THE **FDI** EFFECT

Dr. Grace Wang examines the effects of FOREIGN DIRECT INVESTMENT on host countries.

By Christopher Stolarski

Economically, our planet is shrinking. Technology, foreign policies and the disintegration of certain cultural barriers have transformed the global marketplace, making it more accessible. It teems with merchants, and it's flush with cash.

Multinational corporations — those enterprises that manufacture, sell and provide products and services in more than one country — abound. According to the United Nations, there were approximately 30,000 multinationals in 1990. Today, there are more than double that. And, increasingly, these companies are making physical investments (buildings, machinery and equipment) in less developed countries around the world.

Highly developed countries like the United States house the majority of multinational corporations, and from the Western perspective, this model of "foreign direct investment" is seen as an economic boon for the home countries.

Dr. Miao "Grace" Wang, however, is more interested in the impact FDI has on the host country. "If Apple builds a manufacturing facility in Thailand, what does that mean for Thailand's economy?" she asks. "Put simply, does FDI promote the recipient country's economic growth, and — if so — how?"

According to Wang, an associate professor of economics who has studied FDI for nearly a decade, less developed countries like China want and actively seek FDI. In fact, she says, these countries will often adjust certain regulations to attract multinational corporations.

On the surface, the desire is obvious. "These companies bring increased employment opportunities, better technology and superior management skills," Wang says.

Wang's research, which has been well published in leading economics journals, goes deeper than conspicuous business incentives. She's looking now at empirical data that shows how FDI affects outward migration patterns in the host country, specifically China. According to Wang, China is the world's largest FDI host country among less developed countries. From 1993 to 2009, China received each year on average approximately 25 percent of the world's FDI to all less developed countries, she says.

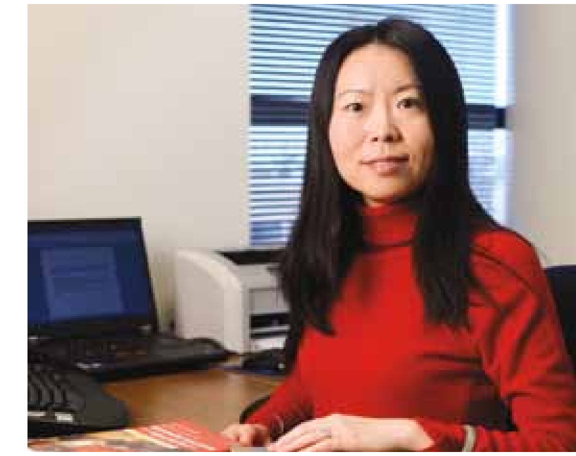
"There are two schools of thought, which I call the 'home effect' and the 'linkage effect,'" Wang explains. "The home effect suggests that FDI can deter emigration. The linkage effect cites the opposite."

The home effect argues that when a multinational corporation builds a facility in a less developed country and hires its labor locally, those new employees are less apt to leave, now content with their wages and improved working environment. The linkage effect, favored by sociologists, posits that this new employment experience serves as an exemplar of what Western life is like, making emigration more attractive.

The findings suggest that those with postsecondary educations are less likely to emigrate because they have better opportunities afforded them by the multinational companies in the host country. Those with only a secondary education are more likely to leave, and FDI seems to have no impact on those with only a primary education.

In addition to studying FDI's effect on outward migration, Wang is examining a phenomenon known as spatial interdependence. According to Wang, past FDI studies have focused solely on the home and host countries. Instead, Wang is considering the home and host countries as well as countries that surround the host.

Studying this "third country effect" is growing increasingly important, she says. Usually, multinationals target one country in which to invest. But, increasingly, corporations consider several neighboring host countries and ultimately choose one on the pretense that products will be exported to the "losing" countries.



Dr. Grace Wang

What attracts and deters inward investment is important for host countries' policymakers so that they can devise policies to encourage it. In the case of China, Wang says this is important provincially, as well.

To delve more deeply into that concept, Wang scaled the focus of her study to look at China's individual provinces as de facto host countries. By measuring the intensity of the spatial interdependence among China's provinces and disaggregating that data by specific industry, Wang says she can demonstrate more clearly what characteristics in China promote or discourage FDI.

Wang has found that, at the aggregate level, host provinces compete with one another for FDI. However, in some manufacturing industries — especially labor-intensive manufacturing — surrounding provinces complement each other. In other words, FDI received in one host province tends to help its surrounding provinces receive more FDI in similar labor-intensive industries.

"In general," she says, "provincial market size, labor cost and quality, policy incentives, and coastal locations are important determinants of FDI." ■