Econ 188 – Exam 2 **NAME:_____**
Spring 2012 **ID:_____**
Professor Spearot

I have neither given nor received unauthorized aid on this examination, nor have I concealed any similar misconduct by others.

*Signature*_____

Part 1 (2 points each – circle your answer for multiple choice)

1. Walmart acquired which company(s) in Germany ?
    a. Wertkauf
    b. ASDA
    c. Interspar
    d. (a) and (b)
    e. (a) and (c)
2. A majority of value added for the typical US Barbie doll is accrued in
    a. China
    b. Indonesia
    c. France
    d. United States
3. What are the benefits of offshoring?
    a. Increased productivity
    b. Increased prices
    c. Increased jobs
    d. None of the above
4. The majority of inward FDI to China comes from
    a. United States
    b. Hong Kong
    c. Japan
    d. Korea
5. China liberalized foreign investment restrictions
    a. Quickly
    b. Slowly
    c. Upon entry to the WTO
    d. Not at all

Part 2 - 2 points Each.

Please mark whether each activity is offshoring, outsourcing, both, or neither

Situation	**Outsourcing?**	**Offshoring?**
Professor Spearot hires TAs to grade papers		
Facebook opens an EU branch in Ireland		
Facebook pays a firm in Poland to code a new service		
Plantronic pays a firm in Santa Clara to find a new accounting executive		
Dominican Hospital uses radiologists at Stanford to read x-rays		

Part 3: (5 points each)

1. Please list three positives and two negatives of FDI for a host country.

2. Please list 5 policies that encourage FDI.

3. Please list and discuss briefly the OLI theory of multinationals.

4. In the case of Ireland, what facts supported the case that the FDI subsidies were not a good policy?

Part 4 – 10 Points each

1. Please discuss why Walmart was not successful in Germany.

Consider the "Melitz"-type exporting/FDI model we discussed in class. A firm must decide whether to exit the market or operate, and if the latter, whether to be purely domestic, export to a foreign market, or produce directly in each market (foreign using FDI). The returns from exiting are zero. If the firm decides to operate in some manner, it must pay F_0 in overhead costs. If the firm also decides to export, it must pay F_X in exporting fixed costs. Finally, if the firm invests in the foreign country, it must pay another overhead cost F_0 and a fixed organizational cost δ.

The firm can earn $\prod_H(\alpha)$ in the domestic market . If the firm sells in the foreign market, potential profits are $\prod_F(\alpha)$. If the firm exports, the foreign government extracts a fraction τ of profits. The term α is firm level productivity, where each profit function is increasing in α.

2. Assuming that all four options occur, please graphically detail how firms sort into the four outcomes.

3. Suppose that the destination market reduces the trade barrier, τ. Please detail graphically the effects of this change on equilibrium cutoffs. Further, please discuss the effects of the policy change on the average productivity of each group of firms.

4. Suppose the destination market is feeling especially nice, and reduces τ to zero. Assuming that $F_X < F_O + \delta$, please graphically detail how firms sort into each outcome.