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Journal of Economic Dynamics & Control
24 (2000) 1345–1379

JOURNAL OF
Economic
Dynamics
& Control

www.elsevier.nl/locate/econbase

Multinationals' response to repatriation restrictions

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Received 1 January 1997; accepted 1 February 1999

Abstract

We present a model that explains how repatriation restrictions can increase or decrease a multinational's capital investment in and technology transfer to its subsidiary. Past remittance restrictions influence the multinational's expectation of current and future repatriation policies which affect its operations. We show that the model can capture the flows of United States multinational's capital and technology in response to various forms of Brazilian repatriation restrictions seen in the eighties. By comparing steady state level effects of the restrictions, we show countries should expect an inflow of foreign direct investment with the abolishment of restrictions, not an outflow as some countries fear. © 2000 Published by Elsevier Science B.V. All rights reserved.

JEL classification: F21; F23; F31

Keywords: Multinational enterprise; Foreign direct investment; Repatriation restrictions

1. Introduction

For the past decade more than 50% of the members of the International Monetary Fund have imposed restrictions suspending remittances by Multinational Enterprises (MNEs). These restrictions take the form of blocking

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PII: S0165-1889(99)00014-7

subsidiaries' remittance of capital, dividends, royalties and fees and/or profit back to their headquarters for days, months or years. Surveys and empirical data suggest that these restrictions affect MNE's operations. Wallace (1990), in a survey of 300 MNEs, finds repatriation restrictions to be one of the top three factors affecting direct investment decisions. Hines (1997) finds these restrictions have an econometrically significant impact on the actions of MNEs.

This paper provides a theoretical and quantitative look at how repatriation restrictions can increase or decrease an MNE's capital investment in and technology transfer to its subsidiary. Understanding the link between capital flows and repatriation policies is important since countries who impose restrictions are often concerned about maintaining a minimum level of foreign exchange reserves and their current stock of foreign direct investment. Since technology transferred by MNEs is diffused into the local economy (see Teece, 1976), it is of interest to know how repatriation policies influence the stock of technology available to domestic firms.

Past research in this area has focused on capital account liberalizations' effect on capital flows.[1] This paper differs from their analysis in three important ways. First, this research focuses on the actions of the MNE as restrictions vary through time. Although other work has explained why a country generally experiences a capital inflow as restrictions are lifted, we focus on explaining how capital investment may increase or decrease in the country when restrictions are enforced. Second, this work not only considers the effect remittance policies have on capital flows but, we analyze the effect it has on technology transfers. Third, besides providing the theoretical underpinnings of the analysis, we quantify the effect repatriation policies have on capital and technology flows.

The theoretical analysis provides intuition for how movements in repatriation restrictions affect the MNE's activities. We show that changes in government restrictions, which alter the MNE's belief about the expected present discounted value of their remittance, can cause the MNE to reinvest in the subsidiary and wait out the restriction or, cause the MNE to get funds out of the subsidiary immediately. Technology transfer to the subsidiary may increase or decrease as government restrictions affect the MNE's valuation of the marginal benefit of an additional unit of technology used in the subsidiary. It is the MNE's belief about the enforcement of current and future restrictions that increase or decrease technology and capital flows.

We quantify the effect of repatriation policies in three ways. First, through impulse responses, we measure how the imposition of restrictions causes capital investment and technology transfer to deviate from their long run mean values. We illustrate that different forms of restrictions, partial versus full blocking of

[1] Some papers include Bacchetta (1992), Bartolini and Drazen (1997a,b) and Itagaki (1989).

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