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Foreign direct investment and spillovers through workers' mobility

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Abstract

We analyze a model where a multinational firm can use a superior technology in a foreign subsidiary only after training a local worker. Technological spillovers from foreign direct investment arise when this worker is later hired by a local firm. Pecuniary spillovers arise when the foreign affiliate pays the trained worker a higher wage to prevent her from moving to a local competitor. We study conditions under which these spillovers occur. We also show that the multinational firm might find it optimal to export instead of investing abroad to avoid dissipation of its intangible assets or the payment of a higher wage to the trained worker. © 2001 Elsevier Science B.V. All rights reserved.

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1. Introduction

The last two decades have witnessed an important change in the attitude of host countries towards multinational enterprises (MNEs). Most countries have removed

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their barriers to foreign direct investment (FDI) and have actively encouraged investment by foreign firms. Advocates of these policies claim that MNEs generate spillovers which benefit the host economy. Such spillovers may take several forms.[1]

First, there may exist backward and forward linkages between foreign affiliates and local firms (Lall, 1980; Rodriguez-Clare, 1996). Second, foreign affiliates may increase local firms' productivity through ''demonstration effects''. For example, domestic competitors might successfully imitate technological innovations introduced by MNEs (Mansfield and Romeo, 1980; Blömstrom, 1986). Third, spillovers arise when subsidiaries of foreign firms train local employees who later join local firms or set up their own companies, bringing with them all (or part of) the technological, marketing, and managerial knowledge that they have acquired.

In this paper, we focus on this last form of spillovers, and we present a model in which technological spillovers arise due to the mobility of workers who have been trained by MNEs. Our main purpose is to study the conditions under which such spillovers occur.

The fact that MNEs undertake substantial efforts in the education of local workers has been documented in many instances (e.g., ILO, 1981; Lindsey, 1986), and empirical research seems to indicate that MNEs offer more training to technical workers and managers than do local firms (Chen, 1983; Gerschenberg, 1987). In early stages, affiliates rely more intensively on expatriates, but subsequently they tend to replace them with (cheaper) local workers who have been properly trained in the meanwhile (UNLTC, 1993).

However, evidence on spillovers due to workers' mobility is scarce and far from conclusive.[2] An early study by Behrman and Wallender (1976) shows that, while labor mobility is important in certain circumstances, it is minimal in others. Gerschenberg (1987) analyzes MNEs' activity in Kenya. He concludes that mobility is lower for managers employed by MNEs than for those employed by local firms. In a study of the Taiwanese economy, Pack (1993) finds that labor mobility from MNEs to local firms is important and that often trained managers leave MNEs to run their own businesses. Aitken et al. (1997) study the effect of inward FDI on the wages of the local workforce in three different host countries. In Mexico and Venezuela, inward FDI increases the wages of the workers in MNE affiliates, but has no effect on the wages of local firms' workers. In the US, inward FDI results in higher wages both in MNE affiliates and in local firms. Indirectly, this might show the existence of technological spillovers through labor mobility in the US, whereas in Mexico and Venezuela such labor mobility might be inhibited by either the higher wages paid by the MNEs or a larger technology gap.

Our paper provides a formalization which is consistent with these findings. We build a model where a MNE trains a local worker to run its subsidiary. Later, the

[1]See Blömstrom and Kokko (1998) for an extensive review of FDI spillovers.

[2]See also Blömstrom and Kokko (1998).

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