

EMPLOYMENT EFFECTS OF FOREIGN DIRECT INVESTMENT: A Theoretical Analysis with Heterogeneous Labour

T. GRIES¹ and S. JUNGBLUT²

¹ University of Paderborn, Germany Thomas.Gries@notes.uni-paderborn.de

² University of Paderborn, Germany jungblut@notes.uni-paderborn.de

9.1 INTRODUCTION

High unemployment rates in South Africa's labour market of approximately one third of the labour force will be the most challenging problem in the next decade. Not only the level of unemployment is intolerable, also the structure is alarming. In the last two decades the gaps in unemployment rates and/or wages of unskilled and skilled labour has increased in almost all developing countries [OECD (1997), Gottschalk/Smeeding (1997), Murphy/Topel (1997)]. Further, as Whiteford/Seventer (2000) point out, in South Africa unemployment is also the major reason for poverty and for high inequality in income distribution.³ High unemployment rates may also become an obstacle for growth, as social unrest and political instability becomes more likely. Without a significant increase in employment, economic and political stability will be hard to obtain. As the problem of unemployment and low or even decreasing wages is likely to strike more unskilled labour [see e.g. Hofmeyr (2000)] most political concern should be devoted to this group of the labour force [see GEAR (1996)].

Both increasing trade and biased technological progress are blamed to cause inequality in labour markets. Empirically, this debate is still open. While OECD (1997) or Cline (1997 Ch.2) conclude that globalisation is of minor importance Wood (1998) summarises "...I review and reappraise the evidence, suggesting that most of it is, in fact, consistent with the hypothesis that the main cause of the rise in labour market inequalities is globalisation." [Wood (1998 p. 1468)]. For South Africa evidence seems to be mixed. Bell/Cattaneo (1997) or Edwards (1999) argue that a labour biased shift in trade affected employment in manufacturing industry negatively. Edwards (2000) not only

³See also the other contributions in Leibbrandt/Nattrass (2000) "South Africa's changing income distribution in the 1990s"

analysed the impact of trade on the level of employment, but also breaks down the occupational employment impact. While in his findings the dominant source of employment change was technology, manufacturing is characterised by a skill bias in net trade reducing elementary employment. A number of approaches are used to model the effects of trade liberalisation on labour market performance.⁴ Especially unskilled labour does not always seem to realise a positive impact from trade liberalisation.

The impact of globalisation on domestic labour markets goes well beyond its linkage with trade. A second channel is opened by factor mobility. Especially capital mobility and FDIs play a major role. There is hope that inflowing capital will create additional jobs and therefore will have positive employment effects. "Areas of economic activity previously closed to foreign enterprises are now being opened up and strong efforts are being made to woo TNCs." [Lall (1995 p.521)]. It seems also evident that FDIs will have positive effects on employment on total, but the structure of these effects is not so clear. "Despite the obvious importance of TNCs in creating employment opportunities in host countries the exact links between FDIs and labour markets are difficult to trace quantitatively" [Lall (1995 p.522)]. What happens if inflowing capital will only match with skilled labour, while unskilled labour is not or even negatively affected?"...the possibility must be considered that international labour market,...operated in such a way as to match machinery and equipment with skill, not only with the least expensive labour that could be found." [Hanson II (1995 p.156)]. Even if there are some contributions to the discussion of employment effects of capital mobility and FDIs [see e.g. Koizumi/Kopecky (1980), Lall (1995), or more recently Glass/Saggi (1999)]⁵ there is still little known about the structure effects on different labour market segments. It is not clear, if the important problem of increasing labour market inequality and large unemployment in the unskilled segment of the labour market will be positively affected by FDIs.

The goal of this contribution is to obtain a better understanding of the unemployment effects of capital mobility on different segments of the labour market. While the Harris-Todaro model is the workhorse in development literature for analysing persistent unemployment problems, we suggest the labour market matching-approach as an interesting alternative for analysing the defined problem.⁶ In a labour market flow model the continuous separation of existing jobs and a growing population indicate the inflow of unemployed

⁴See e.g. Wood (1994, 1995, 1997, 1998), and also chapter seven in this volume.

⁵For a general discussion see also Gilroy (1999).

⁶A major problem concerning the analysis of unemployment in developing countries is a limited number of theoretical approaches. Fields (2000 p.5) mentioned: "There does not yet seem to be a labour market model that properly incorporates the main stylised facts." Therefore, we suggest the labour market flow approach as an additional tool for discussing the problem of persistent structural unemployment.