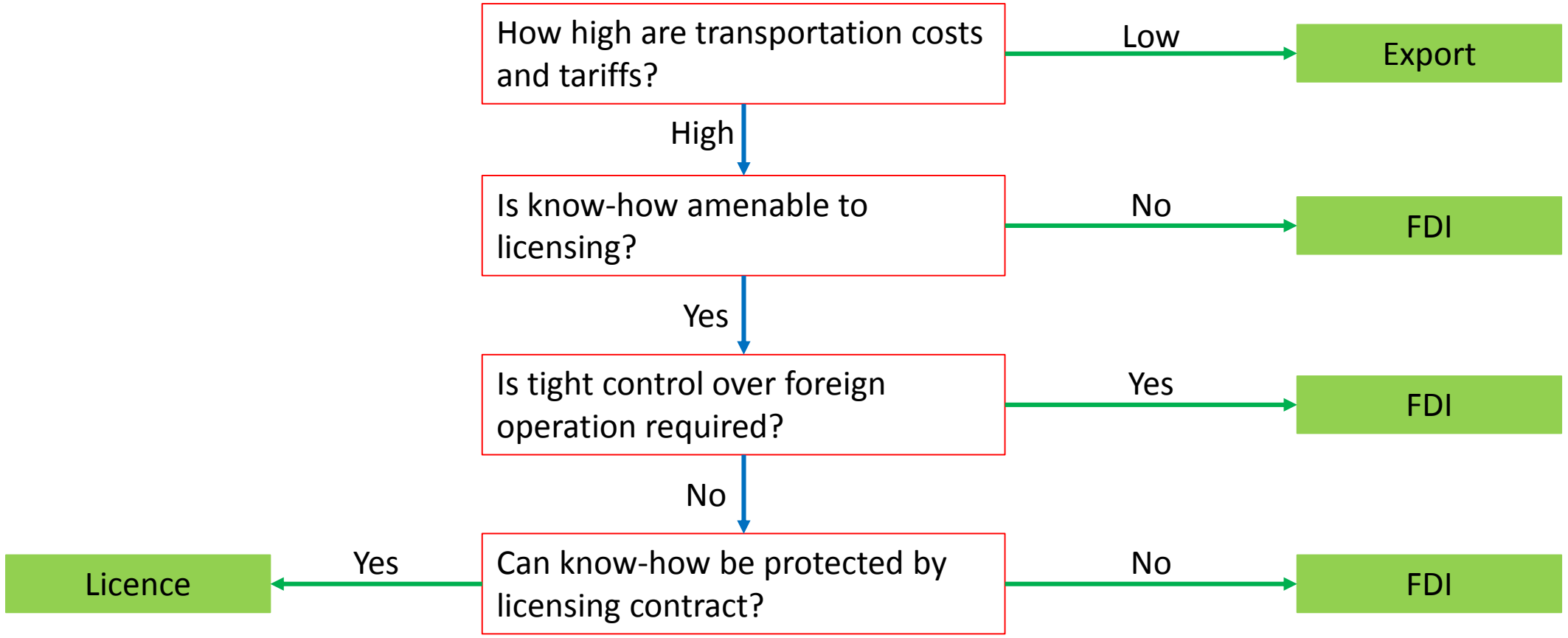
Figure I.32. Top 20 economies with highest inward FDI rates of return, 2011
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

Source: *World Investment Report 2013* (Figures I.25 and I.32)

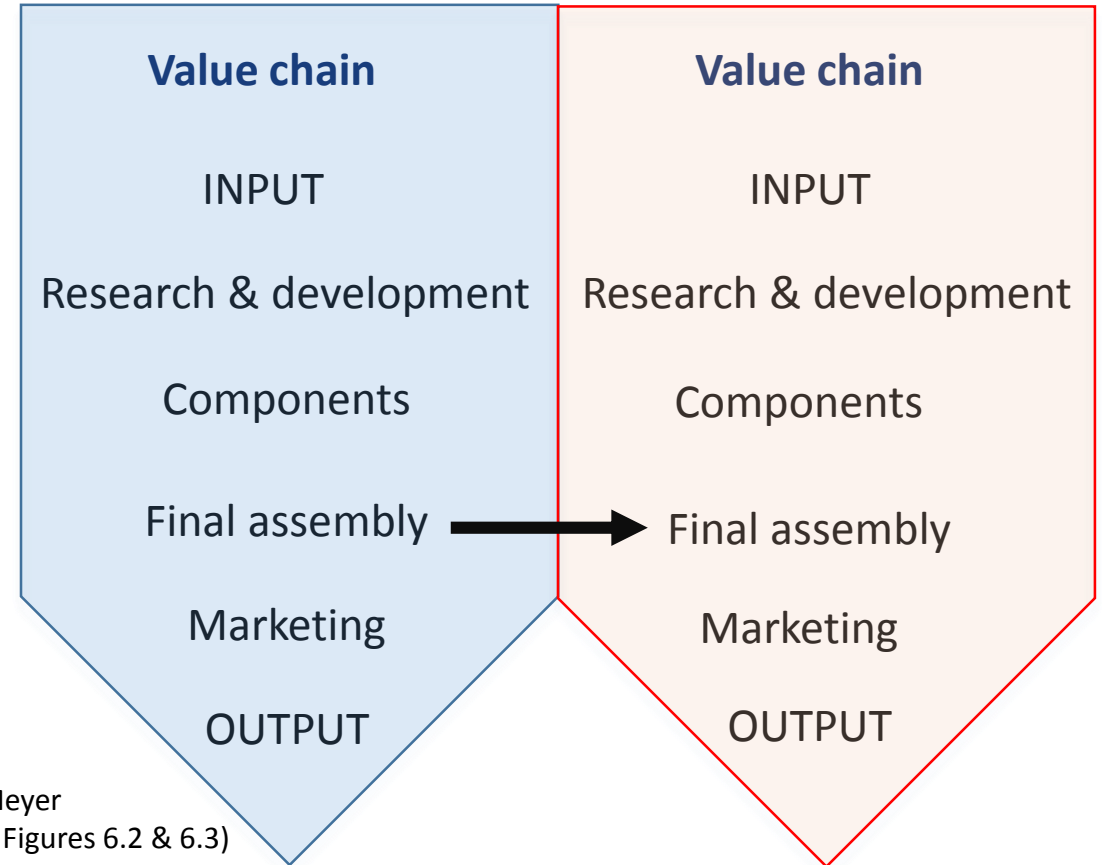
Foreign direct investment
The decision framework



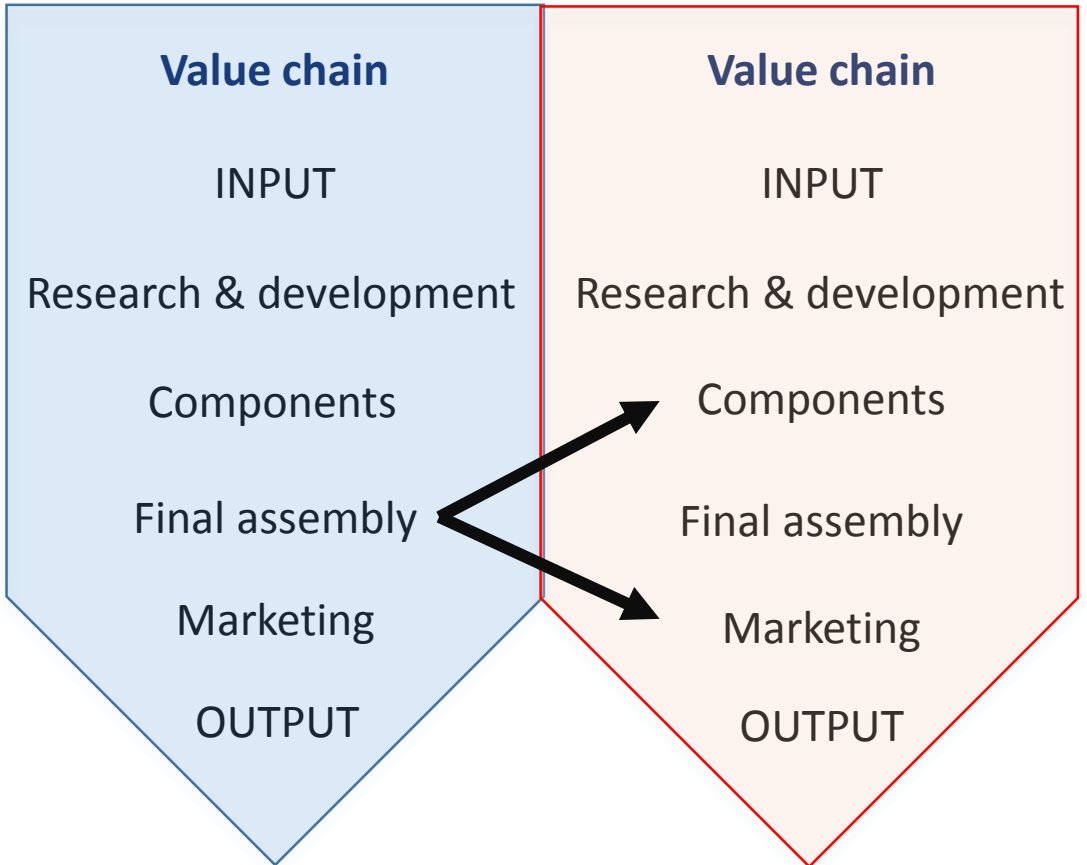
Source: Hill (Chapter 8; Figure 8.6)

Foreign direct investment Typology

Horizontal FDI

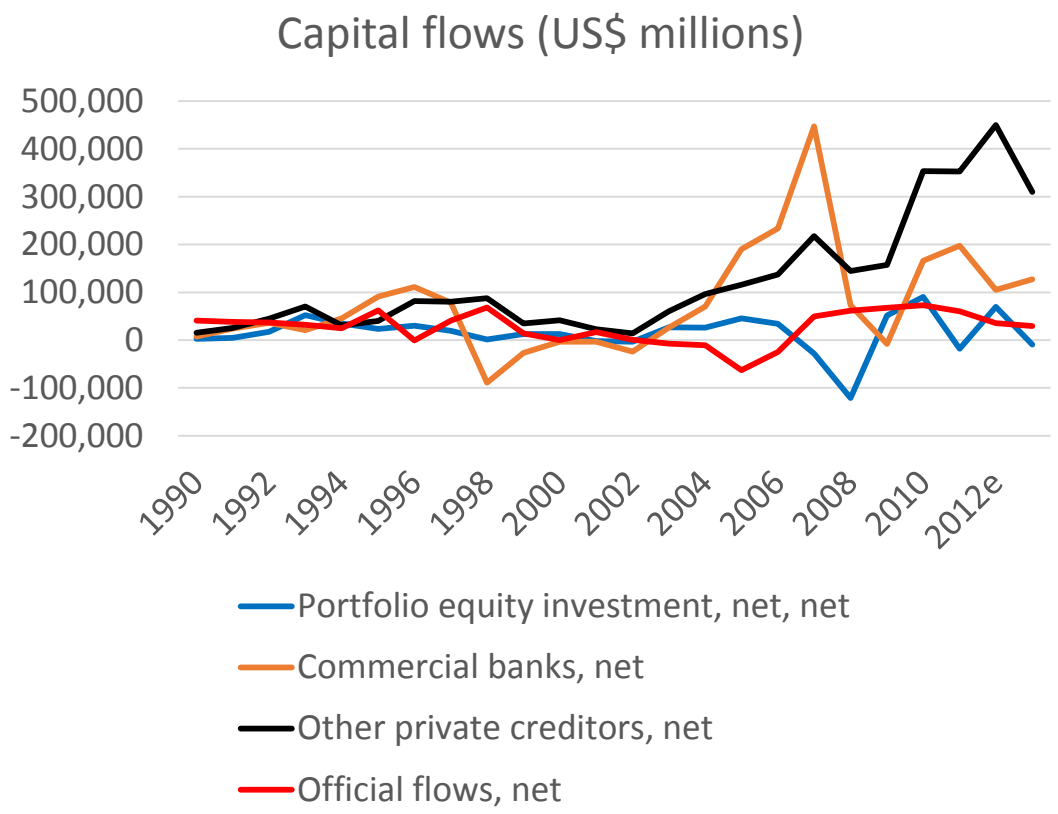


Vertical FDI



Peng and Meyer
(Chapter 6; Figures 6.2 & 6.3)

Cross-border capital flows
Issues and statistics



Note: The data are for the EM7 countries that include the BRIC, Turkey, Mexico and Indonesia.

- Implications for monetary policy
- Implications for exports
- Implications for asset price and exchange rate volatility
- Degree of convertibility of the currency on the capital account of balance of payments

Source: Institute of International Finance (http://www.iif.com/emr/global/capflows/)

Where does that leave us?

- We now know about the big picture issues
  - Fundamental drivers of trade and FDI flows
  - Global patterns of three dimensions of globalisation: trade, foreign direct investment and capital flows
  - Global value chains
  - Decision framework for internationalisation

- Next, we shall move on to something with a narrower focus
  - Institutions and business environment
  - Cultural differences