

# Multinationals and the New Regionalism in the Americas

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# Outline of Talk

- I. Introduction
- II. The FDI Policy Environment in the Americas, 1990-2005
- III. FDI Patterns in the Americas, 1988-2004
- IV. FDI Responses to Regional Integration
- V. Firm-Level Responses to Regional Integration
- VI. Some Research Questions re “Spaghetti Bowl”

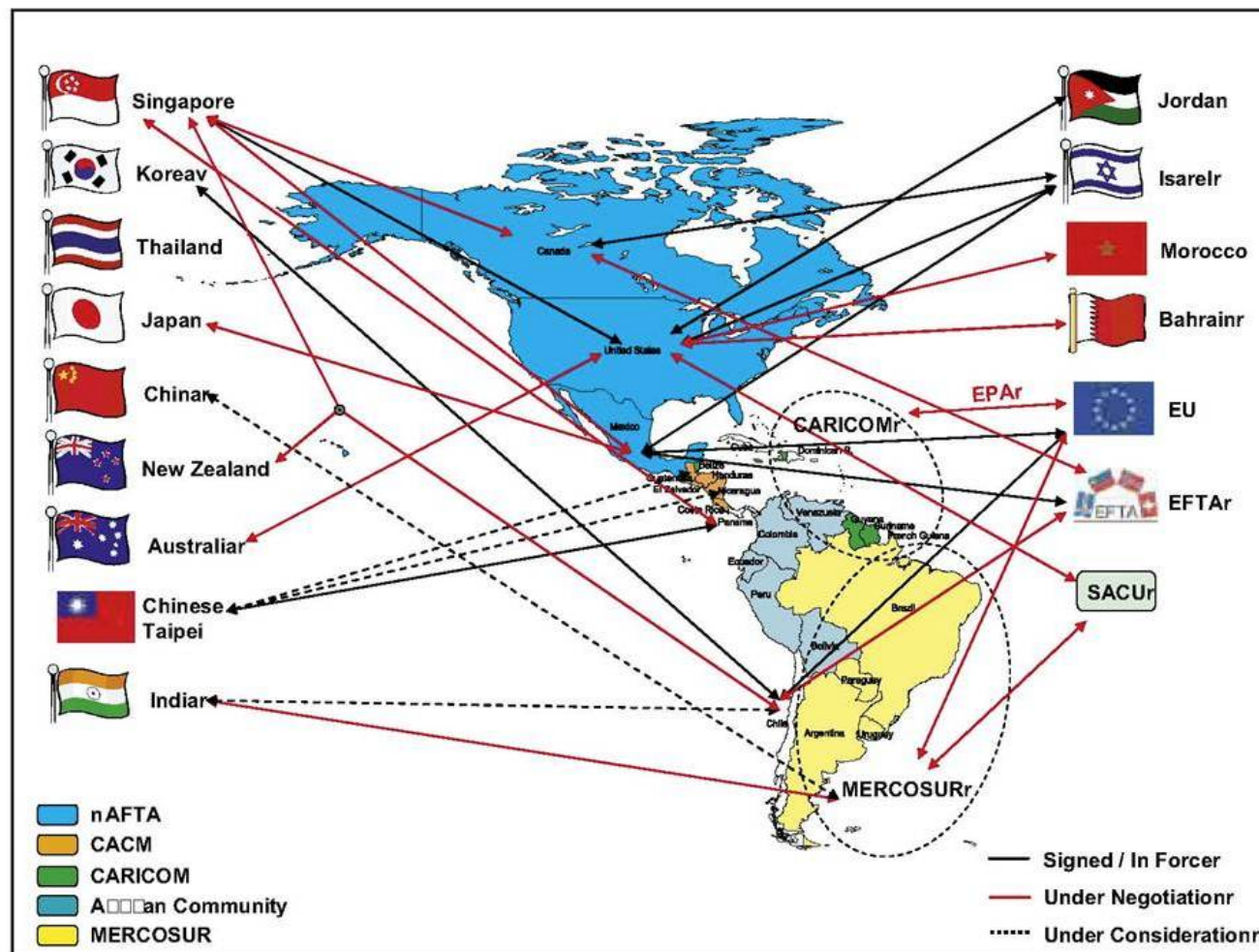
# I. Introduction

- Enormous changes in policy environment facing multinational enterprises (MNEs) in the Americas post-1989.
- Changes at multiple levels – regional, bilateral and national. Most changes pro-FDI.
- How have MNEs responded? What are the key foreseeable trends?

## II. The FDI Policy Environment in the Americas, 1995-2005

- A. Regional – proliferation of RTAs
- B. Bilateral – BITs and DTTs
- C. National – unilateral deregulation, liberalization and privatization.
- D. A Special Case – tax havens.

# A. Regional Level Policy Changes



RTAs in the Americas 40+ and still counting.

Source: Crawford and Fiorentino (2005)

# Examples of the New Regionalism #1: “North-South” RTAs in the Americas

## *Inside the Americas*

Mexico in NAFTA	1992
Chile-Canada	1996
Chile-United States	2002
Canada-Costa Rica	2001

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## *Outside the Americas*

Mexico-European Union	1999
Mexico-EFTA	2000
Mexico-Israel	2000
Chile-European Union	2002

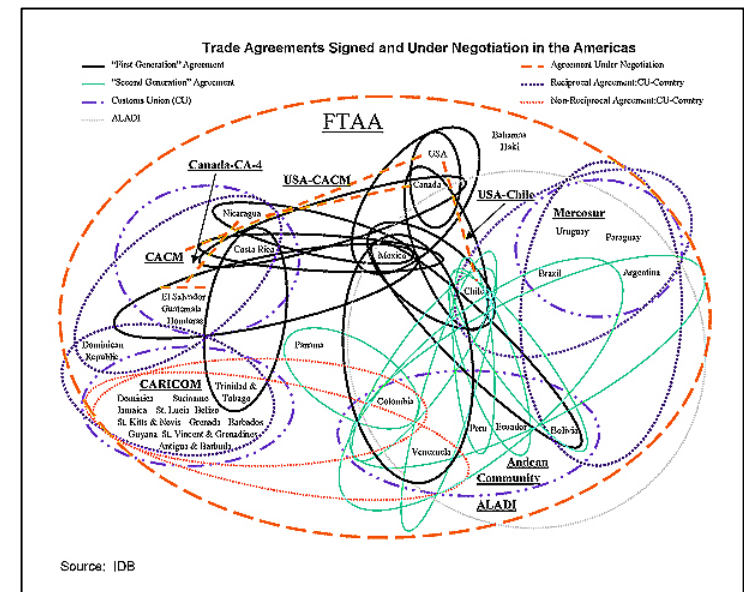
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## Examples of the New Regionalism #2: “South-South” RTAs in the Americas

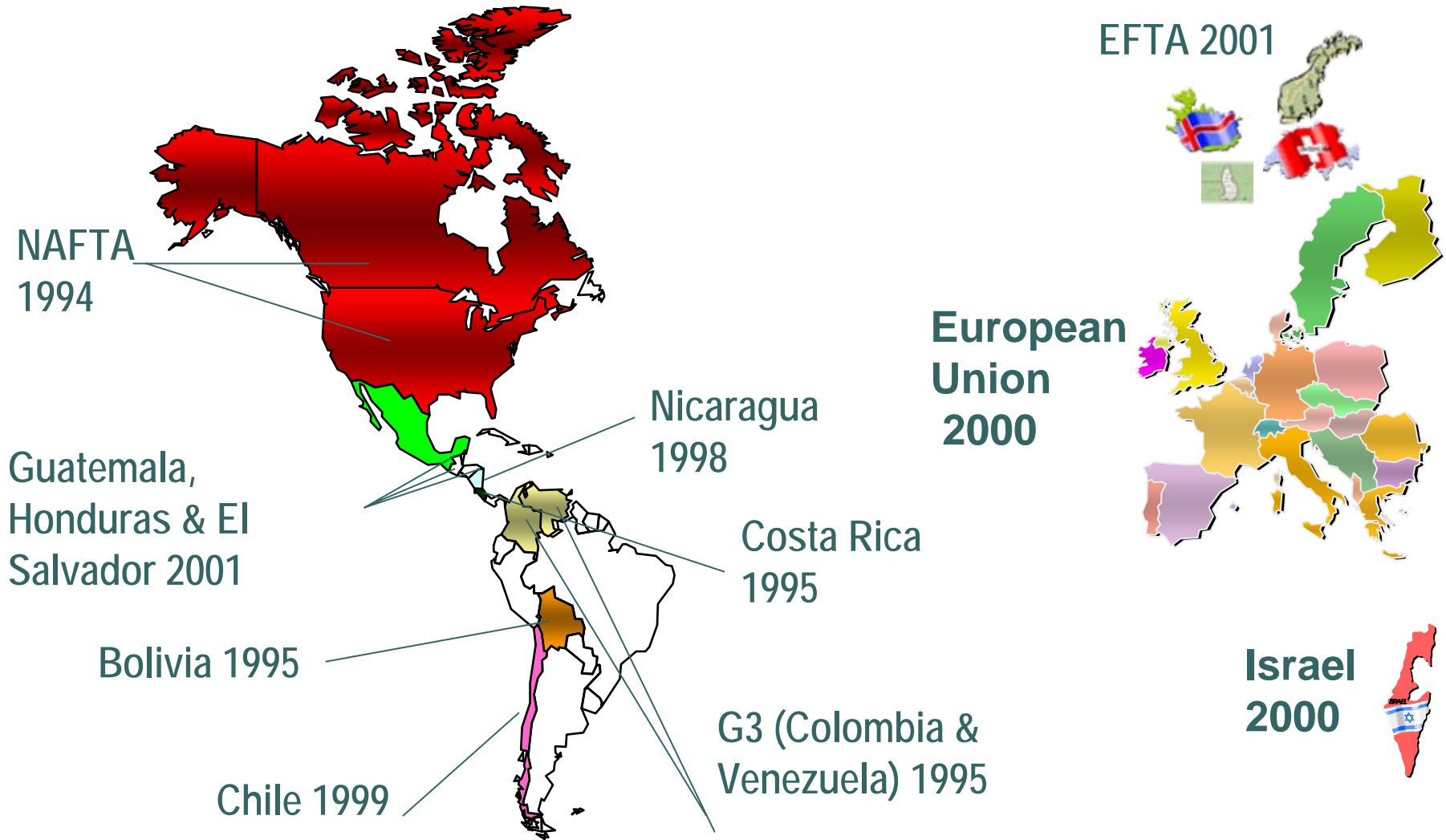
Mercosur	1991	CACM-Dominican Republic	1998
Chile-Venezuela	1993	Chile-Peru	1998
Colombia-Chile	1994	Chile-CACM	1999
Costa Rica-Mexico	1994	Chile-Mexico	1999
Group of Three (G-3)	1994	Mexico-Northern Triangle Central America	2000
Bolivia-Mexico	1994	CARICOM-Dom Rep	2000
Chile-Mercosur	1996	Costa Rica-Trinidad & Tobago	2002
Bolivia-Mercosur	1996	El Salvador-Panama	2002
Mexico-Nicaragua	1997		

# Comparing Old and New Regionalisms

- From **shallow integration** (removal of tariffs) to **deep integration** (reduction in all barriers within the region).
- Slow move from **trade diversion** (diverting trade away from nonmembers) to **trade creation** (generating new trade without harming nonmember countries).
- “Spaghetti Bowl”.
- Hub-and-spoke problems.



# An Example of RTA Proliferation: Mexico

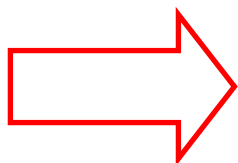


## B. Bilateral Liberalization

- BITs
- DTTs
- TATs



**US-Estonia BIT, 2003**



**Web of bilateral commitments link countries in the Americas, in addition to RTAs**

# C. National Liberalization

## FDI Regulatory Changes, 1992-2002

Year	REGION	Pro-FDI	Anti-FDI	Total	<i>Pro/Total</i>
All Yrs	Caribbean	30	2	32	<i>0.94</i>
<i>All Yrs</i>	<i>CAR/Americas</i>	<i>0.14</i>	<i>0.13</i>	<i>0.14</i>	
All Yrs	Latin America	164	14	178	<i>0.92</i>
<i>All Yrs</i>	<i>LA/Americas</i>	<i>0.75</i>	<i>0.88</i>	<i>0.76</i>	
All Yrs	North America	24	0	24	<i>1.00</i>
<i>All Yrs</i>	<i>NA/Americas</i>	<i>0.11</i>	<i>0.00</i>	<i>0.10</i>	
All Yrs	Americas	218	16	234	<i>0.93</i>

Source: Author's calculations based on confidential UNCTAD data.

# D. Tax Havens in the Americas

Tax Havens	On OECD List	Signed MOU	Tax Havens	On OECD List	Signed MOU
Anguilla	YES	YES	Montserrat	YES	YES
Antigua & Barbuda	YES	YES	Netherland Antilles	YES	YES
Aruba	YES	YES	Puerto Rico	NO	na
Bahamas	YES	YES	St. Kitts & Nevis	YES	YES
Barbados	YES	YES	St. Lucia	YES	YES
Belize	YES	YES	St. Vincent & Grenadines	YES	YES
Bermuda	COOP	YES	Turks & Caicos Islands	YES	YES
British Virgin Islands	YES	YES	US Virgin Islands	YES	YES
Cayman Islands	COOP	YES	Costa Rica	NO	na
Dominica	YES	YES	Panama	YES	YES
Grenada	YES	YES	Uruguay	NO	na

# III. FDI in the Americas, 1998-2004

- **FDI Statistics – stock data**
  - **Astonishing growth**
  - **Largest hosts: US, Canada, Brazil, Mexico**
  - **Shares of non-US FDI in Americas**
    - **Canada 50% → 30%**
    - **Mexico 9% → 18%**
    - **Other winners: Argentina, Chile, Venezuela, Aruba, BVI, Caymans**

# FDI Potential Rankings

	1988-90	2001-03		1988-90	2001-03
Argentina	14	9	Haiti	26	26
<b>Bahamas</b>	<b>3</b>	<b>3</b>	Honduras	22	25
Bolivia	21	13	Jamaica	15	14
Brazil	8	11	<b>Mexico</b>	<b>7</b>	<b>5</b>
<b>Canada</b>	<b>2</b>	<b>2</b>	Nicaragua	23	24
<b>Chile</b>	<b>5</b>	<b>4</b>	Panama	10	7
Colombia	13	21	Paraguay	18	22
Costa Rica	9	10	Peru	19	16
Dominican Rep	16	8	Suriname	6	15
Ecuador	17	23	Trinidad and Tobago	12	6
El Salvador	20	19	<b>USA</b>	<b>1</b>	<b>1</b>
Guatemala	25	20	Uruguay	11	17
Guyana	24	18	Venezuela	<b>4</b>	12

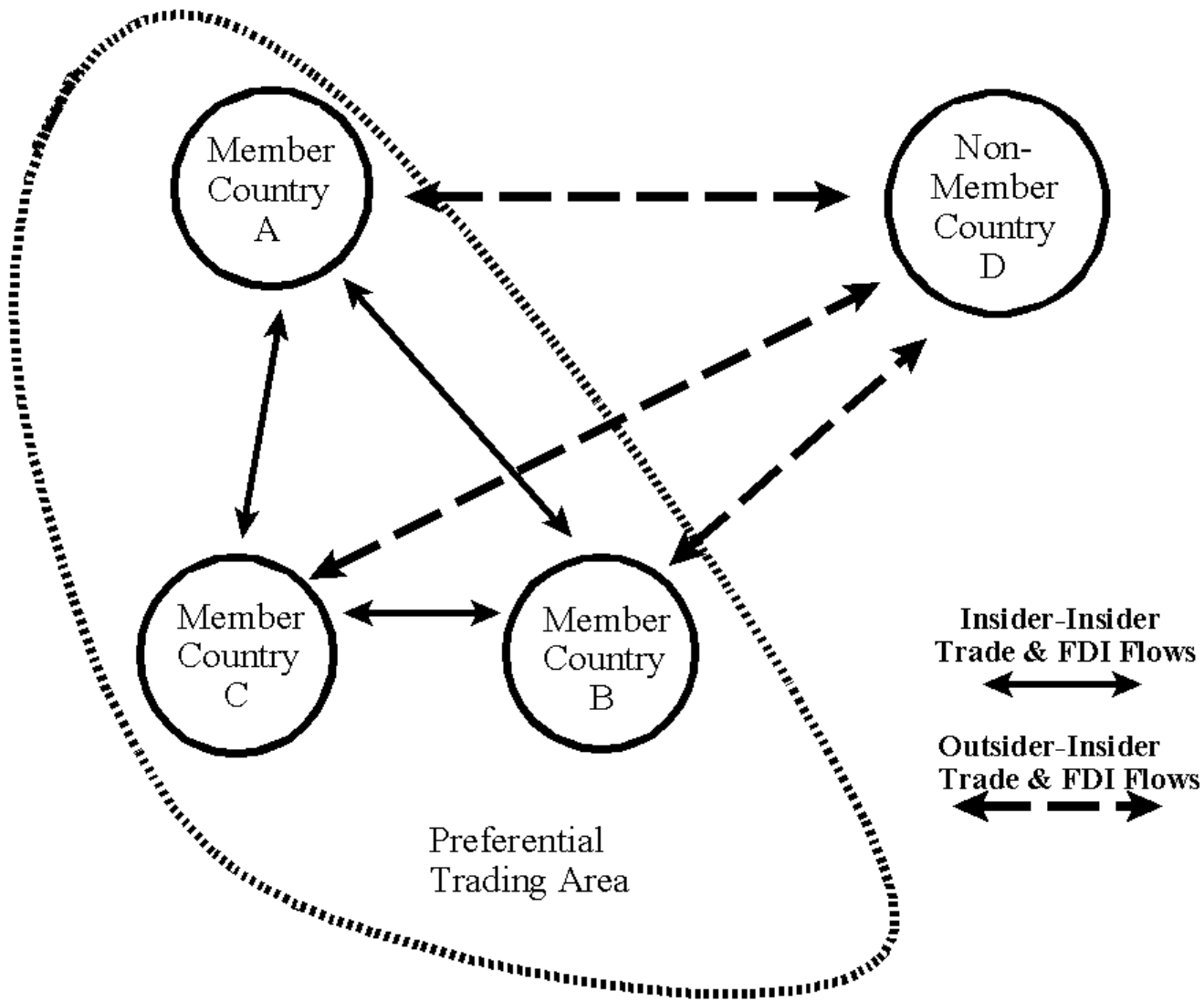
# FDI Performance Rankings

	1988-90	2002-04		1988-90	2002-04
Argentina	12	19	Haiti	21	25
Bahamas	18	10	Honduras	9	11
Bolivia	7	8	<b>Jamaica</b>	<b>5</b>	<b>2</b>
Brazil	20	13	Mexico	10	18
Canada	11	21	Nicaragua	24	<b>5</b>
<b>Chile</b>	<b>1</b>	<b>3</b>	Panama	25	<b>4</b>
Colombia	15	15	Paraguay	16	22
Costa Rica	<b>2</b>	9	Peru	23	14
Dominican Rep	6	12	Suriname	26	26
Ecuador	8	7	<b>Trinidad &amp; Tobago</b>	<b>3</b>	<b>1</b>
El Salvador	22	17	United States	14	23
Guatemala	<b>4</b>	24	Uruguay	19	16
Guyana	17	6	Venezuela	13	20

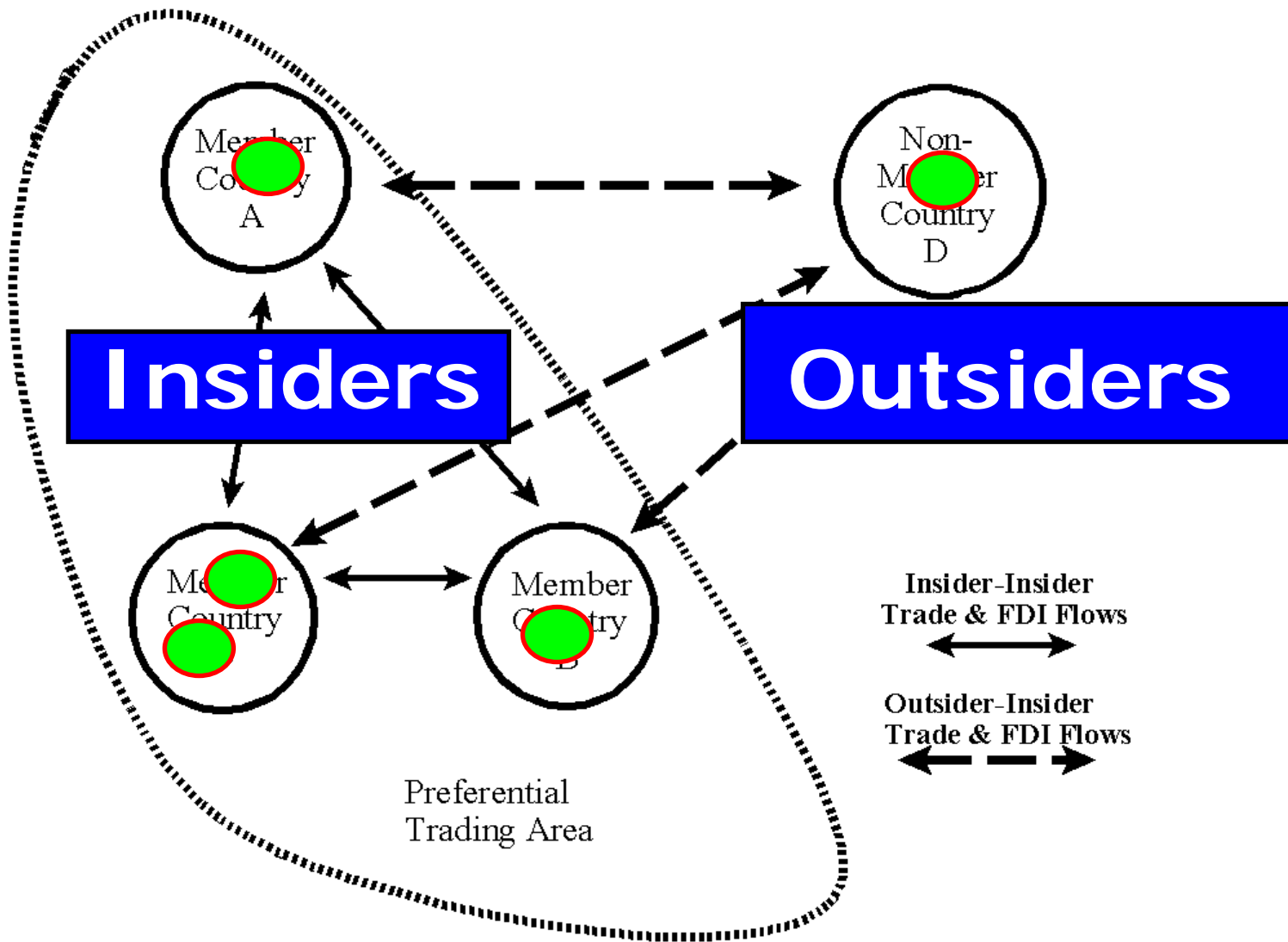
# IV. FDI Responses to Regional Integration

- **Macro-level** approach using **FDI flow and/or stock data**.
- **RTA removes trade & FDI barriers and encourages location for the regional market.**
- RTA causes **investment creation & diversion**, similar to trade creation & diversion.
- **Gravity model** empirical estimates.
- FDI modeled as either **horizontal integration** (market seeking) or **vertical integration** (resource seeking).
- The reaction of firms to formation of RTA depend on whether they are **insiders or outsiders** to the RTA.

# FDI Creation & Diversion in Response to RTA



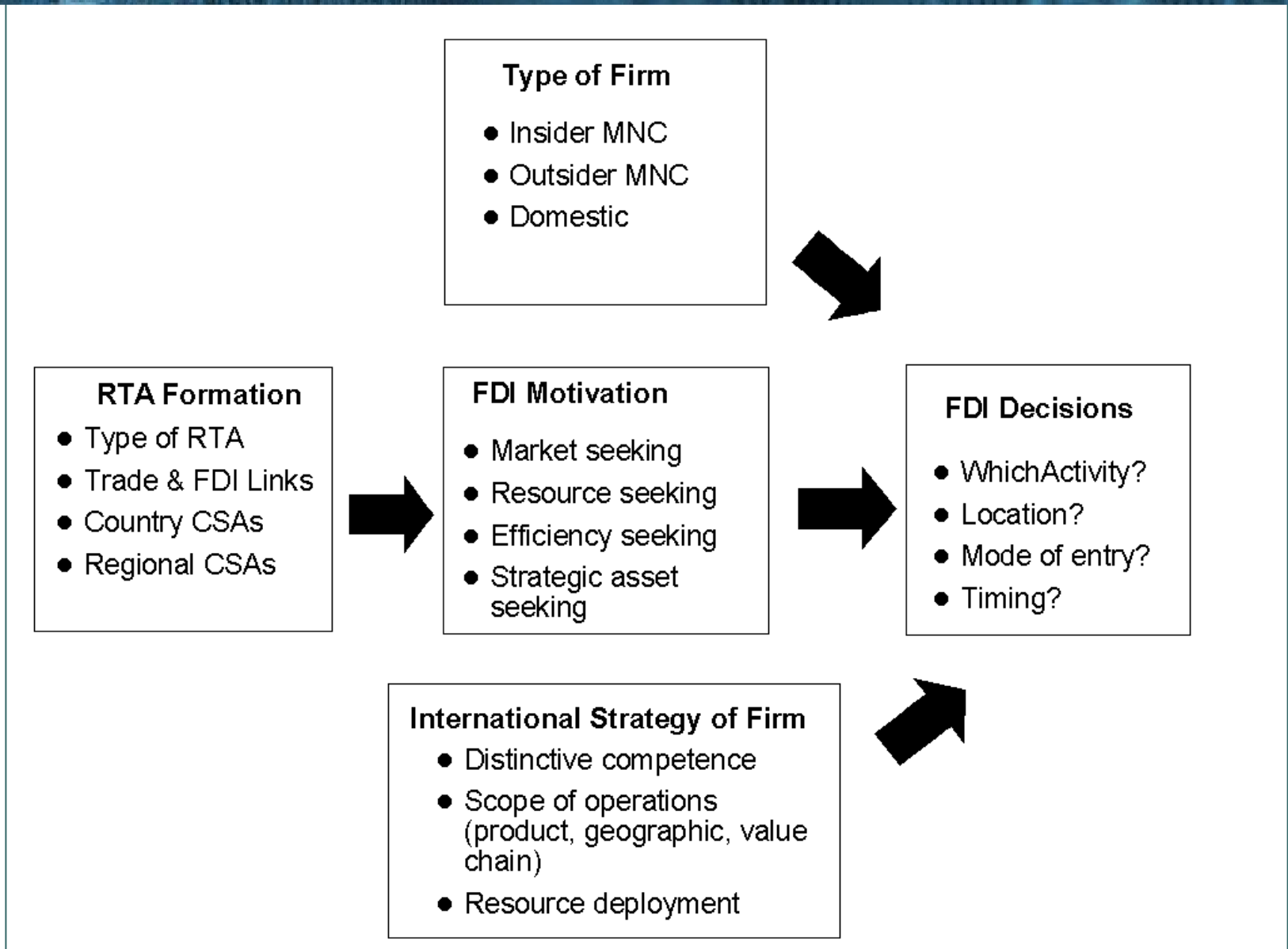
# Insiders and Outsiders – Responding to an RTA



# V. Firm-Level Responses to Regional Integration in the Americas

- A. Locational responses to RTAs
- B. Shift from manufacturing to services
- C. Offshoring and outsourcing of business services (the “new” new international division of labor)
- D. Rise of regional multinationals

# How Do Firms Respond to the Formation of an RTA?



# MNE Motives for Establishing Foreign Plants

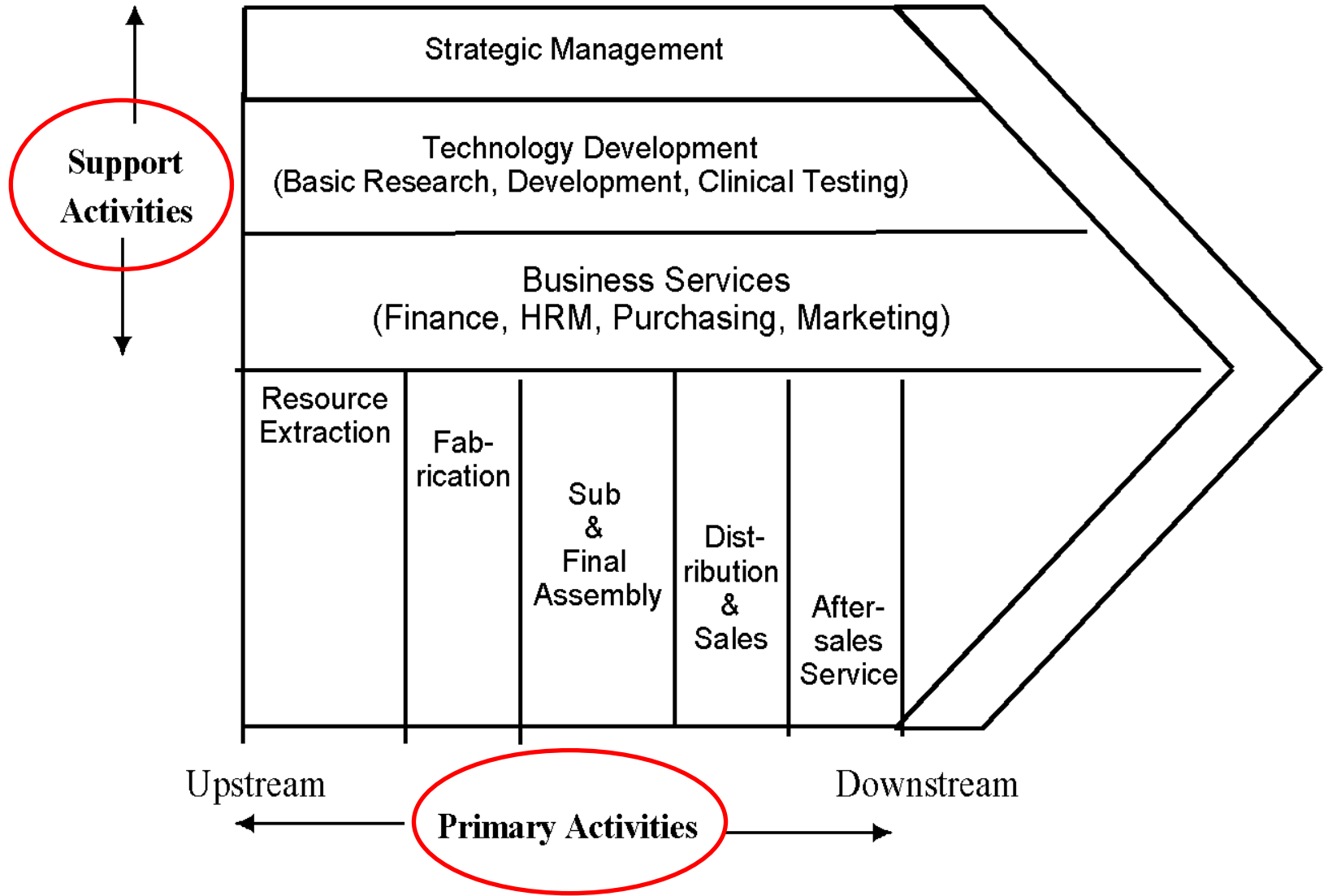
## AT THE INDIVIDUAL PLANT LEVEL

- **Market seeking a.k.a. Knowledge exploitation** (going in to SELL)
- **Resource seeking** (going in to BUY raw materials or basic factor services such as low-cost unskilled labor)
- **Strategic Asset seeking a.k.a. Knowledge seeking** (going in to LEARN, i.e., acquire knowledge, e.g. R&D plants)
- **Support Services** (going in to HELP by providing support services to the MNE network, e.g. business services, regional headquarters)

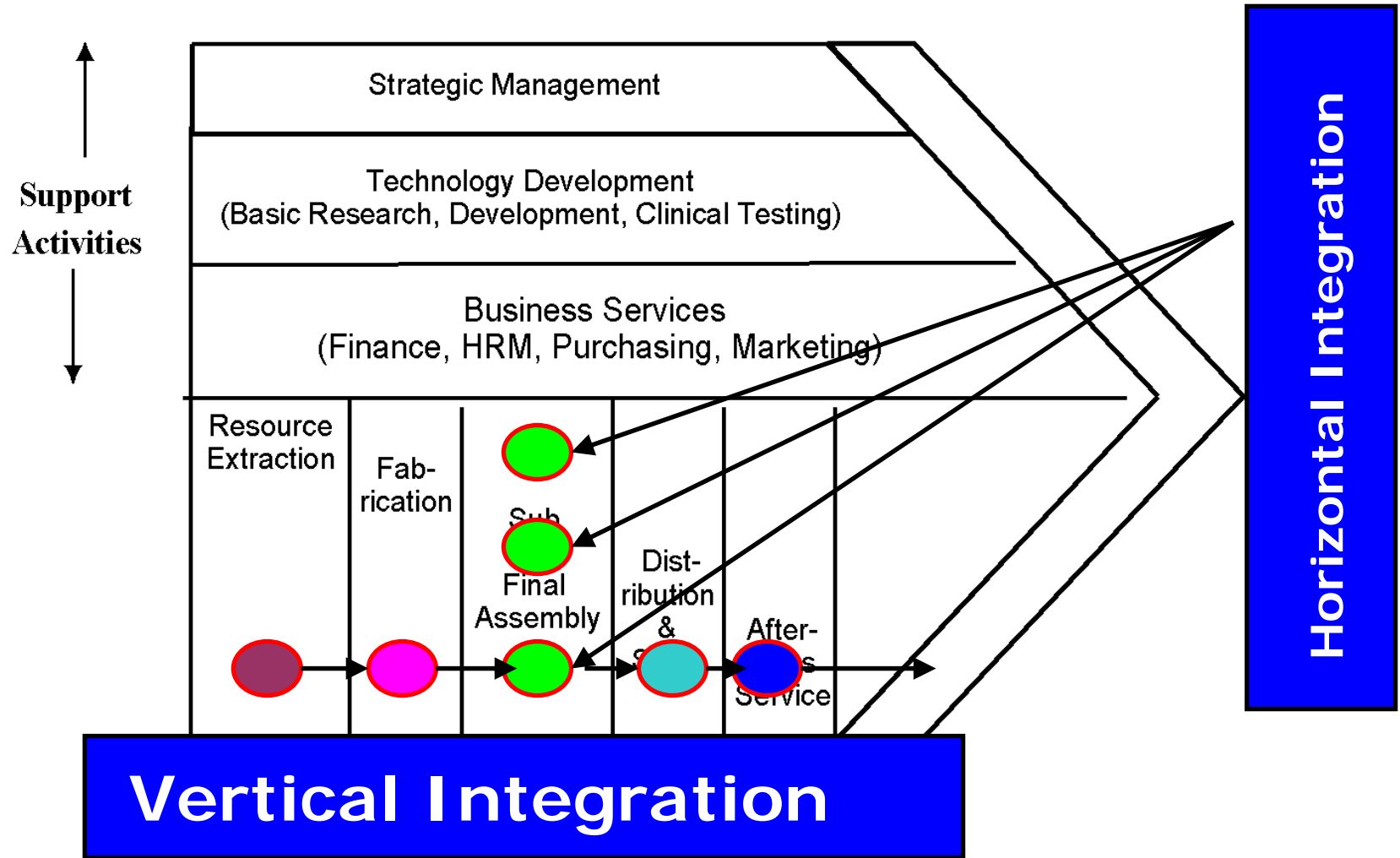
## ACROSS THE MNE NETWORK

- **Rationalization/efficiency FDI:** MNEs respond to new environmental conditions (e.g., creation of an RTA) by changing plant locations and activities to better fit with the environment. Can result in opening and/or closing of plants. Plant reshufflings (Vernon).

# Plant Functions and Locations in the Value Chain



# The MNE's Value Chain Scope



# 1. MNE Locational Responses to RTAs

## Member countries

- Large vs Small?
- Developed vs Emerging/Developing?

## Firm

- Insider vs Outsider?
- Configuration and Coordination before RTA?

## Plant

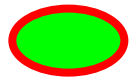
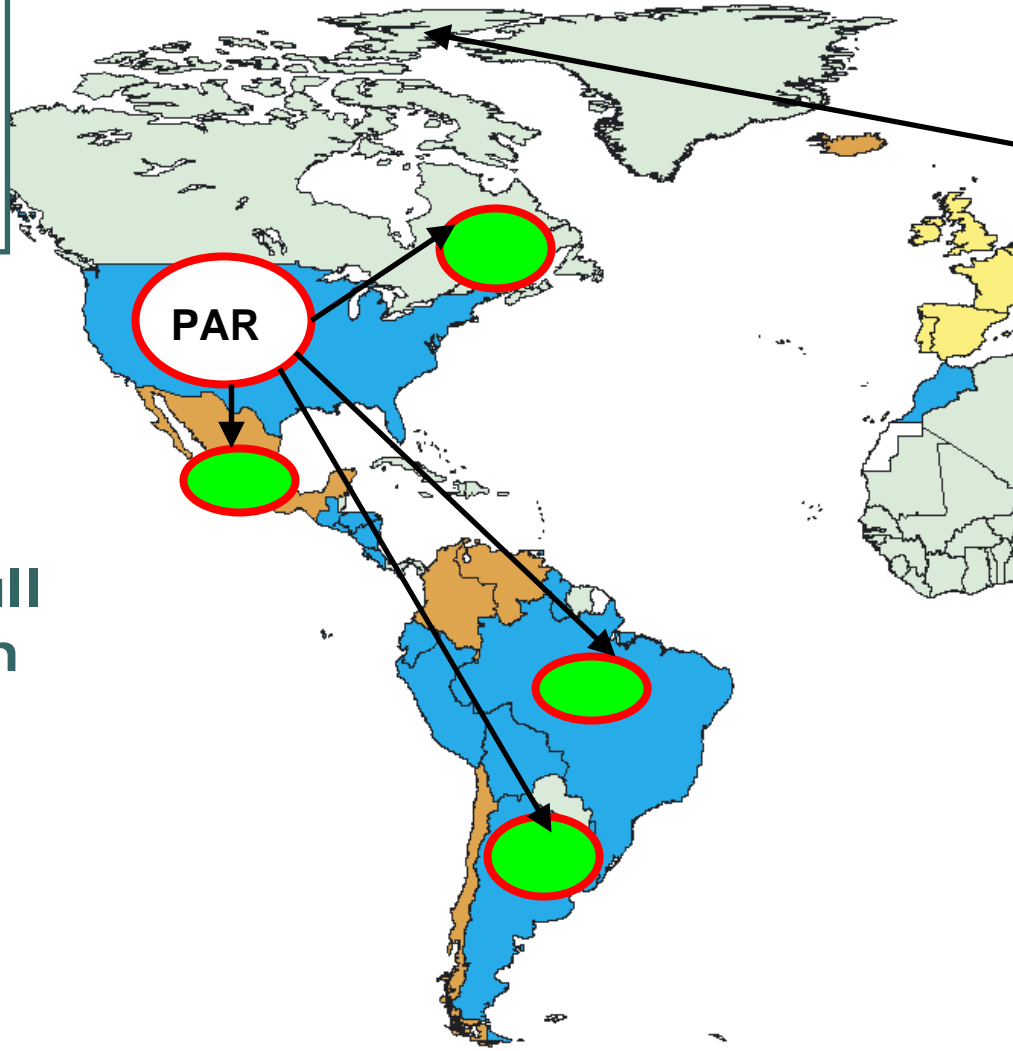
- Current function within MNE network – sell, buy, learn or support?
- Activities before RTA?

# Insider MNEs – Market Seeking

- **Insider Hub Firms:** Compare plant-level EOS to transport and border costs and decide whether to rationalize plants across region (focused factories) or consolidate in one location and export to rest of region.
- **Insider Spoke Firms:** Gear up for regional market if believe market access is secure. If not, may move to the hub. (Harris)
- **Insider Emerging Market Firms (EMFs):** Uncompetitive ones exit (or are bought up via FDI); competitive ones scale up for regional market via exports and/or FDI.

**DMF Insider with market seeking investments in the Americas, pre-RTA**

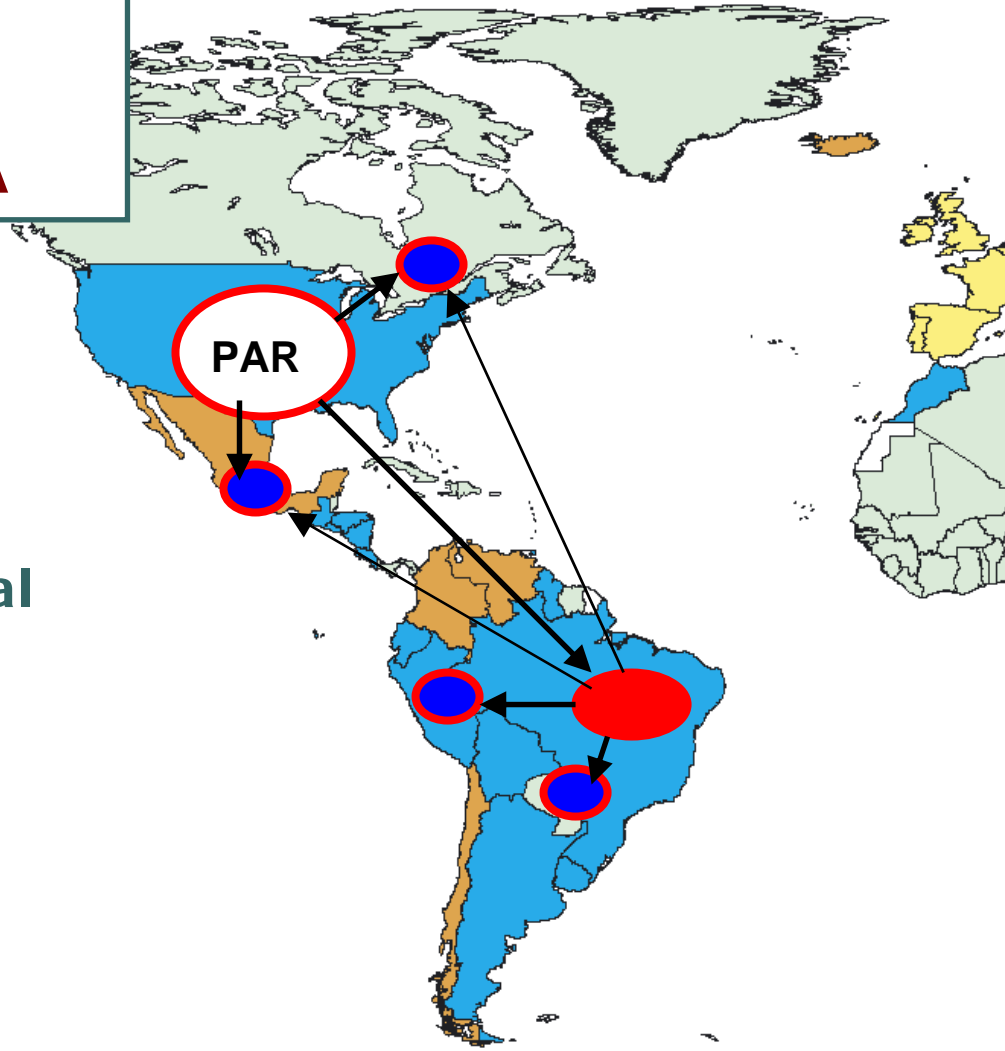
MNE is horizontally and vertically integrated – each affiliate produces full range of activities in its host country location.





**Miniature  
Replica**

# DMF Insider with market seeking investments in the Americas, post-RTA

Focused factories produce for the region, capturing plant EOS. Horizontal integration at distribution stage.



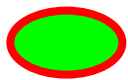
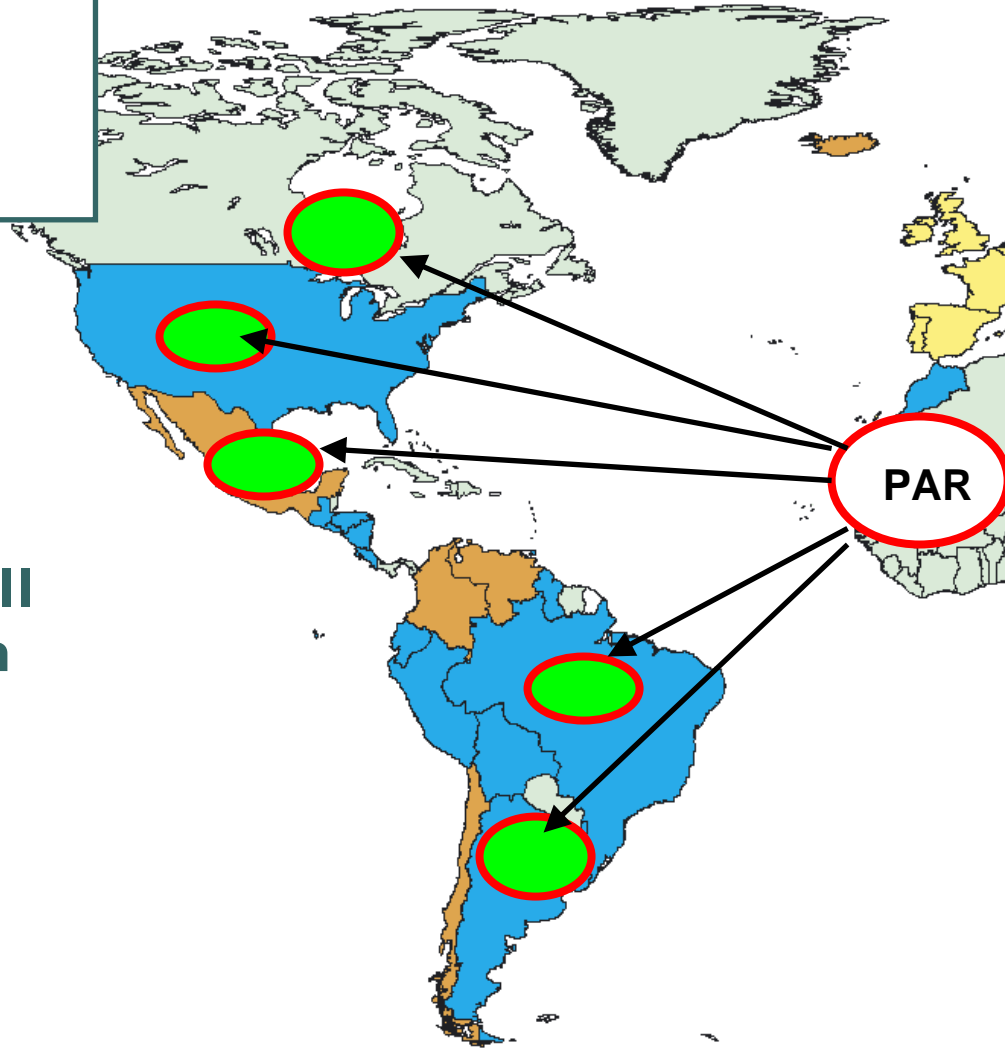
	Distributor
	Focused factories

# Outsider Responses to RTA Formation

- **Outside Developed Market Firms (DMFs):**  
Attracted by larger market. May shift from exports to FDI if external tariffs are high. Tight rules of origin encourage location in hub and exports to spokes. Locate in spokes only if market access to hub is secure.
- **Outsider Emerging Market Firms (EMFs):**  
Attracted by larger market. Look for market niches to exploit. Likely to go in with joint venture partner.

**DMF Outsider with market seeking investments in the Americas, pre-RTA**

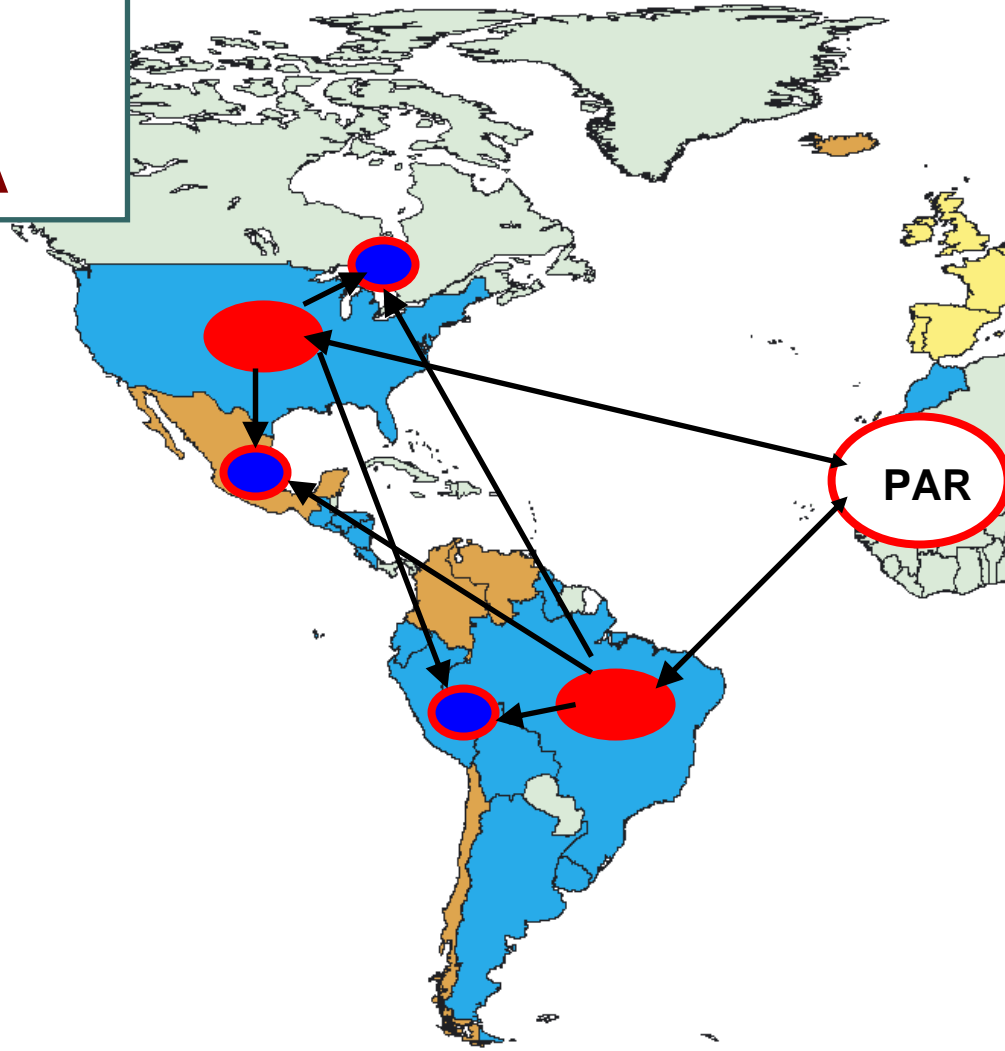
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**Miniature  
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Focused factories produce for the region, capturing plant EOS. Horizontal integration at distribution stage.



Distributor



Rationalized  
Manufacturer

## 2. Shift from Manufacturing to Services

- Manufacturing MNEs setting up **foreign service affiliates** (finance, marketing)
- **Service firms going international** (banking, accounting, consulting)
- **Privatization** of state owned enterprises encouraged inward FDI (telecom)
- **ITES** (information technology enabled services – back office and front office) being relocated to emerging markets.
- **Changes in government regulations** – opening sectors to FDI, WTO liberalization of services

# 3. Offshored Business Services

		Ownership of Production	
		Inourced (internalized)	Outsourced (externalized)
Location of Production	Onshore Production (home country)	1 Production kept in-house at home	2 Production outsourced to third-parties at home
	Offshore Production (foreign country)	3 Production by foreign affiliates in a host country	4 Production outsourced to third-parties abroad

# What Services Are Being Offshored?

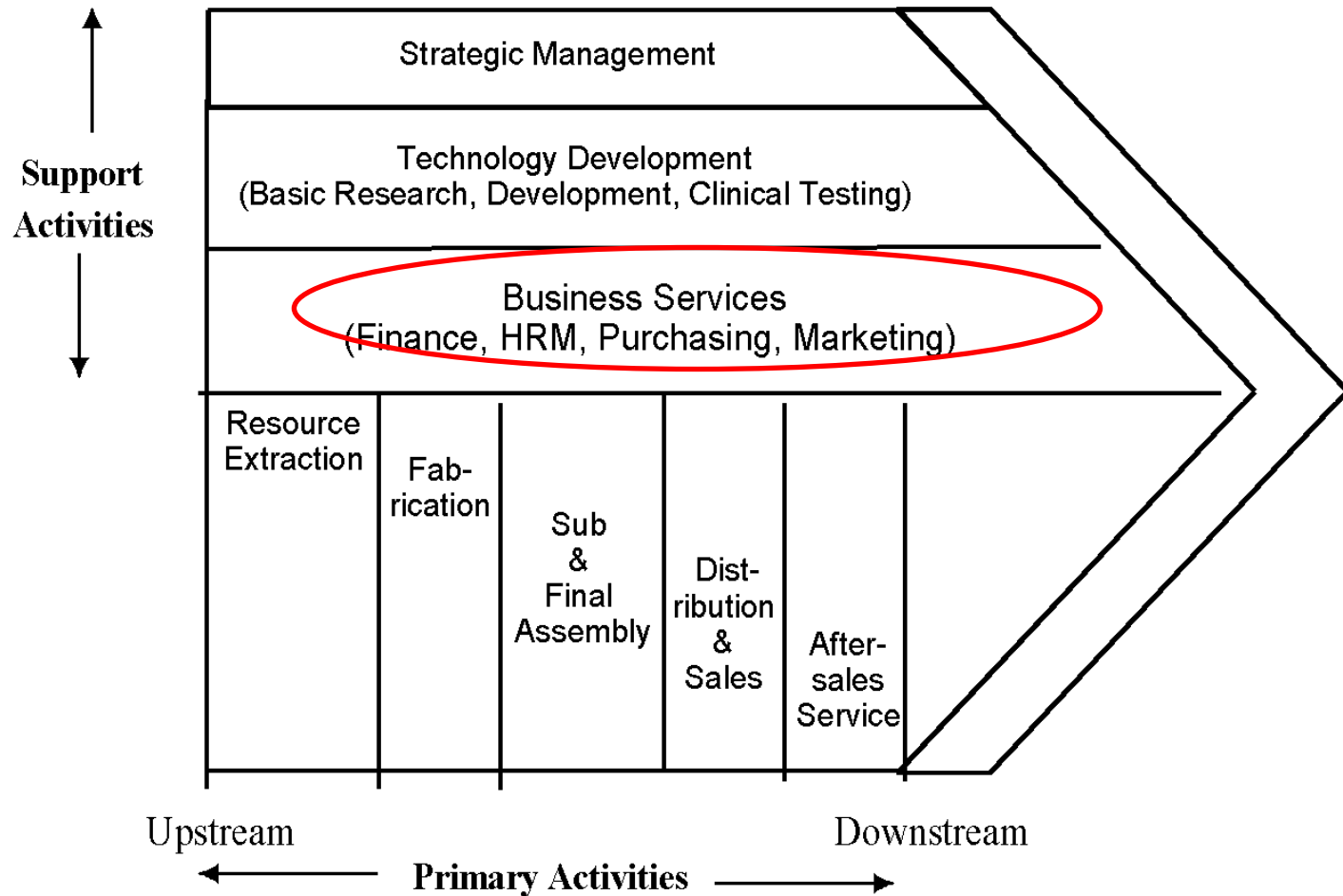
“any job that involves mostly ‘...sitting at a desk, talking on the phone and working on a computer...’ is a job under potential threat” of being offshored. (Bardhan & Kroll, 2003)

Jobs likely to be offshored have the following characteristics:

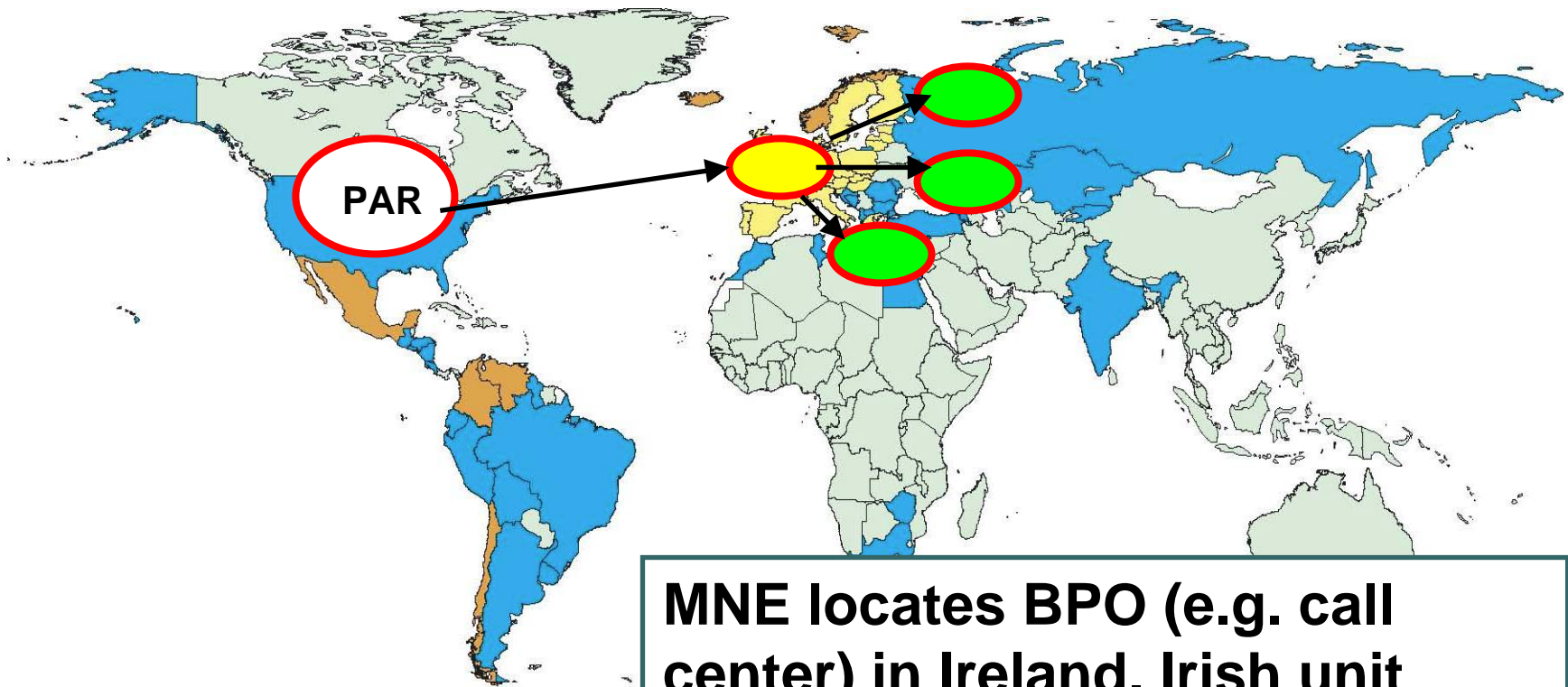
- No face-to-face customer servicing requirement
- High information content
- Work process is telecommutable and internet enabled
- High wage differential with similar occupation in the destination country
- Low setup barriers
- Low social networking requirement

# Outsourcing and Offshoring BSO/BPO Functions

Goal is increased efficiency, cost savings and speed.



# Offshoring BSO/BPO Functions



**MNE locates BPO (e.g. call center) in Ireland. Irish unit supplies support services to MNE network in EU.**

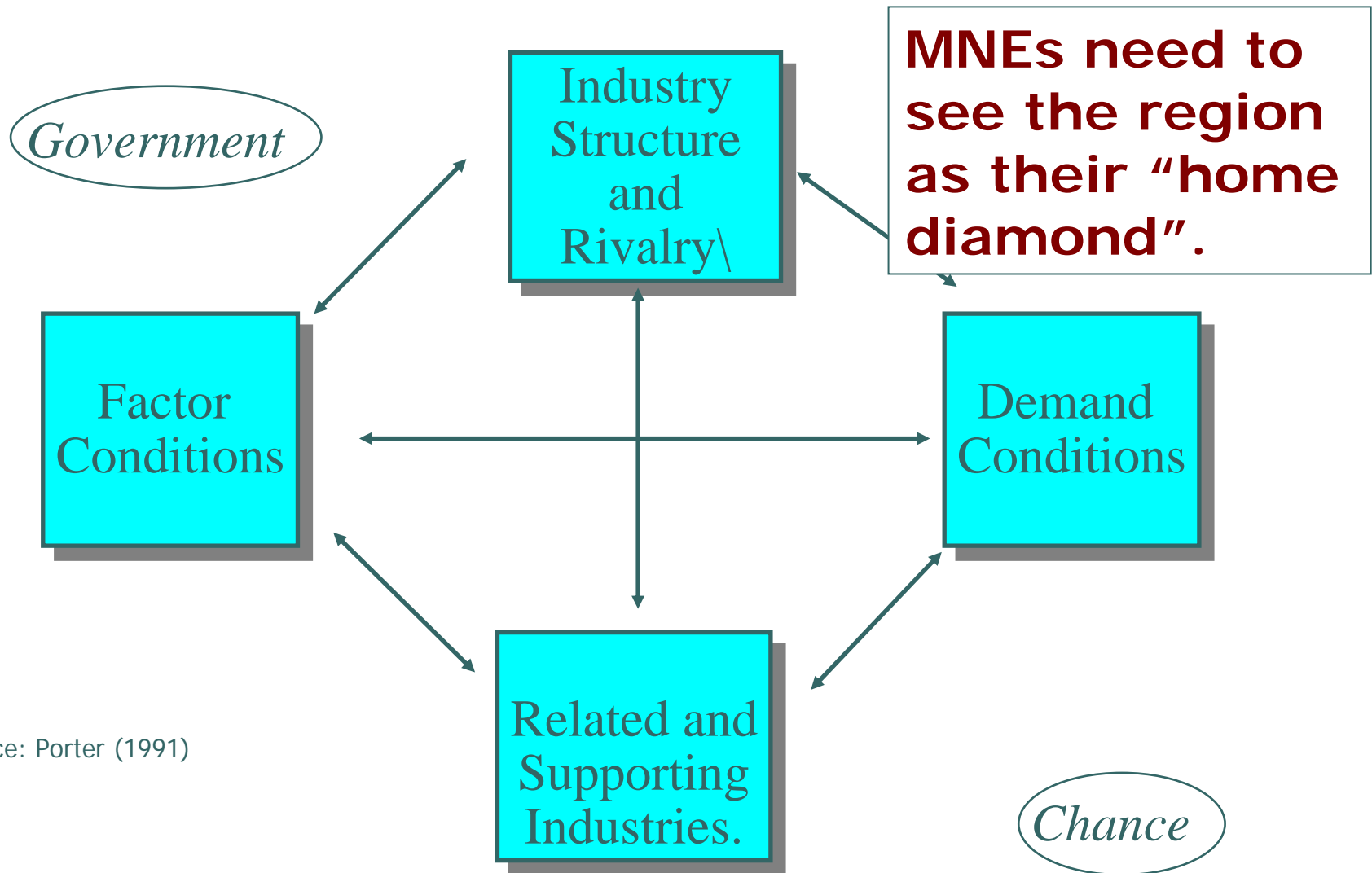
Participation in RTAs (CU, FTA, PS)



## 4. Rise of Regional MNEs

- Rugman found most Fortune 500 firms were home-based, some were regional, few were truly global.
- RTAs encourage growth of regional MNEs. Regional integration allows upscaling of FSAs for the regional market.
- Firms in small countries need a double diamond framework. Gear up for regional market.
- For Outsider MNEs, firm-level economies of scale and scope, together with agglomeration economies, support the creation of regional headquarters, to direct and monitor the MNE's regional production network.

# Porter's Diamond of Competitive Advantage

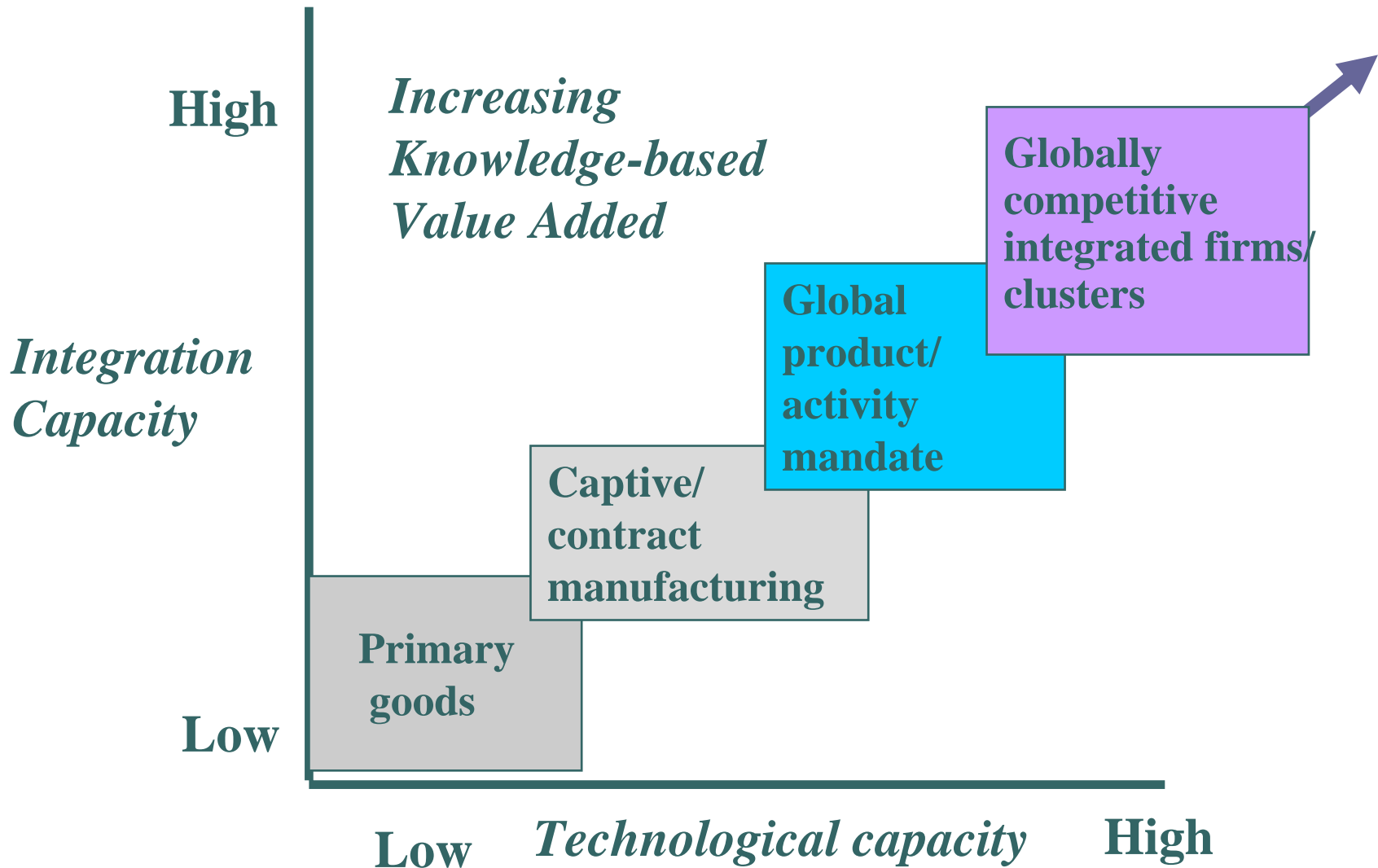


Source: Porter (1991)

# Moving On Up? Domestic → Regional → Global

		Firm Specific Advantages (FSAs)			
		Local FSAs	Regional FSAs	Bi-Regional FSAs	Global FSAs
Market Focus for the Firm	Local Market	1 Domestic Firms	2	3	4
	One Region	5	6 Regional MNEs	7	8
	Two Regions	9	10	11 Bi-Regional MNEs	12
	Global (Triad)	13	14	15	16 Global MNEs

# Insider EMFs Gear up for Regional Market



# V. Questions re “Spaghetti Bowl”

1. How does the proliferation of RTAs affect **big versus small firms**? Firms in **large versus small countries**? Firms in **developed vs developing** markets?
2. How does proliferation of RTAs affect MNE responses to regional integration in terms of **plant location strategies for products, services and intangibles**?
3. How can **insider EMFs** scale up for the regional market and become successful regional MNEs?
4. How are the responses of **state-owned EMFs** different from **grupos (family conglomerates)** and private firms in responding to RTAs?

# RTAs as Strategic FDI Policy?

1. Multiple RTAs add **complexity**. Big MNEs can avoid to negotiate through complexity; small ones cannot. So “spaghetti bowl” favors large MNEs.
2. Proliferation of RTAs engages “**treaty shopping**” across the RTAs for the lowest customs duties, easiest rules of origin and highest locational subsidies.
3. MNEs in hub economies incur lower **transaction costs** of regional integration than MNEs in spoke economies. So “spaghetti bowl” favors MNEs in hub economies. Also discourages investments in spokes.
4. Insider MNEs in hub economies can use **rules of origin and anti-dump/countervailing duties to harass** exporters in spokes and outsiders.

# Conclusions

- Complex subject – and becoming more complex as RTAs proliferate.
- Need better understanding of firm responses in context of multiple RTAs.
- Comments? Questions? Thank you !