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Outward FDI does not necessarily cost domestic employment of MNEs at home: Evidence from Japanese MNEs

by
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Whether outward foreign direct investment (FDI) projects boost or shrink domestic employment of multinational enterprises (MNEs) in home countries has long been a subject of debate. On the one hand, when MNEs implement projects abroad, it is often to replace their exports of goods and tradable services with FDI in production abroad to serve foreign markets, which reduces employment at home.[1] On the other hand, MNEs' foreign operations may enhance production efficiency and global market access, generating greater demand for their final outputs. As a result, MNEs need to hire more employees in several production-related activities that are retained in their home countries to serve the additional foreign customers.[2] Reflecting these countervailing forces, numerous empirical studies have reported mixed and/or inconclusive findings on this subject.[3]

An investigation of the various motivations for outward FDI projects by MNEs at the firm level sheds light on this line of research, as different outward FDI motives[4] could lead to variations in MNE behavior and FDI outcomes, including the domestic employment decisions of MNEs. A recent study[5] explores this argument with a sample of 604 Japanese MNEs that had established 2,345 foreign affiliates operating in 22 industries (including both manufacturing and service sectors) across 58 countries from 1991 to 2010:

- Outward FDI of Japanese MNEs *reduced* their domestic employment levels in Japan when Japanese MNEs conducted labor-seeking FDI to (1) relocate the labor-intensive, home-based production base to foreign countries with lower labor costs or (2) follow downstream customers to serve them in proximity using local employees.
- Outward FDI of Japanese MNEs *increased* their domestic employment levels in Japan when:
  - Japanese MNEs conducted market-seeking FDI to (1) further secure access to immobile resources necessary for generating new markets in host countries, (2) establish foreign sales affiliates to serve neighboring foreign countries, or (3) set up regional sales headquarters in economic integration blocks.

- Japanese MNEs conducted strategic asset-seeking FDI to (1) acquire indirect market/scientific information or (2) conduct direct research-and-development activities.
- Japanese MNEs conducted efficiency-seeking FDI to spread risks across multiple countries through financing- and currency-hedging.

In general, the findings suggest that outward FDI of Japanese MNEs increases their domestic employment when it enhances the MNEs' competitive advantages and hence further expands domestic operations, whereas it reduces domestic employment when it involves a transfer or relocation of domestic operations in foreign countries.

Policy implications from the evidence are two-fold. For general policy makers striving to increase domestic employment, foreign investment policy should focus on the promotion of competitive-advantage-enhancing outward FDI that results in new markets, new knowledge or spread-out risks. While governments have been proactive in attracting inward FDI to generate new jobs within their national borders through a transfer of management resources, business systems and new technology from foreign investors, the study shows that the promotion of competitive-advantage-enhancing outward FDI is also an effective way to boost the domestic employment of MNEs at home and can be a new policy focus when countries undergo a process of industrial restructuring. In the Japanese context, the challenge is how to build effective incentive structures to promote competitive-advantage-enhancing outward FDI, while ensuring that unskilled Japanese workers are retrained instead of resorting solely to unemployment compensations.

The bottom line is that outward FDI does not always produce a hollowing-out effect. Policy on outward FDI should be positioned as an integral part of a country's strategy for economic development and growth.

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[1] *See* K. Head and J. Ries, "Exporting and FDI as alternative strategies," *Oxford Review of Economic Policy*, vol. 20 (2004), pp. 409-423.

[2] *See* S. Federico and G.A. Minerva, "Outward FDI and local employment growth in Italy," *Review of World Economics*, vol. 144 (2008), pp. 295-324.

[3] *See e.g.*, Chapter 13 in J.H. Dunning and S.M. Lundan, *Multinational Enterprises and the Global Economy*, (Cheltenham: Edward Elgar, 2008), pp. 414-462.

[4] Four sets of FDI motives have been distinguished in the literature: (1) (natural) resource-seeking, (2) market-seeking, (3) strategic asset-seeking, and (4) efficiency-seeking. *See* J.H. Dunning, "Location and the multinational enterprise: A neglected factor?", *Journal of International Business Studies*, vol. 29 (1998), pp. 45-66.

[5] *See* E. Hong, I.H. Lee and S. Makino, "Does outbound FDI affect domestic employment? The role of investment motivations." Presented at the *Annual Meeting of the Academy of International Business*, Vancouver, Canada, June 23-26, 2014.

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