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Chapter 2
International Trade and Foreign Direct Investment

True/False Questions

1. The classical international trade theories are from the perspective of a country.
   True; Easy

2. Trade surplus refers to a situation where the value of imports is greater than the value of exports.
   False; Easy

3. The economic theory of mercantilism stated that a country's wealth was determined by the amount of its gold and silver holdings.
   True; Easy

4. Trade deficit refers to a situation where the value of exports is greater than the value of imports.
   False; Easy

5. The modern international trade theories explain trade from a firm, rather than a country, perspective.
   True; Easy

6. The new nations of the 1500s promoted exports by imposing restrictions on imports.
   True; Easy

7. The British colonial empire sought to increase its wealth by using raw materials from places ranging from what are now the Americas and India.
   True; Easy

8. Countries such as China still favor exports and discourage imports through a form of neo-mercantilism.
   True; Easy

9. Free trade only benefits select industries, at the expense of both consumers and other companies, within and outside of the industry.
   False; Easy

10. The product life cycle theory has been better able to explain current trade patterns where innovation and manufacturing occur around the world.
    False; Moderate

11. The Internet has lessened the ability of the countries to regulate or strong-arm companies into abiding by their rules and regulations.
    True; Easy

12. Global businesses can afford to ignore the political and legal climate in countries in which they currently operate.
    False; Easy

13. A main differentiator of political systems is each system's philosophy on the rights of the individual and the group as well as the role of government.
    True; Easy

14. Most countries maintain a balance between anarchism and totalitarianism and the balance is often a reflection of the country's history, culture, and religion.
    True; Easy

15. Totalitarianism occurs when an authoritarian leadership is motivated by a distinct ideology.
    True; Easy

16. Capitalism is an economic system in which the means of production are owned and controlled privately.
    True; Easy

17. Political stability is a key part of government efforts to attract foreign investment to their country.
    True; Easy

18. Foreign direct investment refers to the investment in a company's stocks, bonds, or assets, but not for the purpose of controlling or directing the firm's operations or management.
    False; Easy

19. Companies make portfolio investment by participating in a joint venture with a foreign company.
    False; Easy

20. The foreign direct investment made by a company is primarily a part of its long-term strategy.
    True; Easy

21. Governments want to be able to control and regulate the flow of FDI, so that local political and economic concerns are addressed.
    True; Easy

22. Purchasing goods and services or deciding to invest in a local market depends on a business's needs and overall strategy.
    True; Easy

23. A company needs to sell in the local market in order to deem it a good option for direct investment.
    Easy; False

24. Companies involved in Brownfield foreign direct investment build new facilities right from scratch usually in an area where no previous facilities existed.
    False; Easy

25. Few governments still actively limit and control foreign investment.
    False; Moderate

    26. Most governments intervene in trade between countries.
    True; Moderate

Multiple Choice Questions

26. The _____ refers to the land and water trade routes that covered more than 4,000 miles and connected the Mediterranean with Asia.
    a. Silk Road
    b. Salt Road
    c. Amber Road
    d. Grand Trunk Road
    e. Siberian Route
    a; Easy

27. The _____ states that a country's wealth was determined by the amount of its gold and silver holdings.
    a. Leontief Paradox
    b. absolute advantage theory
    c. comparative advantage theory
    d. mercantilism theory
    e. country similarity theory
    d; Easy

28. Trade surplus refers to:
    a. the ability of a country to produce a good more efficiently than another nation.
    b. a situation where trade policies benefit select industries.
    c. a situation where exports are promoted by imposing restrictions on imports.
    d. a situation where the value of imports is greater than the value of exports.
    e. a situation where the value of exports is greater than the value of imports.
    e; Easy

29. Trade deficit refers to:
    a. a situation where the value of imports is greater than the value of exports.
    b. the ability of a country to produce a good more efficiently than another nation.
    c. a situation where exports are promoted by imposing restrictions on imports
    d. a situation where trade policies benefit select industries.
    e. a situation where the value of exports is greater than the value of imports.
    a; Easy

30. The strategy to promote exports by imposing restrictions on imports is called:
    a. capitalism.
    b. protectionism.
    c. liberalization.

d. mercantilism.
e. free trade.
b; Easy

31. Neo-mercantilism refers to an economic policy in which:
    a. a country trades in manufactured goods with countries having similar per capita incomes.
    b. a country focuses on producing a good more efficiently than another nation.
    c. countries produce and export goods that required resources that were in great supply.
    d. countries promote a combination of protectionist policies and restrictions and domestic-industry subsidies.
    e. countries import goods that required resources that were in short supply.
    d; Easy

32. The _____ stated that a nation's wealth should not be judged by how much gold and silver it had but rather by the living standards of its people.
    a. factor proportions theory
    b. mercantilism theory
    c. absolute advantage theory
    d. comparative advantage theory
    e. Leontief Paradox
    c; Easy

33. _____ has become an optimal location for labor-intensive industries due to the availability of cheap, large pools of labor.
    a. The United States of America
    b. Sweden
    c. India
    d. The United Kingdom
    e. Japan
    c; Easy

34. _____ occurs when a country cannot produce a product more efficiently than the other country; however, it can produce that product better and more efficiently than it does other goods.
    a. Comparative advantage
    b. Differential advantage
    c. Absolute advantage
    d. Global strategic rivalry
    e. Country similarity
    a; Easy

35. Factor proportions theory states that:
    a. firms must develop competitive advantages to counter global competition in their industries.
    b. production of the new product will occur completely in the home country of its innovation.
    c. most trade in manufactured goods will be between countries with similar per capita incomes.
    d. countries would produce and export goods that required resources that were in great supply.

e. a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade.

d; Moderate

36. The _____ theory suggests that companies first produce for domestic consumption.
    a. product life cycle
    b. comparative advantage
    c. country similarity
    d. absolute advantage
    e. factor proportions

    c; Easy

37. Swedish economist Steffan Linder's theory proposed that:
    a. consumers in countries that are in the same or similar stage of development would have similar preferences.
    b. a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade.
    c. countries would produce and export goods that required resources that were in great supply.
    d. firms must develop competitive advantages to counter global competition in their industries.
    e. nations should promote exports by imposing restrictions on imports.

    a; Hard

38. In the early 1950s, the United States was abundant in capital and, therefore, should have been exporting more capital-intensive goods. However, contrary to the factor proportions theory, the United States was importing more capital-intensive goods and exporting labor-intensive goods. This is an example of:
    a. the product life cycle.
    b. mercantilism.
    c. the Leontief Paradox.
    d. protectionism.
    e. neo-mercantilism.

    c; Easy

39. The critical ways that firms can obtain a sustainable competitive advantage are/is called the _____ for that industry.
    a. comparative advantages
    b. factors of production
    c. service factors
    d. brand equity
    e. barriers to entry

    e; Moderate

40. _____ theory focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry.
    a. Global strategic rivalry
    b. Absolute advantage
    c. Product life cycle
    d. Factor proportions
    e. Country similarity

a; Easy

41. Which of the following refers to a political philosophy which contends that every aspect of an individual's life should be controlled and dictated by a strong central government?
    a. Totalitarianism
    b. Pluralism
    c. Anarchism
    d. Capitalism
    e. Democracy

    a; Easy

42. Identify the political philosophy which contends that individuals should control political activities and public government is both unnecessary and unwanted.
    a. Capitalism
    b. Neo-mercantilism
    c. Pluralism
    d. Anarchism
    e. Totalitarianism

    d; Easy

43. Democracy refers to a form of government:
    a. that allows the dominance of one dominant ethnic group over the others.
    b. that derives its power from the people.
    c. which contends that every aspect of an individual's life should be controlled and dictated by a strong, central government.
    d. which contends that individuals controlling political activities and public government is both unnecessary and unwanted.
    e. which asserts that monarchy should replace all forms of elected government.

    b; Easy

44. Pluralism refers to a political philosophy which asserts that:
    a. monarchy should replace all forms of elected government.
    b. both public and private groups are important in a well-functioning political system.
    c. governments should centralize all control in the hands of one strong leader or a small group of leaders, who have full authority.
    d. individuals should control political activities and public government is both unnecessary and unwanted.
    e. that every aspect of an individual's life should be controlled and dictated by a strong central government.

    b; Easy

45. Direct democracy is a form of government in which:
    a. the government derives its power from the people of the country by means of a petition referendum.
    b. the government derives its power from the people of the country by means of elected representatives of the people.
    c. the government derives its power from the dominant ethnic group of the country.
    d. a single party with an ideology controls and directs the functioning of the government.
    e. the government derives its power from the cultures and traditions of the largest religious community of the country.

    a; Easy

46. Capitalism is an economic system in which the:
    a. government does not allow the import or the export of goods.
    b. means of production are owned and controlled privately.
    c. government or state directs and controls the economy, including the means and decision making for production.
    d. government allows the export of goods but does not allow the import of goods.
    e. government allows the import of goods but does not allow the export of goods.

    b; Easy

47. Civil law refers to a legal system based on:
    a. the official dictates of the government ruling a country.
    b. traditions and precedence, wherein judges interpret the law and judicial rulings can set precedent.
    c. the customs and traditions followed by the dominant cultural group of a particular country.
    d. religious guidelines.
    e. a detailed set of laws that constitute a code on how the law is applied to the facts.

    e; Easy

48. Planned economy refers to an economic system in which:
    a. a regional economic bloc directs and controls the economy, including the means and decision making for production.
    b. the government or state directs and controls the economy, including the means and decision making for production.
    c. the domestic, privately owned companies direct and control the economy, including the means and decision making for production.
    d. multinational companies direct and control the economy, including the means and decision making for production.
    e. the dominant ethnic group controls and directs the economy, including the means and the decision making for production.

    b; Easy

49. Common law refers to a legal system based on:
    a. religious guidelines.
    b. the official dictates of the government ruling a country.
    c. a detailed set of laws that constitute a code on how the law is applied to the facts.
    d. traditions and precedence, wherein judges interpret the law and judicial rulings can set precedent.
    e. the customs and traditions followed by the dominant cultural group of a particular country.

    d; Easy

50. The theocratic law is based on:
    a. religious guidelines.
    b. traditions and precedence, wherein judges interpret the law and judicial rulings can set precedent.
    c. the customs and traditions followed by the dominant cultural group of a particular country.
    d. the official dictates of the government ruling a country.
    e. the customs and traditions followed by the weakest cultural group of a particular country.

a; Easy

51. Which of the following is true about Sharia?
    a. It is the least widely accepted religious law system.
    b. It prohibits charging interest on money and other common investment activities.
    c. It is a commercial, rather than a moral, legal system.
    d. It prohibits banks from engaging in sale-buyback or leaseback of an asset.
    e. It does not permit banks to charge large up-front fees.

    b; Moderate

52. Specific tariffs are:
    a. fixed taxes that are imposed on the customers irrespective of the value of the product or the service.
    b. taxes that are levied as a fixed charge, regardless of the value of the product or service.
    c. tariffs that are calculated as a percentage of the value of the product or service.
    d. taxes that are levied on the exporters depending on the value of the products or the service being provided.
    e. taxes that are levied on the producers of specific goods as decided by the ministry in charge of the finances of a country.

    b; Easy

53. _____ refers to the steps taken by governments to limit the convertibility of one currency (usually its own) into others, usually in an effort to limit imports.
    a. Export financing
    b. Subsidy
    c. Currency control
    d. Free trade zone
    e. Import quota

    c; Easy

54. Dumping refers to a situation where:
    a. governments limit the convertibility of one currency (usually its own) into others, usually in an effort to limit imports.
    b. governments provide financing to domestic companies to promote exports.
    c. companies sell products below market price often in order to win market share and weaken a competitor.
    d. countries designate certain geographic areas as free trade zones.
    e. countries continue to require that a certain percentage of a product or an item be manufactured or "assembled" locally.

    c; Easy

55. Ad valorem tariffs are:
    a. fixed taxes that are levied on the customers regardless of the value of the product or the service.
    b. taxes that are levied as a fixed charge, regardless of the value of the product or service.
    c. tariffs that are calculated as a percentage of the value of the product or service.
    d. taxes that are levied on the exporters depending on the value of the products or the service being provided.
    e. taxes that are levied on the producers of specific goods as decided by the ministry in charge of the finances of a country.

    c; Easy

56. Which of the following refers to a form of government payment to a producer?
    a. Export financing
    b. Subsidy
    c. Currency control
    d. VER
    e. Import quota

    b; Easy

57. Local content requirements refer to a situation where:
    a. governments limit the convertibility of one currency (usually its own) into others, usually in an effort to limit imports.
    b. governments provide financing to local companies to promote exports.
    c. companies sell a product below market price often in order to win market share and weaken a competitor.
    d. countries designate certain geographic areas as free trade zones.
    e. countries require that a certain percentage of a product or an item be manufactured or "assembled" locally.

    e; Easy

58. Portfolio investment refers to:
    a. the investment in foreign assets with the intent to control and manage them.
    b. the investment in a company's stocks without the intent to control or manage them.
    c. the acquisition of foreign assets with the intent to control and manage them.
    d. participating in a joint venture with a foreign company.
    e. offering financial and technical help to charitable organizations.

    b; Easy

59. Foreign direct investment refers to:
    a. the investment in foreign assets with the intent to control and manage them.
    b. the investment in a company's stocks without the intent to control and manage them.
    c. offering financial help to developing countries in environmental causes.
    d. offering financial help to boost the agricultural production of a country.
    e. offering financial and technical help to charitable organizations.

    a; Easy

60. Outward FDI for a country:
    a. are investments made by companies from a foreign country into the companies of that country.
    b. are investments made by companies from that country into foreign companies in other countries.
    c. refers to financial help to developing countries in environmental causes.
    d. refers to financial help to boost the agricultural production of a country.
    e. refers to financial and technical help to charitable organizations.

    b; Easy

61. Inward FDI for a country:
    a. are investments made by companies from a foreign country into the companies of that country.
    b. are investments made by companies from that country into foreign companies in other countries.

c. refers to financial help to developing countries in environmental causes.
d. refers to financial help to boost the agricultural production of a country.
e. refers to financial and technical help to charitable organizations.

a; Easy

62. Investors who are interested in portfolio investment are looking to:
   a. financially stabilize economically unstable markets.
   b. capturing and manipulating the foreign markets in which they are investing.
   c. diversify investment risk through multiple markets.
   d. financially control the companies in which the investments have been made.
   e. make financial contributions to the government treasury.

   c; Easy

63. A Japanese retailer builds a store in India to sell badminton rackets. This would serve as an example of:
   a. backward vertical FDI.
   b. brownfield FDI.
   c. forward vertical FDI.
   d. horizontal FDI.
   e. portfolio investment.

   d; Moderate

64. A brownfield FDI is when:
   a. multinational companies make financial contributions to charitable organizations in a foreign country.
   b. a company invests in the agricultural sector of a particular country.
   c. multinational corporations enter into developing countries to build new factories or stores.
   d. firms create new long-term jobs in the foreign country by hiring new employees.
   e. a company or government entity purchases or leases existing production facilities to launch a new production activity.

   e; Easy

65. A greenfield FDI is when:
   a. a company or government entity purchases or leases existing production facilities to launch a new production activity.
   b. multinational companies make financial contributions to charitable organizations in a foreign country.
   c. a company invests in the agricultural sector of a particular country.
   d. multinational corporations enter into developing countries to build new factories or stores.
   e. a company makes financial contributions to environmental causes in a particular country.

   d; Easy

66. Firms invest in production or plant facilities in a country in order to supply raw materials, parts, or finished products to their home country. These firms are engaged in:
   a. backward vertical FDI.
   b. forward vertical FDI.
   c. horizontal FDI.
   d. inward FDI.
   e. portfolio investment.

a; Easy

67. Firms invest in production or plant facilities in a country and then sell the goods in that particular local or regional market. These firms are engaged in:
    a. backward vertical FDI.
    b. forward vertical FDI.
    c. horizontal FDI.
    d. inward FDI.
    e. portfolio investment.
    b; Easy

68. Some host countries encourage that ownership be maintained by a person of local origin to:
    a. encourage unlimited foreign direct investment in their country.
    b. discourage foreign countries from attempting to politically subvert the local population.
    c. execute a hostile takeover of the foreign company in the future.
    d. keep the control of local markets or industries in their citizens' hands.
    e. ensure that the ruling party of that country makes financial gains in the process.
    d; Easy

69. A brownfield investment:
    a. is when a company purchases or leases existing production facilities to launch a new production activity.
    b. is a strategy where a commercial site used for commercial space is used to set up a steel mill or oil refinery.
    c. generally involves setting up a manufacturing unit in a forested area.
    d. leads to the creation of jobs in the country where the investment is made.
    e. escapes the problem of outdated equipment, entrenched processes, and cultural differences as faced by greenfield investments.
    a; Easy

70. With regard to financial incentives, home-country governments offer businesses:
    a. free manpower to attract companies to invest.
    b. a combination of insurance, loans, and tax breaks in an effort to promote their companies' overseas investments.
    c. as the investing companies, a monopolistic share of the market in order to attract them.
    d. heavy taxes imposed on domestic companies to attract foreign companies.
    e. tariff-free entry to the investing companies.
    b; Easy

71. Which of the following is not a method that governments use to intervene and manage trade?
a. Increasing the port fees on shipping containers which arrive at a port in country.
b. Sponsoring trade trips for small businesses to international conferences.
c. Increasing funding for community parks.
d. Requiring that all supplies bought by federal offices must be manufactured in country.
e. None of the above.
c: Moderate

Short Answer Questions

71. How is the concept of mercantilism being used by some of the countries today?
Mercantilism remains part of modern thinking. Countries such as Japan, China, Singapore, Taiwan, and Germany still favor exports and discourage imports through a form of neo-mercantilism in which the countries promote a combination of protectionist policies and restrictions and domestic-industry subsidies. Nearly every country, at one point or another, has implemented some form of protectionist policy to guard key industries in its economy.
Easy

72. What is the impact of the protectionist policies of a government on the consumer?
Export-oriented companies usually support protectionist policies that favor their industries or firms, other companies and consumers are hurt by protectionism. Taxpayers pay for government subsidies of select exports in the form of higher taxes. Import restrictions lead to higher prices for consumers, who pay more for foreign-made goods or services. Mercantilism's protectionist policies only benefit select industries, at the expense of both consumers and other companies, within and outside of the industry.
Moderate

73. What is the Heckscher-Ohlin theory?
In the early 1900s, two Swedish economists, Eli Heckscher and Bertil Ohlin, focused their attention on how a country could gain comparative advantage by producing products that utilized factors that were in abundance in the country. Their theory is based on a country's production factors which provide the funds for investment in plants and equipment. They determined that the cost of any factor or resource was a function of supply and demand. Factors that were in great supply relative to demand would be cheaper. Factors in great demand relative to supply would be more expensive. Their theory, also called the factor proportions theory, stated that countries would produce and export goods that required resources or factors that were in great supply and, therefore, cheaper production factors. In contrast, countries would import goods that required resources that were in short supply, but higher demand.
Moderate

74. What is the product life cycle theory?
The product life cycle theory stated that a product life cycle has three distinct stages:
(a) new product,
(b) maturing product, and
(c) standardized product.
The theory assumed that production of the new product will occur completely in the home country of its innovation. The product life cycle theory has been less able to explain current trade patterns where innovation and manufacturing occur around the world.
Easy

75. What is the country similarity theory as proposed by the Swedish economist Steffan Linder?
Linder's country similarity theory proposed that consumers in countries that are in the same or similar stage of development would have similar preferences. In this firm-based theory, Linder suggested that companies first produce for domestic consumption. When they explore exporting, the companies often find that markets that look similar to their domestic one, in terms of customer preferences, offer the most potential for success. Linder's country similarity theory then states that most trade in manufactured goods will be between countries with similar per capita incomes, and intraindustry trade will be common. This theory is often most useful in understanding trade in goods where brand names and product reputations are important factors in the buyers' decision-making and purchasing processes.

Easy

76. What is the Leontief Paradox?
In the early 1950s, Russian-born American economist Wassily W. Leontief studied the U.S. economy closely and noted that the United States was abundant in capital and, therefore, should export more capital-intensive goods. However, his research using actual data showed the opposite. The United States was importing more capital-intensive goods. According to the factor proportions theory, the United States should have been importing labor-intensive goods, but instead it was actually exporting them. His analysis became known as the Leontief Paradox because it was the reverse of what was expected by the factor proportions theory.
Easy

77. What are "barriers to entry" and what are the barriers to entry that corporations might seek to optimize?
The barriers to entry refer to the obstacles a new firm may face when trying to enter into an industry or new market. The barriers to entry that corporations may seek to optimize include:
- research and development,
- the ownership of intellectual property rights,
- economies of scale,
- unique business processes or methods as well as extensive experience in the industry, and the control of resources or favorable access to raw materials.

Easy

78. What are the extreme forms of political philosophy?
On one end of the political spectrum is anarchism, which contends that individuals should control political activities and public government is both unnecessary and unwanted. At the other extreme is totalitarianism, which contends that every aspect of an individual's life should be controlled and dictated by a strong central government. In reality, neither extreme exists in its purest form. Instead, most countries have a combination of both, the balance of which is often a reflection of the country's history, culture, and religion. This combination is called pluralism, which asserts that both public and private groups are important in a well-functioning political system. Although most countries are pluralistic politically, they may lean more to one extreme than the other.
Easy

79. What are the questions that have to be answered by an organization before investing in a particular country?
A company has to answer the following questions regarding a prospective country's government to assess possible risks:
- How stable is the government?
- Is it a democracy or a dictatorship?
- If a new party comes into power, will the rules of business change dramatically?
- Is power concentrated in the hands of a few, or is it clearly outlined in a constitution or similar national legal document?
- How involved is the government in the private sector?
- Is there a well-established legal environment both to enforce policies and rules as well as to challenge them?
- How transparent is the government's political, legal, and economic decision-making process?

Moderate

80. Why do governments intervene in trade?
    Governments intervene in trade for a combination of political, economic, social, and cultural reasons.Politically, a country's government may seek to protect jobs or specific industries. Some industries may be considered essential for national security purposes, such as defense, telecommunications, and infrastructure. National security issues can impact both the import and exports of a country, as some governments may not want advanced technological information to be sold to unfriendly foreign interests. Some governments use trade as a retaliatory measure if another country is politically or economically unfair. On the other hand, governments may influence trade to reward a country for political support on global matters. Governments are also motivated by economic factors to intervene in trade. They may want to protect young industries or to preserve access to local consumer markets for domestic firms. Cultural and social factors might also impact a government's intervention in trade.
    Easy

Essay Questions

81. The theory of comparative advantage was a solution to the problem posed by the assumptions of the absolute advantage theory. Explain.
    The theory of absolute advantage focused on the ability of a country to produce a good more efficiently than another nation. The challenge to the absolute advantage theory was that some countries may be better at producing more than one good and, therefore, have an advantage in many areas. In contrast, another country may not have any useful absolute advantages. To answer this challenge, David Ricardo, an English economist, introduced the theory of comparative advantage in 1817. Ricardo reasoned that even if Country A had the absolute advantage in the production of both products, specialization and trade could still occur between two countries. Comparative advantage occurs when a country can produce a product better and more efficiently than it does other goods. Comparative advantage focuses on the relative productivity differences, whereas absolute advantage looks at the absolute productivity. A person or a country will specialize in doing what they do relatively better. In reality, the world economy is more complex and consists of more than two countries and products. Barriers to trade may exist, and goods must be transported, stored, and distributed.
    Hard

82. Explain Porter's National Competitive Advantage Theory.
    Porter's theory stated that a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade. His theory focused on explaining why some nations are more competitive in certain industries. Porter identified four determinants that he linked together to explain his theory.
    - Local market resources and capabilities (factor conditions). Porter recognized the value of the factor proportions theory, which considers a nation's resources as key factors in determining what products a country will import or export. Porter added to these basic factors a new list of advanced factors, which he defined as skilled labor, investments in education, technology, and infrastructure. He perceived these advanced factors as providing a country with a sustainable competitive advantage.
    - Local market demand conditions. Porter believed that a sophisticated home market is critical to ensuring ongoing innovation, thereby creating a sustainable competitive advantage. Companies whose domestic markets are sophisticated, trendsetting, and demanding forces continuous innovation and the development of new products and technologies.

- Local suppliers and complementary industries. To remain competitive, large global firms benefit from having strong, efficient supporting and related industries to provide the inputs required by the industry. Certain industries cluster geographically, which provides efficiencies and productivity.
- Local firm characteristics: These include firm strategy, industry structure, and industry rivalry. Local strategy affects a firm's competitiveness. A healthy level of rivalry between local firms will spur innovation and competitiveness.

In addition to the four determinants of the diamond, Porter also noted that government and chance play a part in the national competitiveness of industries. Governments can, by their actions and policies, increase the competitiveness of firms and occasionally entire industries.
Hard

83. How do governments intervene in trade?
While the past century has seen a major shift toward free trade, many governments continue to intervene in trade. Governments have several key policy areas that can be used to create rules and regulations to control and manage trade.
    - Tariffs: Tariffs are taxes imposed on imports. Two kinds of tariffs exist—specific tariffs, which are levied as a fixed charge, and ad valorem tariffs, which are calculated as a percentage of the value. Many governments still charge ad valorem tariffs as a way to regulate imports and raise revenues for their coffers.
    - Subsidies: A subsidy is a form of government payment to a producer. Types of subsidies include tax breaks or low-interest loans; both of which are common. Subsidies can also be cash grants and government-equity participation, which are less common because they require a direct use of government resources.
    - Import quotas and VER: Import quotas and voluntary export restraints (VER) are two strategies to limit the amount of imports into a country. The importing government directs import quotas, while VER are imposed at the discretion of the exporting nation in conjunction with the importing one.
    - Currency controls: Governments may limit the convertibility of one currency (usually its own) into others, usually in an effort to limit imports. Additionally, some governments will manage the exchange rate at a high level to create an import disincentive.
    - Local content requirements: Many countries continue to require that a certain percentage of a product or an item be manufactured or "assembled" locally. Some countries specify that a local firm must be used as the domestic partner to conduct business.
    - Antidumping rules: Dumping occurs when a company sells product below market price often in order to win market share and weaken a competitor.
    - Export financing: Governments provide financing to domestic companies to promote exports.
    - Free trade zone: Many countries designate certain geographic areas as free-trade zones. These areas enjoy reduced tariffs, taxes, customs, procedures, or restrictions in an effort to promote trade with other countries.
    - Administrative policies: These are the bureaucratic policies and procedures governments may use to deter imports by making entry or operations more difficult and time consuming.

    Moderate

84. What are the considerations that influence a company when it is trying to make a direct investment in a country?
Many considerations influence the decision of the company. These include: the cost as the organization has to decide whether it is cheaper to produce in the local market than

elsewhere. It has to look into the transportation costs. The company has to identify a significant local market. The company has to decide whether it is interested in obtaining access to local resources or commodities. The company has to decide whether it wants access to local technology or business process knowledge. The company has to find out whether its clients or competitors operate in the country. The ease with which operations are set in the country is also of importance to the company. The skill level of the workforce also plays an important role in taking a decision. The company has to look at the impact of the investment on the company's revenue and profitability. It has to find out if there are local restrictions with regard to the taking of the profits out of the country. The most important aspect is whether the company can wind up operations in the country if it so desires.
Easy

85. How do you differentiate between foreign direct investment (FDI) and portfolio investment?
Portfolio investment refers to the investment in a company's stocks, bonds, or assets, but not for the purpose of controlling or directing the firm's operations or management. Typically, investors in this category are looking for a financial rate of return as well as diversifying investment risk through multiple markets.
Foreign direct investment (FDI) refers to an investment in or the acquisition of foreign assets with the intent to control and manage them. Companies can make an FDI in several ways, including purchasing the assets of a foreign company; investing in the company or in new property, plants, or equipment; or participating in a joint venture with a foreign company, which typically involves an investment of capital or know-how. FDI is primarily a long-term strategy. Companies usually expect to benefit through access to local markets and resources, often in exchange for expertise, technical know-how, and capital.
Easy

Fill in the Blanks

86. Adam Smith's new trade theory called _____ focused on the ability of a country to produce a good more efficiently than another nation.
absolute advantage; Easy

87. _____ occurs when a country can produce a product better and more efficiently than it does other goods.
Comparative advantage; Easy

88. The _____ theory is based on a country's production factors, i.e., land, labor, and capital, which provide the funds for investment in plants and equipment.
factor proportions; Easy

89. An American economist advocated the _____, which was the reverse of what was expected by the factor proportions theory.
Leontief Paradox; Easy

90. _____ theories incorporate other product and service factors, including brand and customer loyalty, technology, and quality, into the understanding of trade flows.
Firm-based; Easy

91. _____ trade refers to trade between two countries of goods produced in the same industry.
Intraindustry; Easy

92. A(n) _____ is the system of politics and government in a country.
political system; Easy

93. _____ refers to a political philosophy which asserts that both public and private groups are important in a well-functioning political system.
Pluralism; Easy

94. _____ is a form of democratic government in which the government derives its power from the people of the country by means of elected representatives of the people.
Representative democracy; Easy

95. _____ is a form of democratic government in which the government derives its power from the people of the country by means of a direct referendum.
Direct democracy; Easy

96. _____ refers to an economic system in which the government or state directs and controls the economy, including the means and decision making for production.
Planned economy; Easy

97. According to _____ law, banks cannot charge or benefit from interest.
Islamic; Easy

98. Many governments still charge _____ tariffs as a way to regulate imports and raise revenues for their coffers.
ad valorem; Easy

99. Investors who are interested in _____ are looking for a financial rate of return as well as diversifying investment risk through multiple markets.
portfolio investment; Easy

100. _____ is when a company invests internationally to provide input into its core operations—usually in its home country.
Vertical FDI; Easy

