

10. INTERNATIONAL CAPITAL MOVEMENTS

ANSWERS FOR TEST YOUR KNOWLEDGE QUESTIONS

QUESTION NO. 1

- a) **Horizontal Foreign Direct Investment:** It takes place when the investor establishes the same type of business operation in a foreign country as it operates in its home country.

EX: A cell phone service provider based in the United States moving to India to provide the same service.

- b) **Vertical Foreign Direct Investment:** It takes place when the investor establishes or acquires a business activity in a foreign country which is different from the investor's main business activity yet in some way supplements its major activity.

EX: An automobile manufacturing company may acquire an interest in a foreign company that supplies parts or raw materials required for the company.

QUESTION NO. 2

Direct investments through 'automatic route' do not need any prior approval either of the Government or of the Central Bank of a country.

QUESTION NO. 3

Typically of short term nature of foreign portfolio investments with no intention to create capital assets; tendency to often speedily shift the capital from one country to another with changes in prospects of returns.

QUESTION NO. 4

Impact of FDI have on host country employment:

Better opportunities for employment, likely to concentrate in less skill requiring jobs, possible displacement due to use of capital intensive methods

QUESTION NO. 5

Effect of FDI on technology of host country:

Possible state-of-the-art technology transfer, improvement in host country technology (may be inappropriate for a labour abundant nation). Often criticized of transferring outdated technology

QUESTION NO. 6

Effect of FDI on domestic industries:

- Unequal competition, gainfully outperforms the host country's domestic firms
- Tendency to undercut a competitive local industry,
- May even drive out domestic firms from the industry,
- Exercise a high degree of market power and exist as monopolists,
- High growth of wages in foreign corporations can influence a similar escalation in the domestic corporations,
- Decreasing competitiveness, detrimental to the long term interests.

QUESTION NO. 7

FDI would help by preventing the formation of monopolies. It is through increased competition, it decreases market power and the chance of formation of monopolies. However, foreign firms may also act as monopolists.

QUESTION NO. 8

FDIs are likely possible to reduce employment due to capital intensive technology which is inappropriate for a labour abundant country; displacement of labour if industries fail or are forced to close down

QUESTION NO. 9

Implications of FDI on domestic resource use: Better and more efficient utilization of available resources, but resources are likely to be unsustainably overexploited causing environmental damage.

QUESTION NO. 10

- i) Not FDI because less than 10 percent (which is the globally accepted criterion)
- ii) FDI since 100 percent shares are bought
- iii) Not FDI because an insignificant part of the total stake is acquired
- iv) FDI because it involves more than 10 percent of the company's shares.
- v) FDI; lending to a company in which Kora has majority stake
- vi) FDI; lending to a company in which Augusta Corp has majority stake
- vii) **Arguments by Labour in against to the entry of FDI in to the country:**
- Foreign corporates concentrate on capital-intensive methods of production - so they need to hire only relatively few workers.
 - Technology inappropriate for a labour-abundant country
 - Does not support generation of jobs or address poverty and unemployment
 - Help accentuate the already existing income inequalities
 - Jobs that require expertise and entrepreneurial skills for creative decision making may generally be retained in the home country and therefore the host country is left with routine management jobs that demand only lower levels of skills and ability.
 - The argument of possible human resource development and acquisition of new innovative skills through FDI may not be realized in reality - may resort to anti-ethical, and anticompetitive practices
 - Off -shoring, or shifting jobs – negative effects on employment potential of home country- continuance of lower labour or environmental standards
 - Ruthless labour and natural resources exploitation.
- viii) **Arguments in convincing labour or to support to the entry of FDI in to the country:**
- FDI will accelerate growth and foster economic development
 - FDI will bring in technological know-how, management skills and marketing methods
 - FDI will generate direct employment in the recipient country.
 - Subsequent FDI as well as domestic investments propelled in the downstream and upstream projects that come up in multitude of other services generate multiplier effects on employment and income.
 - FDI will generate indirect employment opportunities.
 - FDI will promote relatively higher wages for skilled jobs.
 - More indirect employment will be generated to persons in the lower- end services sector occupations thereby catering to an extent even to the less educated and unskilled engaged in those units.
 - Better work culture and higher productivity standards.
 - FDI will induce productivity related awareness and
 - FDI will also contribute to overall human resources development.

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