THE FOREIGN DIRECT INVESTMENTS AND THE LABOUR MARKETS FROM DEVELOPING COUNTRIES

Laura Diaconu (Maxim)
Department of Economics and International Relations
Faculty of Economics and Business Administration
"Alexandru Ioan Cuza" University of Iasi, Romania
lauradiaconu_07@yahoo.com

Abstract: *At a first glance, the impact of the foreign direct investments (FDI) on the labour force of the host country may seem very clear and obvious. However, the complexity of the consequences results from the fact that they can be both direct and easily noticeable, and indirect, case in which they are difficult to predict and analyse. The aim of the present paper is to analyse the direct and indirect effects of the FDI on the labour markets from the developing countries, particularly on employment and on wages. In order to achieve this objective, we have conducted an analysis of the secondary data offered by the specialized literature. These secondary sources included various reports and empirical investigations. The study starts from the hypothesis that, in general, the presence of the multinational companies in a developing country determines an unemployment reduction and a wage increase. This hypothesis is only partially confirmed by the empirical results which show that these assumptions are true only under certain circumstances. Regarding the direct impact of the FDI on the employment, the examples offered by the countries analysed in the study allow us to notice that these investments lead to a higher employment level if each country directs the investments' inflow to certain industries, based on their labour market needs. The indirect impact of the FDI on employment should be, in general, a positive one, taking into account the multinationals' relations with the local suppliers, subcontractors, service providers or distributors. However, there are also exceptions, such as Vietnam. From the point of view of the salaries, the conclusions of the study underline that the multinationals pay higher average wages compared to the local firms only to the extent to which they employ a more skilled workforce compared to the local firms or if they have to compensate workers for some undesirable characteristics of the jobs. Regarding the indirect impact of the FDI on wages, considered from the point of view of the consequences of these investments on the local firms' salaries, the empirical evidences show divergent results.*

Keywords: foreign direct investments; labour markets; employment; wages; developing countries.

JEL classification: F23; J21; J31.

1. Introduction

At a first glance, the impact of the foreign direct investments (FDI) on the local labour force may seem very clear and obvious. It is known that multinationals, by opening new subsidiaries or through the modernization of the existing firms (by introducing new technologies), will need to employ people and the paid wages will be higher than in the local firm, usually because they want to attract the most qualified workforce available. However, the effects of the FDI on the host economy are much more complex and diverse.

The effects can be both direct and easily noticeable, and indirect, case in which they are difficult to predict and analyse. In a classification made by UNCTAD (1994), which takes into account the FDI impact area, the effects can be quantitative, qualitative and locational (see Table 1). The quantitative effects reflect the number of jobs created or substituted in the investment process, the qualitative ones are focused both on the wage evolution and on the practices drawn from the organizational framework of the investing firm and the locational effects refer to the location of subsidiaries created through FDI. Some specialists consider that the analysis of the FDI impact should be focused both on the direct consequences and on the indirect effects regarding the job creation and the level of the wages, including the skills acquired by local employees (Bhagwati, 2007). This approach presents a particular importance, taking into account the leading role of labour in promoting the economic development.

Table 1: Consequences of the FDI on the local labour markets

	Type of effects			
	Direct		**Indirect**	
Impact area	***Positive***	***Negative***	***Positive***	***Negative***
Quantity	New jobs in growing industries	M&A may lead to rationalization and job losses	New jobs upstream and downstream	Substituting some local raw materials through imports
Quality	Higher salaries and increased productivity	Misleading tactics on employment or promotion	Dissemination of the organizational practices to the domestic firms	Decrease in the wages of the local firms due to multinationals' competition
Location	New jobs in the areas with high unemployment	Agglomerations in congested urban areas	Encourage suppliers moving to areas with higher labour availability	Substitute local producers with imported materials

Source: adapted from UNCTAD, 1994, "Transnational Corporations, Employment and the Workplace", *World Investment Report,* p. 167, http://unctad.org/en/Docs/wir1994_en.pdf

Some FDI are mainly determined by the quality and the cost of the labour force. For example, the investors mainly focused on the intensive usage of the local resources in order to increase the efficiency will be more attracted by those markets which offer them skilled workers at low wages. On contrary, the investors mainly focused on the intensive usage of the local markets will pay less attention to the costs and educational background of the potential employees. Another major difference between the two types of investors with a direct impact on the labour market is related to the job stability. Thus, in the context of the FDI's positive impact on the economic development of the host country, the costs may increase and, therefore, the investors attracted especially by these advantages may relocate their production. Meanwhile, those investors for which the low costs are not a main determinant will continue the activities in the host country.
Considering all these differences, the present paper intends to analyse both the direct and indirect effects of the FDI on the labour markets of the developing countries from two points of view: the consequences on the employment and on the wages. In order to achieve this objective, we have conducted an analysis of the secondary data offered by the specialized literature. These secondary sources included various reports and empirical investigations.
The present study starts from the hypothesis that, in general, the presence of the multinational companies in a developing country determines an unemployment reduction and, on average, a wage increase. The two major investigation directions are presented in the following parts of the paper.

2. Direct and indirect effects of the FDI on the employment in the developing states

One of the most important roles of the foreign investments is their ability to influence the unemployment of the host country. The impact of the FDI on the labour force results from the entry mode of the multinationals: undertaking the local firms through Merges & Acquisitions (M&A) or Greenfield investments. In the first case, the takeover of domestic companies (which were eventually privatized), following restructuring programs, usually leads to layoffs, generating, on short term, the increase of the unemployment and of the competition on the labour market. The Greenfield investments generate new jobs and the wages are higher than those offered by similar national firms, allowing the employment of some well-trained specialists and, therefore, increasing the labour productivity (Bhagwati, 2007). In certain circumstances, M&A can bring some short-term benefits, for example when the alternative would be closing a certain local company (UNCTAD, 2012). According to a report conducted by UNCTAD (2012), M&A are followed by some investments similar to the Greenfield ones. This is why the different impact of the two entry modes usually disappears during time. The job losses under privatization are considered to be an insignificant disadvantage if the restructured enterprises are efficient and competitive. Moreover, apart from the jobs created inside the multinationals' subsidiaries, these firms can generate new jobs through the upstream or downstream activities because their suppliers, subcontractors and service providers will also increase the number of the employees. Actually, at the global level, it is estimated that in the 1990s the number of jobs indirectly generated in the manufacturing sector is up to two times higher than those created by the subsidiaries of the multinationals' (UNCTAD, 1999). Analysing the situation of the developing Ireland from 1952-1974, Barry (1999) shows that the upstream connections of the multinationals have generated more jobs than the same connections of the local firms. However, the situation of Vietnam is different. In this country, the investing firms tend to import a large part of the inputs and have fewer connections with the local firms (Jenkins, 2006). Moreover, due to the increased competition generated by the foreign

firms, the less profitable state companies have to reduce the personnel, fact that might increase the unemployment.
According to Ernst (2005), during the 1990s, the FDI inflows in Argentina and Brazil had only a minimal contribution to the reduction of the unemployment in these countries. The main cause was related to the fact that most of them were not made in new production activities. FDI in services were especially through M&A, such as privatization of the utility companies or restructuring the banking system, using existing productive assets instead of establishing new ones. There were also disappointing results in the secondary sector, where the economic liberalization has led to the increase in the competition and to the usage of the restructuring strategies, which typically involve rising the unemployment. However, opposite impact was found in Mexico, where the FDI inflows in manufacturing have significantly reduced the unemployment through the emergence of the "maquiladora" firms (Ernst, 2005). These factories, established through a governmental program aimed to reduce the unemployment, were very attractive for the US firms especially due to the cheap labour force of Mexico. The maquiladoras usually imported certain materials and equipment on a tariff-free basis and then they exported the manufactured products, sometimes back to the origin country of the raw materials. However, the comparative advantage of this type of production was reduced. This aspect could explain the fact that, after 2000, the FDI inflows to Mexico have diminished, which led to an increase in the unemployment.
These results could be explained with the help of the arguments offered by Lall (1995) who considers that FDI inflows leads to a higher employment level if each country directs the investments' inflow to certain industries, based on their labour needs. This idea seems to have been taken into account by the Caribbean countries where, according to Craigwell (2006), these investments were mainly directed towards tourism, to the mining and manufacturing industries. The results were as expected: an increase in FDI in the entire sample of the states has led to an approximate one-to-one increase in employment (Craigwell, 2006). Fazekas (2005), analysing the labour market's situation in Hungary, notes that the Greenfield investments has significantly contributed on the increase in the employment rate, especially after 2000. The same conclusion was underlined by Hamar (1999), who revealed that, in the Hungarian regions that attracted most of the FDI, the concentration of the jobs offered by the multinationals was much higher than the concentration of the working age population and higher than the concentration of the domestic firms' employees. However, as mentioned by Fazekas (2000), from the point of view of the M&A that took place in the context of the privatization of state companies in Hungary, the results were not as expected: only in half of the analysed companies the number of employees has increased.
In the case of the Sub-Saharan African states, an empirical study conducted between 1991 and 2011 by Mayom (2015) presents the positive and significant impact of the FDI on the employment of these countries. Using the Ordinary Least Square regression estimator on a sample of 48 states, Mayom (2015) finds out that increasing the FDI inflows into the Sub-Saharan African countries is associated with a significant increase in employment ratio for both youth and mature population. Taking the case of Nigeria, Inekwe (2013) analyses the sectoral data for the period 1990-2009 in order to determine the impact of FDI on employment. His conclusions are that, while in the manufacturing sector, FDI positively correlates with the employment, in the service sector there is a negative relationship between these investments and the employment.
One of the best examples regarding the positive impact of the FDI on job creation is brought by China. Using data regarding the FDI attracted by this country on different categories of manufacturing firms between 1998 and 2004, Karlsson et al (2009) argue

that this significant impact of the foreign investments on the local employment is due to the favourable firms' characteristics, such as high capital intensities and productivity, and to the relatively high survival rate of the foreign-owned firms.

3. The impact of the FDI on the wages in the host developing states

Creating new jobs is one of the positive effects generated by the Greenfield investments. However, the specialized literature notes that not the quantity, but the quality of the jobs created through FDI are important in assessing the global impact of these investments on a market (Iacovoiu, 2009).

From the qualitative point of view, it is considered that, in general, the multinationals' employees have higher salaries than the employees of the domestic firms (the exceptions being in the case of those subsidiaries of the labour intensive sectors, usually located in the free areas) and they have also better work conditions, even in the developing countries. These aspects are a result of the increased productivity of the multinationals, due to the greater technological know-how and modern management practices that allows them to efficiently compete in foreign markets. Yet, there are also a few studies which consider that the multinationals pay higher average wages only to the extent that they employ a more skilled workforce compared to the local firms or if they have to compensate workers for some undesirable characteristics of the jobs (OECD, 2008a).

However, a large number of other studies indicate the fact that the multinationals pay higher salaries than the local companies, fact that can be explained through several reasons.

One of the reasons might be that the companies are trying to maintain the employees' loyalty, in order to avoid the technological knowledge leakage (Fosfuri, Motta and Ronde, 2001). Moreover, in the context in which most of the employees benefit from various trainings, the companies are motivated to increase their salaries than to permanently rotate their personnel. The income differences between the multinationals and the domestic firms may also be explained through the fact that the first ones usually offer more complex jobs, which require a more intensive work (Fabri, Haskel and Slaughter, 2003) and longer working hours (OECD, 2008b), or through the fact that the competition generated by the multinationals leads to the closure of some national companies (Bernard and Sjöholm, 2003). Another reason of the high wages of the multinationals' subsidiaries is that these firms act in dynamic sectors, with high labour productivity. A study conducted by OECD (2008a) shows that the differences in the labour productivity between the multinationals and the domestic firms are statistically significant for all the analysed regions: Africa, Asia, Latin America and Middle East.

A study conducted by Te Velde and Morrissey (2004) on 5 states of Africa concludes that, in the beginning of the 1990s, in the manufacturing sector, the wages of the multinationals' employees have been with 20 to 37% higher than the wages of the employees of the domestic firms. Yet, when taking into account some control variables related to multinationals' particularities (such as firms' dimension, types of industry, location), the wages' differences considerable diminishes to 8 to 23%. However, these results have to be analysed by taking into account the fact that the multinationals attract, on average, better educated labour force than the national firms.

The results of an empirical investigation conducted by Blomström (1983) in Mexico in the beginning of the 1980s show that the salaries paid by the foreign firms are with 25-30% higher than those offered by the local firms, with the exception of the companies producing capital goods, for which the difference is smaller. The explanation for the higher wages in the multinationals is offered by Feenstra and Hanson (1997). They notice that the FDI have

led to an increased demand for the skilled labour in Mexico in the 1980s, thereby increasing the wages of this category of workers. In the 1990s, the results of a more comprehensive study, including not only Mexico but also USA and Venezuela, show the same positive connection between the FDI and the wages of the multinationals' workers (Aitken, Harrison and Lipsey, 1996). The conclusions of this study have also highlighted the fact that the development level of a country is not important in determining the role played by the FDI in the wages' increase in that state. However, the development level is important when considering the knowledge spillover effects towards the local firms. While in a developed country such as USA the spillover effect takes place, in less developed states such as Mexico or Venezuela this does not occur (Aitken, Harrison and Lipsey, 1996). A more recent study published by Bircan in 2013 shows that this spillover effect can also take place in a developing country. Taking the example of Turkey, his study indicates that greater foreign equity participation leads to greater transfer of both tangible and intangible assets. Moreover, he finds out that there is a 15% difference between the multinationals' average wages and the salaries of the local firms, the highest difference being in the case of the skilled workers (Bircan, 2013).

A more evident impact of the FDI on the local wages is underlined by Haddad and Harrison (1993), in the case of Morocco, where the multinationals offered salaries with approximately 70% higher than the local firms in the 1990s.

In the case of the Central and Eastern European states, a cross-country analysis conducted between 2000 and 2004 and based on one-digit level panel data for the manufacturing industry in the Czech Republic, Slovenia, Slovakia, Poland and Hungary revealed that FDI inflows have a positive effect on wages only in the capital and skill intensive sectors: a 10 %-point increase in the FDI stock/output ratio leads to a 1.1%-point real wage growth (Onaran and Stockhammer, 2008). The conclusions of this study were representative for all the analysed countries if we consider that the manufacturing industry is accounting for 20-28% of the employment and in each state this sector is attracting almost half of the FDI inflows. Faggio (2001) underlines that in Poland, Bulgaria and Romania, despite different economic conditions and levels of development, higher levels of FDI are associated with higher manufacturing wages. In the case of Poland, the same conclusion was reached by Bedi and Cielik (2002). Moreover, Faggio (2001) find out that the multinationals' activity in Poland also influences the domestic firms, leading to positive wage increases: a 1% increase in local FDI is associated with a 1.3% increase in domestic firms' wages. The opposite situation occurred in Venezuela, where the presence of the multinationals led to average lower incomes in the local firms (Aitken, Harrison and Lipsey, 1996). This situation is explained by Aitken, Harrison and Lipsey (1996) through the fact that the multinationals have acquired the most profitable local firms and they have also attracted the most qualified workers from the local enterprises.

In the case of Indonesia, the hypothesis of the high wages in the multinational firms is confirmed by Hill (1990) and Manning (1998). Starting from their results, Lipsey and Sjöholm (2003) have analysed if the high wages from the multinationals are a results of the fact that these firms have selectively invested through the M&A process in the best available options. Their conclusion is that the multinational firms tend to acquire larger companies where the wages are already above the average level. Following the acquisition, these wages considerably increase.

The multinationals' wage level and job offer have a particular importance when talking about migration. It can be argued that at a high rate of foreign investments, the net migration rate should record positive values, because the FDI generates new jobs and motives the workers with higher salaries. According to the human capital theories, the more skilled workers are in a developing country, the more multinationals will enter that

state. In this way the so-called brain drain phenomenon might be reduced. However, if the skilled labour emigrates to more developed states in search of better work conditions, this will determine a reduced economic competitiveness of that country and a diminish in the FDI inflows. Considering these aspects, we may notice that it is important for a developing country to attract the multinational companies in the right moment in order to avoid the skilled labour migration.

4. Conclusions

Taking into account all the aspects mentioned before, we may say that the hypothesis launched in the beginning of this study is only partially supported by the empirical evidences, only under certain circumstances.

Regarding the direct impact of the FDI on the employment, the examples offered by various countries that were taken into account allow us to notice that these investments lead to a higher employment level if each country directs the investments' inflow to certain industries, based on their labour market needs. Related to this aspect, the entry mode of the multinationals is also very important. The examples brought by Argentina and Brazil show that M&A may have almost no impact on the employment compared to the Greenfield investments. Apart from these situations, in order to have a positive impact on the employment, the multinationals have to offer more jobs in a market than those lost due to the closure of some local firms which could not survive the competition.

Generally, the indirect impact of the FDI on employment should be a positive one, taking into account the multinationals' relations with the local suppliers, subcontractors, service providers or distributors. However, there are also exceptions, such as Vietnam, when the foreign companies do not use these services from the local firms and thus there is no indirect impact of the multinationals on the employment.

Another conclusion of this study refers to the fact that, the multinationals pay higher average wages compared to the local firms only to the extent to which they employ a more skilled workforce compared to the local firms or if they have to compensate workers for some undesirable characteristics of the jobs. The fact that the multinational's salaries are higher than the local companies particularly in the skilled intensive sectors was proven by various developing states, such as those from the Central and Eastern Europe, some African countries and Mexico.

The indirect impact of the FDI on wages may be considered from the point of view of the consequences of these investments on the local firms' salaries. The empirical researches offer divergent results. There are cases when the presence of the multinationals positively influences the local firms' salaries, but there are also examples of states where the wages in the domestic firms have diminished after the entrance of the foreign companies on that market. These last situations can also be explained through the fact that the multinationals usually attract the most qualified workers from the local enterprises, offering them higher salaries and generating a decrease in the wages of the local companies.

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