The Employment Effects of FDIs

The mere existence of resources in a country is no guarantee they will contribute to output. Multinational enterprises (MNEs) may enable idle resources to be used. Oil production for instance, requires not only the presence of underground deposits but also the knowledge of how to find them and the capital equipment to bring the oil to the surface. Production is useless without markets and transportation facilities, which an international investor may be able to supply. Access to foreign markets, particularly the investor's home market, may be particularly important to developing countries that lack the knowledge and resources necessary to sell there. Additionally, another less tangible aspect of Foreign Direct Investment (FDI) is greater resource utilization. Through exposure to new consumer products, the local labor force may develop new wants, which could encourage them to work longer and harder to acquire the additional goods and services.

MNEs' upgrading of resources may be brought about through educating local personnel to utilize equipment, technology, and modern production methods. Even such seemingly minor programs as those promoting on-the-job safety may result in a reduction of lost worker time and machine downtime. The transference of work skills increases efficiency, thereby freeing time for other activities. Further, additional competition may force existing companies to become more efficient.

Some trade unions have claimed that there are examples of MNEs making investments, which domestic companies otherwise would have undertaken. The result may be the displacement of local entrepreneurs and entrepreneurial drive or the bidding up of prices without additional output. Such trade unions argue, for example, that by their ability to raise funds in various countries, MNEs can reduce their capital cost relative to that of local companies and apply the savings either to attract the best personnel or to entice customers from competitors through greater promotional efforts. However, evidence for these arguments is inconclusive. MNEs frequently do pay higher salaries and spend more on promotion than local companies do, but it is uncertain whether these differences result from external advantages or represent required added costs of attracting workers and customers when entering new markets. Added compensation and promotion costs may negate any external cuts advantages obtained from access to cheaper foreign capital. Additionally, in many instances, the local competition also has access to that cheaper capital.

Trade unions also contend that FDI destroys local entrepreneurial drive, which has an important effect on development. Since the expectation of success is necessary for the inauguration of entrepreneurial activity, the collapse of small cottage industries in the face of MNEs consolidation efforts may make the local population feel incapable of competing. However, the presence of MNEs sometimes may increase the number of local companies in host-countries markets since MNEs serve as a role model that local talent can emulate. Further, an MNE often buy many services, goods, and supplies locally and thus may stimulate local entrepreneurship. For example, automobile producers typically add less than half the value of an automobile at the factory, buying the remaining parts, subassemblies, and modules from suppliers. In fact, true entrepreneurs will find areas in which to compete; consequently, in any country there are success stories that can be emulated.

Another argument trade-unions use is that investors have access to high technology abroad that may use later in their home-countries. This access may prevent original developers from maintaining proprietary advantages. It may also prevent production from remaining in the country where the innovation is originated as the product moves through its life cycle. Taking advantage of the host-country's progress may result for MNEs in developing competitive capabilities in their home-countries that are based in foreign scientific and technical investments.

Moreover, trade unions observe that MNEs absorb local capital, either by borrowing locally or by receiving investment incentives. This raises the local cost of funds and/or makes insufficient funds available to local companies. Subsidiaries have borrowed heavily in local markets and have exploited investment incentives. For example, more than 53 percent of the value of assets owned abroad by U.S. companies is financed by foreign debt. The link to the ability of local companies to finance expansion is unclear. For MNEs to have a noticeable effect on capital availability in a country, the amount of funds diverted to those investors would have to be larger in relation to the size of the capital market than is probably the case. Further, few MNEs acquire all resources locally; the additional resources brought in usually should yield a gain for the economy.

Host-countries at times have not only prohibited the entry of MNEs believed to inhibit local companies, but also restricted local borrowing by MNEs and provided incentives for them to locate in depressed areas in which resources are idle rather than scarce.

Concluding, of particular concern to many countries is the foreign purchase of local companies. The employment effects continue to be debated because of assumptions about what would have happened had the acquisition not taken place, particularly when it involves a company that is not doing well and is subsequently downsized. It is thus impossible to say for certain whether there was more or less employment because of the acquisition. For these reasons, the employment effects of FDIs have been evaluated as both negative and positive.

About the Author

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