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Foreign divestment: What stays when multinationals leave?

by

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When multinational enterprises (MNEs) close foreign affiliates, they often attract significant media attention. They may even stir public protests in their host countries, such as when German logistics company, DHL, closed its logistics center in Pennsylvania. While estimates vary, one out of five foreign affiliates disappears within five years of existence,[1] and this occurs more frequently as MNEs become increasingly "footloose." As a result, there is enormous pressure on policymakers to manage the aftermath of MNE closures. Such closures create uncertainty for foreign affiliate employees, impacting their future job opportunities and the economic prospects of entire regions. This particular group of job seekers is referred to as "displaced" because their contracts are not terminated due to individual misconduct. Using social security data, we studied 110,133 displaced employees in Portugal between 2005 and 2009; 8,139 of these employees were displaced by foreign affiliates.[2] This data set allows us to identify those employees that are particularly vulnerable to closure events and would, therefore, benefit the most from policy support.

The salaries of displaced employees in their new jobs are good indicators of how their experience working for a foreign MNE is rewarded after the closure. This MNE experience has two elements. On the one hand, the MNE provides employees with opportunities to learn about advanced technologies, procedures and approaches from abroad. Moreover, employees can develop key skills, like managing international teams and creating professional networks with clients or suppliers, both of which are transferrable to a new firm. On the other hand, much of this human capital—international skills, knowledge and networking—are highly specific to the MNE in which they were acquired. A new employer may doubt that the displaced employee of a foreign affiliate will fit within the context of the new firm. Consequently, a new employer will offer higher wages when signals indicate that the human capital acquired in the foreign affiliate is valuable, but lower when signals indicate that the human capital is MNE-specific.

Three major implications follow from this duality of prior MNE work experience. First, displaced employees of foreign affiliates are better off than their counterparts from closed domestic firms. There is a wage premium originating from having worked for such a firm, even after it has closed. Interestingly, though, this premium is smaller, and even negative, for majority-owned foreign affiliates; dominant or full foreign ownership of the closed affiliate raises doubts about the usability of the acquired human capital of employees for new employers.

Second, the productivity of the closed foreign affiliate has a positive effect—when compared with host country standards—on the future wages of its displaced employees. This seems counterintuitive since the affiliate has been closed down. Then again, it may have been closed down because of cost/performance comparisons with other countries. It may still be performing well when compared with host country competitors—and it is this latter benchmark that is relevant for future employers in the host country. Therefore, displaced employees from more productive foreign affiliates can expect a wage premium in their new jobs.

Finally, new employers reward displaced employees of foreign affiliates if they had managerial roles in the affiliate and a relatively short tenure. The former indicates that displaced managers accumulate valuable, tacit human capital while working for the MNE. This type of knowledge is scarce and, hence, valuable because it can only be acquired through experience. Meanwhile, short tenure indicates that employees were not acculturated to MNE procedures and beliefs that would hamper their adaptation to other firms.

Based on these findings targeted policies can be developed for governments and municipalities that have to deal with the consequences of worker displacement. We suggest a three-layer policy response that reflects the individual risks of displaced employees. At the basic level, because displaced employees of domestic firms suffer more from its consequences, they require more policy support, such as active counseling and placement services. Therefore, a structural response should be put in place in which governments provide additional resources for local authorities to deliver placement services. Among the displaced employees of foreign affiliates, highly vulnerable employees, such as those with manual jobs and long tenures with an affiliate that was largely owned and controlled from abroad, can be identified for intense placement support. A comprehensive definition of such placement services must also include informing and educating potential local employers about the particular international skills and experiences that these displaced employees can bring to their companies. Finally, low-risk groups among the displaced employees of foreign affiliates (managers with short tenure and local ties) are adequately served through limited policy support, e.g., more standardized information seminars, since their risks for experiencing significant earnings losses are comparatively lower.

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[1] A. B.Bernard and F. Sjoholm, "Foreign owners and plant survival" (Cambridge: NBER, 2003), mimeo.

[2] We use the Quadros de Pessoal database, a Portuguese, longitudinal-matched, employer-employee data set covering the period from 2002 to 2009.

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