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 any that apply)

1. Control of Walmart of Mexico was _____.
   a. Gradually acquired by Walmart USA
   b. Immediately acquired by Walmart USA
   c. Not acquired – it was new investment
   d. Sold after the bribery scandal

2. In the Barbie example for offshoring, what share of value added was attributable to work done overseas?
   a. 20%
   b. 40%
   c. 60%
   d. 80%

3. Rents and wages increased during the FDI boom in Ireland. Who does this help?
   a. Local businesses
   b. Local workers
   c. Local land owners
   d. Local governments

4. Outsourcing a given task is good idea if
   a. Your firm pays low wages
   b. Your firm is good at that task
   c. Your firm is good at other tasks
   d. Your firm produces a high-tech good.

5. When evaluating large layoffs of 50 or more people in the US, _____ percent of these layoffs involved movement of work.
   a. 11%
   b. 26%
   c. 55%
   d. 90%
Part 2 - 2 points Each.

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

<table>
<thead>
<tr>
<th>Situation</th>
<th>Outsourcing?</th>
<th>Offshoring?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professor Spearot hires a RA from Shiv Nadar University in India to digitize financial statements</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Avanti Ristorante uses OpenTable, a US firm, to handle all reservations</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Tesla purchases car bodies from Lotus, UK.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>General Motors closes a factory in Mexico.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jeep opens a truck factory in China.</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

Part 3: (10 points each)

1. Please discuss four ways in which FDI is complicated by entering a new pool of resources.

   Raise capital in foreign countries
   Hire foreign workers
   Deal with foreign suppliers
   Deal with foreign governments
2. Why did Walmart fail in Germany?

- Poor locations of acquired stores
- Purchased stores in need of repair
- Did not mesh with local culture
- Customer service
- Government regulations
- Business conditions were very competitive

3. What are three reasons why countries fight to host offshoreable activities?

- Investment and jobs
- Technological know-how
- Revenues
4. When offshoring to a foreign country, please discuss the pros and cons for the firms engaging in the offshoring. Please be comprehensive with your answer.

**Pros**

- Lower wages or cheaper resources in the foreign market
- Can find firms better at accomplishing certain tasks ("task matching")
- Dealing with multiple governments may provide better incentives (tax competition for example)

**Cons**

- Might be difficult to enforce property rights, especially for high tech firms
- There are agency problems – it’s hard to monitor the behavior of the foreign affiliate.
- Dealing with multiple governments might be a problem if they’re both trying to tax the firm, or generally extract rents from the firm.
Part 4: (10 points each)

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 $\delta$.

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

1. Assuming that all options occur, please graphically detail how firms sort into the four outcomes.
2. Suppose that the foreign government reduces tariffs and foreign investment policies (via $\delta$) at the same time. Thinking of only direct effects, how do these changes affect the sorting of firms? Please illustrate your answer carefully with a graph, and discuss how the share of each type of firm changes with this joint policy.

There are two possible answers to this question, depending on the size of the change in tariffs and $\delta$. In terms of changing the cutoff between domestic and exporting, in both answers the cutoff falls, reducing the share of firms that are purely domestic.

In terms of the cutoff between exporting and FDI, there are two possible changes. In the first, the reduction in $\delta$ is large relative to the reduction in tariffs. Thus, at the indifference point between FDI and exporting, the profits of FDI rise more than the profits of exporting. Thus, the cutoff falls. The region of FDI rises, and changes to the region of exporting are unclear since both cutoffs are moving in the same direction. An illustration of this answer is below. Note: If you drew it like this and say the share of exporting rises, I'll accept that for full credit.
In the second answer, tariff cuts are relatively larger compared with reductions in δ. Thus, at the upper cutoff, the profit function of exporting rises more than the profits function for FDI. Thus, the cutoff between these options increases. In this case, the region of exporting rises, the region of FDI falls, and the region of domestic firms also falls.

If the answer includes both answers, +5 in extra credit.