

Study Questions
(*with Answers*)

Lecture 11
Multinationals and International Capital Movements

Part 1: Multiple Choice

Select the **best** answer of those given.

1. Which of the following would be an example of foreign direct investment from the United States to Taiwan?
 - a. A U.S. bank buys bonds issued by a Taiwan computer manufacturer.
 - b. A U.S. car manufacturer enters into a contract with a Taiwan firm for the latter to make and sell it spark plugs.
 - c. Microsoft hires a Taiwanese computer programmer to debug some software for it.
 - d. The state of California rents space in Taipei for one of its employees to use promoting tourism in California.
 - e. Warren Buffet (a U.S. citizen) buys a controlling share in a Taiwanese electronics firm.

Ans: e

2. What is the relationship between foreign direct investment (FDI) and multinational enterprises (MNEs)?
 - a. An MNE never involves FDI.
 - b. FDI is never done by an MNE.
 - c. All MNEs involve FDI.
 - d. All FDI is done by MNEs.
 - e. Some (but not all) MNEs do some (but not all) FDI.

Ans: c or e (I can imagine an MNE that has people abroad but owns nothing there, in which case c would not be true. But in practice, I'm sure that all MNEs do own assets in different countries and must therefore have engaged in FDI.)

3. What is the connection, if any, between comparative advantage (CA) and foreign direct investment (FDI)?
- Nothing. CA has nothing to do with FDI.
 - Countries often engage in FDI in industries where the country they invest in has a comparative disadvantage.
 - Countries often engage in FDI in industries where the country they invest in has a comparative advantage.
 - When a country's firms invest abroad, this helps to create CA in the same industry at home.
 - When a country's firms invest abroad, this helps to create CA in the same industry in the country where they undertake the investment.

Ans: c (and actually, b is also true in cases of tariff-jumping FDI)

4. If a German manufacturer of household appliances wants to take advantage of the cheaper labor available in the Czech Republic, which of the following actions will **not** serve that purpose?
- Build a manufacturing subsidiary there and employ Czech workers.
 - Build a plant in the Czech Republic and send all German workers to operate it.
 - License a Czech firm to produce its products under its own label.
 - Contract for a Czech firm to do some of the processing for it.
 - Buy a Czech firm that produces similar products, and adapt it to produce its own products.

Ans: b

5. Tariff Jumping occurs when
- A firm that otherwise would have exported to a country instead invests there in order to avoid paying the country's tariff.
 - A country raises a tariff against a foreign exporter who sells to it below cost.
 - Countries raise (and lower) their tariffs in an effort to stabilize the price of a product on the domestic market.
 - A firm buys inputs from domestic firms rather than importing them from abroad over a tariff.
 - A government levies a tariff on the price of a good that already has been increased by another tariff.

Ans: a

6. When a company moves its tax residence to a low-tax jurisdiction such as the UK or Ireland, on what portion of its earnings does it pay less taxes?
- Its earnings from production in the country that it moves its tax residence from.
 - Its earnings from production in the country that it moves its tax residence to.
 - Its earnings on intangible assets, like holdings of noble gases.
 - Its earnings on intangible assets, like patents.
 - None. Rules of the IMF require that such jurisdictions levy taxes at the same rate as a firm's original country.

Ans: d

Part II: Short Answer

Answer in the space provided.

1. Look back at the choices provided for question 4 above. Which of them constitute acts of foreign direct investment?

Ans: a, b, and e

2. Suppose that Mexico has previously had restrictions on inflows of foreign direct investment from all sources, including the United States. Then suppose that they remove those restrictions on flows from the United States in a particular industry, say hammocks. As a result, several hammock producers in the U.S. move production to Mexico via FDI. Indicate for each of the groups below whether you expect them to gain or to lose from this flow of investment.

- a. Workers previously employed in hammock production in the U.S.

Gain / Lose *Ans: Lose*

- b. Workers previously employed in hammock production in Mexico.

Gain / Lose *Ans: Gain*

- c. Owners of firms that move production to Mexico.

Gain / Lose *Ans: Gain*

- d. Owners of U.S. hammock firms that **do not** move production to Mexico.

Gain / Lose *Ans:* *Lose*

- e. Owners of firms in Mexico that previously produced hammocks.

Gain / Lose *Ans:* *Lose*

- f. Consumers of hammocks (assume that there already was free trade in hammocks).

Gain / Lose *Ans:* *Gain*

3. What do the following acronyms stand for, and what do they mean?

- a. DFI *Ans:* *Direct foreign investment: Building or buying real assets, such as factories and equipment, in another country.*

- b. MNE *Ans:* *Multinational enterprise: A company that operates in more than one country.*

- c. TNC *Ans:* *Transnational corporation: Same as MNE if a corporation, but usually used with a negative connotation.*

- d. MOFA *Ans:* *Majority-owned foreign affiliate: A foreign subsidiary of a company, a majority of whose ownership shares are held by that company.*

4. What are three ways that a company in one country can serve (sell its product to) a market in a foreign country?

Ans: Exporting (produce its product at home and export it to the foreign country)

Licensing (license a foreign company to produce it there, paying a fee or royalty to the home country)

FDI (engage in foreign direct investment to establish a subsidiary in the foreign country to produce the product.)

5. How could U.S. firms doing FDI abroad cost jobs in the United States? How could it save jobs in the United States?

Ans: FDI could cost jobs if a U.S. firm moves production abroad that it would otherwise have continued to do in the U.S. It could save jobs if moving part of a firm's operations abroad permits it to stay in business when it otherwise would not, thus saving the jobs of those it continues to employ in the U.S.