Case Discussion Questions

1. What factors underlay the decision by Volkswagen to invest directly in automobile production in Russia? Why was FDI preferable to exporting from existing factories in Germany?
2. Which theory (or theories) of FDI best explain Volkswagen's FDI in Russia?
3. How do you think FDI by foreign automobile companies might benefit the Russian economy? Is there any potential downside to Russia from this inflow of FDI?
4. Russia is largely dependent on oil exports to drive its economy forward. Given the sharp fall in global oil prices that occurred in 2014 and 2015, what impact do you think this will have on FDI into Russia?
5. Volkswagen has signaled that it is going to stay the course in Russia, despite current political and economic headwinds. Why do you think it made this decision? What are the pros and cons of this decision? In your opinion, is it the correct decision?

The NAFTA Tomato Wars

When the North America Free Trade Agreement (NAFTA) went into effect in December 1992 and tariffs on imported tomatoes were dropped, U.S. tomato producers in Florida feared that they would lose business to lower-cost producers in Mexico. So they lobbied the government to set a minimum floor price for tomatoes imported from Mexico. The idea was to stop Mexican producers from cutting prices below the floor to gain share in the U.S. market. In 1996, the United States and Mexico agreed on a basic floor price of 21.69 cents a pound.

At the time, both sides declared themselves to be happy with the deal. As it turns out, the deal didn't offer much protection for U.S. tomato growers. In 1992, the year before NAFTA was passed, Mexican producers exported 800 million pounds of tomatoes to the United States. By 2011, they were exporting 2.8 billion pounds of tomatoes, an increase of 3.5-fold. The value of Mexican tomato exports almost tripled over the same period, to $2 billion. In contrast, tomato production in Florida has fallen by 41 percent since NAFTA went into effect. Florida growers complained that they could not compete against low wages and lax environmental oversight in Mexico. They also alleged that Mexican growers were dumping tomatoes in the U.S. market at below the cost of production, with the goal of driving U.S. producers out of business.

In 2012, Florida growers petitioned the U.S. Department of Commerce to scrap the 1996 minimum price agreement, which would then free them up to file an antidumping case against Mexican producers. In September 2012, the Commerce Department announced a preliminary decision to scrap the agreement. At first glance, it looked as if the Florida growers were going to get their way. It soon became apparent, however, that the situation was more complex than appeared at first glance. More than 370 business and trade groups in the United States—from small family-run importers to meat and vegetable producers and Wal-Mart Stores—wrote or signed letters to the Commerce Department in favor of continuing the 1996 agreement.

Among the letter writers was Kevin Ahern, the CEO of Ahern Agribusiness in San Diego. His company sells about $20 million a year in tomato seeds and transplants to Mexican farmers. In a letter sent to *The New York Times,* Ahern noted that "yes, Mexico produces their tomatoes on average at a lower cost than Florida; that's what we call competitive advantage." Without the agreement Ahern claimed that his business would suffer. Another U.S. company, NatureSweet Ltd., grows cherry and grape tomatoes under 1,200 acres of greenhouses in Mexico for the American market. It employs 5,000 people, although all but 100 work in Mexico. The CEO, Bryant Ambelang, said that his company couldn't survive without NAFTA. In his view, Mexican-grown tomatoes were more competitive because of lower labor costs, good weather, and more than a decade of investment in greenhouse technology. In a similar vein, Scott DeFife, a representative of the U.S. National Restaurant Association, stated, "people want tomato-based dishes all the time. . . . You plan over the course of the year where you are going to get your supply in the winter, spring, fall." Without tomatoes from Mexico, a winter freeze in Florida, for example, would send prices shooting up, he said.

Faced with a potential backlash from U.S. importers, and from U.S. producers with interests in Mexico, the Commerce Department pulled back from its initial conclusion that the agreement should be scrapped. Instead, in early 2013, it reached an agreement with Mexican growers to raise the minimum floor price from 21.69 cents a pound to 31 cents a pound. The new agreement also established even higher prices for specialty tomatoes and tomatoes grown in controlled environments. This was clearly aimed at Mexican growers, who have invested billions to grow tomatoes in greenhouses. Florida tomatoes are largely picked green and treated with gas to change their color.

Sources

E. Malkin, "Mexico Finds Unlikely Allies in Trade Fight," *The New York Times*, December 25, 2012, p. B1; S. Strom, "United States and Mexico Reach Tomato Deal, Averting a Trade War," *The New York Times*, February 3, 2013; J. Margolis, "NAFTA 20 Years After: Florida's Tomato Growers Struggling," *The World*, December 1, 2012.

Case Discussion Questions

1. Was the establishment of a minimum floor price for tomatoes consistent with the free trade principles enshrined in the NAFTA agreement?
2. Why, despite the establishment of a minimum floor price, have imports from Mexico grown over the years?
3. Who benefits from the importation of tomatoes grown in Mexico? Who suffers?
4. Do you think that Mexican producers were dumping tomatoes in the United States?
5. Was the Commerce Department right to establish a new minimum floor price rather than scrap the agreement and file an antidumping suit? Who would have benefited from an antidumping suit against Mexican tomato producers? Who would have suffered?
6. What do you think will be the impact of the new higher floor price? Who benefits from the higher floor price? Who suffers?
7. What do you think is the optimal government policy response here? Explain your answer.

Subaru's Sales Boom Thanks to the Weaker Yen

For the Japanese carmaker Subaru, a sharp fall in the value of the yen against the U.S. dollar has turned a problem—the lack of U.S. production—into an unexpected sales boom. Subaru, which is a niche player in the global auto industry, has long bucked the trend among its Japanese rivals of establishing significant manufacturing facilities in the North American market. Instead, the company has chosen to concentrate most of its manufacturing in Japan in order to achieve economies of scale at its home plants, exporting its production to the United States. Subaru still makes 80 percent of its vehicles at home, compared with 21 percent for Honda.

Back in 2012, this strategy was viewed as something of a liability. In those days, 1 U.S. dollar bought only 80 Japanese yen. The strong yen meant that Subaru cars were being priced out of the U.S. market. Japanese companies like Honda and Toyota, which had substantial production in the United States, gained business at Subaru's expense. But from 2012 onward, with Japan mired in recession and consumer prices falling, the country's central bank repeatedly cut interest rates in an attempt to stimulate the economy. As interest rates fell in Japan, investors moved money out of the country, selling yen and buying the U.S. dollar. They used those dollars to invest in U.S. stocks and bonds, where they anticipated a greater return. As a consequence, the price of yen in terms of dollars fell. By December 2015, 1 dollar bought 120 yen, representing a 50 percent fall in the value of the yen against the U.S. dollar since 2012.

For Subaru, the depreciation in the value of the yen has given it a pricing advantage and driven a sales boom. Demand for Subaru cars in the United States has been so strong that the automaker has been struggling to keep up. The profits of Subaru's parent company, Fuji Heavy Industries, have surged. In February 2015, Fuji announced that it would earn record operating profits of around ¥410 billion ($3.5 billion U.S.) for the financial year ending March 2015. Subaru's profit margin has increased to 14.4 percent, compared with 5.6 percent for Honda, a company that is heavily dependent on U.S. production. The good times continued in 2015, with Subaru posting record profits in the quarter ending December 31, 2015.

Despite its current pricing advantage, Subaru is moving to increase its U.S. production. It plans to expand its sole plant in the United States, in Indiana, by March 2017, with a goal of making 310,000 a year, up from 200,000 currently. When asked why it is doing this, Subaru's management notes that the yen will not stay weak against the dollar forever, and it is wise to expand local production as a hedge against future increases in the value of the yen. Indeed, when the Bank of Japan decided to set a key interest rate below zero in early February 2016, the yen started to appreciate against the U.S. dollar, presumably on expectations that negative interest rates would finally help stimulate Japan's sluggish economy. By late March 2016, the yen had appreciated against the dollar and was trading at $1 = ¥112.

Sources

Chang-Ran Kim, "Subaru-Maker, Fuji Heavy Lifts Profit View on Rosy US Sales, Weak Yen," *Reuters*, February 3, 2015; Yoko Kubota, "Why Subaru's Profit Is Surging," *The Wall Street Journal*, November 14, 2014; Doron Levin, "Subaru Profit Soaring on Weaker Yen," *Market Watch*, November 15, 2014; Y. Kubato, "Weaker Yen Drives Subaru Maker's Profit Higher," *The Wall Street Journal*, February 4, 2016.