THE IMPACT OF FOREIGN DIRECT INVESTMENT ON EMPLOYMENT IN HOST COUNTRIES: THE CASE OF CENTRAL AND EASTERN EUROPE

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Abstract
The relationship between foreign direct investment (FDI) and host countries is a complex, multi-faceted one. One of the issues that recently gained more attention in the literature is the impact of FDI on employment. The aim of this paper is to investigate the way in which FDI impacts the labor force in the host countries and to reveal the factors that determine the outcome of this relationship. Based on a thorough desktop research, the approach of the paper is twofold: both the quantitive impact and the qualitative impact of FDI on employment are analyzed. The main findings are that quantitatively, the result is largely determined by the type of FDI, while qualitatively, most effects (on productivity, wages, and training) are positive. The impact of FDI on employment is analysed further on the special case of Central and Eastern European countries. These went through a transition period in which former state-owned companies were privatized with the help of foreign investors, giving rise to specific effects. The conclusions highlight the positive and the negative aspects associated with the impact of FDI on employment, turning into recommendations which may become a valuable toolokit for policy-makers in host countries.

Keywords: *foreign direct investment, employment, host countries, labor, Central and Eastern Europe*

JEL Classification: *F21, F23, F16*

1. Introduction

In a globalized context, the spectacular growth of foreign direct investment (FDI) over the last decades and the expansion of international production have increased the proportion of the workforce engaged in activities that compete with each other or are interconnected worldwide. This has reduced the segmentation of national labor markets, while increasing their interdependence.

The effects generated by FDI on employment are both quantitative (number of jobs) and qualitative (type of activity provided, job security, wages, working conditions, training of employees, etc.). The impact depends on a number of elements such as the size of the investment, the type of investment, the main motivation of the investor or various labor market factors in the host countries.

The paper is structured as follows: the next section comprises some of the most important propositions in the academic literature concerning the topic of FDI and employment; the third section investigates the effects of this relationship, on both facets; the fourth section dwells deeper into the impact of FDI on employment in Central and Eastern European countries, while the final section highlights the main conclusions reached after the analysis.

2. Literature review

The literature on FDI and employment embraces the widespread view that FDI contributes to higher wages, higher productivity, but also to a widening of the wage gap between skilled and unskilled workers.

The opinions considering the potential contribution of FDI to employment creation in host countries are still divided though. The difficulty associated with assessing the impact of FDI on employment is twofold: on the one hand, FDI brings a higher dynamic in the market and economic growth leads to more employment, but on the other hand, jobs may be lost due to more intense competition, and technological upgrading.

Ultimately, the net effect of FDI on employment depends on the type of investment and on the balance between job-creation and job-displacing activities [9]. In the case of horizontal FDI, the results are mixed, considering own affiliates and local less efficient firms, while in the case of vertical FDI, the result is usually positive, jobs being created by exporting, without displacing domestic firms [1].

The positive impact of FDI on employment at the level of the receiving country is not something for granted. It depends on specific circumstances, such as geography and origin of investor. For instance, Vacaflores et al. (2017) demonstrate a positive effect of FDI on employment in host countries located in the Americas, and when FDI originates from Asian-based transnational companies (TNCs) [12].

Moreover, there are three important factors that determine the impact of FDI on employment, when dividing host countries into developing and developed categories of states, as Hale and Xu (2016) reveal [4]. They refer to the differences in the skill composition of the labor force, the motivations of the investors and the technological gap between home and host countries.

Also, as Golejewska (2002) finds, the magnitude of the impact on employment is highly industry and country specific, depending on the amount invested, the size, development and resources of the host country, and on the industry involved [3].

With reference to qualitative aspects, a large part of the literature on FDI and employment in host countries focuses on the wages paid by foreign affiliates. Most studies find that foreign-owned companies pay higher wages than domestic counterparts. This is typically explained by the superior technology transferred and by the higher skills of the workers attracted [7].

3. Analysis of the impact

There are two facets to be considered when investigating the impact of FDI on employment in host countries, one is quantitative, the other of qualitative nature.

The quantitative impact of FDI on jobs in the host countries can be divided into three broad categories [11]:

- FDI may contribute to increased employment directly through newly formed subsidiaries or by expanding existing ones, and indirectly by generating jobs in supply and distribution firms. In the long term, new jobs may also be created by increased demand for the products manufactured once they sell well;
- FDI may preserve existing jobs by acquiring and restructuring a firm that would otherwise have gone bankrupt;
- FDI may decrease employment in case of divestment of foreign subsidiaries or through restructuring of the firms acquired, implying staff layoffs, but also indirectly, through crowding-out of domestic firms.

The net employment outcome clearly depends on the size of the investment, to which job creation is usually directly proportional. The exception is only for investments that transfer a very sophisticated top-notch technology that does not require the input of a significant number of employees.

The type of investment also plays an important role. A greenfield investment, i.e. an investment in a completely new production facility, will lead to the creation of previously non-existing jobs, while a foreign investor's participation in an existing enterprise in the form of a merger or acquisition merely transfers responsibility for the jobs in the acquired company. The new owner may decide to reduce them on efficiency criteria. But in the long run, if the restructuring works, the number of jobs in the acquired company will usually increase.

As mentioned in the previous section, the effect on employment also varies depending on the investor’s main motivation to take over a local firm, as follows.

In the case of market-seeking FDI, the effect is generally neutral, if the intention is to maintain the existing workforce to serve the local market; or positive when demand increases or the company expects to expand to neighboring markets. Efficiency-seeking FDI generally reduces jobs, precisely because of efficiency considerations in the international network or because of existing excess capacity, and the introduction of new, capital-intensive technologies. Strategic-asset seeking FDI tends to keep employees, due to their consistent skills and the training they have undergone.

The qualitative impact of FDI on employment in the host countries includes different aspects, which are detailed below.

- Wages: Subsidiaries of transnational companies generally pay better wages than domestic companies in similar activities, but the difference is much more significant in technology or knowledge-intensive industries [11]. Otherwise, in export-oriented industries that create low added value, wages are often low because cheap labor is the main motivation for the investment.
- Job security: Usually job security is higher in subsidiaries of transnational companies due to their size, financial capacity, and transparency. As above, if cheap resources are the main motivation for investment, foreign companies can easily move their operations to other countries where they encounter more favorable conditions.
- Working conditions: the working conditions provided by foreign companies are often higher than those offered by domestic companies, and intense media coverage makes these companies more transparent and aware of the need to comply with both local and international standards. In labor-intensive industries, however, conditions are generally the same as in local firms engaged in similar activities.
- Professional training: transnational companies tend to improve staff employed in their subsidiaries at a faster pace than domestic companies, through considerable investment in training programs, which have a major positive impact on the training of the workforce. They also have beneficial effects on suppliers and distributors by providing them with assistance and pressure to meet the required quality standards.

It follows from the above that foreign-owned subsidiaries have usually net positive qualitative effects on jobs in the host countries. However, there are differences depending on the nature of the work performed. The labor-intensive or the low value-added industries are typically disadvantaged. Also, qualitative effects are higher in the case of greenfield investments than with mergers or acquisitions, because the latter retain some of the old, lower labor standards for a certain time after acquisition.

The quality of employment is also affected by the conditions in the host countries. Some of the most important drivers in this regard are: the level of education, a feature that clearly enhances the quality of jobs provided by foreign-owned companies; and the characteristics of the labor market, such as flexibility, worker mobility, the bargaining power of trade unions, all of which have a strong impact in the medium and long term.

4. The case of Central and Eastern Europe

In Central and Eastern Europe (CEE), where state-owned companies held the largest share in employment at the start of the transition period, privatization with the help of foreign or domestic investors together with the subsequent restructuring, frequently led to massive staff cuts in the acquired companies.

It certainly was the case in Romania, with over-employment being the norm in most of the large industrial companies. New owners also reduced the staff of the acquired companies significantly in the Czechia, much rarer in Hungary, with a few exceptions, and only in about 20% of the acquired Polish enterprises, as a cross-country study suggests [10].

Empirical observation on FDI in CEE countries shows that the number of employees in state-owned companies bought up by foreign subsidiaries has decreased both before and after privatization.

However, it is worth noting that the rate of employment decline in privatized companies has often been lower than the average in these economies and has been more pronounced in the period preceding privatization [11].

This result can have two major explanations:

- domestic companies have kept the number of jobs stable to a lesser extent than foreign investors;
- foreign investors acquired the most efficient companies of the ones put up for privatization.

Even in the case of job losses following the acquisition of a local firm by a foreign investor, this cannot be considered a net loss for the economy as a whole if the acquired firm found itself previously in a difficult financial or competitive situation and would have gone bankrupt in the absence of privatization. In this situation, FDI leads to employment conservation, even if the number of employees is lower than before. Evidence for such creative destruction with an initial decline of employment followed by a positive long-run trend has been found for 20 CEE countries during the period 1995-2012 by Jude and Pop Silaghi, 2015 [6].

Renault for instance has undertaken lay-offs and has given up a lot of cooperation contracts with domestic companies after the takeover of Romanian car maker Dacia in 1999. This move has led to a decrease in jobs not only in the plant itself, but in the horizontal industry as well, albeit temporary. The competitive situation of Dacia improved continuously though, after capital and technology have been transferred in the following years, making Dacia a decade later one of the top exporters and tax contributors in the country.

Once the initial adjustment has taken place following privatization and firms become competitive, additional job creation may be spurred when demand for the manufactured products increases, accompanied by further investments. Estrin (2017), an expert on FDI in CEE, actually finds unemployment to be inversely correlated to FDI levels in the 2000s, with unemployment lowest in times when FDI peaked [2].

A significant job-creating effect also occurs in related industries, namely suppliers and distributors. Apart from direct jobs, FDI generates a considerable number of indirect jobs as a result of a multiplier effect.

Otherwise, on the grounds of general strategies of transnational companies (TNCs) regarding efficiency, several jobs may get lost as local or regional plants are shut down. Examples from Romania include the Daewoo facility in Craiova, as well as the Kraft Foods and GlaxoSmithKline facilities in Brasov, to name just a few.

Job destruction takes place also in the domestic small and medium-sized sector, as an effect of competition from larger and financially more powerful subsidiaries of TNCs. Some of the most visible effects in this regard include supermarket chains that drove small shops and groceries out of the market [5].

Irrespective of the quantitative effect of FDI on privatized or newly-established companies, in most cases qualitative effects in CEE countries were clearly found to be positive, in terms of productivity gains, wage levels, working conditions and the implementation of training programs.

A premier example is the privatization of the lighting company Tungsram in Hungary, by American giant General Electric (GE) at the beginning of the 1990s. Despite outrage following the cut of the workforce to about one half, new technology was introduced, new products developed, productivity increased steeply and the transformed company became the main business center of GE for its lighting activity at worldwide level [13].

As for the wages paid by foreign-owned subsidiaries, they are usually higher than the domestic industry average, in most of the CEE countries. Foreign subsidiaries need a stable workforce, so they offer a bonus on the wage payment in order to attract and keep their employees.

In the case of Romania, it was observed that for similar positions with leading responsibilities, the level of wages in a large transnational company may be two or three times higher than in a Romanian private company or in a state-owned firm. It is worth noting, however, that in the some of the country's export industries, most notably wood production, the wages of workers are among the lowest in the country even in the case of foreign-owned subsidiaries, precisely because cheap labor is the source of competitive advantage for companies in this field.

However, as a recent study at European Union level shows, wages in CEE didn't narrow the gap to wages in Western Europe. In Czechia and in Slovakia, wages stand at about 40% of the German average, in Poland and Hungary at about 33% and in Romania only at about 25% [8]. This outcome shows a relatively strong dependence of these countries on subsidiaries of TNCs and their subsequent strategies for profit-raising.

Productivity levels cannot be made responsible for the wage gap which is still in place after more than 25 years of transition. The workforce in subsidiaries often displays the same level of efficiency across different European countries. This is why the general level of wages in the host country, together with the ongoing domestic economic performance, can be considereed a stronger determinant for the lower wages paid by foreign-owned companies in CEE countries.

5. Conclusions

The analysis of the impact of FDI on employment reveals that from a quantitative point of view, the type of investment is a major factor that determines the outcome for job creation. While the result is uncertain for acquisitions, it has a high probability to be positive in the case of greenfield FDI. Thus, policy-makers in host countries should strive to set legal measures that encourage the establishment of totally new foreign subsidiaries, offering fiscal or financial incentives tailored for greenfield FDI. In the case of privatization deals, a matter highly relevant to countries in Central and Eastern Europe, legal requirements may be set for acquiring companies to keep existing employment constant, pegged proportionately to a certain output level.

On the qualitative side, FDI influences employment mostly in a positive vein, driving productivity up and generally paying higher wages than the domestic industry average. Professional training is also ensured in a more systematic and modernized manner. Therefore, policy-makers should link incentives offered to foreign investors with certain benchmarks to be met in terms of working conditions and on-the-job training provisions. Such improvements in the labor market and in the general level of skills of the working population will be, after all, beneficial to the host country, as a whole.

Only with an economic strategy of increasing higher-skilled activities can Central and Eastern European countries move beyond the follower-model of Western European countries and reduce dependence on the "keep-wages-low" model of foreign-owned subsidiaries. A more active, strategic role of policy-makers is required. They should focus on a coherent and consistent policy towards promoting and attracting the quality-skills FDI they envisage, coupled with massive domestic investment in education and research, to match requirements of TNCs.

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