

## **Chapter 02**

### **International Trade and Investment**

#### **True / False Questions**

1. International trade includes exports, imports, and foreign direct investment.

True   False

2. Importing and foreign direct investment are two approaches to meeting overseas demand.

True   False

3. International firms must export their products or services in order to establish and expand their overseas operations.

True   False

4. The dollar value of total world exports in 2007 was greater than the gross national product of every nation in the world except Japan.

True   False

5. The magnitude of international trade and how it has grown are reflected in that one-fourth of everything grown or made in the world is now exported.

True   False

6. The proportion of manufacturing value added that is located in developed countries has been roughly stable since 1995.

True   False

7. South and East Asia's share of the world's manufacturing value added has nearly tripled since 1980.

True   False

8. In 2009, the top 10 exporting and importing nations collectively accounted for over half of all exports and imports of merchandise and services worldwide.

True False

9. Both developed nations and developing nations tend to trade more with developed nations.

True False

10. Approximately 70 percent of the exports from developed countries go to developed countries.

True False

11. The development of expanded regional trade agreements, such as the Association of Southeast Asian Nations, Mercosur, and the EU, can substantially alter the level and proportion of trade flows within and across regions.

True False

12. There are a number of advantages in focusing attention on a nation that is already a sizable purchaser of goods coming from the would-be exporter's country.

True False

13. China, Mexico, and Japan are the three largest trading partners of the U.S., in terms of the total volume of imports and exports.

True False

14. The first formulation of international trade theory, by Adam Smith, was motivated by political considerations.

True False

15. The central idea of mercantilism is there should be an export surplus so a nation can accumulate precious metals.

True False

16. Arguments in support of mercantilism largely disappeared after the end of the mercantilist era in the late 1700s.

True False

17. The theory of absolute advantage suggests that under free, unregulated trade, each nation should specialize in producing those goods it can produce most efficiently, based on naturally occurring endowments such as minerals.

True False

18. Adam Smith explained how countries can benefit from international trade, even if they lack any absolute advantage over their trade partners.

True False

19. According to the theory of comparative advantage, a nation can gain from trade if it is not equally less efficient in producing two goods.

True False

20. If a Chinese worker earns \$1.00 a day, then goods produced by this worker will cost less than the same goods produced by an American earning \$18.00 an hour.

True False

21. The price of one currency stated in terms of another currency is the exchange rate.

True False

22. Currency devaluation helps a nation avoid losing markets and regain competitiveness in world markets.

True False

23. Linder's theory of overlapping demand explains the direction of trade for minerals and agricultural products.

True False

24. Michael Porter claims that demand conditions, factor conditions, related and supporting industries, and firm strategy, structure, and rivalry, rather than government and chance, are factors that affect national competitiveness.

True False

25. A nation's relative ability to design, produce, distribute, or service products within an international trading context, while earning increasing returns on its resources, is known as national competitiveness.

True False

26. The primary reasons for international trade is a lack of natural resources in the developed nations.

True False

27. According to the text, differences in taste, a demand variable, can reverse the direction of trade predicted by the theory.

True False

28. International trade theory shows that nations will attain a higher level of living by specializing in goods for which they possess a comparative advantage and importing those for which they have a comparative disadvantage.

True False

29. Portfolio investment is the purchase of sufficient stock in a firm to obtain significant management control.

True False

30. Direct investment refers to overseas purchases of stocks and bonds to gain a return on the funds invested.

True False

31. The book value, or the value of the total outstanding stock, of all foreign direct investment worldwide was \$16.2 trillion at the end of 2008.

True False

32. The proportion of the outstanding stock of foreign direct investment accounted for by the United States declined by two-thirds between 1980 and 2008.

True False

33. Reflecting their continued economic development, developing countries have dramatically increased their share of FDI stock, from 1 percent in 1980 to nearly 15 percent in 2008.

True False

34. An important development in the level of worldwide FDI is the emergence of what has been called the "bamboo network" of ethnic Chinese family businesses based outside of China.

True False

35. An arrangement where one or more activities that could be provided in-house are instead provided by another company is offshoring.

True False

36. Some observers have argued American industry and the American economy as a whole will be strengthened by offshoring activities to workers in India or other nations that have comparative advantages in areas such as labor costs.

True False

37. Industrialized nations invest primarily in one another just as they trade more with one another.

True False

38. Historically, approximately two-thirds of the value of corporate investments made in the United States from abroad have been spent to acquire going companies rather than to establish new ones.

True False

39. Developed by the United Nations Conference on Trade and Development, the Trade and Development Index is a tool whose goal is to assist efforts "to systematically monitor the trade and development performance of developing countries with a view to facilitating national and international policies and strategies that would ensure that trade serves as a key instrument of development."

True False

40. If a nation is continuing to receive appreciable amounts of foreign investment, its investment climate must be favorable.

True False

41. Historically, foreign direct investment has followed foreign trade, and one reason is that foreign trade is typically less costly and less risky than making a direct investment into foreign markets.

True False

42. Foreign direct investment may be an attempt by foreign companies to establish competitive advantage over potential competitors in other markets, due to possession of advantages not available to local firms. Such advantages possessed by foreign companies over their local competitors include knowledge about local market conditions and cost efficiencies from operating at a distance.

True False

43. Internalization theory suggests that what an organization is good at should not be outsourced without very careful consideration.

True False

44. The dynamic capability theory states that for a firm to invest overseas, it must have three kinds of advantages: ownership specific, internalization, and location specific.

True False

45. Dunning's Eclectic Theory of International Production provides an explanation for the choice by the international firm of its overseas production facilities.

True False

46. The major part of foreign direct investment is made by large, research-intensive firms in oligopolistic industries.

True False

#### Multiple Choice Questions

47. One measure of the magnitude of international trade and how it has grown is \_\_\_\_\_ of everything grown or made in the world is now exported.

- A. 10%
- B. 25%
- C. 32%
- D. 45%

48. In examining the volume of international trade:

- A. exports of merchandise grew nearly fivefold between 1990 and 2008.
- B. exports of services grew more than tenfold between 1980 and 2008.
- C. The proportion of world exports of commercial services accounted for by the U.S. fell by nearly 20 percent between 1980 and 2008.
- D. exports of merchandise fell nearly fivefold between 1990 and 2008..
- E. exports of merchandise and exports of services grew nearly fivefold from 1990-2008 and tenfold from 1980-2008 respectively..

49. The rapid expansion of world exports since 1980 demonstrates that \_\_\_\_\_.

- A. businesspeople must be prepared to meet increased competition
- B. domestic business cannot compete with cheap imports
- C. the opportunity to increase sales by exporting is a viable growth strategy
- D. the proportion of worldwide manufacturing value added generated by South and East Asia has fallen since 1980
- E. the opportunity to increase sales by exporting is a viable growth strategy and businesspeople must be prepared to meet increased competition



50. In examining the volume of international trade:

- A. The proportion of manufacturing value added generated by South and East Asia has quadrupled since 1980.
- B. The proportion of manufacturing value added generated by Latin America has doubled since 1980.
- C. The proportion of world exports of world exports and imports accounted for by the 10 largest exporting and importing nations exceeded 70 percent in 2009.
- D. The proportion of worldwide manufacturing value added generated by South and East Asia has fallen since 1980.
- E. The proportion of manufacturing value added generated by Latin America has quadrupled since 1980.

51. More than one-half of the exports from developing countries go to \_\_\_\_\_ countries, and this proportion has been \_\_\_\_\_ over the past 35 years.

- A. developed, increasing
- B. developing, increasing
- C. developed, decreasing
- D. developing, decreasing
- E. third world countries, constant

52. More than half of the exports from developing nations go to developed nations and:

- A. this proportion has been declining over the past 35 years.
- B. approximately 70 percent of exports from developed economies goes to other industrialized nations.
- C. the proportion of world trade accounted for by members of regional trade agreements has grown to nearly 50 percent.
- D. approximately 90 percent of exports from developed economies goes to other industrialized nations.
- E. The proportion of exports from developing nations that go to developed nations is on decline over the past 35 yrs and approx 70% of exports from developed nations go to other industrialized nations.

53. When considering where to export, advantages to managers of focusing on a nation that is already a sizable purchaser of goods coming from the home country include:

- A. The cultures of the two countries should be relatively similar and compatible.
- B. The climate for foreign direct investment in the importing nation is relatively favorable.
- C. Export and import regulations are not insurmountable.
- D. The cultures of the two countries should be relatively distinct and compatible.
- E. The climate for foreign direct investment in the importing nation is unfavorable.

54. When considering where to export, advantages to managers of focusing on a nation that is already a sizable purchaser of goods coming from the home country include:

- A. The political climate in the importing nation is relatively stable.
- B. There are abundant natural resources in the importing nation.
- C. Satisfactory transportation facilities have already been established.
- D. The cultures of the two countries are relatively distinct and compatible..
- E. Import channel members (merchants, banks, and custombrokers) who are new at handling import shipments.

55. The three largest markets for American exports of goods in 2009 were:

Refer To: Figure: Table 2.2 Major trading partners of the United States

- A. Japan, the U.K., and China.
- B. Japan, Mexico, and the U.K.
- C. Canada, Mexico, and China.
- D. Canada, Japan, and the U.K.
- E. Japan, Mexico, and China.

56. The three nations that exported the largest amount of goods to the United States in 2009 were:

Refer To: Figure: Table 2.2 Major trading partners of the United States

- A. Japan, Canada, and China.
- B. China, Mexico, and the U.K.
- C. Japan, China, and Saudi Arabia.
- D. Canada, Japan, and Mexico.
- E. Canada, Mexico, and China.

57. Many of the same Asian countries that are major exporters to the United States are also significant importers of American goods because:

- A. their rising standards of living enable their people to afford more imported products.
- B. they are purchasing large amounts of capital goods to further their industrial expansion.
- C. they are importing raw materials and components that will be assembled and subsequently be exported, often to the U.S.
- D. of their rising standards of living, their purchasing of large amounts of capital goods and their importing raw materials and components.
- E. they are purchasing lesser amounts of capital goods to hinder the industrial expansion.

58. Supporters of mercantilism:

- A. viewed accumulation of precious metals as an activity essential to a nation's welfare.
- B. viewed industrial development as the primary source of a nation's wealth.
- C. promoted trade policies that generally benefitted consumers and emerging industrialists.
- D. viewed strong agrarian policies to be the primary source of a nation's wealth.
- E. viewed unique cultural notions to be the primary source of a nation's wealth.

59. Mercantilists believed that:

- A. merchants should import goods to raise the level of living.
- B. governments should lower import duties.
- C. a nation should have an export surplus in order to accumulate precious metals.
- D. a nation should produce goods for which there is a comparative advantage.
- E. a nation should have distributed precious metals for a comparative advantage.

60. Adam Smith claimed:

- A. that governments, not market forces, should determine the directions, volume, and composition of international trade.
- B. a nation could trade advantageously if it had a comparative advantage.
- C. that market forces, not government controls, should determine direction, volume, and the composition of international trade.
- D. that customers' tastes are affected by income levels.
- E. that a nation should always specialize in producing what the government espouses without considering any absolute advantage it may have.

61. The capability of one nation to produce more of a good with the same amount of input than another country is a/an \_\_\_\_\_.

- A. comparative advantage
- B. absolute advantage
- C. mercantilist advantage
- D. capitalist advantage

62. If Ecuador has an absolute advantage in coffee and Argentina in wheat, then, according to trade theory:

- A. Ecuador should focus production on coffee and trade for other goods.
- B. Ecuador would do well to produce its own coffee rather than import it from Bolivia.
- C. Argentina should focus on producing wheat and trade for coffee.
- D. Ecuador should focus on production of coffee and trade for other goods, it should not import coffee and should increase trading its coffee and also produce other goods.
- E. Argentina should start accumulating coffee from trading with Ecuador to gain an absolute advantage.

63. A nation having absolute disadvantages in the production of two goods with respect to another nation has a/an \_\_\_\_\_ in the production of the good in which its absolute disadvantage is less.

- A. comparative advantage
- B. absolute advantage
- C. mercantilist advantage
- D. bilateral advantage

64. According to the theory of comparative advantage,

- A. a nation should produce the goods at which it is most efficient.
- B. a nation can gain from trade if it is equally inefficient in producing two goods.
- C. a nation must have an absolute advantage in at least one good to gain from trade.
- D. a nation must have an absolute advantage in at least three goods to gain from trade.
- E. a nation should trade with countries with similar levels of per capita income.

65. According to trade theory,

- A. Traders need to know the exchange rate between their own currency and that of the nation they are considering trading with, before they can decide whether it is advantageous to import, export, or buy locally.
- B. If a currency's exchange rate strengthens, then its exporters will no longer be able to profitably export their products.
- C. Devaluation of a currency will automatically cause a nation's products to be price competitive in international markets.
- D. Traders need not consider the exchange rate between their own currency and that of the nation they are considering trading with, before they can decide whether it is advantageous to import, export, or buy locally.
- E. The differences in resource endowments suggest that developed countries would more
- F. likely trade only with other developed countries.

66. Theory based on \_\_\_\_\_ states that international and interregional differences in production costs occur because of differences in the supply of production factors.

- A. comparative advantage
- B. absolute advantage
- C. mercantilist advantage
- D. resource endowments
- E. capitalist advantage

67. The theory of resource endowment:

- A. explains why France sends us cosmetics, wine, and clothing.
- B. states that a nation will trade goods that can be produced with the production factor that is most abundant.
- C. explains why an automobile can be made either by hand or by a capital-intensive process.
- D. explains why transportation costs may be ignored when calculating the costs of imports.
- E. states that a nation will trade goods that can be produced with the production factor that is most scarce.

68. The theory of overlapping demand:

- A. explains how international trade in manufactured goods will be linked to gross national income.
- B. states that a nation will trade goods that can be produced with the production factor that is most abundant.
- C. explains why companies will add excess capacity to their production systems.
- D. explains why exchange rate is the price of one currency stated in terms of another..
- E. deduces that international trade in manufactured goods will be greater between nations with similar levels of per capita income..

69. Which of the following elements are included in Porter's Diamond Model of national advantage?

- A. competitive conditions
- B. export conditions
- C. social conditions
- D. supply conditions
- E. demand conditions

70. Which of the following elements are included in Porter's Diamond Model of national advantage?

- A. competitive conditions
- B. export conditions
- C. factor conditions
- D. supply conditions
- E. social conditions

71. Porter's Diamond Model of national advantage:

Refer To: Figure 2.2 Variables affecting competitive advantage: Porter's diamond

- A. claims that the ability of local firms in a country to utilize the country's resources to gain a competitive advantage is based on demand conditions, factor conditions, substitute products, and firm strategy, structure, and rivalry.
- B. links intraindustry trade to relative levels of per capita income.
- C. is based on anecdotal evidence.
- D. claims that the ability of local firms in a country to utilize the country's resources to gain a competitive advantage is based on entirely on supply conditions and export conditions.
- E. is not affected by chance.

72. \_\_\_\_\_ occurs primarily because of relative price differentials among nations.

- A. Foreign direct investment
- B. International trade
- C. Portfolio investment
- D. Firm Rivalry
- E. Direct Investment x

73. To sum up international trade theory, we can say that the primary reason for trade is:

- A. the increase in OPEC oil prices.
- B. governments want to accumulate money.
- C. the existence of price differentials among nations.
- D. the creation of new nations from former colonies.
- E. the existence of price similarity among nations.

74. Which of the following is explained by international trade theory?

- A. Differences in production costs.
- B. Differences in levels of technology.
- C. Foreign exchange rates.
- D. Differences in efficiency of factor use.
- E. It explains differences in production costs, levels of technology, in efficiency of factor use and foreign exchange rates.

75. Regarding foreign investment:

- A. it can be divided into three components: international trade, portfolio investment, and direct investment.
- B. portfolio investment involves investors who participate in the management of the firm in addition to receiving a return on their money.
- C. deals that result in the foreign investor's obtaining at least 10 percent of the shareholdings are classified as portfolio investments.
- D. it is noticed that international trade in manufactured goods will be greater between nations with similar levels of per capita income.
- E. it can be divided into two components: portfolio investment, and direct investment.

76. Firms from \_\_\_\_\_ had the largest total outstanding stock of direct overseas investment at the end of 2008.

- A. Germany
- B. the United States
- C. the United Kingdom
- D. Japan
- E. China

77. At the end of 2008, the value of the outstanding stock of foreign direct investment of all nations totaled more than:

- A. 500 billion dollars
- B. 3 trillion dollars
- C. 12 trillion dollars
- D. 16 trillion dollars
- E. 21 trillion dollars

78. Regarding the annual outflows of foreign direct investment,

- A. the proportion that came from developing nations in 2008 was nearly double the average from those nations from 1985 to 1995.
- B. the proportion that came from the United States and Europe was nearly 50 percent.
- C. much of the recent increase has been associated with mergers, acquisitions, and other international investments made by companies in industries facing increased competition and global consolidation.
- D. nearly half went to China and its territories from 2006 to 2008.
- E. much of the recent increase has been associated with mergers, acquisitions, and other international investments made by companies in industries facing decreased competition and global consolidation.

79. Locating activities in another nation is \_\_\_\_\_.

- A. outsourcing
- B. offshoring
- C. foreign direct investment
- D. portfolio investment
- E. national competitiveness



80. Offshoring is an application of:

- A. comparative advantage.
- B. differences in taste.
- C. money market rates.
- D. exchange rate theory.
- E. annual outflows of FDI.

81. Regarding annual inflows of FDI:

- A. Industrialized nations primarily invest in one another.
- B. An average of nearly 70 percent of annual FDI investments have been going into developed countries in recent years.
- C. Developed countries obtained a 70 percent increase in the level of FDI between 2000 and 2008.
- D. Industrialized nations primarily invest only in only underdeveloped countries.
- E. Industrialized nations primarily invest in one another and on an average of nearly 70 percent of the annual FDI investments have been going into developed countries in recent years.

82. Regarding economic and social development:

Refer To: Figure: Table 2.3 Top and bottom ranked countries on the Trade and Development Index, 2006

- A. International trade has an important role in influencing nations' economic and social performance, with this role being even more fundamental in the case of developed countries.
- B. Expansion of trade guarantees improvement for a country and its people.
- C. The Trade and Development Index attempts to provide a quantitative indication of a nation's social and economic development.
- D. The 30 highest-ranked nations in the initial Trade and Development Index were all developed countries.
- E. For the Trade and Development Index, the best regional performance among developing countries was that of the countries of the East Asia and Pacific region.

83. Regarding foreign direct investment and trade:

- A. Historically, foreign trade has followed foreign direct investment.
- B. Foreign trade is typically more costly and more risky than making a direct investment into foreign markets.
- C. Typically, a firm would hire sales representatives to live in overseas markets as a first step in developing international trade.
- D. Fewer government barriers to trade, increased competition from globalizing firms, and new production and communications technology are causing many international firms to disperse the activities of their production systems to locations close to available resources.
- E. Historically, foreign trade has followed portfolio investment.

84. The monopolistic advantage theory suggests that firms in oligopolistic industries are likely to \_\_\_\_\_ foreign direct investment when they have technical and other advantages over indigenous firms.

- A. increase
- B. reduce
- C. ignore
- D. not change
- E. exceed

85. The monopolistic advantage theory states that:

- A. a firm that has a monopoly has a major advantage in overseas investment.
- B. FDI is made by firms in oligopolistic industries possessing technical advantages over local companies.
- C. a firm that has a monopoly domestically will have no competition making overseas investments.
- D. the firm making the overseas investment first has a monopolistic advantage.
- E. FDI is made by firms in monopolistic industries possessing technical advantages over local companies.

86. Dunning's Eclectic Theory of International Production states that if a firm is going to invest in production facilities abroad, it must have the following kinds of advantages:

- A. ownership-specific, location-specific, and internationalization.
- B. strategic, organizational, and technological.
- C. ownership-specific, location-specific, and internalization.
- D. technological, financial, and human resource.
- E. financial, and human resource and technological.

**Essay Questions**

87. Discuss the advantages in focusing attention on a nation that is already a sizable purchaser of goods coming from the exporter's home country.

88. Explain the logic of mercantilism and why it is generally viewed as a deficient theory.

89. Discuss the theory of absolute advantage and how it explains the basis for trade between nations.

90. Discuss the keystone of international trade, the theory of comparative advantage.

91. Discuss Dunning's eclectic theory of international production as a theory to explain flows of international trade and foreign direct investment.

## Chapter 02 International Trade and Investment **Answer Key**

### **True / False Questions**

1. (p. 25) International trade includes exports, imports, and foreign direct investment.

**FALSE**

International trade includes exports and imports, not foreign direct investment.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

2. (p. 25) Importing and foreign direct investment are two approaches to meeting overseas demand.

**FALSE**

Exporting and foreign direct investment are two approaches to meeting overseas demand.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

3. (p. 25) International firms must export their products or services in order to establish and expand their overseas operations.

**FALSE**

ICs can engage in foreign direct investment to establish and expand their overseas operations.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

4. (p. 26) The dollar value of total world exports in 2007 was greater than the gross national product of every nation in the world except Japan.

**FALSE**

The dollar value of total world exports in 2008 was greater than the gross national product of every nation in the world except the U.S.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

5. (p. 26) The magnitude of international trade and how it has grown are reflected in that one-fourth of everything grown or made in the world is now exported.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

6. (p. 26) The proportion of manufacturing value added that is located in developed countries has been roughly stable since 1995.

**FALSE**

The proportion of manufacturing value added that is located in developed countries has been declining since 1995.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

7. (p. 27) South and East Asia's share of the world's manufacturing value added has nearly tripled since 1980.

**FALSE**

South and East Asia's share of the world's manufacturing value added has quadrupled since 1980.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

8. (p. 27) In 2009, the top 10 exporting and importing nations collectively accounted for over half of all exports and imports of merchandise and services worldwide.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Appreciate the magnitude of international trade and how it has grown.*

*Topic Area: International trade*

9. (p. 27) Both developed nations and developing nations tend to trade more with developed nations.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02 Identify the direction of trade; or who trades with whom; and trends in such trade.*

*Topic Area: Direction of trade*

10. (p. 27) Approximately 70 percent of the exports from developed countries go to developed countries.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Identify the direction of trade; or who trades with whom; and trends in such trade.*

*Topic Area: Direction of trade*

11. (p. 27) The development of expanded regional trade agreements, such as the Association of Southeast Asian Nations, Mercosur, and the EU, can substantially alter the level and proportion of trade flows within and across regions.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02 Identify the direction of trade; or who trades with whom; and trends in such trade.*

*Topic Area: Direction of trade*



12. (p. 28) There are a number of advantages in focusing attention on a nation that is already a sizable purchaser of goods coming from the would-be exporter's country.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02 Identify the direction of trade; or who trades with whom; and trends in such trade.*

*Topic Area: Major trading partners: Their relevance for managers*

13. (p. 28) China, Mexico, and Japan are the three largest trading partners of the U.S., in terms of the total volume of imports and exports.

**FALSE**

China, Mexico and Canada are the three largest trading partners of the U.S.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02 Identify the direction of trade; or who trades with whom; and trends in such trade.*

*Topic Area: Major trading partners: Their relevance for managers*

14. (p. 29) The first formulation of international trade theory, by Adam Smith, was motivated by political considerations.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

15. (p. 29) The central idea of mercantilism is there should be an export surplus so a nation can accumulate precious metals.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

16. (p. 30) Arguments in support of mercantilism largely disappeared after the end of the mercantilist era in the late 1700s.

**FALSE**

Mercantilist sentiments are still cited for explaining or criticizing behavior of countries such as China, and when arguing that exports are "good" for a country or that imports are "bad".

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

17. (p. 30) The theory of absolute advantage suggests that under free, unregulated trade, each nation should specialize in producing those goods it can produce most efficiently, based on naturally occurring endowments such as minerals.

**FALSE**

Specialization should be based on market forces.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

18. (p. 31) Adam Smith explained how countries can benefit from international trade, even if they lack any absolute advantage over their trade partners.

**FALSE**

Ricardo developed an explanation of how countries can benefit from international trade, even if they lack any absolute advantage over their trade partners.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

19. (p. 31) According to the theory of comparative advantage, a nation can gain from trade if it is not equally less efficient in producing two goods.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

20. (p. 31) If a Chinese worker earns \$1.00 a day, then goods produced by this worker will cost less than the same goods produced by an American earning \$18.00 an hour.

**FALSE**

Wage costs are neither all of the production costs nor all of the labor costs, and labor can also exhibit differences in productivity.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

21. (p. 32) The price of one currency stated in terms of another currency is the exchange rate.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

22. (p. 32) Currency devaluation helps a nation avoid losing markets and regain competitiveness in world markets.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

23. (p. 32) Linder's theory of overlapping demand explains the direction of trade for minerals and agricultural products.

**FALSE**

Linder's theory attempted to explain how demand for products was affected by income levels, and therefore a nation's income per capita, and therefore exports will be influenced by similarity in income levels across countries.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

24. (p. 34) Michael Porter claims that demand conditions, factor conditions, related and supporting industries, and firm strategy, structure, and rivalry, rather than government and chance, are factors that affect national competitiveness.

**FALSE**

Porter's theorizing about his Diamond Model of national advantage also acknowledged that competitiveness could be affected by government and chance.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

25. (p. 33) A nation's relative ability to design, produce, distribute, or service products within an international trading context, while earning increasing returns on its resources, is known as national competitiveness.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

26. (p. 34) The primary reasons for international trade is a lack of natural resources in the developed nations.

**FALSE**

International trade occurs primarily because of relative price differences across nations, which stem from differences in production costs.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

27. (p. 34) According to the text, differences in taste, a demand variable, can reverse the direction of trade predicted by the theory.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

28. (p. 34) International trade theory shows that nations will attain a higher level of living by specializing in goods for which they possess a comparative advantage and importing those for which they have a comparative disadvantage.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

29. (p. 34) Portfolio investment is the purchase of sufficient stock in a firm to obtain significant management control.

**FALSE**

Portfolio investment is the purchase of stocks and bonds to obtain a return on the funds invested. Direct investment is the purchase of sufficient stock in a firm to obtain significant management control.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

30. (p. 35) Direct investment refers to overseas purchases of stocks and bonds to gain a return on the funds invested.

**FALSE**

Portfolio investment refers to overseas purchases of stocks and bonds to gain a return on the funds invested.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

31. (p. 35) The book value, or the value of the total outstanding stock, of all foreign direct investment worldwide was \$16.2 trillion at the end of 2008.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

32. (p. 35) The proportion of the outstanding stock of foreign direct investment accounted for by the United States declined by two-thirds between 1980 and 2008.

**FALSE**

The proportion of the outstanding stock of foreign direct investment accounted for by the United States declined by nearly 46 percent between 1980 and 2008.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

33. (p. 35) Reflecting their continued economic development, developing countries have dramatically increased their share of FDI stock, from 1 percent in 1980 to nearly 15 percent in 2008.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

34. (p. 35) An important development in the level of worldwide FDI is the emergence of what has been called the "bamboo network" of ethnic Chinese family businesses based outside of China.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

35. (p. 36) An arrangement where one or more activities that could be provided in-house are instead provided by another company is offshoring.

**FALSE**

An arrangement where one or more activities that could be provided in-house are instead provided by another company is outsourcing.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*



36. (p. 37) Some observers have argued American industry and the American economy as a whole will be strengthened by offshoring activities to workers in India or other nations that have comparative advantages in areas such as labor costs.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

37. (p. 38) Industrialized nations invest primarily in one another just as they trade more with one another.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

38. (p. 37) Historically, approximately two-thirds of the value of corporate investments made in the United States from abroad have been spent to acquire going companies rather than to establish new ones.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

39. (p. 39) Developed by the United Nations Conference on Trade and Development, the Trade and Development Index is a tool whose goal is to assist efforts "to systematically monitor the trade and development performance of developing countries with a view to facilitating national and international policies and strategies that would ensure that trade serves as a key instrument of development."

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Are economic and social development affected by trade and investment?*

40. (p. 38) If a nation is continuing to receive appreciable amounts of foreign investment, its investment climate must be favorable.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Foreign investment*

41. (p. 40) Historically, foreign direct investment has followed foreign trade, and one reason is that foreign trade is typically less costly and less risky than making a direct investment into foreign markets.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the size; growth; and direction of foreign direct investment*

*Topic Area: Are economic and social development affected by trade and investment?*

42. (p. 41) Foreign direct investment may be an attempt by foreign companies to establish competitive advantage over potential competitors in other markets, due to possession of advantages not available to local firms. Such advantages possessed by foreign companies over their local competitors include knowledge about local market conditions and cost efficiencies from operating at a distance.

**FALSE**

Lack of knowledge about local market conditions and increased costs of operating at a distance are usually liabilities, rather than advantages, for ICs.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05 Explain some of the theories of foreign direct investment.*

*Topic Area: Explaining FDI: Theories of international investment*

43. (p. 41) Internalization theory suggests that what an organization is good at should not be outsourced without very careful consideration.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-05 Explain some of the theories of foreign direct investment.*

*Topic Area: Explaining FDI: Theories of international investment*

44. (p. 43) The dynamic capability theory states that for a firm to invest overseas, it must have three kinds of advantages: ownership specific, internalization, and location specific.

**FALSE**

Ownership specific, internalization, and location specific advantages are part of Dunning's Eclectic Theory of International Production.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-05 Explain some of the theories of foreign direct investment.*

*Topic Area: Explaining FDI: Theories of international investment*

45. (p. 43) Dunning's Eclectic Theory of International Production provides an explanation for the choice by the international firm of its overseas production facilities.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05 Explain some of the theories of foreign direct investment.*

*Topic Area: Explaining FDI: Theories of international investment*

46. (p. 43) The major part of foreign direct investment is made by large, research-intensive firms in oligopolistic industries.

**TRUE**

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05 Explain some of the theories of foreign direct investment.*

*Topic Area: Explaining FDI: Theories of international investment*

**Multiple Choice Questions**

47. (p. 26) One measure of the magnitude of international trade and how it has grown is \_\_\_\_\_ of everything grown or made in the world is now exported.

- A. 10%
- B. 25%**
- C. 32%
- D. 45%

One measure of the magnitude of international trade and how it has grown is 25% of everything grown or made in the world is now exported.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-01*  
*Topic Area: International trade*

48. (p. 26) In examining the volume of international trade:

- A. exports of merchandise grew nearly fivefold between 1990 and 2008.
- B. exports of services grew more than tenfold between 1980 and 2008.
- C. The proportion of world exports of commercial services accounted for by the U.S. fell by nearly 20 percent between 1980 and 2008.
- D. exports of merchandise fell nearly fivefold between 1990 and 2008..
- E. exports of merchandise and exports of services grew nearly fivefold from 1990-2008 and tenfold from 1980-2008 respectively..**

On examining the volume of international trade we notice that exports of merchandise and exports of services grew nearly fivefold from 1990-2008 and tenfold from 1980-2008 respectively..

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 3 Hard*  
*Learning Objective: 02-01*  
*Topic Area: International trade*

49. (p. 26) The rapid expansion of world exports since 1980 demonstrates that

- \_\_\_\_\_.
- A. businesspeople must be prepared to meet increased competition
  - B. domestic business cannot compete with cheap imports
  - C. the opportunity to increase sales by exporting is a viable growth strategy
  - D. the proportion of worldwide manufacturing value added generated by South and East Asia has fallen since 1980
  - E. the opportunity to increase sales by exporting is a viable growth strategy and businesspeople must be prepared to meet increased competition

The rapid expansion of world exports since 1980 demonstrates that the opportunity to increase sales by exporting is a viable growth strategy and that businesspeople must be prepared to meet increased competition..

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-01*  
*Topic Area: International trade*

50. (p. 27) In examining the volume of international trade:

- A. The proportion of manufacturing value added generated by South and East Asia has quadrupled since 1980.
- B. The proportion of manufacturing value added generated by Latin America has doubled since 1980.
- C. The proportion of world exports of world exports and imports accounted for by the 10 largest exporting and importing nations exceeded 70 percent in 2009.
- D. The proportion of worldwide manufacturing value added generated by South and East Asia has fallen since 1980.
- E. The proportion of manufacturing value added generated by Latin America has quadrupled since 1980.

The proportion of manufacturing value added generated by South and East Asia has quadrupled since 1980.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 3 Hard*  
*Learning Objective: 02-01*  
*Topic Area: International trade*

51. (p. 27) More than one-half of the exports from developing countries go to \_\_\_\_\_ countries, and this proportion has been \_\_\_\_\_ over the past 35 years.

- A. developed, increasing
- B. developing, increasing
- C. developed, decreasing**
- D. developing, decreasing
- E. third world countries, constant

More than half the exports from developing nations go to developed countries, this proportion has been declining over the past 35 years, from 72 percent in 1970 to about 50 percent in 2009.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-02*  
*Topic Area: Direction of trade*

52. (p. 27) More than half of the exports from developing nations go to developed nations and:

- A. this proportion has been declining over the past 35 years.
- B. approximately 70 percent of exports from developed economies goes to other industrialized nations.
- C. the proportion of world trade accounted for by members of regional trade agreements has grown to nearly 50 percent.
- D. approximately 90 percent of exports from developed economies goes to other industrialized nations.
- E. The proportion of exports from developing nations that go to developed nations is on decline over the past 35 yrs and approx 70% of exports from developed nations go to other industrialized nations.**

More than half of the exports from developing nations go to developed nations and this proportion has been declining over the past 35 years and approximately 70% of exports from developed economies also go to other industrialized nations.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-02*  
*Topic Area: Direction of trade*

53. (p. 28) When considering where to export, advantages to managers of focusing on a nation that is already a sizable purchaser of goods coming from the home country include:

- A. The cultures of the two countries should be relatively similar and compatible.
- B. The climate for foreign direct investment in the importing nation is relatively favorable.
- C. Export and import regulations are not insurmountable.
- D. The cultures of the two countries should be relatively distinct and compatible.
- E. The climate for foreign direct investment in the importing nation is unfavorable.

When considering where to export, advantages to managers of focusing on a nation that is already a sizable purchaser of goods coming from the home country include the business climate, export and import regulations, transportation facilities, import channel members, Foreign exchange and the government of a trading partner.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-02*

*Topic Area: Major trading partners: Their relevance for managers*

54. (p. 28) When considering where to export, advantages to managers of focusing on a nation that is already a sizable purchaser of goods coming from the home country include:

- A. The political climate in the importing nation is relatively stable.
- B. There are abundant natural resources in the importing nation.
- C. Satisfactory transportation facilities have already been established.
- D. The cultures of the two countries are relatively distinct and compatible..
- E. Import channel members (merchants, banks, and custombrokers) who are new at handling import shipments.

When considering where to export, advantages to managers of focusing on a nation that is already a sizable purchaser of goods coming from the home country include the business climate, export and import regulations, transportation facilities, import channel members, Foreign exchange and the government of a trading partner.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-02*

*Topic Area: Major trading partners: Their relevance for managers*



55. (p. 28) The three largest markets for American exports of goods in 2009 were:

Refer To: Figure: Table 2.2 Major trading partners of the United States

- A. Japan, the U.K., and China.
- B. Japan, Mexico, and the U.K.
- C. Canada, Mexico, and China.**
- D. Canada, Japan, and the U.K.
- E. Japan, Mexico, and China.

The three largest markets for American exports of goods in 2009 were Canada, Mexico, and China.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02*

*Topic Area: Major trading partners: Their relevance for managers*

56. (p. 28) The three nations that exported the largest amount of goods to the United States in 2009 were:

Refer To: Figure: Table 2.2 Major trading partners of the United States

- A. Japan, Canada, and China.
- B. China, Mexico, and the U.K.
- C. Japan, China, and Saudi Arabia.
- D. Canada, Japan, and Mexico.
- E. Canada, Mexico, and China.**

The three nations that exported the largest amount of goods to the United States in 2009 were Canada, Mexico, and China.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02*

*Topic Area: Major trading partners: Their relevance for managers*

57. (p. 29) Many of the same Asian countries that are major exporters to the United States are also significant importers of American goods because:

- A. their rising standards of living enable their people to afford more imported products.
- B. they are purchasing large amounts of capital goods to further their industrial expansion.
- C. they are importing raw materials and components that will be assembled and subsequently be exported, often to the U.S.

D. of their rising standards of living, their purchasing of large amounts of capital goods and their importing raw materials and components. E. they are purchasing lesser amounts of capital goods to hinder the industrial expansion.

Many of the same Asian countries that are major exporters to the United States are also significant importers of American goods because of their rising standards of living, their purchasing of large amounts of capital goods and their importing raw materials and components.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02*

*Topic Area: Major trading partners: Their relevance for managers*

58. (p. 29) Supporters of mercantilism:

- A. viewed accumulation of precious metals as an activity essential to a nation's welfare.
- B. viewed industrial development as the primary source of a nation's wealth.
- C. promoted trade policies that generally benefitted consumers and emerging industrialists.
- D. viewed strong agrarian policies to be the primary source of a nation's wealth.
- E. viewed unique cultural notions to be the primary source of a nation's wealth.

Supporters of mercantilism viewed accumulation of precious metals as an activity essential to a nation's welfare.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

59. (p. 29) Mercantilists believed that:

- A. merchants should import goods to raise the level of living.
- B. governments should lower import duties.
- C.** a nation should have an export surplus in order to accumulate precious metals.
- D. a nation should produce goods for which there is a comparative advantage.
- E. a nation should have distributed precious metals for a comparative advantage.

Mercantilists believed that a nation should have an export surplus in order to accumulate precious metals.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

60. (p. 30) Adam Smith claimed:

- A. that governments, not market forces, should determine the directions, volume, and composition of international trade.
- B. a nation could trade advantageously if it had a comparative advantage.
- C.** that market forces, not government controls, should determine direction, volume, and the composition of international trade.
- D. that customers' tastes are affected by income levels.
- E. that a nation should always specialize in producing what the government espouses without considering any absolute advantage it may have.

Adam Smith claimed that market forces, not government controls, should determine direction, volume, and the composition of international trade.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

61. (p. 30) The capability of one nation to produce more of a good with the same amount of input than another country is a/an \_\_\_\_\_.

- A. comparative advantage
- B. absolute advantage**
- C. mercantilist advantage
- D. capitalist advantage

The capability of a nation to produce more of a good with the same amount of input than any other country is called an absolute advantage. This can be either natural or acquired.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

62. (p. 30) If Ecuador has an absolute advantage in coffee and Argentina in wheat, then, according to trade theory:

- A. Ecuador should focus production on coffee and trade for other goods.
- B. Ecuador would do well to produce its own coffee rather than import it from Bolivia.
- C. Argentina should focus on producing wheat and trade for coffee.
- D. Ecuador should focus on production of coffee and trade for other goods, it should not import coffee and should increase trading its coffee and also produce other goods. E. Argentina should start accumulating coffee from trading with Ecuador to gain an absolute advantage.**

Ecuador should focus on production of coffee and trade for other goods, it should not import coffee and should increase trading its coffee and also produce other goods.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

63. (p. 31) A nation having absolute disadvantages in the production of two goods with respect to another nation has a/an \_\_\_\_\_ in the production of the good in which its absolute disadvantage is less.

- A. comparative advantage
- B. absolute advantage
- C. mercantilist advantage
- D. bilateral advantage

A nation having absolute disadvantages in the production of two goods with respect to another nation has a comparative advantage in the production of the good in which its absolute disadvantage is less.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

64. (p. 31) According to the theory of comparative advantage,

- A. a nation should produce the goods at which it is most efficient.
- B. a nation can gain from trade if it is equally inefficient in producing two goods.
- C. a nation must have an absolute advantage in at least one good to gain from trade.
- D. a nation must have an absolute advantage in at least three goods to gain from trade.
- E. a nation should trade with countries with similar levels of per capita income.

According to the theory of comparative advantage, a nation should produce the goods at which it is most efficient.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

65. (p. 31) According to trade theory,

- A. Traders need to know the exchange rate between their own currency and that of the nation they are considering trading with, before they can decide whether it is advantageous to import, export, or buy locally.
- B. If a currency's exchange rate strengthens, then its exporters will no longer be able to profitably export their products.
- C. Devaluation of a currency will automatically cause a nation's products to be price competitive in international markets.
- D. Traders need not consider the exchange rate between their own currency and that of the nation they are considering trading with, before they can decide whether it is advantageous to import, export, or buy locally.
- E. The differences in resource endowments suggest that developed countries would more
- F. likely trade only with other developed countries.

According to trade theory, traders need to know the exchange rate between their own currency and that of the nation they are considering trading with, before they can decide whether it is advantageous to import, export, or buy locally.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

66. (p. 32) Theory based on \_\_\_\_\_ states that international and interregional differences in production costs occur because of differences in the supply of production factors.

- A. comparative advantage
- B. absolute advantage
- C. mercantilist advantage
- D. resource endowments
- E. capitalist advantage

Theory based on resource endowments states that international and interregional differences in production costs occur because of differences in the supply of production factors.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

67. (p. 32) The theory of resource endowment:

A. explains why France sends us cosmetics, wine, and clothing.

**B.** states that a nation will trade goods that can be produced with the production factor that is most abundant.

C. explains why an automobile can be made either by hand or by a capital-intensive process.

D. explains why transportation costs may be ignored when calculating the costs of imports.

E. states that a nation will trade goods that can be produced with the production factor that is most scarce.

The theory of resource endowment states that a nation will trade goods that can be produced with the production factor that is most abundant.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

68. (p. 32) The theory of overlapping demand:

A. explains how international trade in manufactured goods will be linked to gross national income.

B. states that a nation will trade goods that can be produced with the production factor that is most abundant.

C. explains why companies will add excess capacity to their production systems.

D. explains why exchange rate is the price of one currency stated in terms of another..

**E.** deduces that international trade in manufactured goods will be greater between nations with similar levels of per capita income..

The theory of overlapping demand deduces that international trade in manufactured goods

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

69. (p. 33) Which of the following elements are included in Porter's Diamond Model of national advantage?

- A. competitive conditions
- B. export conditions
- C. social conditions
- D. supply conditions
- E.** demand conditions

Porter's Diamond Model claims that four kinds of variables will have an impact on the ability of local firms in one country to utilize the country's resources to gain competitive advantage, and "demand conditions" one of the variables..

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

70. (p. 33) Which of the following elements are included in Porter's Diamond Model of national advantage?

- A. competitive conditions
- B. export conditions
- C.** factor conditions
- D. supply conditions
- E. social conditions

Porter's Diamond Model claims that four kinds of variables will have an impact on the ability of local firms in one country to utilize the country's resources to gain competitive advantage, and "factor conditions" one of the variables..

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*



71. (p. 33) Porter's Diamond Model of national advantage:

Refer To: Figure 2.2 Variables affecting competitive advantage: Porter's diamond

A. claims that the ability of local firms in a country to utilize the country's resources to gain a competitive advantage is based on demand conditions, factor conditions, substitute products, and firm strategy, structure, and rivalry.

B. links intraindustry trade to relative levels of per capita income.

C. is based on anecdotal evidence.

D. claims that the ability of local firms in a country to utilize the country's resources to gain a competitive advantage is based on entirely on supply conditions and export conditions.

E. is not affected by chance.

As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

72. (p. 34) \_\_\_\_\_ occurs primarily because of relative price differentials among nations.

A. Foreign direct investment

B. International trade

C. Portfolio investment

D. Firm Rivalry

E. Direct Investment x

International trade occurs primarily because of relative price differentials among nations.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

73. (p. 34) To sum up international trade theory, we can say that the primary reason for trade is:

- A. the increase in OPEC oil prices.
- B. governments want to accumulate money.
- C. the existence of price differentials among nations.
- D. the creation of new nations from former colonies.
- E. the existence of price similarity among nations.

To sum up international trade theory, we can say that the primary reason for trade is the existence of price similarity among nations.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

74. (p. 34) Which of the following is explained by international trade theory?

- A. Differences in production costs.
- B. Differences in levels of technology.
- C. Foreign exchange rates.
- D. Differences in efficiency of factor use.
- E. It explains differences in production costs, levels of technology, in efficiency of factor use and foreign exchange rates.

International trade theory explains differences in production costs, levels of technology, in efficiency of factor use and foreign exchange rates..

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03*

*Topic Area: Explaining trade: International trade theories*

75. (p. 34) Regarding foreign investment:

- A. it can be divided into three components: international trade, portfolio investment, and direct investment.
- B. portfolio investment involves investors who participate in the management of the firm in addition to receiving a return on their money.
- C. deals that result in the foreign investor's obtaining at least 10 percent of the shareholdings are classified as portfolio investments.
- D. it is noticed that international trade in manufactured goods will be greater between nations with similar levels of per capita income.
- E.** it can be divided into two components: portfolio investment, and direct investment.

Foreign investment can be divided into two components: portfolio investment, and direct investment.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 3 Hard*  
*Learning Objective: 02-04*  
*Topic Area: Foreign investment*

76. (p. 35) Firms from \_\_\_\_\_ had the largest total outstanding stock of direct overseas investment at the end of 2008.

- A. Germany
- B.** the United States
- C. the United Kingdom
- D. Japan
- E. China

Firms from the United States had the largest total outstanding stock of direct overseas investment at the end of 2008.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-04*  
*Topic Area: Foreign investment*

77. (p. 35) At the end of 2008, the value of the outstanding stock of foreign direct investment of all nations totaled more than:

- A. 500 billion dollars
- B. 3 trillion dollars
- C. 12 trillion dollars
- D.** 16 trillion dollars
- E. 21 trillion dollars

At the end of 2008, the value of the outstanding stock of foreign direct investment of all nations totaled more than 16 trillion dollars.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-04*  
*Topic Area: Foreign investment*

78. (p. 35) Regarding the annual outflows of foreign direct investment,

- A. the proportion that came from developing nations in 2008 was nearly double the average from those nations from 1985 to 1995.
- B. the proportion that came from the United States and Europe was nearly 50 percent.
- C.** much of the recent increase has been associated with mergers, acquisitions, and other international investments made by companies in industries facing increased competition and global consolidation.
- D. nearly half went to China and its territories from 2006 to 2008.
- E. much of the recent increase has been associated with mergers, acquisitions, and other international investments made by companies in industries facing decreased competition and global consolidation.

Much of the recent increase in the annual outflows of foreign direct investment has been associated with mergers, acquisitions, and other international investments made by companies in industries facing increased competition and global consolidation..

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-04*  
*Topic Area: Foreign investment*

79. (p. 36) Locating activities in another nation is \_\_\_\_\_.

- A. outsourcing
- B.** offshoring
- C. foreign direct investment
- D. portfolio investment
- E. national competitiveness

Locating activities in another nation is offshoring.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-04*  
*Topic Area: Foreign investment*

80. (p. 36) Offshoring is an application of:

- A.** comparative advantage.
- B. differences in taste.
- C. money market rates.
- D. exchange rate theory.
- E. annual outflows of FDI.

Offshoring is an application of comparative advantage.

*AACSB: Reflective thinking*  
*Bloom's: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-04*  
*Topic Area: Foreign investment*

81. (p. 38) Regarding annual inflows of FDI:

- A. Industrialized nations primarily invest in one another.
- B. An average of nearly 70 percent of annual FDI investments have been going into developed countries in recent years.
- C. Developed countries obtained a 70 percent increase in the level of FDI between 2000 and 2008.
- D. Industrialized nations primarily invest only in only underdeveloped countries.
- E. Industrialized nations primarily invest in one another and on an average of nearly 70 percent of the annual FDI investments have been going into developed countries in recent years.

Regarding annual inflows of FDI the industrialized nations primarily invest in one another and on an average of nearly 70 percent of the annual FDI investments have been going into developed countries in recent years.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04*

*Topic Area: Explaining trade: International trade theories*

82. (p. 39) Regarding economic and social development:

Refer To: Figure: Table 2.3 Top and bottom ranked countries on the Trade and Development Index, 2006

- A. International trade has an important role in influencing nations' economic and social performance, with this role being even more fundamental in the case of developed countries.
- B. Expansion of trade guarantees improvement for a country and its people.
- C. The Trade and Development Index attempts to provide a quantitative indication of a nation's social and economic development.
- D. The 30 highest-ranked nations in the initial Trade and Development Index were all developed countries.
- E. For the Trade and Development Index, the best regional performance among developing countries was that of the countries of the East Asia and Pacific region.

Regarding economic and social development for the Trade and Development Index, the best regional performance among developing countries was that of the countries of the East Asia and Pacific region.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-04*

*Topic Area: Are economic and social development affected by trade and investment?*

83. (p. 40) Regarding foreign direct investment and trade:

- A. Historically, foreign trade has followed foreign direct investment.
- B. Foreign trade is typically more costly and more risky than making a direct investment into foreign markets.
- C. Typically, a firm would hire sales representatives to live in overseas markets as a first step in developing international trade.
- D.** Fewer government barriers to trade, increased competition from globalizing firms, and new production and communications technology are causing many international firms to disperse the activities of their production systems to locations close to available resources.
- E. Historically, foreign trade has followed portfolio investment.

Fewer government barriers to trade, increased competition from globalizing firms, and new production and communications technology in foreign direct investment and trade are causing many international firms to disperse the activities of their production systems to locations close to available resources.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-04*

*Topic Area: Are economic and social development affected by trade and investment?*

84. (p. 41) The monopolistic advantage theory suggests that firms in oligopolistic industries are likely to \_\_\_\_\_ foreign direct investment when they have technical and other advantages over indigenous firms.

- A.** increase
- B. reduce
- C. ignore
- D. not change
- E. exceed

The monopolistic advantage theory suggests that firms in oligopolistic industries are likely to increase foreign direct investment when they have technical and other advantages over indigenous firms.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05*

*Topic Area: Explaining FDI: Theories of international investment*

85. (p. 41) The monopolistic advantage theory states that:

- A. a firm that has a monopoly has a major advantage in overseas investment.
- B. FDI is made by firms in oligopolistic industries possessing technical advantages over local companies.**
- C. a firm that has a monopoly domestically will have no competition making overseas investments.
- D. the firm making the overseas investment first has a monopolistic advantage.
- E. FDI is made by firms in monopolistic industries possessing technical advantages over local companies.

The monopolistic advantage theory states that the FDI is made by firms in oligopolistic industries possessing technical advantages over local companies.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05*

*Topic Area: Explaining FDI: Theories of international investment*

86. (p. 42) Dunning's Eclectic Theory of International Production states that if a firm is going to invest in production facilities abroad, it must have the following kinds of advantages:

- A. ownership-specific, location-specific, and internationalization.
- B. strategic, organizational, and technological.
- C. ownership-specific, location-specific, and internalization.**
- D. technological, financial, and human resource.
- E. financial, and human resource and technological.

Dunning's Eclectic Theory of International Production states that if a firm is going to invest in production facilities abroad, it must have the following kinds of advantages: ownership-specific, location-specific, and internalization.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05*

*Topic Area: Explaining FDI: Theories of international investment*



**Essay Questions**

87. (p. 28) Discuss the advantages in focusing attention on a nation that is already a sizable purchaser of goods coming from the exporter's home country.

Answers may vary, but might include the following points: focusing on a nation that is already a sizable purchaser of goods coming from a would-be exporter's country has such potential advantages as (1) the business climate in the importing nation is relatively favorable, (2) export and import regulations are not insurmountable, (3) there should be no strong cultural objections to buying that nation's goods, (4) satisfactory transportation facilities have already been established, (5) import channel members (merchants, banks, and customs brokers) are experienced in handling import shipments from the exporter's area, (6) foreign exchange to pay for the exports is available, and (7) the government of a trading partner may be applying pressure on importers to buy from countries that are good customers for that nation's exports.

Feedback: As stated directly in the text. Refer To: Figure: Table 2.2 Major trading partners of the United States, 2009

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02 Identify the direction of trade; or who trades with whom; and trends in such trade.*

*Topic Area: Major trading partners: Their relevance for managers*

88. (p. 29) Explain the logic of mercantilism and why it is generally viewed as a deficient theory.

Answers may vary, but mercantilism traditionally has been interpreted as an economic philosophy that viewed the accumulation of precious metals as an activity essential to a nation's welfare because these metals were, in the mercantilists' view, the only source of wealth. As a result, the government established economic policies that promoted exports and stifled imports, resulting in a trade surplus and protection of jobs in the mercantilist nation. Mercantilist behavior tended to be costly to groups such as consumers and some emerging industrialists, and to raise the potential for retaliatory efforts by other governments who encounter trade deficits due to the policies of the mercantilist nation.

Feedback: As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

89. (p. 30) Discuss the theory of absolute advantage and how it explains the basis for trade between nations.

Answers may vary, but the theory of absolute advantage states that a nation has absolute advantage when it can produce a larger amount of a good or service for the same amount of inputs as can another country, or when it can produce the same amount of a good or service using fewer inputs than could another country. Under conditions of free, unregulated trade, each nation should specialize in producing those goods that it could produce more efficiently, exporting some of those goods to pay for imports of goods that could be produced more efficiently elsewhere and thus enabling both nations to gain from trade.

Feedback: As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

Chapter 02 - International Trade and Investment

90. (p. 31) Discuss the keystone of international trade, the theory of comparative advantage.

Answers may vary, but the theory of comparative advantage states that a nation having absolute disadvantage in the production of two goods with respect to another nation has a comparative or relative advantage in the production of the good in which its absolute disadvantage is less. Therefore, there will be potential gains from trade even if one country is less efficient than another in the production of each of two goods (as long as it is not equally less efficient in the production of both goods).

Feedback: As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the theories that attempt to explain why certain goods are traded internationally.*

*Topic Area: Explaining trade: International trade theories*

91. (p. 43) Discuss Dunning's eclectic theory of international production as a theory to explain flows of international trade and foreign direct investment.

Answers may vary, but Dunning's eclectic theory of international production is currently the most widely cited and accepted theory for explaining FDI. The theory maintains that if a firm is going to invest in production facilities overseas, it must have three kinds of advantages: ownership specific, location specific, and internalization. The firm must have both location and ownership advantages to invest in a foreign plant. It will invest where it is most profitable to internalize its monopolistic advantage. These investments can be proactive, being strategically anticipated and controlled in advance by the firm's management team, or reactive, in response to the discovery of market imperfections.

Feedback: As stated directly in the text.

*AACSB: Reflective thinking*

*Bloom's: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05 Explain some of the theories of foreign direct investment.*

*Topic Area: Explaining FDI: Theories of international investment*