

## Definitions

### Flow of foreign direct investment

The FLOW of FDI refers to the AMOUNT of FDI undertaken over a given period of time (normally a year).

Foreign direct investment occurs when a firm invests directly in facilities to produce or market a product in a foreign company. Can be an investment in terms of (1) buying a company in target host country or (2) expanding operations of an existing business into that country.

**Example:**

1. Target buying Zellers and entering the Canadian market.
2. Walmart entering the Indian market as 'Best Price' – Stores operated by a joint venture with Bharti an Indian company -allowed to sell to other businesses. By 2020 the venture had 20 stores in India.

### Stock of foreign direct investment

Refers to the total ACCUMULATED VALUE of foreign investments at a given time.

**Example:** Stock value could represent the total monetary amount of FDI in one country. China's FDI increased from zero to \$378 billion in 2008.

### Common law system

Common law is based on TRADITION (legal history), PRECEDENT (past cases) and CUSTOM (specific situations). When law courts interpret common law, they do so according to those characteristics.

- This gives common law systems a degree of flexibility that other systems, such as civil law, lack.
- The United states practices common law

### Civil law system (how it's different from common law)

Civil law is based on a detailed set of laws organized into codes. When law courts interpret civil law, they do so with regard to these CODES.

- There is no interpretation of tradition in civil law, the law is SET in codes. Therefore under a civil law system, judges have much less flexibility and power to interpret the law.
- Germany, Japan, Russia, France all practice civil law
- Quebec is a combination of common and civil law.

## Hecksher-Ohlin Theory

Swedish economists who argued that comparative advantage DID NOT arise from differences in productivity, rather that it was the product of differences in national FACTOR ENDOWMENTS.

- This theory attempts to explain the pattern of international trade that we observe in the world economy.
- Assumes that technologies are the same across countries, which is not always the case. Differences in technology lead to differences in productivity.

**Example:** China has excelled in the export of goods produced in labour intensive manufacturing industries. This reflects China's relative abundance of low-cost labour. The United States, which lacks low-cost labour, has been a primary importer of these goods.

## Factor endowments

Factor endowments refer to the extent to which a country is endowed with resources such as land, labor and capital. Nations have varying factor endowments, and different factor endowments explain differences in factor cost.

- The more abundant a factor, the lower it's cost

## Leontief Paradox (how is it different from HO theory)

Using the Hecksher-Ohlin theory, Leontief hypothesized that because the United States was relatively abundant in capital compared to other nations, the US would be an exporter of capital-intensive goods and an importer of labour intensive goods.

HOWEVER, Leontief found the INCONSISTENCY in the theory, that US exports were less capital intensive than US imports.

- Economists prefer the H-O theory on theoretical grounds, however it is a poor predictor of real world international trade patterns

Best solution may be to return to the Ricardian idea- that trade patterns are largely driven by international differences in productivity.

- The U.S exports commercial aircrafts and imports textiles, not because its factor endowments are especially suited to aircraft manufacture, and not suited to textiles. But because the U.S is relatively MORE PRODUCTIVE at producing aircrafts than textiles.

## Purchasing power parity

Gross national income (GNI) is a common measure of economic development. Total annual income received by the residents of a nation.

- GNI figure can be misleading because they do not consider differences in cost of living.

**Purchasing power parity** allows for a more direct comparison of living standards in different countries. To account for the differences in the cost of living one can adjust the GNI per capita by purchasing power.

- The base for the adjustment is the cost of living in the United States, the PPP for different countries is then adjusted up/down depending whether it is lower or higher than the U.S.

**Example:**

(1) Although the GNI per capita of Switzerland at \$76,350 exceeded that of the United States \$48,620. The higher costs of living in Switzerland meant that U.S citizens could actually afford almost as many goods and services as the average Swiss citizen.

(2) In 2001, the GNI per capita in China was \$4,940, but the PPP per capita was \$8,390. Suggesting that the cost of living was lower in China and that \$4,940 in China would buy as much as \$8,390 in the United States.

**Subsidy**

A subsidy is a government payment (financial assistance) to a domestic producer. Can take many forms including: cash grants, low-interest loans and tax breaks etc.

By lowering production costs, subsidies benefit domestic producers in two ways; (1) by competing against foreign imports and (2) gaining export markets.

The main gains of subsidies accrue to domestic producers, whose international competitiveness is increased as a result.

- Agriculture tends to be one of the largest beneficiaries of subsidies in most countries.

**Example:** (1) Bombardier received subsidies from the Canadian government.

(2) GM received subsidies from the U.S government.

**Local content requirement**

Is a requirement that a specified fraction of a good must be produced domestically.

Provides protection for domestic producers by limiting foreign competition.

- Benefits producers (not consumers)

**Example:**

- (1) The 'Buy America Act' specifies that government agencies must buy give preference to American products when putting contracts for equipment out to bid. "American" if 51% of the materials used to produce it are American.
- (2) Quebec radio stations, a certain percentage of what is played on the radio must be French.
- (3) Canadian radio music, at least 35% of weekly music must be Canadian

### **Political risk**

The Likelihood that political forces will cause drastic changes in a country's business environment that adversely affects the profit and other goals of the business enterprise. Political risk can deter companies from investing abroad, and make it very difficult for countries to attract foreign investment. Political risk can have a large impact on business with very little warning.

- Example:**
- (1) War- Afghanistan, Syria.
  - (2) Social unrest- terrorism, strikes, violent conflict
  - (3) Corruption and nepotism- Middle East, Russia, Montreal?
  - (4) Religion inspired violence- Nigeria

### **Greenfield Investment**

Involves the establishment of a new operation in a foreign country. One of the TWO forms of FDI

- Example:**
- (1) BMW entering the United States
  - (2) Forever XXI entering Canadian market

### **Voluntary Export Restraints (VER)**

A restriction (quota) -generally set by the importing government- on the quantity of goods that can be exported out of a specific country over a specified period of time. Typically VER's arise when the import-competing industries seek protection from a surge of imports from particular exporting countries.

- **Benefits...**  
-DOMESTIC PRODUCERS, by limiting import competition
- **A disadvantage for...**  
-CONSUMERS, an import quota or VER always raises the domestic price of an imported good.

**Example: Japanese cars entering the American Market!**

One of the most famous historical examples, is the limitation on auto exports to the United States enforced by Japanese auto producers in 1981. A response to

direct pressure from the U.S government, this VER limited Japanese imports to no more than 1.68 million vehicles per year.

### Expropriation (missing example)

It is governmental action to dispossess a foreign company or investor. Whereby compensation should be provided in a “prompt, effective and adequate manner”.

- Falls within the seizure of assets.

## Questions

*1. What is globalization? During the recent past 10 years what have been the major drivers of globalization? Is globalization a zero-sum game?*

**Globalization** refers to the shift toward a more intergraded and interdependent world economy. Globalization has several facets including the globalization of markets and the globalization of production.

- Globalization of markets- refers to the merging of historically distinct and separate national markets into one huge global marketplace.
  - The tastes and preferences of consumers in different nations are beginning to converge on some global norm, helping to create a global marketplace. (Coca-Cola, McDonald's, IKEA)
- Globalization of production- refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in cost and quality in factors of production (labor, energy)
  - Goal: Lower overall cost structure, to compete more effectively.

### Major Drivers of Globalization

Two macro factors underlie the trend towards greater globalization.

(1) The first is **the decline in barriers toward the flow of goods, services and capital** that has occurred since the end of World War II. Lowering barriers to international trade allows firms to view the WORLD, rather than a single country as their market. Lowering barriers to investment, allows firms to base production at optimal locations for their activity.

- According to WTO the volume of world trade was 31% larger in 2012 than in 1950. Laws governing foreign investment changed between 1992 and 2009 creating a more favourable environment for FDI. Such trends have been driving both the globalization of markets and production.

(2) **Technological change** has made the globalization of markets and production a tangible reality, especially the dramatic developments in the recent years. The world has seen major advances in communication, information processing and transportation processing. All thanks to the explosive emergence of the Internet!

In addition to globalization of production, technological innovations have facilitated the globalization of markets.

- Electronic global market places
- Economical shipping worldwide
- Low cost travel- reducing cultural distance between countries bringing about the convergence of consumer tastes and preferences.

Is globalization a zero-sum game?

A zero-sum game is one in which a gain by one country results in the loss of another. Adam Smith argued that this is not the case; trade is in fact a positive-sum game, a situation where all countries benefit. Smith demonstrates that, by specializing in the production of goods in which each has an absolute advantage, BOTH countries BENEFIT by engaging in trade. Therefore trade is a POSITIVE-SUM GAME as it produces net gains for all involved. Although 'privileged countries' often gain more from trade than poorer countries, there are benefits to all countries involved.

***2. Governments often intervene in international trade. Identify and briefly describe four ways that governments conduct international trade intervention. In your opinion, why do they do this and outline why you think government intervention is a good or bad thing? Who does it benefit most and least?***

There are TWO arguments for government intervention: political and economic.

- **Political arguments** for intervention – concerned with protecting the interests of certain groups (producers) or protect the environment/ human rights.
  - Protecting jobs and industries
  - National security
  - Retaliation (used as a bargaining tool to help open foreign markets)
  - Protection consumers
  - Furthering policy objectives (grant preferential trade terms to a country with which it wishes to build strong relations)
- **Economic arguments** for intervention- typically concerned with boosting overall wealth of a nation to the benefit of all; both producers and consumers.

### **Instruments of Trade Policy: Trade Intervention**

1. **Tariffs:** A tax levied on imports or exports. In most cases tariffs are placed on imports to protect domestic producers from foreign competition by RAISING the prices of imported goods.

- Government gains (increased revenues), domestic producers gain (less competition) and consumers lose (increased prices).
2. **Subsidies:** A government payment to a domestic producer. By lowering production costs, subsidies help domestic producers in two ways; (1) by competing against foreign imports and (2) gaining export market share.
    - Domestic producers gain as international competitiveness is increased as a result. (Bombardier in Canada, GM in the U.S)
  3. **Import Quota:** a direct RESTRICTION on the QUANTITY of some good that may be imported into a country. (Ex: U.S has a quota on cheese imports)
  4. **Voluntary Export Restraint (VER):** a quota on trade imposed by the exporting country, generally at the request of the importing country's government. (Ex. When the U.S car industry was suffering, the limitation on auto exports to the United States by Japanese automobile producers)
    - Benefits domestic producers by reducing competition, a loss for consumers as they pay higher prices for imported goods

*Answer:*

*Government intervention is a good thing as it helps a nation protect jobs and industries, as well as help domestic firms gain first mover advantages in global industries, and protect industries for reasons of national security.*

*Domestic producers are rewarded the benefits from government intervention as competition is reduced and international competitiveness increased. However, political intervention has a large impact on the consumers of that nation, as they will pay a premium for imported goods.*

**3 .It is argued that the benefits of free trade far outweigh the costs associated with it. What are the potential benefits of free trade to a country such as Canada? What are the potential costs to all major stakeholders of adopting a free trade regime? Should governments intervene to minimize these costs? If so, under what circumstances and specifically what should they do?**

**Free trade** refers to a situation in which a government does not attempt to influence through quotas or duties what its citizens can buy from another country, or what they can produce or sell to another country.

- *Benefits of free trade for Canada?*

Unrestricted free trade brings about increased world production that is a trade positive-sum game. Therefore, free trade – as it already has - would help Canada boost its economy and create more jobs.

- Open new markets for Canadian companies
- Spark Canadian innovation and productivity
- Eliminate barriers to trade in goods and services between partner countries
- Liberalize conditions for investment

- The costs of a free trade regime?
  - Some groups may benefit from the trade at the expense of others

***4. The interests of producers are typically the beneficiaries of government trade policy usually at the expense of consumers. Why is this case? Can arguments be made for putting consumers' interests ahead of those of producers? What might these arguments be?***

Government intervention on free trade, specifically political intervention, is primarily concerned with protecting certain groups of producers, often at the expense of other groups (i.e. The consumers). This is the case as the nations government is trying to protect the countries jobs, industries and national security. In most cases instruments of trade policy come at the expense of consumers cash flow as the prices for imported goods are increased.

Instruments of trade policy can be used to benefit consumers as well. Governments have regulations in place to protect the well-being and safety of consumers by restricting the import of unsafe products.

***Example:*** Japan and Korea decided to ban the import of American beef after the outbreak of mad cow disease and ban on counterfeited pharmaceutical products

***5. Culture can influence the costs of doing business in a country. Define culture. Using at least four examples, identify and discuss how culture affects the cost of doing business – both positively and negatively - in Canada.***

**Culture** is the system of values and norms shared amongst a group of people, that when put together constitute a design for living.

-Values: difference between right and wrong

-Norms: what is socially acceptable, social rules and guidelines

There are **six determinants of culture**: political philosophy, economic philosophy, social structure, language, religion, and education.

In Canada

- **Language-** language can have an affect on the cost of doing business in Canada, especially in Quebec. Although being a bilingual society is often viewed as a positive quality, Quebec's language laws often discourage businesses from entering the province. Business must be conducted in French and label and packaging must be bilingual; consequently increasing the costs to run the business.

- **Religion-** Canada's multi-cultural population can have an impact on business operations. Different religions have different holidays; therefore employers are required to grant vacation and special privileges to religious employees requesting time off that is not part of the company's 'normal' calendar.
- **Economic philosophy-** Canada has strict minimum wage requirements and labour laws. Additionally, each province has its own provincial tax deductions which can make it more or less expensive to do business, depending on where you go.
- **Social structure-** As a western country, Canada's social structure supports individual achievement. An individualistic society can have both positive and negative impacts on business operation. The benefit is high level of entrepreneurial activity, leading to the creation of many new products and business opportunities. The downside is managerial mobility between companies, moving from company to company and building a strong resume is good for the individual, however it is a negative side effect for the business as there is lack of loyalty and commitment to the growth of the organization as a whole.

***6. Trade (i.e. labour) unions in developed countries often are against imports from low-wage countries and advocate trade barriers to protect jobs that they characterize as representing 'unfair' import competition. Examples could be found in the clothing manufacturing and automobile industries. Do you think that this argument is in the best interests of (a) corporations, (b) consumers, (c) union members and (d) the country as a whole? Explain why you think this way for each of these.***

#### 1. Corporations

Free trade allows companies to view the world as their market, increasing expansion opportunity, as well as allow firms to base their production activities for optimal efficiency. NO, trade barriers restrict the flow of goods, services and capital for corporations and is therefore not in their best interest. Barriers can increase costs, limit operations and profitability potential for multinational companies.

#### 2. Consumers

Trade barriers are NOT in the best interest of consumers as import tariffs, quotas and restraints significantly increase the price of imported goods for domestic consumers. YES, barriers can benefit consumers in the event of a health or safety concern on an imported good.

#### 3. Union members

YES this argument supports the best interest of union members, as trade barriers are implemented to protect employment.

**Example:** The 1994 establishment of the NAFTA caused Canadian and U.S workers of low-cost, low-skilled industries (textiles) to lose their jobs as production activities were moved off shore.

4. Country as a whole:

YES, the government gains as trade barriers increase government revenues. Additionally, trade barriers help protect jobs and industries within the country. However, in the U.S/ Canada higher labour costs prevent such industries from having the same production efficiency as other countries. Therefore is it beneficial to implement trade policies to protect such industries? Or should the government focus on investing and supporting promising firms to help them gain a first mover advantage and surpass barriers to entry. (Short term: Yes, long term: No)

***7. Assume that you are a buyer for a chain of retail stores, which specialize in consumer electronics such as smart phones, tablets, computers, television monitors and cameras. On a buying trip to one of your suppliers in a poor nation, you find out that, contrary to your employer's policy and that of your supplier, the supplier has hired a nine year old boy who is working assembling game consoles. Shocked, you tell your supplier that this situation is untenable particularly since the boy should be in school. The supplier answers that the boy is an orphan who cannot afford to go to school let alone eat unless he earns the income that the job pays. He goes on to say that if the boy loses his job, he'll most likely become homeless and will be relegated to living on the street. What would you do in this situation and why would you do it? Would the Friedman doctrine; cultural relativism, the naïve moralist and the righteous moralist notions influence your decision? For each of these discuss why they would or wouldn't.***

This situation poses an **ethical dilemma**, as it is a situation where none of the available alternatives seem ethically acceptable. Encouraging child labour is WRONG, however by correcting such actions the supplier would be stripping the boy of his only source of income, which he needs for shelter and food.

Although child labor is illegal by Canadian standards and a violation of the company's own ethical code, child labor is still common in many developing nations. Personally I would allow the boy to work, as I would not want him to starve or be living on the streets. Access education is a major problem across developing countries. Although I would allow the boy to continue working I would request that the company make contributions to respected organizations within that country providing access to affordable education with the goal of abolishing poverty and child labor in the long run. This decision would be supported by the Friedman doctrine, cultural relativism and naïve

relativism as child labour is accepted and practiced by the host nations culture. The righteous moralist view would not approve of this decision, as child labour is not supported by the multinationals home employment standards and laws.

*Freidman doctrine* -The only social responsibility of business is to increase profits so long as the company stays within the rules of the law. However he states that businesses should behave in an ethical manner and not engage in deception or fraud.

*Cultural relativism*- Belief that ethics are nothing more than a reflection of culture – all ethics are culturally determined- and therefore a country should adopt the ethics of the country in which its operating. “ When in Rome do as Romans do”

*Righteous moralist*- claims that a multinational’s home standards of ethics are the appropriate ones for companies to follow in foreign countries. (Should not take this too far, there are some moral principles that should not be violated.)

*Naïve moralist*- if a manager sees that firms from other nations are not following ethical norms in a host nation, that manager should not either. “Everyone does it”

**8. Identify the key tenets of absolute advantage, comparative advantage and national competitive advantage. Using examples, illustrate how they differ from each other.**

### **Absolute Advantage**

A country has an absolute advantage in the production of a product when it is MORE EFFICIENT than any other country at producing it. According to Smith by specializing in the production of goods in which each has advantage, both countries benefit by engaging in trade.

*Example:* The French have an absolute advantage in the production of wine. England specializes in producing textiles. The two countries simply trade. Smith states that a country should never produce goods at home that it can buy at a lower cost from another country.

### **Comparative Advantage**

“What happens when a country has the absolute advantage in the production of all goods?” – specialize in the most efficient.

Suggests that it makes sense for a company to specialize in producing those goods that it can produce most efficiently, while buying goods it can produce relatively less efficiently from other countries.

- Comparative advantage believes that free trade stimulates global production and economic growth.

### **National competitive advantage**

Porter states that the degree to which a nation is likely to achieve international success in a certain industry is a function of the combined impact of factor endowments, domestic demand, relating and supporting industries, and domestic rivalry. The presence of all four is required to boost competitive advantage.

**Example:** England has an absolute advantage in both cheese and wine since it can produce it more efficiently. England is comparatively more efficient in producing cheese than it is in producing wine therefore England should produce cheese and Italy wine. If factor endowments, demand conditions in related and supporting industries, firm strategy, and structure and rivalry are all favorable for the cheese industry then England should produce cheese.

**9. What are the major recent trends in global foreign direct investment? Identify and briefly discuss the factors underlying these trends.**

**10. Discuss how globalization can be the tide that raises all ships? How can it result in a race to the bottom? Use six examples to illustrate your answers.**

**11. Identify and describe the main factors which determine the overall attractiveness of a country as a potential market or investment site for international business.**

**12. Discuss the key economic implications of Islam. If Islamic banks cannot charge interest, how do they make money?**

The Koran speaks approvingly of free enterprise and of earning legitimate profit through trade and commerce. The protection of the right to private property is embedded within Islam, however, Islam asserts that all property is in favor from Allah (God), who created and therefore owns everything. Therefore, in the Islamic religion, those who hold property are regarded as TRUSTEES not owners.

As a TRUSTEE you are entitled to receive profit from the property but are instructed to use it in a righteous, socially beneficial, and prudent manner. Simply put, in Muslim countries, it is fine to earn a profit, as long as that profit is earned justly and not based on the exploitation of others for one's own advantage.

That being said, one economic principle of Islam PROHIBITS the payment or receipt of interest, because it is considered USURY. This is not just a matter of principle; in several Islamic states it is THE LAW.

“How do Islamic banks make money?”

Conventional banks predominant stream of profit is INTEREST, so Islamic banks had to find an alternative way to make money.

They experimented with two different banking methods:

A *mudarabah* contract- similar to a PROFIT SHARING scheme Whereby, when an Islamic bank lends money to a business, rather than charging the business interest on the loan, it takes a SHARE of the profits that are derived from the INVESTMENT. Similarly, if an individual deposits money into an Islamic bank, the depositor receives a share in profit from the banks investment of the money.

A *murabaha* contract –\***The most widely used** amongst the worlds Islamic Banks, primarily because it is the easiest to implement. (Similar to interest)

- Illustrated through an example: A firm tells the bank they need a piece of equipment costs \$1,000. The bank then buys the equipment for \$1,000, and the borrower buys it back from them at a later date for, say \$1,100, a price including a \$100 markup for the bank. \*(A cynic might point out that this IS a form of interest, which is why it is so easy and widely accepted for banks do adapt to)

### ***13. Identify and briefly describe the six major determinants of a country's culture.***

It is difficult to attribute ONE simple definition to culture, however, generally speaking, CULTURE is viewed as a system of values and norms that are shared among a group of people and that when taken together constitute a design for living.

- **Values:** abstract ideas about what a group believes to be good, right and desirable (How things ought to be)
- **Norms:** the social rules and guidelines that prescribe appropriate behavior in particular situations.
- **Society:** Refers to a group of people sharing a common set of values and norms.

#### **The Determinants of Culture**

(Differentiating characteristics across countries)

1. Political philosophy
2. Economic philosophy
3. Social Structure
4. Religion
5. Language
6. Education

The values and norms of a culture do not emerge fully formed. They evolve over time in response to a number of factors. The six determinates of culture can be broken in two categories (1) guiding philosophies and (2) structure.

### *Guiding philosophies*

Political Philosophy; political systems can be assessed according to two dimensions – degree to which they are collectivist vs. individualist and democratic vs. totalitarian.

*Example*: The values of Communist North Korea towards freedom.

Economic Philosophy; There are 3 broad types of economic systems:

1. Market economy- all productive activities PRIVATELY owned
2. Command economy- the government plans the goods and services that a country produces (owned by the STATE)
3. Mixed economy.

### *Structure*

Social Structure; Refers to societies basic social ORGANIZATION.

1. Individualist vs. group societies
2. Social stratification – Hierarchical social categories defined on the basis of characteristics such as family background, income, and occupation. (key terms: social mobility, class systems, class consciousness)

Religion; Religion and Ethical systems. Most of the world's ethical systems are product of religion.

1. Religion- defined as a system of shared beliefs and rituals are concerned with the realm of the sacred.
2. Ethical systems - refer to a set of moral principles, or values, that are used to guide and shape behavior.

Language; Both verbal and nonverbal means of COMMUNICATION.

1. Spoken language- shapes the way people perceive the world and thereby helps define culture.
2. Unspoken language- nonverbal cues, very important, as they are CULTURALLY BOUND. Failure to understand the non-verbal cues of another culture can lead to communication failure.

Education; Formal education plays a \*KEY ROLE in society. Formal education is the foundation for....

- Language, conceptual and mathematical skills
- Values and norms (taught both directly and indirectly)
- General understanding of the political and social nature of society

- Cultural norms (taught indirectly \*”hidden curriculum”)
- Fundamental obligations of citizenship

#### ***14. Ethical Decision making question***

**Answer:** The motor company, a multinational organization, is trying to capitalize on the growing vehicle sales in the Asian and African markets. In order to gain a competitive advantage they have decided to (1) remove features and (2) remove the sophisticated anti-pollution equipment required in the developed world version in order to keep PRODUCTION COSTS LOW.

A reduction in production costs benefits both the company and population of the developing nations. How?

- The company would benefit from this decision as the lower production costs would allow them to offer the vehicle at a lower price, gaining a competitive advantage over car companies that simply offer higher priced “developed car models”. (Due to required features.)
- The Asian and African car buyers would benefit as a larger percentage of the population would be able to purchase the vehicles due to its low price.

However in making this decision the motor manufacturer faces an ethical dilemma -as the lower priced models are expected to drastically increase Nitrogen Oxide emissions-harming not only the host countries, but the world's atmospheric environment.

The removal of the features does not pose an ethical problem, as they are not essential to the car's basic function. Sound system, air conditioner, heaters, automatic windows, electric seats, automatic transmission, are all “luxury” features that essentially increase the car's value. Although anti lock brakes and dynamic stability control enhance a car's safety (found on most standard vehicles today) they are not required by law.

Conversely, the removal of the sophisticated anti-pollution equipment is an ethical consideration as it leads directly to environmental pollution. The motor manufacturer is able to remove such equipment as the environmental regulations in the host country are inferior to those in the home nation.

Answers to the questions:

1. Does my decision fall within the accepted values or standards that typically apply in the organizational environment?

Yes the decision falls within the accepted values and standards as the vehicle the motor company would be producing does comply with legal standards and regulations in the host country. Cars within developing nations are simply held to lower environmental

standards, therefore there is nothing wrong with the cars in the eyes of the developing communities.

2. Am I willing to see the decision communicated to all stakeholders affected by it

As a vice-president of a CAR manufacturer (clearly not overly concerned in environmental pollution in the first place) I would personally say YES. Obviously if the story was released to the news the company would receive negative backlash -especially from environmentalists- however the company has found a way to make cars more affordable to the population of developing nations so that they have easier access to transportation.

3. Would the people with whom I have a significant personal relationship, such as family members, friends or even managers in other businesses approve of this decision?

IT DEPENDS on the values cultural perspectives of those you surround yourself with.

***15. Identify and briefly discuss the benefits and costs of foreign direct investment to the home country and the host country.***

Foreign direct investment (FDI) occurs when a firm invests directly in facilities to produce or market a product in a foreign country. Once a firm undertakes foreign investment it becomes a MULTINATIONAL ENTERPRISE.

FDI can take on 2 main forms:

1. Greenfield Investment; which involves the establishment of a new operation in a foreign country.
2. Acquisitions; acquiring or merging with an existing firm in a foreign country.

**The Benefits and Costs of FDI**

➤ **Host Country**

***(1)Benefits***

- Resource-Transfer Effects  
Supplies capital (financial resources not available to host country's firms), technology (stimulates economic development and industrialization), and management resources (can help improve the efficiency of operations) that would otherwise not be available and thus boost that countries economic growth rate.
- Employment Effects  
It brings jobs to a host country that would otherwise not be created there. The affects of FDI on employment are both direct (when foreign MNE employ host

country citizens) and indirect (when jobs are created in local suppliers as a result of investment).

- Balance-Payments Effects

A country's balance of payments accounts track both its payments and receipts from other countries. (Balance of import vs. exports)

-Current account: tracks the export and import of goods and services. A surplus in current accounts means that a country is exporting more goods than it is importing.

FDI can help countries run a current account surplus in one of two ways:

1. If the FDI is a substitute for imports of goods or services, the effect can be to improve the current account of the host country's balance of payments.
2. Second potential benefit arises when the MNE uses a foreign subsidiary to export goods and services to another country.

## *(2) Costs*

- Effects on Competition

Host governments sometimes worry that the subsidiary companies on multinational enterprises (MNE's) may have GREATER economic power than indigenous competitors.

Can drive indigenous companies out of business and allow the MNE firm to MONOPOLIZE the market.

Can have a harmful effects on the economic welfare of the host nation.

- Balance of Payments

1. The OUTFLOW of earnings from the host country to the parent company.

Some governments have responded by restricting the amount of earnings that can be returned to a foreign subsidiary's home country.

2. When a subsidiary IMPORTS a substantial amount of input from abroad.

Affects the country's current accounts balance.

- National Sovereignty and Autonomy

Host governments worry that FDI is accompanied by some loss of economic independence. The concern is that KEY decisions that can affect a host country's economy will be made by a foreign parent that has no REAL COMMITMENT to

the host country, and over which the host country's government has NO REAL CONTROL.

➤ **Home-Country**

*(1) Benefits*

The benefits of FDI to the home (source) country arise from three sources.

1. The home country's balance of payments benefits from the INWARD flow of foreign EARNINGS
2. Benefits to the home country from OUTWARD FDI arise from employment effects. Arise when the foreign subsidiary creates demand for home-country exports.

*Example:* Toyota's investment in auto assembly operations in Europe has benefited both the Japanese balance of payments position and employment in Japan, as Toyota imports some component parts for its European-based auto assembly operations DIRECTLY FROM Japan.

*(2) Costs*

The most important concerns are centered on the balance of payments and employments effects of OUTWARD FDI.

1. The home country's balance of payments may suffer....
  - Because of the initial CAPITAL OUTFLOW required to finance the FDI. (But, usually recovered by inflow of related EARNINGS)
  - Current accounts balance suffers if the purpose of the foreign investment is to serve the home market from a low-cost production location.
  - Current accounts balance suffers if FDI is a substitute for direct imports .
2. With regard to employment effects, the most serious concerns arise when FDI is seen as SUBSTITUTE for DOMESTIC production.