Problem Set 4: Movements of labor and capital between countries

1. Assume that Portugal receives an inflow of FDI. Suppose two factors (labor and capital) are used in the production in two industries (shoes and cars). Further assume that cars are capital intensive relative to shoes. Use the HO model to answer the following questions.
   a) What happens to the equilibrium output of each good?
   b) How does the wage change in terms of shoes and cars?

2. Consider the HO model for a country producing two products (digital cameras and shirts) using capital and labor.

   a) Which good would you expect to be capital intensive? Which good would you expect to be labor intensive?
   b) Suppose that foreign owners of domestic capital decide to decrease their investment. Does output in each industry increase, decrease, or stay the same? Do wages increase, decrease, or stay the same in each industry?
   c) Suppose now that there is an influx of refugees. Does output in each industry increase, decrease, or stay the same? Do wages increase, decrease, or stay the same in each industry?

3. For some low-income countries, remittances account for a larger source of income than foreign aid. Should these countries have policies to encourage emigration? Explain.

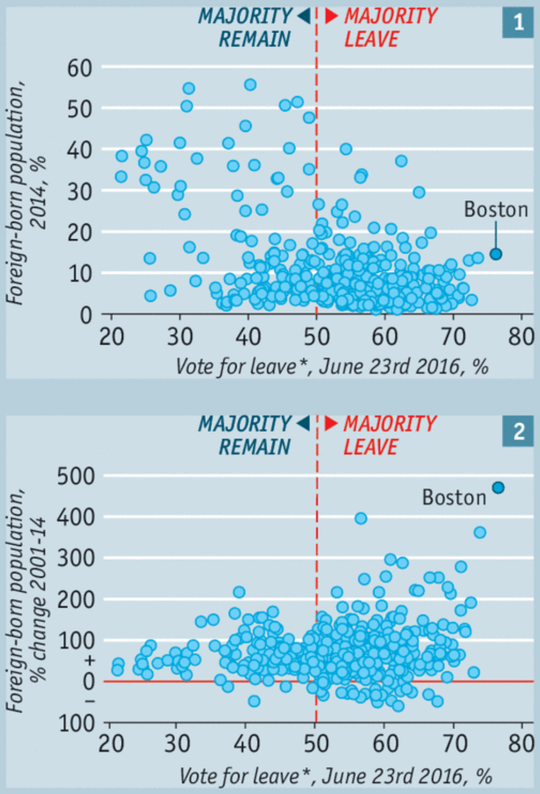
4. Only developing countries compete for FDI. Comment.

5. Which policy options do countries have to promote inward FDI flows? Which are more likely to be effective? Explain.

6. Consider the figure below. How can you rationalize the evidence presented there? Does economic theory and empirical evidence support negative attitudes towards immigration in some high-income countries? Explain.

Poles apart

Britain's EU referendum results



Sources: Electoral Commission; ONS

*By local authority area