2. Free movement of persons. Workers have the right to work elsewhere in the EU.
3. Free movement of services. It must be able to offer EU services of a country in another EU country.
4. Free movement of capital.

The main institutions of the EU are:

- The Council of the European Union
- The European Commission
- The European Parliament
- The European Court of Justice
- The European Central Bank (ECB)

Chapter D: Multinationals

Multinational corporation or transnational corporation: A company that is producing and selling products on more than one country. Multinationals are becoming increasingly important for the global economic system. The most multinationals are in the OECD countries. Becoming a multinational requires foreign direct investment (FDI). This can in either three ways:

- Greenfield investments: Setting up a foreign factory or subsidiary.
- Acquisitions: Buying foreign parts of existing firms.
- Mergers: Forming a new company with a foreign firm

In all cases, host-country assets are placed under the governance of multinational firms, but greenfield investments also contribute to the growth of an international production system. The majority of the FDI is in the form if mergers and acquisitions (M&A).

We can distinguish between three types of mergers and acquisitions

- Horizontal M&A: Between competitors in the same industry. Often to capture economies of scale or to gain market power. The majority of mergers and acquisitions is horizontal.
- Vertical M&A: Between client and supplier or between buyer and seller. To reduce transaction costs and uncertainty.
- Conglomerate M&A: Between companies in unrelated activities. To diversify risk.

Data on foreign direct investment have has been gathered systematically by the UNCTAD. FDI has increased enormous since 1993 but though with large fluctuations.

According to Dunning to become a multinational three conditions need to be satisfied, called the OLI approach:

- Ownership advantages. Allows a firm to overcome disadvantages of a foreign location. E.g. technology to which competing foreign firms do not have access.
- Location advantages. E.g. input prices, trade policy or tariff structures that favor production in foreign locations.
- Internalization advantages. For a reason, the firm is perceived to be better off if production is done within the boundaries of the firm rather than outside these(dealing with foreign partner).

Characteristics for multinationals:

- High ratios of R&D
- They employ large numbers of scientific, technical workers
- High value of intangible assets
- New/technically complex products
- Negatively associated with plant-level scale economies
- Associated with product-differentiation variables
- A minimum level of firm size is important for whether a firm can be a multinational
- They tend to be older and more established

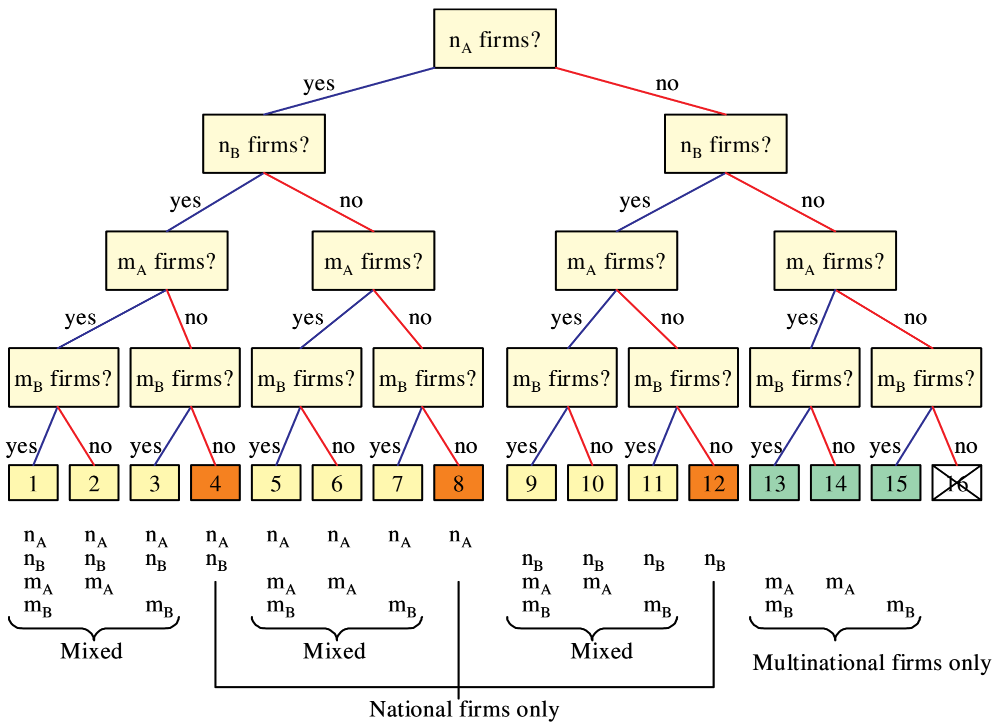
In the Markusen and Venables model we focus on horizontal multinationals. We analyze two countries (A and B) and two products (F and M).

- Food: produced in A and B according to the same technology, perfect competition
- Manufactures: homogeneous good, only labor used (no capital), firm-level and plant-level fixed costs and constant returns to scale.

The production of manufactures, which uses only labor, is characterized by four parameters:

- *c*: Constant marginal costs (expressed in labor units, to be multiplied by national wage rates)
- *t*: Transportation costs per unit of M, from country A to country B,
- *F*: Fixed costs per firm in terms of labor (e.g. R&D to develop product)
- *G*: Fixed costs per plant in terms of labor

Figure. Possible national/multinational regimes



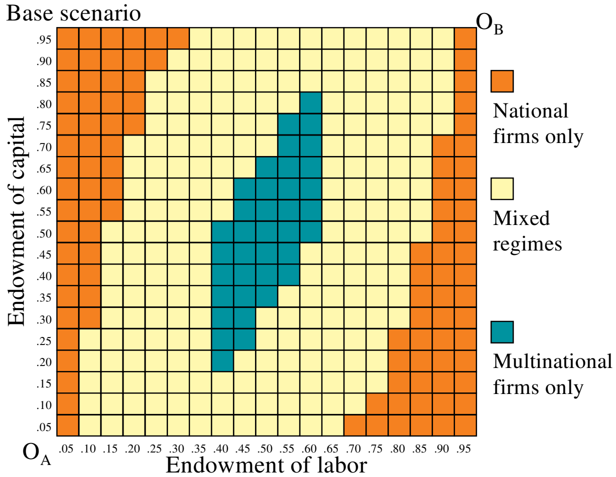
There are in total fifteen regimes. To simplify this they are divided into three groups:

1. Mixed regimes
2. National firms only
3. Multinational firms only

In the figure on the next page we can see all possible distributions of the world endowment of capital and labor between two countries for the three main types; mixed firms, national firms and multinational firms. From this model we can make the following conclusions:

- If country A and country B are of similar size and have similar factor endowments, so the capital-labor ratio is about the same size: multinational firms are dominant.
- If one of the countries is very large: national firms become more important.
- If the countries have very different relative endowments: national firms dominate.
- For intermediate endowment distributions, both national and multinational firms are important.

a. Base scenario



The decision to start up a multinational depends on size of the extra fixed plant costs relative to the transport costs. Looking at endowment ratios and size between two countries:

- If the endowment ratio between two countries is very different, there is a strong incentive for Heckscher-Ohlin inter-industry trade. Labor abundant country will specialize on the product that intensively uses labor. Labor is expensive in the capital abundant country and therefor it is to costly for this country to set up an extra production plant. Therefore the equilibrium is characterized by national firms in the labor abundant country only.
- If one country is small compared to the other, it is less attractive as a home base for production and as a basis for a foreign affiliate. Therefore the equilibrium is characterized by national firms in the large country only.