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IS TTIP (TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP) PART OF A WORLD MOVEMENT TO TRUE GLOBALIZATION?

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Abstract

The Transatlantic Trade and Investment Partnership (TTIP) agreement between the European Union and the United States has the potential to be the most ambitious trade and investment agreement between two developed economies. Most EU Member States do not currently maintain Free Trade Agreements (FTAs) or Bilateral Investment Treaties (BITs) with the United States, so the TTIP has the possibility of breathing new life into trade and investment flows as well as their corresponding protection on both sides of the Atlantic. This paper discusses TTIP, issues arising, effects on globalization, FDI (Foreign Direct Investment) and the treasury management by the MNCs (Multinational Companies) (Prof. Dr. Christian Tietje, 2014).

The TTIP can affect the developing countries and influence the global trading system through the large increasing in the trade and investment predicted to take place between the two Atlantic sides.

Introduction

TTIP (Transatlantic Trade and Investment Partnership) would remove economic barriers between EU (European Union) with all its 28 members and the USA (United States of America) to increase the flow of goods through exports and imports between the two sides of the Atlantic without tariffs, also the investments between the both EU and USA.

On its simplest benefits, the TTIP will increase the products variety and lower prices will be provided for the customers and will increase jobs needed and consequently the economic growth.

As in the past, many MNCs have established manufacturing plants in the Eastern European countries since the wages in some of these countries are lower than the Western ones; also the Governments in some of the new EU countries have also reduced corporate tax rates and offered other incentives to encourage MNCs to establish facilities there. (Jeff Madura, 2011).

The reason that I think is the most persuasive for the TTIP is that both USA and EU FDI (Foreign Direct Investments) are the most country for each other if it is taken in million in euros, the EU outwords FDI is 1,195 in USA and 563 in switzerland the second one, and the EU inwords FDI is 1,201 from USA and 365 from switzwerland the secon one in the arrangement (Joseph Francois, 2013).

Part One

Issues arising from TTIP when considering MNC host country relationships

MNCs will seek benefits from TTIP through finding cheaper sources of debt and expanding their markets of selling products. TTIP will remove trade barriers between the US and EU. Some EU firms will export their products to the US that had previously been restricted by barriers to US. Other firms from US can gain advantage by opening subsidiaries in the EU countries with low salaries and wages.

Producing the US products in the EU will minimize the costs and consequently prices, which will increase the purchasing power and so pushes the Economic growth.

MNC investments are affected by the host country conditions; economic, industrial and socio-political country conditions affect the financial decisions of the MNC, although these risk is present, the MNCs still interested in opening foreign subsidiaries.

From the point of view of the host country it encourages the presence of a MNC as it will offer employment, increase domestic tax revenues, shares in the foreign trade, replaces the imports, sharing in the economic growth and increasing the available of the foreign currency needed for importing.

Although international business can reduce an MNC’s exposure to its home country’s economic conditions but it increases the risk of exchange rate, foreign economic and political conditions. If the an EU corporation is exporting goods to a US one in euros, so the US company will purchase euros and then purchase the goods and if the euro goes up, the US company will have to pay more for the goods. The EU exporter may find that the US customers are not asking for the goods any more. To avoid the risk of losing the US customer, EU Company may agree to sell in US dollars but this is not a root solution. The root solution is to form a foreign subsidiary in the US which will buy inputs in US dollars and sell outputs in the same currency and finalize the financial statements in US dollars and then consolidated in the whole MNC financial statements after translating it into euros.

Figure (1) MNC based in EU exporting goods to a US customer and collecting in euros, there is no currency risk here for the MNC but for the US customer which will be obligated to pay in a foreign currency.

Figure (1)

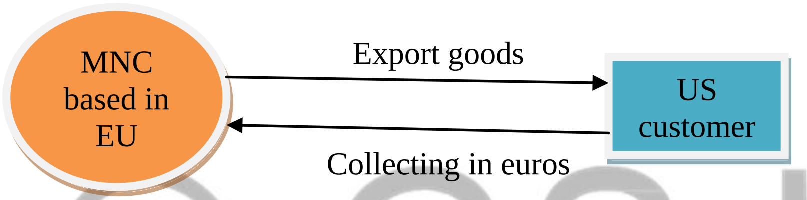

Figure (2) MNC based in EU exporting goods to a US customer and collecting in USD, and then converting the USD into euros through a currency exchange transaction, and in this case the MNC bear the currency risk instead of its US customer as it goes through a currency exchange to sell the USD and buy euros in order to operate, although the MNC can enter into hedging tool such as forward contract, future contract or currency options but still there is a risk or a cost to avoid this risk.

Figure (2)

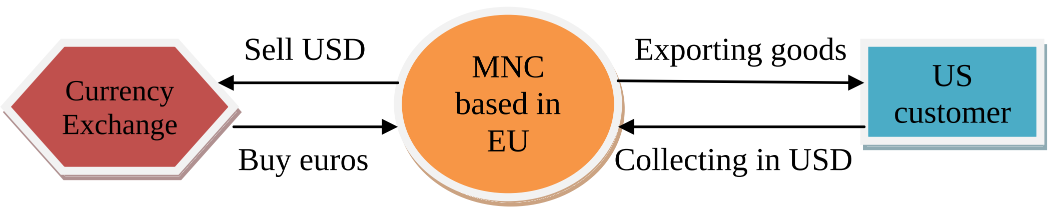

Figure (3) MNC based in the EU establishes a foreign subsidiary at USA which sells the goods directly to the US customer and then its results are consolidated in the MNC consolidated financial statements. This case benefits all in my opinion as the MNC invests in a foreign subsidiary placed in USA, operates and sells goods directly to US customers and collects from them in their local currency, USD. There is no need to convert the collected USD into euros as the MNC subsidiary will need USD currency to operate in the USA; paying for inputs such as row materials, labour and even utilities are all paid in the USD.

EU MNC subsidiary which is placed in the USA will add value to the USA as the MNC subsidiary will pay taxes, use the US employees and will share in the domestic economic growth.

Figure (3)

Other benefit for the MNC is that it can offer its stocks or bonds in its foreign subsidiary host as it is well known in that market. They may consider this approach to obtain partial funding in a currency that they need to finance a foreign subsidiary's operations.

Part Two

How might foreign direct investment be affected by TTIP and like developments?

MNCs are interested in the FDI (Foreign Direct Investment) to increase their profits through boosting revenues or reducing costs or the both. Establishing a foreign subsidiary should increase the revenues by attracting new customers in new markets, also those new markets may be a chance for superior profits if the product itself or its quality or features hasn't been presented in those markets before.

Looking towards maximizing profits is good but MNCs although look for minimizing expenses while entering new markets through establishing new subsidiaries and it may be the main reason behind is that to get benefits from well trained and low cost labour or the usage of foreign row materials instead of importing them. The technology is another important factor that the MNCs are watching and seeking for while forming new foreign subsidiaries.

FDI importance can clearly appear by knowing that large European MNCs such as BP plc (United Kingdom), Renault (France), Koninklijke Philips Electronics NV (Netherlands) and many other firms have more than one half of their assets in foreign (non-euro) countries. Businesses, such as Nokia (Finland), Diageo (United Kingdom), ThyssenKrupp Group (Germany), Alcatel (France), Tesco (United Kingdom) and Adidas (Germany), commonly generate more than a third of their sales outside Europe (Jeff Madura, 2011).

There are two opinions around the relationship between trade and FDI, the first one states that this relation is complementary as the increased sales through the new markets and the corresponding demand of the intermediate goods makes up for the lost export volume, in contrast the other opinion states that trade will substitute FDI as the international trade

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occurs due to a difference in factor rewards. FDI will lead for equalization of the rewards which should decrease trade between countries.

The first opinion is much reasonable as by removing the economic barriers stated earlier between EU and USA, TTIP will increase the FDI the most and the need for the intermediate goods and manufacturing inputs will increase the trade between the bilateral economics agreement.

Trading between the TTIP countries is important and removing barriers to achieve the high trade volumes and free float of the goods is good but the FDI is much important as it solves problems such as unemployment and lack of technology without taking away business away from local firms. Host governments may possess incentives in order to attract FDI such as rent-free land, low interest loans or whatever to gain benefits from employment or technology.

Of course the TTIP will increase goods sold to the Eastern European countries and may increase the usage of their low paid labor, all of this will benefit the USA side, but it may have a bad side effect on the employment which will be substituted by the EU FDI in the USA.

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Part Three

How might treasury management be affected by TTIP?

Treasury management can be defined as the process of controlling and managing the financial assets and liabilities of the MNC. These financial assets and liabilities can also be noted as short term ones. How can MNC finance their international trade, sources of short-term fund, and the short term investment decisions?

A: Ways to finance the international trade:

Payments for the international trade have five ways; prepayments, letters of credit (L/C), drafts, consignments, and open accounts. Each of the previous ways has different degree of risk to the buyer (importer) and the seller (exporter) presented in the figure (4), the less risky way from the point of view of the seller (exporter) is to receive prepayments and then ships the goods, and of course this is the most risky to the buyer (importer). The less risky way to the buyer (importer) which is the most risky to the seller is to use the open account as the goods are shipped to the buyer as a first step and then the buyer pay for the goods.

The other ways to pay for the imported goods varies in their degree of risk; the second way is to use the L/C in which there will be an issuing bank and a correspondent bank for the buyer and seller respectively in which there is little risk on the seller and the risk to the buyer is to receive the goods described in the document. The risk then goes step by step through the Sight draft as a third way and time draft as a fourth one to be much risk for the seller (exporter).

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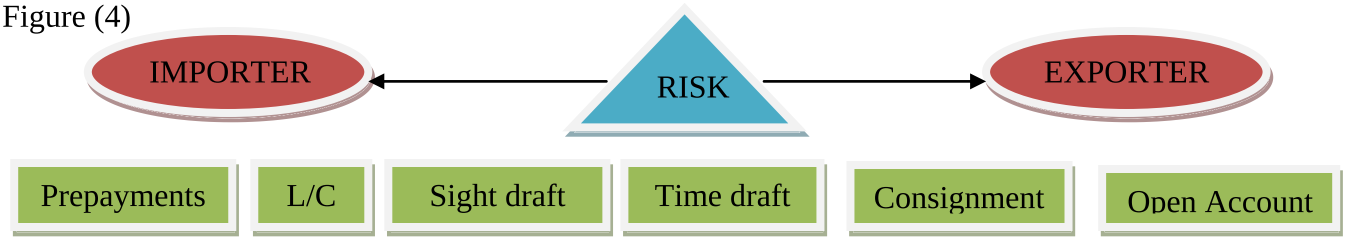
Figure (4)



TTIP will have no effects on the ways to finance international trade, TTIP will increase the trading but it doesn't mean that the ways to pay will be changed, maybe there will be much easier and time shorter ways to pay in the future but it will arise due to the increase in the global trades not due to the Transatlantic trades only.

(B) Sources of short-term fund:

MNCs in contrast with other companies can make use of different currencies which can maximize the profits and the value of the MNC. It can provide short term financing through Euronotes, Euro-commercial paper and Euro bank loans. MNC management should check the subsidiaries cash flows, cash balance and projected cash flows before they seek for lending money.

MNC parent can bring cash from the liquid subsidiaries to provide them to less liquid subsidiaries or to the parent itself in order to minimize lending from outside parties as much, this can be done by lending money from subsidiaries but this may face a restrictions or taxes from the national subsidiary government, but the best way is to raise the markup of the goods send to the subsidiary to collect cash without be remitted to it.

Figure (5)

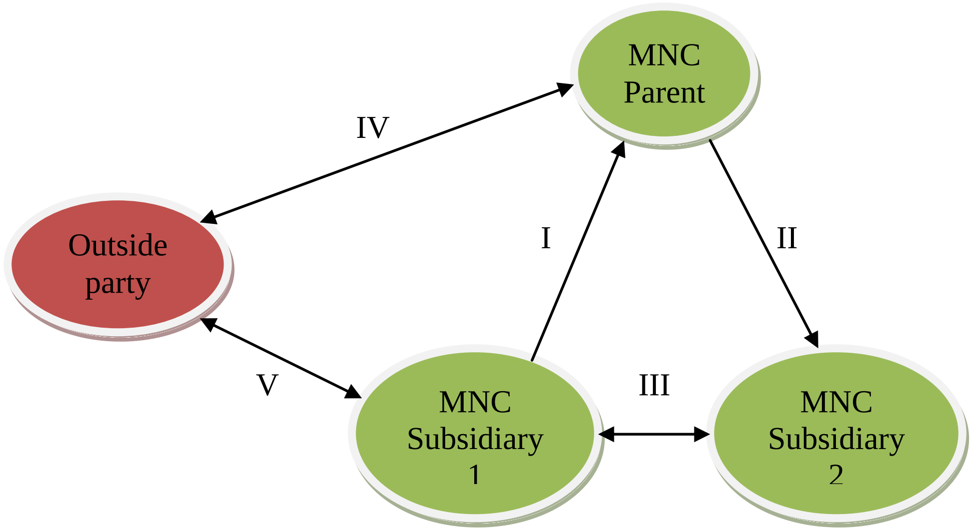


Figure (5) represents the transactions that can be made between the MNC parent, subsidiaries and the outside parties. The transaction (I) represents the flow of the cash between the liquid subsidiary number 1 and the MNC parent in the forem of lending money or increasing the markup which is better, the transaction (II) represents the flow of cash from the parent to subsidiary number 2, as this subsidiary hasn't much liquid money so the parent sent it in the form of loans or investments. The transaction (III) represents the flow of cash between the subsidiary 1 & 2. The subsidiary 1 lends cash to the subsidiary 2 and the last pays annual interest and then repay back the loan after a period of time.

The transaction (IV) presents the flow of cash from the outside party, for example bank, to the MNC parent who invest money and is responsible for paying interest and principal. The last transaction (V) as the previous one, but between the outside party and one of the subsidiaries, any subsidiary can borrow money from outsiders after the parent permeation in a centralized cash management in order to achieve the overall MNC goals, this borrowing may be in the local subsidiary currency.

A good example for foreign financing was what Avon did during the Asian crisis; it purchased more material locally, borrowed fund locally to finance its operations so that it could use some of its cash inflows in Asian currencies to repay the debt, it then hired more local sales people to increase its local sales, and then it began to remit it earnings more frequently so that excess cash flows denominated in Asian currencies would not accumulate (Jeff Madura, 2011).

TTIP will increase the needs for cash to productions and services provided by MNCs that will get into new markets and attract new customers. MNCs may increase their loans from banks provide cash with low interest rates in USA or in EU, or they can concentrate their efforts to manage the cash internally to avoid lending as much which is more profitable to the MNCs.

(C) Short term investment decisions:

In order to get into investments MNC should optimize cash flows, it can optimize cash flow by accelerating cash inflows; since the more quickly the money is received the more quickly MNC can invest. MNC can use lockboxes in which customers are instructed to send payment or preauthorized payment in which MNC can charge a customer's account up to a limited value.

Other ways to optimize cash flows are minimizing currency conversion costs through netting as all subsidiaries should net their needs together in order to reach a net need for another currency. Managing blocked funds created by host governments that restrict money to be in the subsidiary country, MNC can impose this subsidiary to incur expenses that helps other subsidiaries and the parent as well such as creating a research and development department which will incur costs in a specific subsidiary but increase the revenues of all subsidiaries, also MNC can raise the markup to this subsidiary or the parent may instruct subsidiary to obtain financing from a local bank to minimize investments sent to this subsidiary. Managing inter-subsidiary cash transfers to provide cash flows at MNC much time as possible through leading and lagging payment to maximize the MNC benefits.

Short term investment decisions will definitely affected by the TTIP as the MNC will have a new areas to invest money much more than the past, MNC should optimize cash inflows as fast as possible to offer cash out flows to investments. MNC will concentrate much on where to invest their money under the new agreement.

Conclusion

Definitely TTIP is a part of a world movement to true globalization; recent history shown that all economic options and agreement was in its first phase between two or more countries or unions until all have done. Globalization is a fact that will happen in the near future and my advice to the MNCs management is to get ready for. TTIP will increase the trade, FDI and investments. Jobs will be offered in regions with low labour paid price, and goods are assumed to be provided at lower prices.

The only disadvantage is that the TTIP may affect the employment, as employers worldwide are accelerating their efforts to scour the globe to find the lowest cost locations to produce, which means that there will be job losses in the short term in some regions but employees will adjust themselves to the new employer needs, even this effect is short term but it hurts.

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