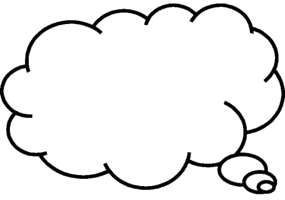
**The Role of Foreign Direct Investment – 4.5**

1. Please give examples of companies that you would consider to be ‘**multinationals**.’
2. What characteristics do these companies share?



1. Therefore, how would you **define a ‘multi-national’** company?
2. “**Foreign Direct Investment**” is a term that I.B. Economics students must be able to define. It can be broken down into three components.

 *Define investment - * *Who does it? - * *Where do they do it?*

1. Give two examples of **Foreign Direct Investment.**



1. Why was there a significant increase in **Foreign Direct Investment** during the 1990s?
2. There are several reasons why certain LEDCs have been the recipients of increasing large flows of FDIs. Complete the table below.

|  |  |
| --- | --- |
|  | Rich in natural resources |
| 1 – |
| 2 – |
| 3 - |
|  | Huge and growing markets. |
| 1 – |
| 2 – |
| 3 - |
|  | Cheap Labour  1 –  2 – |
|  | Low tax rates, lax government regulations  1 –  2 - |

List of countries

# China Morocco

**India Oman**

**Equitorial Guinea Bahrain**

**Nigeria Qatar**

# Angola Bangladesh

**Vietnam Morocco**

1. - On the diagrams below illustrate the impact that multinational activity **could have** on the economies of **Less Economically Developed Countries**.

**Capital Goods**

**Consumer Goods**

**Price Level**

**Real GDP**

 It is said that foreign direct investment by multi-nationals can “**Break crucial supply side bottlenecks in LEDC’s.**”

1. - Explain what this means by using the table below.

|  |  |
| --- | --- |
| Foreign Exchange |  |
| Taxes |  |
| Technology |  |
| Saving |  |
| Human Skills |  |

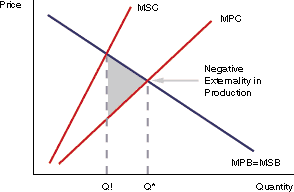
Drawbacks of foreign direct investment by multi-nationals and their presence in LEDCs.

1. What is a tax concession and how might a multi-national company gain a tax concession from a host government?
2. How might Multinational companies move profits to **avoid paying tax**?
3. Why might the presence of a multi-national company in an LDC **inhibit local enterprise**?



1. - Why do many people believe that multi-national corporations exploit the workers that they employ?
2. - Why might the presence of Multinational companies in an LEDC not be beneficial in the long-term for the nation (**think natural resources**)?
3. - What often happens to the profits of multi-national companies that are located in LEDCs?



1. – Why might the presence of a multi-national company generate negative externalities?

Multinational Companies – Transfer Pricing

A multinational corporation called Farrowtech operates in the U.S.A. and Botswana. Let us assume that the rate of corporation tax in **Botswana is 40%** and the rate in the **U.S.A. is 20%**

# Scenario A

The firm produces it products in Botswana at an average cost of

$200. It then sells the products to its own company in the

U.S.A. at a price of $400. This is the transfer price. In the U.S.A., the product is sold at a price of $500.

|  |  |
| --- | --- |
| Calculate these outcomes | |
| Profit per unit in  Botswana |  |
| Profit per unit in the  U.S.A. |  |
| Total profit per unit |  |
| Tax per unit in Botswana |  |
| Tax per unit in the  U.S.A. |  |
| Total tax per unit |  |
| After tax profit per unit |  |

# Scenario B

Farrowtech decide to change their transfer price and to sell to its company in the USA at a price of $300.

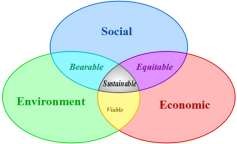
|  |  |
| --- | --- |
| Calculate these outcomes | |
| Profit per unit in Botswana |  |
| Profit per unit in the U.S.A. |  |
| Total profit per unit |  |
| Tax per unit in Botswana |  |
| Tax per unit in the U.S.A. |  |
| Total tax per unit |  |
| After tax profit per unit |  |

# Scenario C

Farrowtech now set the transfer price at $250.

|  |  |
| --- | --- |
| Calculate these outcomes | |
| Profit per unit in Botswana |  |
| Profit per unit in the U.S.A. |  |
| Total profit per unit |  |
| Tax per unit in Botswana |  |
| Tax per unit in the U.S.A. |  |
| Total tax per unit |  |
| After tax profit per unit |  |

1. What has happened to the amount of tax paid by Farrowtech as the transfer price has decreased?
2. Explain what has happened to the after tax profit per unit.
3. Explain how the transfer pricing affects the governments of Botswana and the U.S.A.

20) – Why might firms behave in an increasingly ethical manner in LEDCs?