ASK AN ECONOMIST

Silvio Contessi has been an economist in the Research division of the Federal Reserve Bank of St. Louis since 2007. His main expertise is international economics with a focus on multinational firms and international factors movement. Recently, Contessi also has studied the behavior of commercial banks during the financial crisis. In his free time, he enjoys unwinding at the gym and in the park, playing guitar and sand volleyball, and chilling at the pool. For more on his work, see http://research.stlouisfed.org/econ/contessi.

Why would a firm want to become a multinational?

Let's be clear about what we mean by a multinational. This is a firm that extends beyond the borders of an individual nation and operates with affiliates and branches in at least two countries. A multinational organizes phases for producing goods and services to sell in different countries. For example, many car companies have mastered the so-called international segmentation of production, which works like this: A Toyota vehicle assembled in San Antonio may have been designed at the Toyota design center in Australia; the vehicle's aluminum-wheel components may have been produced in Delta, British Columbia; and its other components may have been produced in yet another location.

Other multinationals replicate entire production processes in different countries. Consider Coca-Cola. If you are visiting Poland, the Coke you drink probably was produced in a plant in Lodz, Poland, not in the United States, although the brand and the company hail from the U.S.

International business scholars and economists have observed that firms become multinationals to exploit three broadly defined sets of advantages. The first is ownership advantage. Multinational firms usually develop and own proprietary technology (the Coca-Cola formula is patented and kept extremely secret) or widely recognized brands (such as Ferrari) that other competitors cannot use. Multinationals often are technological leaders and invest heavily in developing new products, processes and brands, while usually keeping them confidential and protected by intellectual property rights. Maintaining stronger protection of these elements helps firms enjoy greater profits from innovation.

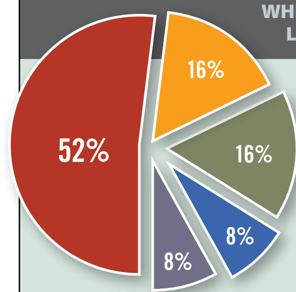
Second, consider localization advantage. Multinationals usually try to build facilities that produce and sell their products in locations near the consumer (the Polish consumers of Coke in our example). This helps reduce transportation costs or helps the company fit in better with local tastes and needs. Proximity to demand also helps firms adapt their products and services to different markets. At the same time, they also may take advantage of lower production costs (for example, labor costs, energy, sometimes even lower environmental standards) or more abundant production factors, such as expert engineering or greater raw materials). For example, the Polish affiliate of Coca-Cola also owns bottling plants in the Beskidy Mountains region of Poland, which is rich in mineral water for making other beverages.

Finally, multinationals want to internalize the benefits from owning a particular technology, brand, expertise or patents that they find too risky or unprofitable to rent or license to other firms. Enforcing international contracts can be costly or ineffective in countries in which the rule of law is weak and court procedures are long and inefficient. In these cases, the company also may risk losing its ownership advantage, which it has created at a substantial cost.

FED FLASH POLL RESULTS

Whenever a new issue of *The Regional Economist* is published, a new poll is posted on our web site. The poll question is always pegged to an article in that quarter's issue. Here are the results of the poll that went with the July issue. The question stemmed from the article "Digging into the Infrastructure Debate."

WHICH OF THESE COMES CLOSEST TO YOUR LIST OF INFRASTRUCTURE PRIORITIES?



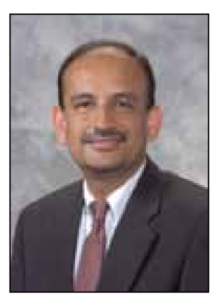
THIS ISSUE'S POLL QUESTION:

How has the threat of terrorism affected the way that your company does business?

1. It has had no effect at all.
2. We keep up to date with the latest news on terrorism threats.
3. We are branching out only to areas with low threat levels.
4. We've had unpredictable disruptions in our supply chain due to terrorism threats.
5. Our company specializes in products designed to combat terrorism.

After reading "Increasing Political Freedom May Be Key To Reducing Threats," go to www.stlouisfed.org to vote. Anyone can vote, but please do so only once. (This is not a scientific poll.)

NEW EDITOR



The Regional Economist has a new editor, Subhayu Bandyopadhyay, an economist in the Research division of the Federal Reserve Bank of St. Louis. Bandyopadhyay joined the Bank in 2007, but had been a visiting scholar at the Bank on multiple occasions earlier this decade. Bandyopadhyay has taught at West Virginia University and the University of Maryland. He has also been a visiting professor at the University of the Andes, in Bogota, Colombia, and a research fellow and visiting scholar at the Institute for the Study of Labor in Bonn, Germany. He has a Ph.D. in economics from the University of Maryland; a master's in economics from the Jawaharlal Nehru University in New Delhi, India; and a bachelor's in economics from Calcutta University, India. A native of India, he has lived in the United States since 1987 and is a U.S. citizen. Bandyopadhyay's research interests include international trade, development economics and applied microeconomics. Bandyopadhyay succeeds Michael Pakko, who left the Bank to become the chief economist and state economic forecaster at the Institute for Economic Advancement at the University of Arkansas at Little Rock.