




Opinions

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The Heterogeneous Effects of Outward FDI on Domestic Employment



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Over the past few decades, for multi-national enterprises (MNEs), the strategy of using outward foreign direct investment (OFDI) for seeking better business opportunities has played an important role in increasing their production efficiency and overseas sales. Nevertheless, an increase in OFDI has raised widespread public concerns about the possibility of domestic job losses because OFDI could transfer certain domestic production activities to foreign affiliates, so that some domestic workers are replaced with foreign labor. With rising concerns over job displacement, a number of researchers have examined a relationship between OFDI and employment of a source country. Unfortunately, these studies have produced mixed results and there still remain many controversies and unanswered questions regarding the employment effect of OFDI. It turns out that the employment effect of OFDI in a source country depends on the type of overseas investment (for example, efficiency-seeking, market-seeking, export-platform-seeking, technology-seeking), workers' skill level (low-, medium- or high-skilled) and employment status (permanent or temporary).



As is well known, OFDI has two opposite effects on domestic employment: scale effect versus substitution effect. Scale effect is associated with an increase in domestic employment as a result of improving market access (horizontal FDI) and efficient resource allocation (vertical FDI) across multiple nations. OFDI can have a negative effect on domestic employment, through substitution effect, since some domestic workers previously employed by the MNEs' parent firms are replaced by foreign labor. The overall effect of OFDI on domestic employment is ambiguous and varies depending on whether the OFDI is horizontal or vertical, which is closely linked to the types of overseas investment.

Another important factor that determines the employment effect of OFDI is workers' skill level (or occupation) in that particular stages or tasks of production are outsourced abroad. To be more specific, the demand for domestic labor forces, who were previously employed in a certain task of production stages that is being moved overseas, will decrease. The domestic demand for unskilled labor, for instance, might decrease when MNEs relocate a certain stage of production abroad that is using unskilled labor more intensively. Meanwhile, the relative demand for skilled labor will increase if the remaining stages of production, which stay at home, are relatively skill intensive.

Another important factor in determining the effect of OFDI on domestic employment is the status of workers, that is, whether they are permanent or temporary. Firms initiating FDI may prefer to use temporary workers so as to avoid uncertainty about the success of overseas investment. Another reason why firms investing abroad prefer temporary workers to permanent workers is that multi-national firms cannot find workers with proper qualifications in a frictional labor market immediately after the FDI decision was made. Thus, they may prefer to employ temporary workers until they can find the qualified permanent workers. In this context, the impact of OFDI on temporary employment may depend on the flexibility of the labor market in the countries in which the FDI takes place. In fact, Korea is a country with serious rigidity in its labor market. According to OECD statistics, Korea has more stringent employment protection than the OECD average. This explains why Korea has relatively high demand for temporary workers, which may be closely associated with OFDI.

A recent study from KIEP used the data on 83 manufacturing industries in Korea, for the period of 2007-2015, to decompose the impacts of OFDI on overall domestic employment into the forms of OFDI, workers' skill level and employment status. The main finding was that OFDI has no effect on the overall employment of permanent workers, while it is positively associated with the overall employment of temporary workers. These results possibly indi-

cate that the MNEs initiating FDI, at least in Korea, prefer employing temporary workers rather than permanent workers when the success of their FDI is not clearly visible. Given the high degree of labor market rigidity in Korea, these results seem legitimate and self-explaining. When looking into the effect of OFDI on the relative demand for temporary workers (that is, the employment ratio of temporary-to-permanent workers within each skill group), efficient-seeking FDI only leads to an increase in the relative demand for temporary workers in the medium skilled group, while the relative demand for temporary workers in other skilled groups (low- and high-skilled) does not appear to be affected by OFDI. This result implies that, rather than hiring permanent workers, efficiency-seeking FDI firms, that is, those that aim to achieve higher productivity efficiency through lower factor costs, prefer to use temporary medium-skilled workers.

Although there is little evidence that OFDI has an impact on overall domestic employment, especially for permanent workers, there does exist heterogeneous effects of OFDI on employment depending on the types of FDI, workers' skill level and employment status. For instance, market-seeking FDI, which is the most common form of the outward FDI initiated by Korean MNEs, has no impact on domestic employment, and both efficiency-seeking and export-platform-seeking types of OFDI are positively associated with employment regardless of employment status. These results suggest that one needs to take into account all the heterogeneous effects of OFDI on employment so as to capture a link between OFDI and domestic employment in a source country.

Since these results were based on the analysis using industry-level data that includes other related firms as well as multi-national firms, such as subcontracting firms to MNEs or domestic suppliers, one should be cautious in interpreting the results; they reflect the overall effect of OFDI on the industry-level employment, thus going beyond the changes in employment within firms that invest abroad. Despite these advantages of industry-level data, the analysis using firm-level data may be useful in deriving policy implications in that it can provide meaningful information about the fundamental causes and backgrounds of a link between OFDI and employment. [KIEP](#)