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Should trade unions appreciate foreign direct investment

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Abstract

It is often argued that FDI hurts workers in the home country because jobs are moved abroad. Contrary to that view, businessmen often argue that FDI benefits home workers because there will be an expansion in the firm. We show that both views may be correct, and whether home workers gain or lose on FDI depends on which kinds of activities the firm moves to the host country. If there is a big degree of substitutability (complementarity) between activities in the home country and activities in the host country, it is likely that the workers lose (gain) on FDI. © 2001 Elsevier Science B.V. All rights reserved.

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1. Introduction

How the labor market in the home country is affected by outward foreign direct investment (FDI) has always been a controversial issue (see e.g. Lipsey, 1994), and there seems to be at least two popular views. One view, often heard from trade unions, is that FDI is an export of jobs. The other view, often heard from managers of firms, is that these investments will be to the advantage of workers in the home country because the lower wage costs in the host country make the firm more

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competitive. In this paper we show that both views may be correct since the effects of FDI depend on which kinds of activities the firm moves abroad.

More specifically, we set up a simple model with one firm which at the labor market in the home country faces a trade union. These two parties bargain over the wage rate in the home country. The production in the firm can be split into several activities, and the firm has the opportunity to become multinational and move one of the activities to the host country. In the host country, the firm has to bargain over the wage rate with a local trade union. In our analysis, we focus on whether it would be optimal for the firm to become multinational and whether the trade union in the home country would appreciate that the firm becomes multinational. We find that, if there is a big degree of complementarity between activities moved abroad and activities remaining in the home country, it is likely that the firm and the home country workers agree whether it is preferable to undertake FDI. On the other hand, if there is a big degree of substitutability between activities in foreign affiliates and activities in the home country, it is likely that the firm gains but the workers lose from FDI.

A paper closely related to ours is Horn and Wolinsky (1988). They consider two groups of workers employed in a single firm, and these workers can either choose to be organized in a single encompassing trade union or in two separate trade unions. The firm bargains with the trade union(s) over the wage rate(s). A main result is that, if the two groups of workers are sufficiently close substitutes in production, it is an equilibrium that the workers unite in an encompassing trade union, whereas, if the degree of complementarity between the two groups of workers is sufficiently high, the equilibrium is two separate trade unions. The intuition is that, if the two groups of workers are complements in production, each group is more or less able to paralyse the firm on its own. Therefore, the workers are better off bargaining with the firm in two separate trade unions. Oppositely, if the workers are substitutes, separate groups have a weaker stance in the bargaining with the firm than if the two groups unite. The reason being that the total damage on the firm if both groups stop producing, simultaneously, is bigger than two times the damage if a single group stops producing. The same basic mechanism is at work in our paper, and it partly explains why workers in the home country may gain if the firm becomes multinational. If the activities kept in the home country are sufficiently complementary to the activities moved to the host country, the workers in the home country keep a strong bargaining position relative to the firm. However, there are also important differences between our model and the model by Horn and Wolinsky. First, in our model, it is the firm which decides whether to move activities to the host country and by this splitting the workers into two groups.[1] Second, in the Horn and Wolinsky model, it is the same workers who are employed in the firm no matter whether there are one or two trade unions. In our

[1] It should be mentioned that Horn and Wolinsky do shortly note that, if the two groups of workers are close substitutes, the firm may have an incentive to split up production on several plants.

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