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## Globalization, Foreign Direct Investment, and Labor

In the United States, opposition to globalization is centered in the organized labor movement and in certain environmentally oriented non-governmental organizations. This chapter deals with the former. The concerns of the latter are discussed in chapter 5.

Leaders of the labor movement sometimes talk of globalism and its effects on people in the world's poor countries in terms that border on the apocalyptic. For example, writing in a recent issue of *Foreign Affairs*, Jay Mazur, president of the Union of Needletrades, Industrial, and Textile Workers (UNITE), states:

Millions of workers are losing out in a global economy that disrupts traditional economies and weakens the ability of their governments to assist them. They are left to fend for themselves within failed states against destitution, famine, and plagues. They are forced to migrate, to offer their labor at wages below subsistence, sacrifice their children, and cash in on their natural environments and often their personal health—all in a desperate struggle to survive. (Mazur 2000, 82)

Much of this chapter is devoted to examining whether or not the causal link that Mazur implies between globalization and the undeniable miseries that one sees in many developing countries is borne out by the evidence. But if US union leaders like Mazur are concerned about the effects of globalization on workers everywhere (and in this they are joined by a number of human rights-oriented NGOs), they are especially concerned, and understandably so, about the effects of globalization generally—and of outward US direct investment specifically—on the members of their

own unions. Therefore this chapter examines the evidence on the effects of globalization and of FDI on workers in the United States and other developed countries as well.

Here the concerns regarding direct investment center around two issues. The first has to do with the “export” of US jobs. It is alleged that, when US firms make direct investments overseas, the output of these ventures substitutes for output of domestic plants operated by these same firms, and thus reduces job opportunities in the United States. The second is that this direct investment abroad suppresses wages at home in the affected industries. A more subtle version of this argument is that wages of US workers are bid downward as employers threaten to move production offshore.

In fact, US labor leaders’ concern about the effects of globalization on the wages and working conditions of workers in foreign countries is linked to their concerns about its effects at home. US labor unions fear that US direct investment in countries where average wages are low by US standards not only further impoverishes workers in those countries, especially where collective bargaining rights are lacking, but lowers wages and reduces employment opportunities in the United States as well.

On the face of it, the proposition that the establishment of US-owned operations in developing countries would act to reduce wages in those countries seems counter to basic economic reasoning. After all, the entry of a new employer into a labor market should tend to *increase* the demand for labor and, all else being equal, that should drive up the price of labor. Therefore wages should rise, not fall.

But the unions’ position is more subtle than this. The unions are mostly concerned that workers in these countries lack collective bargaining rights of the sort that unionized workers have fought for and won in the United States. Lacking these rights, the unions believe, workers in developing countries lack the power to translate the increased demand for their labor into higher wages and better working conditions. Worse still, US-based and other multinational firms, they allege, actively work to suppress the organization of labor unions in developing countries, among other means by supporting governments in those countries that deny workers the right to unionize. If workers in these countries had these rights, and if they had union representation, US unions maintain, their wages would be higher than they are. Thus, with respect to the plight of workers in these countries, direct investment is seen as the source of the problem, or at least an aggravating factor.

These are serious concerns. Is there empirical evidence to support them? This chapter will argue that the empirical evidence does *not* support the contention that outward US investment creates or contributes to low wages or, in most cases, creates or contributes to poor working conditions in developing countries. Nor does the evidence support the con-

tion that outward US FDI causes a net loss of job opportunities in the United States or even the destruction of jobs in high-paying industries. Indeed, the evidence largely suggests that the effects of FDI are the opposite of what organized labor in the United States claims they are. US direct investors in the manufacturing sectors of developing countries tend to pay significantly *higher* wages than do domestically based employers there. In addition, outward US FDI, if anything, tends in the aggregate to create rather than destroy US job opportunities in high-wage, export-oriented industries. Although outward investment doubtless has the effect of destroying some jobs at home, it creates others, and the jobs thus gained tend to pay higher wages than the jobs lost. Thus, in the aggregate, outward direct investment helps rather than hurts US workers.

However, it must be acknowledged that some US workers are indeed hurt by US outward direct investment—by no means will all workers who lose their jobs because of FDI be rehired at one of the higher-paying jobs that FDI creates. Nor is the evidence presented here meant to deny that working conditions are often miserable in the world's poorer countries, or that some workers there are being prevented from forming independent unions, capable of bargaining for higher wages or better working conditions on their behalf.

Nor is it easy to dismiss the claim that the bargaining position of some workers in the United States (and other advanced countries) may be weakened by FDI. Whether or not this translates into reduced wages in some industries is likewise a matter not easily resolved. As this chapter will argue, considerations such as the particular skills of the affected workers and the structure of the market for the goods they produce are likely to matter greatly in determining whether and how FDI affects their bargaining power.

This chapter is organized in five sections. The first addresses the issue of the relationship between the activity of multinational firms and the wages earned in the countries, especially developing countries, that host their operations. The second section addresses what might be termed the "sweatshop" issue: whether international trade and investment foster unacceptable working conditions in developing countries. The third section explores whether the activity of multinational firms has an adverse effect on labor in the home countries of those firms, including job loss or reduced wages. The fourth section examines the specific issue of whether multinationals' activity acts to reduce the bargaining position of unionized workers in their home countries. The final section draws some conclusions from the findings of the previous four.<sup>1</sup>

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1. For an overview of the issues discussed in this chapter, see Moran (1999).

## Direct Investment and Wages in Developing Countries

Let us start with the following bold assertion: Whatever effects direct investment has on the home country (e.g., the United States), this investment, if it flows into activities that are internationally competitive, will in principle be in the economic interests of workers in the host country. Whether, thus qualified, the proposition is actually true is an empirical matter, to which we will turn shortly. But first, let us examine this assertion on the basis of what amount to first principles.

Let us first examine the “if” clause. If the condition it stipulates is not met—that is, if foreign investment flows into activities in the host country that are *not* internationally competitive—then its effects on workers there might not be positive at all. Sad to say, a significant portion of the FDI that has gone to developing countries in the past has been invested in activities that were not internationally competitive. Often in the past, the governments of developing countries have been eager to substitute local production for imports, on the now outmoded theory that the key to development lay in building self-sufficiency in domestic industry. And all too often, governments have offered inducements to foreign-controlled firms to get them to set up shop in their countries and produce these import substitutes. Among these inducements have been various forms of trade protection, often at levels that made imports prohibitively costly, thus enabling the foreign producer to become a monopoly supplier. In some cases the foreign firm has even been subsidized or (what amounts to the same thing) granted exemptions from local taxes. Encarnation and Wells (1986), in a detailed analysis of 50 foreign investment projects in a large (but unnamed) developing country during the 1970s and early 1980s, conclude that about 40 percent of these were uncompetitive. Earlier studies reported similar findings.

Why are foreign investments under these circumstances not in the interests of workers? Such investments do create jobs, after all, sometimes even jobs at (by local standards) attractive wages.<sup>2</sup> However, the operations associated with these jobs absorb scarce resources and thus penalize other, often more promising sectors with the potential to create better

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2. There are, as always, exceptions. Some foreign-controlled operations start out uncompetitive but become competitive as they evolve. Indeed, part of the intellectual justification for import substitution has been based on so-called infant-industry arguments: the notion that internationally competitive operations can be created through import substitution, but that these operations will initially be uncompetitive, and must be protected, until they accumulate operating experience. In practice, however, import substitution policies premised on infant-industry arguments have resulted in the creation of numerous facilities that have little or no hope of ever becoming competitive. Evidence is reviewed in Meier (1987).

employment opportunities. Trade liberalization will destroy these jobs, and hence the very existence of these operations can create political pressures against liberalization. But as is now widely recognized, trade liberalization is often the key to economic reform that has the potential to put the developing country on a more dynamic growth path than import substitution policies could ever have hoped to achieve. Thus, in many cases, citizens of these countries—including workers—would have been better off if FDI of the import substitution variety had never entered the country.

In recent decades, economic reform in many developing countries has led to the replacement of import substitution policies by more open trade policies, and the result is that foreign direct investors must now seek projects that are, or have strong potential to become, internationally competitive. Alas, no empirical study of recent prospects along the lines of Encarnation and Wells has been conducted. However, Louis Wells, coauthor of the study cited above, recently revisited the country on which the study was based. In correspondence to this author, he asserts, “it is almost certain that declining protection [in this country, which has undergone policy reform] has meant that an increasing percentage of foreign investment projects are ‘good’.”

To be sure, many of the policies that foster uncompetitive FDI remain in place, even in countries that have experienced some policy reform (Moran 1998 and 2000). Indeed, one potential benefit of a multilateral agreement on investment, if it were extended to developing countries, would be to help push along the process of dismantling such counterproductive policies. But given that much policy reform has taken place, and that more seems likely to come, in what follows we assume that FDI takes place in projects that are internationally competitive.

We begin by exploring some simple yet powerful theoretical reasons why direct investment in competitive endeavors in any country, and especially developing countries, should bring benefits. Most recent FDI in developing countries has been “greenfield” investment, that is, investment in the form of new plant and equipment, rather than acquisitions of ongoing operations of existing companies.<sup>3</sup> And new investment—whether by domestic residents or by foreigners—in developing countries that practice open international trade policies contributes, in most instances at least, positively to economic growth, which in turn increases

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3. In contrast, much US outward FDI in more developed countries, especially in Europe, has been in the form of acquisitions of existing firms or their subsidiaries. There may be a trend afoot toward more such acquisitions in some developing countries, for example as a result of “fire sales” of assets in East Asia in the wake of that region’s recent crisis, and as a result of privatizations in Latin America. But the available data do not indicate that acquisition has yet become the dominant mode of FDI in developing countries.

the demand for labor. Empirical studies confirm this.<sup>4</sup> In the case of FDI, the additional demand for labor comes not only from the investors themselves but also from local firms that supply inputs to the foreign-controlled firms. And it is certainly true in labor markets, as in any market, that increased demand causes the price—in this case, wages, which are the price of labor—to rise.

This statement, too, has to be qualified, however. Empirical evidence suggests (see below) that foreign direct investors tend to demand relatively skilled rather than unskilled labor. Thus it is plausible that the gains from FDI for workers are largely captured by a subset of workers who hold the needed skills. As we shall see, some evidence does exist that wage differentials between skilled and unskilled labor have widened in those developing countries most affected by globalization. But with some exceptions, the main reason (at least in those countries where the phenomenon has been studied) seems to be that the wages of the former have risen, rather than that those of the latter have fallen.

This argument notwithstanding, some US labor leaders have made statements suggesting that direct investment actually tends to reduce wages in developing countries. We say “suggesting” because their statements are not always models of clarity. For example, these leaders sometimes assert that globalization creates income inequality. This may or may not be true, but rising inequality may or may not lower wages. If inequality results from a rapid but uneven growth of income in response to globalization, higher-paid workers will benefit more than lower-paid workers, but all receive higher, not lower-wages. Writing in the *Washington Post* on 30 January 2000, AFL-CIO President John J. Sweeney states that, “If the global system continues to generate growing inequality, environmental destruction, and a race to the bottom for working people, then it will create an increasingly volatile reaction that will make Seattle look tame.” Which kind of inequality is he talking about? Does a “race for the bottom for working people” mean that workers will suffer from declining real wages as a result of globalization? Or simply that the gap between rich and poor will widen, with everyone gaining, but the rich gaining more? The grim scenario of social upheaval that he depicts seems to imply the former, but he does not say so explicitly, possibly because the empirical evidence supports more the latter, which weakens Sweeney’s case.

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4. However, Borzenstein et al. (1998) also find that this positive relationship between FDI and growth of the host economy is subject to a “human capital constraint.” The workforce of the host country must have achieved a certain minimal educational level before inward FDI can create growth. This only makes sense: without a threshold level of education, workers might not be able to use the technology brought in by the foreign firm. Also, in some instances new investment has been found *not* to contribute positively to growth: de Gregorio (1992) suggests that there are circumstances where the relationship is neutral. It is nonetheless difficult to envisage circumstances where the relationship would be negative.

It is also true that increased demand for labor created by foreign direct investors could be offset by reduced demand for labor by locally controlled enterprises, if the former drive the latter out of business or force them to curtail their operations. (There have been cases where this has happened; see, for example, Langdon 1975.) Also, if the foreign firm is more efficient than the domestic rival, and thus able to generate the same output with fewer workers, the job gains created by the former's entry might not fully offset the job loss resulting from the latter's exit. Under these circumstances, whether there is a net gain or a net loss in demand for labor may depend on how much economic growth the foreign investment generates. For if the foreign-controlled firm is more efficient than the local firm it replaces, and if that greater efficiency leads to lower prices for its products, demand for those products will rise. Then the foreign firm will be able to expand its output, and it will seek to hire additional workers.<sup>5</sup>

Also, to the extent that FDI accelerates overall economic growth, new job opportunities will be created outside the sectors in which this investment occurs. Empirical evidence suggests that this growth effect might in fact swamp any displacement effect in those countries meeting a "human capital threshold" (see note 4)—those whose workers possess the skills and levels of educational attainment that multinational firms require. (Alas, this might not hold for the poorest countries, where these preconditions are not met.)

In countries where the human capital threshold is met, FDI in principle does not place upward pressure only on domestic wages generally. Foreign-controlled firms are also likely to compensate workers in these economies better than do locally controlled firms. In other words, workers employed by foreign-controlled firms can expect to benefit from a "wage premium." Empirical evidence for such a wage premium is presented below.<sup>6</sup> For the moment, let's explore why in principle such a wage premium might prevail.

The main reason centers around explanations for why FDI occurs at all. A rather large body of literature has accumulated to explain the occurrence of FDI and the multinational spread of firms and their consequences.<sup>7</sup> The key point for this discussion to emerge from this literature

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5. The aggregate effect of an increase in the average efficiency of enterprises in an economy is measured econometrically as an increase in total factor productivity. The evidence suggests that, in economies with rapid rates of growth of total factor productivity, unemployment rates tend to be low, not high. This can happen because those workers who lose jobs because of efficiency gains (which, in isolation, cause jobs to be shed) are reemployed as economic growth results in new jobs being created.

6. Much of the recent work on FDI and compensation has focused on Mexico, in response to the debate over the North American Free Trade Agreement. This work is summarized later in this chapter.

7. Comprehensive, if somewhat dated, reviews of the relevant literature are contained in Dunning (1993) and Caves (1995).

is that, for a firm to succeed as a multinational, it must possess some attribute or attributes that give it advantages over local rivals in foreign markets. These attributes may include superior product or process technologies, superior management skills, access to markets not possessed by local rivals, or some other “ownership advantage.”<sup>8</sup> It has also been argued that, to succeed as a multinational, a firm must be able to achieve some sort of economy by working these advantages internally, that is, in operations controlled by the parent firm within the foreign market.<sup>9</sup> A firm doing business abroad does, after all, have alternatives to setting up its own local operations there: it can simply export goods produced at home, or it can license the use of its ownership advantage to independent local firms in the foreign market. If it cannot achieve any economies through the internal working of its advantages, the firm will choose to serve overseas markets through one of these cheaper, simpler alternatives to local operations.

One implication is that, to be competitive as a multinational, a firm must be prepared actually to use its ownership advantage in its overseas operations. This typically implies transfer of technology to the firm’s overseas subsidiaries and, in many cases, transfer of technology to suppliers and distributors as well. To the extent that this technology transfer occurs, the effect will be to raise the productivity of the foreign subsidiary above that of its rivals. The productivity rise enables the subsidiary to pay wages in excess of those prevailing in the local economy. Furthermore, to the extent that technology is transferred to local firms that act as suppliers or distributors to the subsidiary, these firms can pay a wage premium as well. However, the productivity rise does not automatically ensure that a wage premium is paid by either the subsidiary or its suppliers or distributors. Indeed, if these firms were to be “price takers” in the local labor market, there would be no wage premium.

Empirical evidence, to be presented shortly, does indicate however that there is indeed a wage premium associated with foreign ownership. Such a premium most likely is caused by foreign firms bidding for relatively scarce skilled labor, such that workers with needed skills are paid a premium over what they would have been paid had the foreign direct investment not occurred. However, it remains that a precondition for such a premium is that technology transfer does occur. And that such transfer actually does occur is very well documented.<sup>10</sup> A consequence of this technology transfer should be that local affiliates of multinationals are more productive than their domestically owned rivals, and empirical research has consistently found this to be so. One recent study (Aitken and Harrison 1999), for ex-

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8. The classic work on this is Hymer (1976). See also Dunning (1988).

9. The classic work on this is Buckley and Casson (1976).

10. The evidence is summarized by Caves (1999).



ample, find that local affiliates of multinationals in Venezuela are more productive than domestically controlled firms, even after allowance is made for factors affecting productivity other than ownership. There is also some evidence, however, that the widespread use in developing countries of certain policies toward inward FDI, most notably local content requirements, joint venture requirements, and mandatory technology transfer requirements, actually reduce the incentives of multinational firms to transfer their best technologies to local affiliates (Moran 1998).

Technology transfer from multinational firms to local firms is termed technological spillover. This, as noted, results in an enhancement of productivity of these local firms. Some additional spillover happens as a result of technological “catch-up” effects, as local rivals of the multinational firm upgrade their own technological and managerial capabilities in an effort to remain competitive. It has been demonstrated empirically that the activity of multinationals does result in technological spillovers, including technological catch-up, under some circumstances but not others.<sup>11</sup> Several factors have been found to affect the extent of spillovers. One is the specific type of FDI and the circumstances under which it takes place; for example, manufacturing for export is more likely to create spillovers than manufacturing for import substitution. Another set of factors is the characteristics of the foreign company making the investment, including its strategy. Others include the absorptive capacity of the local economy, the nature of markets in the local economy for inputs used by the foreign-owned company, and the policies of the host-country government.

Where technology transfers and spillovers do occur, the aggregate effect is to increase productivity of both labor and capital. Although these increases are important in their own right, the main point to be made here is that the resultant gains in labor productivity should, in theory at least, enable affiliates of multinational firms and certain local firms to pay higher real wages than generally prevail. Indeed, theory argues that wages must equal the marginal product of labor, which is another way of saying that wages are determined by labor productivity.<sup>12</sup> (Appendix A lays out the elementary theory.)

Thus, to the extent that FDI does in fact result in technology transfer and technological spillover, theory predicts that the consequences could include higher wages paid not only by foreign-controlled operations in

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11. The classic work on this is Dunning (1958), who found significant spillovers resulting from US direct investment in the United Kingdom during the 1950s. Later work pertaining to developing countries includes Blomström and Persson (1983), who found such effects in Mexico. Recent literature bearing on the evidence for spillovers is summarized by Caves (1999), who finds that the evidence is mostly positive.

12. Or at least this is so if markets for labor and for end products are competitive. The situation where entry into these markets is restricted is discussed later.

the host country, but also by local firms affected by these operations.<sup>13</sup> These wage differentials could, in principle, occur even if FDI does not create a net increase in the local demand for labor.<sup>14</sup>

A major question posed by US labor unions is, Does this happen in practice? Do increases in the productivity of labor really translate into higher wages for workers, as theory says they should? Answering this empirical question requires addressing two issues. One of these is whether in fact foreign-controlled enterprises in developing countries pay a premium over the generally prevailing wage rate. We defer this question for now to address a more basic question first, namely, Do wage differences across countries in general reflect productivity differentials? One way to test this is to determine whether, when productivity in developing countries rises more quickly than in the United States, real wages in these countries also rise relative to wages in the United States.

In the real world there are cases where this would appear not to be so. For example, Mexico during the early 1980s suffered a major drop in real wages, at a time when measured labor productivity in Mexico was rising faster than it was in the United States.<sup>15</sup> However, such counterexamples are relatively rare. The empirical evidence shows that, in most developing countries most of the time, there is a positive correlation between rising relative productivity (that is, a faster rise in productivity than in the United States) and rising relative wages (that is, a faster rise in wages than in the United States).<sup>16</sup> Major exceptions to this finding are just that—exceptions—and most of them can be explained. In Mexico, for example, the steep decline in real wages occurred following the debt crisis there during the early 1980s. That crisis was the result of too much public spending by the Mexican government, financed by international borrowing, and it caused the Mexican peso to suffer a very sharp depreciation, which lowered the average wage as measured in dollars.

One indicator of whether rising relative productivity is correlated with rising relative real wages is the index of unit labor costs at purchasing

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13. Strictly speaking, for an economy in full equilibrium, this wage differential should disappear. If foreign-controlled firms face no constraints on their ability to substitute labor for capital, they will add labor up to the point where diminishing marginal returns cause the marginal product of labor to fall to the prevailing wage rate. However, it is almost surely true that the nature of the technology employed by the foreign firm typically constrains the extent to which labor can substitute for capital. Given such a constraint, and given its higher labor productivity, the foreign-controlled firm might seek to hire workers selectively, paying a premium for workers with skills or innate characteristics (e.g., those who are intelligent and hence easy to train) needed for particular tasks. Such a premium could last indefinitely.

14. But the existence of a wage premium does not negate the concern of unions that, in the absence of collective bargaining rights and union representation, workers employed by US-controlled firms would be better compensated than they currently are. We return to this issue below.

15. Golub (1999); Golub's findings are summarized later in this chapter.

16. Golub (1999).

power parity. This quantity reflects corrections in labor costs for both productivity changes and deviations of exchange rates from levels that would hold real prices constant. Golub (1999) examines changes in this index for seven developing countries and finds that, for five of them (India, Korea, Malaysia, the Philippines, and Thailand), it rose from 1970 through 1993. This indicates that real wages in these countries have actually risen faster than productivity growth would suggest. In two other countries (Mexico and Indonesia), however, Golub found that this index had fallen. Golub also found a strong correlation, on a cross-sectional basis (that is, comparing a number of countries at a single point in time), between productivity growth and growth in real wages.<sup>17</sup>

These findings support the theoretical proposition that, for an economy as a whole, the relationship between productivity increases and wage changes in developing countries is generally positive. But as stated above, theory also indicates that the greater productivity of foreign-controlled enterprises in developing countries should enable these firms to pay a wage premium over and above the wages prevailing in the broader economy.<sup>18</sup> But does empirical evidence show that they do so?

To begin to answer this question, table 4.1 presents data on compensation paid by the overseas affiliates of US firms, broken down by industry and by income category of the host country. (The table uses the three income categories defined by the World Bank; details of this categorization are presented below.) The table also shows compensation paid by US parent firms to their employees in the United States and US domestic average compensation, broken down by the same industries. The data pertain to 1996, the latest year for which all of the data were available as of this writing.

As the table shows, the employees of foreign affiliates of US firms in the high-income economies—who constitute the majority of non-US employees of US firms—typically are compensated at least as well as, or even somewhat better than, the employees of parent firms in the United States. This result varies somewhat from industry to industry. In the petroleum, wholesale trade, and services industries, for example, overseas workers in the high-income countries are slightly better compensated on average than their counterparts at home, whereas in the manufacturing and finance sectors the reverse is true. Within the manufacturing sector, domestic employees are

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17. Regressing a wage index (the dependent variable) against a productivity index (the independent variable) for 49 countries, where the index is expressed such that its value for the United States is one, the regression coefficient is 1.30 and the  $R^2$  statistic (which measures “goodness of fit”) is about 0.7, using unadjusted data. This indicates a positive relationship (rises in productivity are associated with rises in real wages) that explains about 70 percent of the variation in the data. When the data are adjusted (e.g., using purchasing power parity rates), the regression coefficient comes closer to unity and the  $R^2$  statistic improves.

18. These economywide findings do not exclude the possibility that some MNCs (and some countries) have high productivity but pay low wages.

**Table 4.1 Annual compensation per worker by foreign affiliates and parent companies of US multinational corporations, by industry, 1996** (thousands of dollars)

Industry	Affiliates					
	All countries	Income category of host country			Parent companies	US average
		High	Middle	Low		
All	34.5	45.9	19.3	10.1	44.9	34.9
Petroleum	49.7	72.8	30.7	25.4	64.8	65.8
Manufacturing	32.9	45.0	14.1	4.9	51.8	45.1
Food and kindred products	29.2	45.6	13.8	5.9	33.4	36.8
Chemicals and allied products	42.9	56.6	21.7	5.7	64.2	51.7
Primary and fabricated metals	32.8	38.6	18.0	13.8	45.6	46.3
Industrial machinery and equipment	41.1	50.2	n.a.	5.1	53.7	49.7
Electronic and electric equipment	19.0	32.0	8.8	3.6	49.5	48.8
Transportation equipment	38.1	47.2	n.a.	n.a.	66.1	63.2
Other	32.7	43.0	15.9	n.a.	45.2	37.9
Wholesale trade	50.1	56.0	25.0	11.8	38.4	44.1
Finance, insurance, and real estate <sup>a</sup>	57.4	65.3	24.8	27.3	68.2	52.9
Services	39.2	42.4	19.7	25.8	33.2	30.8
Other	19.6	22.3	13.1	5.1	32.8	25.8

n.a. = indicates that data were available for fewer than half the countries in the income category.

a. Excludes deposit institutions.

*Sources:* Affiliate figures calculated by the author from data from Bureau of Economic Analysis (1999); US data from Bureau of Labor Statistics (2000).

less well compensated than overseas employees in the food and kindred products industry, whereas the reverse is true in other industries. Overall, however, the difference in compensation between domestic employees and overseas employees in the high-income countries is only about 5 percent.

However, what concerns the critics is, of course, not the wages paid by affiliates of US multinationals in the affluent countries but the wages paid by these affiliates in poorer countries. Table 4.1 also indicates that compensation by affiliates of US firms in middle- and low-income countries is much lower than compensation by their parent firms in the United States. On average, compensation in the middle-income countries is only 37 percent of that in the United States, and in the low-income countries this ratio drops to 18 percent. These data confirm that compensation of workers by US multinationals in low-wage countries is indeed low by US standards.

But the question we are asking is whether these wages are high or low by *local* standards. The most direct test is simply to look at compensation per

worker in foreign-controlled companies as a ratio to economywide compensation in each of the same three country income groups. If this ratio is approximately one for any group of countries, it would be reasonable to conclude that compensation by US-controlled firms in that group of companies is determined solely by prevailing local wages. If instead this ratio turns out to be lower than one for any group, it would suggest that US-controlled firms pay lower than the prevailing wage in these countries. But, of course, if this ratio were found to be greater than one, it would suggest that workers employed by US-controlled firms in these countries are, by local standards, relatively well off—that there is indeed a wage premium.

One practical problem with comparing average compensation in foreign-controlled firms with an average economywide compensation, as suggested in the previous paragraph, is that within an economy, average compensation in one sector can be quite different than in another sector. Thus, the comparison just suggested could be affected by “selection bias.” This would occur if, say, foreign-controlled firms were concentrated in those sectors in which workers were compensated at rates above those prevailing in other sectors where foreign direct investment did not occur. In this instance, even if foreign-controlled firms compensated their workers at rates no higher than their domestically owned rivals, the compensation of the former would be at rates above average economywide compensation. Hence, such comparisons are more meaningful if they pertain to a common sector. In what follows, comparisons are limited to within the manufacturing sector, which accounts for the largest sectoral share of US direct investment abroad.

Accordingly, table 4.2 shows compensation per worker by US-controlled firms relative to manufacturing wages in each of the three income groups. The figures are adjusted to take out the possible distortions caused by including expatriate employee compensation. (Especially in the low-income countries, one might expect expatriates, who mostly would be in managerial or skilled technical positions, to be paid much more than domestic residents.)

In the high-income countries, compensation per worker in the foreign affiliates is 1.4 times average manufacturing compensation. In the middle-income countries this ratio is substantially higher, at 1.8. And in the low-income countries this ratio is 2.0. Thus, adjusted compensation per employee in the overseas affiliates of US manufacturing firms, measured as a ratio to average local manufacturing wages, is well above one, and higher in developing than in developed countries. Of course, as the table also shows, compensation is significantly higher in absolute terms in the high-income countries than in the middle- or low-income countries. Thus, relative to employees in high-income countries, employees in low- and middle-income countries fare less well. But relative to other workers in their own countries, the employees of overseas affiliates do much better in the lower-income countries than in higher-income countries.

This conclusion is consistent with results recently reported in the academic literature that workers employed by foreign investors in develop-

**Table 4.2 Average compensation paid by foreign affiliates and average domestic manufacturing wage, by host-country income, 1994**

	All countries	Income category of host country		
		High	Middle	Low
Average compensation paid by affiliates <sup>a</sup> (thousands of dollars)	15.1	32.4	9.5	3.4
Average domestic manufacturing wage <sup>b</sup> (thousands of dollars)	9.9	22.6	5.4	1.7
Ratio <sup>c</sup>	1.5	1.4	1.8	2.0

a. Total compensation paid by foreign affiliates of US firms (less an estimate of compensation paid to US citizens employed by these affiliates) divided by the number of non-US citizens employed by these affiliates. Compensation to US citizens is estimated from base data from the Internal Revenue Service for 1987, extrapolated to 1994 using average growth in compensation for all US workers.

b. Hourly wage rate published by the International Labour Organization (ILO) times average working hours per year for 1990-94 as published by the World Bank.

c. Ratio of the average compensation paid by affiliates to the average domestic manufacturing wage.

Sources: Author's calculations based on data from Bureau of Economic Analysis (1997), ILO (2000), Internal Revenue Service (1998), and World Bank (1997).

ing countries tend to be paid high wages relative to workers employed by domestic investors in those countries. For example, Feenstra and Hanson (1997) show that wages are higher along the US-Mexico border, where the maquiladora operations of US firms are concentrated, than in other regions of Mexico. Aitken, Harrison, and Lipsey (1996) show that direct investors pay higher wages in Mexico and Venezuela than do local firms, even after controlling for industry and other factors that might affect wage premiums. There in fact seems to be a wage premium associated with foreign investment even in advanced countries. For example, Bora and Wooden (1998) demonstrate that wages paid by foreign-controlled firms even in high-income Australia exceed those paid by domestic enterprises, after controlling for other variables that might affect wage levels, such as the amount of physical capital per worker and the amount of human capital (i.e., educational attainment of the workers).<sup>19</sup> Rosen (1999)

19. Such a wage premium indeed exists in the United States (Graham and Krugman 1995). However, Aitken et al. (1996) show that, in the United States at least, this premium is associated with certain industries, not with foreign versus domestic ownership. That is, although foreign-controlled enterprises in the United States do pay higher than average wages, they concentrate their activities in sectors where higher than average wages are the norm. Compared with US-controlled firms operating in the same sectors, the foreign-controlled firms do not pay higher wages. By contrast, Feenstra and Hanson (1997) show that wage premiums in Mexico have arisen within sectors following inflow of FDI, suggesting that the wage premium there is not due to sectoral selection bias.

argues that firms with foreign investors in China are able to (and do) pay their workers more than do state-owned enterprises, precisely because the former are significantly more productive.

In short, are local workers employed by affiliates of US firms in lower-income countries underpaid? By US standards, they are. But US standards are irrelevant in developing countries—very few workers are paid at US levels in these countries. The key point is that, by local standards, these workers typically fare quite well.

The bottom line would seem to be that FDI in developing countries benefits labor in these countries, or at least benefits those workers employed by local affiliates of foreign firms, in the sense that these workers earn more than workers employed in these nations. How much benefit accrues to these workers, however, seems to depend upon a number of factors, including the type of activity in which they are employed. Also, there appears to be little to no evidence that FDI makes workers not employed by foreign-owned firms worse off. The closest such evidence is that of Hanson and Harrison (1999), which indicates that the least-skilled Mexican workers might not be gaining from trade liberalization.<sup>20</sup> Even this result does not suggest that liberalization actually makes these workers worse off; rather, they do not receive the gains that other, more skilled workers receive. Furthermore, other work by Feenstra and Hanson (1997) shows that less-skilled workers are generally not associated with direct investment in Mexico; foreign investors tend to demand skilled, not unskilled, labor in their operations. The case seems to be strong, then, that as nongainers from trade (and perhaps investment) liberalization, the least-skilled workers suffer more, not because they are thrust onto a down escalator, but because they are unable to get onto the up escalator.<sup>21</sup> Thus, the very bottom line seems to be that FDI in developing countries brings benefits that are captured primarily by workers possessing some threshold of skills. Very little FDI flows to areas or sectors where wages, and hence skills, are low. This point is demonstrated in the next section.

Before that, however, one more important point should be made. We have demonstrated here two facts that bear on the wages paid by multinational firms in low-income countries. First, these firms pay higher wages than prevail locally, and the wage premium paid by these firms persists even after certain other factors (such as industry composition) are

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20. However, this result might be idiosyncratic to Mexico. A recent paper by Dollar and Kray (2000) concludes that the lowest income quintile of the population in other developing countries—a group that is likely to contain the least-skilled workers—generally benefits from greater openness of the economy.

21. However, as noted earlier, Mexican unit labor costs have fallen relative to US unit labor costs over the past 25 years. Thus, Mexico as a whole has been on the down escalator, largely because of the real depreciation of the peso. It is not clear to what extent this phenomenon is related to trade or investment liberalization, but clearly a number of other developing countries that have also undergone liberalization have *not* experienced this phenomenon.

accounted for. Second, these firms tend to transfer technology to their overseas locations, raising the productivity of labor in these firms above that in their local rivals.

But we have not yet resolved whether the wage premium accurately reflects the greater productivity of the local operations of multinational firms in developing countries. A position taken by some in the US labor unions is that wages paid by the local affiliates of multinational corporations are low in the sense that the marginal product of the worker exceeds the wage paid, when the marginal product is valued at world prices. In this view, the multinationals, rather than paying what they “should” pay the workers in their foreign affiliates, are making handsome profits in overseas markets from their labor. For example, suppose the wages paid by the local affiliates of multinationals in the world’s poorest nations are indeed (as table 4.2 suggests) twice the average manufacturing sector wage prevailing there, but that the marginal product of these workers is four times that of the average manufacturing worker. Then the case could be made that local affiliates are paying half what they should be paying.<sup>22</sup>

Whether the wage premium fails to fully reflect the productivity differential thus measured is an issue that the empirical literature does not resolve fully. (Importantly, even if the wage premium does not fully reflect the productivity differential, it is nonetheless a premium and not a discount: what we are talking about now is not whether FDI enriches or impoverishes workers, but rather by how much these workers are enriched!) If this were to be the case, that the wage premium did not reflect the differential, it would fly in the face of economic reasoning. This reasoning holds that a firm’s profits are maximized only when it pays a wage equal to the value of the marginal product of the worker. The reason is that, in general, as more and more workers are hired, the marginal product of an additional worker falls (at least beyond a certain level of total employment). Hence a firm could increase its profits by hiring additional workers until the point is reached where the marginal product has fallen to the level of the wage.<sup>23</sup> Thus, if it is true that the marginal product of a typical

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22. If this were so economic theory suggests that, under normal circumstances, output would be expanded until marginal product of labor equaled the wage paid. However, there are a number of circumstances that might plausibly apply to foreign-controlled operations in developing countries wherein this would not happen, e.g., for a variety of reasons, there might be discontinuities in the marginal product and/or marginal revenue schedules of the operation. Also, in nations where regulations make it difficult to lay off workers, firms might not hire workers during periods of economic expansion if they expect future downturns to occur; the costs associated with layoffs (or with retaining excess labor) during downturns might exceed the expected value of the additional workers.

23. This is because if the value of the marginal product of an additional worker is greater than the wage paid to that worker, the value of the additional output of that worker exceeds the cost of the worker (virtually by definition) and hence contributes to additional profit. Also, the very fact that a wage premium exists might indicate that firms do not expand their



worker employed by a multinational firm in a developing country is higher than the wage paid that worker, it is hard to conceive why the firm would not react by hiring more workers and expanding output until the marginal product of the firm equaled that wage. This would contribute to still greater demand for workers, placing additional upward pressure on wages. It is only when the point where the value of the marginal product, i.e., the marginal productivity, of a worker equals the wage that the firm's profits are maximized. As a practical matter, the exact maximum might not be realized, but the firm surely will try to get as close to this point as it is able.

To repeat, however, the matter of whether wage premiums accurately reflect marginal productivity differences remains unresolved in the empirical literature, and the case made above is therefore strictly conjectural.<sup>24</sup> Evidence that the wage differential is less than the productivity differential is the fact that, on average, US-based multinationals in the manufacturing sector pay workers in the poorest countries less than one-tenth what they pay workers in the United States (table 4.1). If the technology that these firms transfer to these countries were identical to what they use in the United States, it would be somewhat unlikely that the marginal product of their workers in the host country is only one-tenth that in the United States. But there is reason to think that the technology transferred is not the same. The operations established in these labor-abundant countries are likely to be predominantly labor intensive and may not embody the most advanced technologies. In that case the 10-fold differential is not implausible. Moreover, and most important, a 10-fold differential in marginal product does not necessarily mean a 10-fold difference in average product, and it is marginal product, not average product, that determines wages (see appendix A).

Why would the ratio of marginal to average product be different in two otherwise similar operations of a firm, one of which is located in a developed country where prevailing wages are high, and the other in a developing country where prevailing wages are low? The answer is simple: in

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workforces to the point where marginal product equals wages. This will be true if two conditions hold. The first is that the wage premium does not reflect greater skills of workers employed by foreign-controlled enterprises relative to workers employed by domestically controlled enterprises (on this, we have already noted that such a skill difference, however, does seem to exist). The second is that the wage differential does otherwise reflect some element of labor scarcity in the former enterprises. The latter might occur if the workers were unionized, if the enterprises functioned as closed shops (where nonunion workers are not allowed), and if the unions limited membership. This type of restriction does seem to occur. For example, Romer (1994) finds that larger numbers of workers are employed in export processing zones in developing countries than are employed in similar facilities outside these zones, and that union activity is limited in the zones. This would suggest that unions do create some restrictions on the number of workers hired.

24. This omission in the empirical studies occurs in large part because the marginal product of a worker is very difficult to measure (and is not equal to average product, as shown below).

the former, where labor is expensive, it is also conserved, for example by using machinery (a form of capital) to do things that could in principle be done manually. But in the developing country it might be economical to do these same tasks manually. Is this harmful to workers' interests in the developing country? Clearly not, because more jobs are created than if the task were done by machinery. But the effect is to widen the wedge between marginal and average product. Employing workers rather than using machines to perform such tasks lowers the average product of a worker, though only slightly. But the marginal product falls substantially: in fact, no additional output is created, but cost savings in the form of reduced requirements for machinery, power, and so forth are realized. If the difference between the reduction in cost and the wages paid to the worker is slight, marginal product will be low.<sup>25</sup>

Given this result, we can return to the issue of whether the wages paid by multinational firms in developing countries are less than what they might be if those countries were more unionized. First, it must be conceded that in some countries, such as Mexico, workers in some industries where FDI plays a significant role are in fact represented by unions, and their wages do seem to be higher than those paid in nonunionized sectors.<sup>26</sup> Indeed, their high wages might account for some significant portion of the wage premium paid by foreign-controlled firms in Mexico. But in the end, whether there is or is not scope for unions to extract higher wages rests in large measure on the issue already touched upon, namely, whether or not workers are currently underpaid relative to the marginal product that they generate. If they are underpaid in this sense, then there is significant scope for union action to raise wages. If they are not, then this scope is much more constrained.

Unfortunately, the bottom line is that we simply do not know from direct empirical evidence whether workers are in this sense underpaid. Some critics of globalization (e.g., Greider 1997) have rather boldly, and on the face of almost no evidence, asserted that they are. These authors talk about multinational operations that are as productive as those in developed countries but that employ workers at third world wages. But what these critics miss is that if a multinational firm actually did this, it would not be maximizing profits! It could produce more output simply by continuing to hire more workers until the marginal productivity of a worker fell to the level of the wage paid that worker. By doing so, the firm increases its profits without increasing its investment in the operation. Surely these critics do not mean to imply this—indeed, they typically criticize multinational firms for being greedy and putting profit above all

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25. Furthermore, less-skilled workers are likely to be employed in this type of task, and it is precisely these workers who, as shown above, are the most likely to be left behind by globalization.

26. Moran (2000).

other considerations. But, if these firms do attempt to maximize profit, they will not pay workers “third world wages” while hiring just enough of them so that the marginal productivity of the worker is equal to that of a counterpart in a high wage country.

Thus, in short, whether or not workers employed by multinational firms in developing countries are underpaid relative to the marginal product they generate is a matter on which the empirical evidence is admittedly scant. But the empirical evidence that does exist is more consistent with these workers being paid their marginal product than with their being paid significantly less. More important, it simply does not make economic sense that workers are not paid their marginal product. If this were so, firms would be forgoing opportunities to reduce costs or increase output by employing still more workers in these operations. Rather than that multinationals are failing to pay workers the value of their marginal product, it is much more likely that these firms take advantage of lower wages in developing countries to employ workers to perform manual tasks that might be done using machinery in a developed country. And if this is so, workers in the developing country unequivocally benefit, because additional employment opportunities are created. Moreover, at least some of these benefits might be available to less skilled workers who otherwise might not be employed at all.

## Globalization and the Sweatshop Issue

For some labor activists, the main grievance against direct investment in developing countries is not that direct investors pay their workers sub-standard wages, however defined.<sup>27</sup> Rather, the complaint is that workers in these countries are forced to work under what amount to sweatshop conditions.<sup>28</sup>

“Sweatshop conditions” are by their nature rather difficult to define. But like pornography, you know them when you see them. Typically, a sweatshop is a manufacturing operation where some combination of the following circumstances prevails: workers put in long hours, the facility is crowded, working conditions are unsafe or unsanitary, lighting and/or ventilation is poor, or treatment of workers is harsh.

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27. A lengthy study by the US Department of Labor (Bureau of International Labor Standards 2000) addresses whether or not wages meet workers’ needs in the apparel and footwear industries of 35 countries that are the largest exporters of apparel and footwear to the United States. The study’s executive summary reports that “For the countries considered, there appears to be little conclusive evidence on the extent to which wages and non-wage benefits in the footwear and apparel (sic) meet workers’ basic needs.”

28. “Forced to work” here is meant in the sense that better opportunities for these workers do not exist. As odious as sweatshops are, they do not employ slave labor.

It would be hiding one's head in the sand to assert that sweatshops do not exist, or that, if they exist, they are in no way associated with international trade or investment. Indeed, this author has visited facilities in a number of developing countries that meet the "you know it when you see it" test. Nor is it any defense that sweatshop facilities are not limited to developing countries—that they can be found even in New York, San Francisco, and the suburbs north of Paris. But no one would dispute (even if the fact is not well documented) that sweatshops are more commonly found in developing than in more developed countries.

All the sweatshop facilities that I have visited were producers of apparel destined for export. Even in this industry and in these countries, however, my experiences have been mixed. For example, although conditions in some apparel facilities I have seen were little short of appalling, other facilities were clean and well lit, and the workers were treated well by any reasonable standard.

Importantly, none of the sweatshops I visited were actually owned or run by multinational enterprises, nor, indeed, are the operations often cited by activists (e.g., suppliers to Nike or The Gap). Rather, they are owned and managed by local entrepreneurs in the economies in which they operate. Many do, however, produce apparel products under contract for international companies. In some cases, these companies are brand-name retailers of apparel, but in most cases they are Hong Kong-based wholesale distributors who supply product to mass marketers in the United States, Europe, and Asia. Thus, activists might claim—with reason—that although the facilities are not actually part of any multinational firm, they are under the de facto control of such firms. In some cases the subcontractors for international retailers are themselves foreign owned. For example, Korean investors own apparel and footwear plants in Guatemala and Southeast Asia.

My visits taught me some of the complexities of the sweatshop issue. For instance, it is easy, from the vantage point of a country like the United States, to argue that no factories in any location or under any circumstance should be allowed to employ children. In Bangladesh, however, I visited one apparel factory where children (in this case, girls in their early teens) were employed. This factory was owned by a local entrepreneur but served as a subcontractor to an international apparel maker. On the face of it, such employment might seem shameless. But this particular facility was clean and well lit, wages were more than adequate by local standards, and most important, the young women were required as a condition of employment to spend several hours a day in a company-run school where they were taught to read and write.<sup>29</sup> This was in a country where, at the time, the illiteracy rate among women bordered on 90 percent, and one

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29. The factory owner, who sought to project an image of a hard-headed businessperson and not that of an altruist, indicated that he provided schooling for these employees because the operation was beginning to use computer-driven process controls, whose implementation required that the production workers be literate.

could not help but notice that hordes of children lived on the streets of the capital and earned their keep by begging. Also, in much of rural Bangladesh, where most of the population lives, extreme poverty is endemic. Rural women typically are married and bearing children by the time they reach the age of the workers in the apparel factory. Thus, compared with most of their compatriots, these young women were well off.

However, it must be stressed that, in other facilities I visited, conditions were very much worse. Others have observed and reported even worse practices than any I saw, and some of these are discussed below. But the only general statement that one can make regarding the conditions I witnessed was that they varied greatly from plant to plant, from deplorable to commendable. In some, by any definition, sweatshop conditions did prevail.<sup>30</sup> But in others it was hard to find significant fault with working conditions.

The question then becomes, How prevalent are sweatshops in developing countries, and to what extent are they associated with direct investment or export activities? Some antiglobalist authors have claimed that essentially all foreign-owned facilities in developing countries are sweatshops.<sup>31</sup> But this is simply not true. I am not aware of any effort that has been made to collect comprehensive data on the incidence of sweatshops, but most of the anecdotes (including my own) seem to involve the footwear, apparel, toy-making, and sporting goods industries, with most of the problems apparently in the first two.<sup>32</sup> These industries are not dominant ones in the global economy. Products originating in these four industries combined accounted for less than 10 percent of world exports of merchandise in 1997, and for well under 7 percent of the stock of US direct investment abroad in 1998.<sup>33</sup> If indeed sweatshop conditions are con-

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30. However, the worst working conditions I observed were to be found in locally owned plants that did not serve the international market. Rosen (1999) finds similarly that working conditions in foreign-controlled, export-oriented plants in China are typically better than in plants controlled by state-owned enterprises with a domestic market focus. This would seem to belie the claims made by some antiglobalists that it is international trade and investment that create the sweatshop conditions and that the answer is local control of economic activity. See Goldsmith (1996).

31. That sweatshops are the rule is essentially the claim of Wallach and Sforza (1999), for example.

32. Perhaps for this reason the US Department of Labor, in its efforts to determine if export sectors in developing nations employ child labor (Bureau of International Labor Standards 2000), has concentrated on the apparel and footwear sectors.

33. World Trade Organization (1998, table iv.1), Bureau of Economic Analysis (1998). Unfortunately, footwear products are not broken out separately in the WTO statistics, and thus the assumption is made that these are equal in value to clothing exports. If this is so, then textile products account for 2.9 percent of world merchandise exports, and clothing and footwear 3.3 percent each. In the BEA data, the footwear, textile, and apparel industries are not shown separately but are included in "other manufacturing." The total stock of "other manufacturing" represents about 6.6 percent of the total stock of US direct investment abroad.

centrated in these industries, they do not represent the greater part of globalized economic activity.<sup>34</sup> And as already noted, not all facilities even in these industries are sweatshops.

Also, even if these industries are ones where sweatshops tend to be prevalent, it does not follow that the answer is to shut down international trade and investment in these industries and for all countries to make these products locally, as some antiglobalist authors suggest.<sup>35</sup> In fact, in a number of once-poor economies, the establishment of export-oriented apparel and footwear operations has been the first step on a long journey to prosperity. Hong Kong, Korea, Singapore, and Taiwan all began their successful marches out of poverty and into the ranks of the middle- and high-income economies in just this way.<sup>36</sup> And the evidence is robust that developing countries that foster export-oriented activity do much better at alleviating poverty than do those that maintain inward-looking regimes (see, e.g., Krueger 1998 and Dollar 1992).

None of this, of course, excuses the worst sweatshops, wherever they are found. Indeed, one of the benefits of modern technology is that buildings virtually anywhere in the world can now be lighted properly, ventilated adequately, and equipped with sanitary restrooms at reasonable cost. There is simply no longer any excuse for subjecting workers to such degrading working conditions. A few years ago the chief executive of Nike offered to send basketball star Michael Jordan to inspect Nike's overseas suppliers for bad working conditions. Labor and human rights activists countered, possibly accurately, that all such overseas facilities could be upgraded to remove the objectionable conditions for a fraction of what Nike was paying Jordan at that time to endorse its basketball shoes.

What are the offensive practices that occur in sweatshops? Some that have been reported are the following.<sup>37</sup>

## **Inadequate Wages and Unfair Wage Practices**

As already noted, there is not much evidence one way or the other on whether sweatshops in developing countries pay wages sufficient to meet the basic needs of their workers. However, the anecdotal evidence sug-

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34. However, just as it is clear that not all textile, apparel, or footwear factories in developing countries are sweatshops, neither is it clear that sweatshops do not exist outside of these industries. On this matter, as noted, little systematic evidence exists.

35. See, for example, Morris (1996) for an exposition of this view.

36. Will other countries follow in their footsteps, such that apparel and footwear exports will lead a significant number of countries that are today among the world's poorest out of poverty? For some differing views, see Varley (1998, chapter 3).

37. All of these are taken from Varley (1998); for each practice listed, there is at least anecdotal evidence to suggest that it has actually taken place. However, as noted earlier, one problem is that there are no data to indicate exactly how prevalent such practices are.

gests that wages are often so low that they cover only the barest minimum of living standards. In addition, there is evidence that some employers delay paying their workers what is owed them (sometimes, it would seem, for months). Overtime pay is often nonexistent, and many such operations pay on a piece-rate basis, where the basic unit of pay is very low. Some of the worst cases that have been uncovered (e.g., the stitching of soccer balls by young children in Pakistan) involve work done at home on a piece-rate basis.

## **Excessive Overtime**

Complaints are commonly heard from around the world that, during busy times, workers are required to work overtime, often with no overtime bonus and in excess of statutory maximums, and that during such times workers are sometimes forbidden from taking breaks, even to use the toilet. Some of the relevant industries in which sweatshops are common (especially apparel) are highly seasonal, so that suppliers are often forced to meet short production deadlines. Even so, situations that require workers to be on the job for periods of time that are excessive to the point of being inhumane seem commonplace.

## **Abusive Treatment of Workers**

Abusive treatment can take several forms, one of which is that workers are sometimes required to work under conditions where they are exposed to undue risks of injury or disease. Cases have also been reported where workers are punished abusively—that is, subjected to the risk of bodily harm—for violation of work rules. Also, given that many factory workers in developing countries are young and female, cases of sexual harassment by male supervisors are often reported. In extreme (but apparently not uncommon) cases, such workers can be required to grant sexual favors to supervisors virtually as a condition of employment.

## **Bonded Labor**

Under bonded labor schemes, a worker pledges his or her labor for a specified time in return for a loan. In some countries, parents pledge the labor of their children in this way. The worker thus in bondage is virtually a slave. Numerous variants have been reported. For example, in some reported cases, workers pay a deposit for the “right” to work in a distant operation, are transported there, and receive back the deposit only if they stay a minimum specified time. During this time they are little more than slaves.

## Child Labor

Child labor is one issue on which reasonably accurate data do exist, and they are not comforting. According to the International Labour Organisation, 250 million children worldwide under the age of 14 are working, although more than half of these work only part-time. As my experience in Bangladesh showed, not all these children are employed in sweatshop conditions, but it is a safe bet that a large percentage are. In some cultures child labor is socially acceptable and indeed part of the culture. And in many countries children may have few alternatives to starting work at an early age. Indeed, the children who work might be considered more fortunate than their contemporaries on the streets.

However, in today's world, in every culture no matter what its norms and traditions, a child needs education if he or she is to grow into an adult with a promising future. How can a child who is working full-time hope to receive an education? As my visit to Bangladesh also shows, a lucky few may receive education from their employers, but such cases are likely to be rare.

In many countries this problem is compounded by inadequate educational infrastructure: there are simply not enough public schools to educate all the country's children. And in most of these countries the vast majority of parents cannot afford to send their children to private schools. In these countries there is no real alternative for many children except to work. This situation simply cries out for the provision of a better educational infrastructure. If there is a case to be made for increasing the flow of concessional aid to the world's poorer countries, that case surely is strongest for aid to build and staff public schools.

## What Is the Solution to the Sweatshop Problem?

At the end of the day, there simply is no excuse on humanitarian grounds for sweatshop conditions to prevail anywhere. If at least some apparel factories in Bangladesh can provide for their workers a living wage, humane working hours, and a clean, safe, and harassment-free working environment, and still earn a profit for their owners, surely the same can be accomplished in virtually any industry and in any country.

But what is the best way to achieve this? Unions and human rights activists in the United States advocate imposing sanctions on imports from countries where sweatshops exist, to induce those countries to improve working conditions. Would sanctions work? This is not an easy question to answer. But clearly it makes no sense to impose sanctions on a whole country for labor standards violations by a relative few employers. That would be to punish the innocent along with the guilty, for again, not even all apparel, toy, or footwear factories are sweatshops. It would not serve a



useful purpose to subject the employers and employees of the good facilities to possible shutdown and loss of employment in an attempt to root out the bad facilities. This would only deprive workers of the chance to earn a living, and in some cases even deprive them of the chance to become literate.

A fairer (and effective) approach would be to sanction only the products of those specific facilities that do not implement good labor practices. Indeed, in the United States itself, labor unions target for punitive action only those employers, not whole sectors or regions, against which workers have legitimate grievances. Admittedly, selective imposition of sanctions would not be easy. In Dacca, Bangladesh, at the time of this author's visit, there were upward of 800 firms producing garments for export. To distinguish the bad from the good among these firms, it would be necessary to devote sufficient resources to enable impartial inspectors to visit each of these firms for purposes of certification.

Difficult though this would be, it would not be impossible. Indeed, one means of doing it is already being implemented, through associations under which firms agree to adhere to voluntary codes of labor standards. One of the more ambitious of these is the Fair Labor Association, under which firms agree to rather stringent, but self-enforced, standards of monitoring. This group has been organized by the Apparel Industry Partnership, a private industry group, with the backing of the US Department of Labor.<sup>38</sup> A large number of US universities have joined this association to ensure that clothing bearing their logos is not made in operations in which workers are mistreated.

Skeptics might question whether such voluntary associations that follow codes of conduct, or even associations that require that members implement monitoring procedures, will be effective at curtailing the more egregious labor practices. Their effectiveness could be enhanced if such associations were open to inspection by outside agents. For example, inspection teams from recognized human rights advocacy groups could be allowed to spot-check factories supplying firms that are members of the association.

Some role for the multilateral organizations might not be out of the question here. For example, the WTO could allow its members, if they choose, to apply tariffs on products imported by firms that elect not to join an effective monitoring association. Alternatively, sanctions might be allowed on products that the International Labour Organisation (ILO) determined had to have been made in operations that do not meet ILO basic labor standards. This latter would necessitate the creation of a corps of inspectors within the ILO whose mission it would be to visit plants around

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38. The charter of the Fair Labor Association is available on the Internet at <http://www.dol.gov/dol/esa/public/nosweat/partnership/aip.htm>.

the world to determine if core standards were violated.<sup>39</sup> Such a corps would not necessarily have to be large to be effective. Its existence might create a large incentive for firms to comply with ILO standards.

## **US Direct Investment Abroad and Employment in the United States**

Let us now turn to the effects of direct investment abroad on workers in the home country, again focusing on the United States. To stylize somewhat, labor leaders critical of FDI maintain that multinational firms typically shut down factories and other operations in their home countries and replace their production with new factories in countries where wages are lower. Alternatively, they use the threat of relocation to bargain for lower wages in the home country. Thus, these critics maintain, the effect of outward direct investment on the home country is either that jobs are lost (unemployment rises) or that wages are reduced below levels that would otherwise prevail.<sup>40</sup>

As this section will show, the first allegation simply does not stand up to careful examination of the relevant evidence. There is, in fact, little or no evidence to link outward US direct investment to rising overall unemployment. To the contrary, in those industries where FDI is prevalent, the evidence is actually consistent with the notion that FDI leads to job creation, not net job loss. At least this is so in those countries where this issue has been studied in some depth, notably the United States, France, and Japan.

The second allegation, however, is not so easily dismissed. We finish this section by addressing this issue.

But, to begin, a simple fact is worth noting: most US direct investment abroad does not occur in low-wage areas. Table 4.3 shows that the vast bulk—almost 80 percent—of the stock of US direct investment abroad at the end of 1997 was located in other high-income countries such as those of Western Europe, Canada, Australia, New Zealand, and Japan. Nearly all the rest—18 percent of the total—is in the world’s middle-income countries. Only about 1.5 percent of the stock of US outward direct in-

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39. Other antisweatshop initiatives and proposals are evaluated in Varley (1998), which surveys the whole issue of sweatshops much more comprehensively than is possible here.

40. In this view, it is not only the threat of plant relocation and the consequent bargaining down of wages that reduces wages. If plants in some sectors are shut down as the result of FDI, but workers from these plants are reemployed in other sectors, there could be a reduction in average wages (but no net loss of jobs) if wages in the sectors to which the workers relocate are lower than those in the sectors from which they came. Kletzer (1997) shows that this can indeed happen when workers are displaced by imports in durable goods sectors, and at least some of this displacement might be caused by plant relocations.

**Table 4.3 US direct investment position abroad by host-country income, 1997**

Income group	Billions of dollars	Percent of total
High-income countries	679.7	79.5
Middle-income countries	162.2	19.0
Low-income countries	13.2	1.5
All countries	855.2	100.0

Source: Calculated by author from Bureau of Economic Analysis (1998).

vestment is located in low-income countries.<sup>41</sup> (Table 4.4 indicates which countries are classified as high income, middle income, and low income.) To the extent that US FDI goes to other high-income, high-wage countries, the threat of firms relocating abroad to obtain cheaper labor would appear to be a hollow one.

Skeptics might counter that the stock of FDI largely reflects overseas investments made decades ago—what if the more recent acceleration of globalization has led to a rising trend in current FDI *flows* to poor countries, which the stock measure obscures? But this is not the case: the official statistics do not reveal any marked shift in recent flows of direct investment toward these countries. Figure 4.1 breaks down dollar flows of outward US direct investment since 1983 by the income category of the host. Figure 4.2 does the same in terms of percentages of annual totals. As figure 4.2 shows, the percentage of these flows going to high-income countries did drop somewhat during the late 1980s but was quite stable during the 1990s. Moreover, the corresponding rise in the 1980s was registered not by the low-income countries but rather by the middle-income countries. The share of US outward direct investment received by this group of countries in fact rose sharply between 1988 and 1990 but has remained quite stable since then. There has been no trend toward a greater share of these flows going to low-income countries.

Figures 4.1 and 4.2 are based on country income classifications published by the World Bank as of 1995. During the past 10 years, however, certain countries have changed their income category. In most cases this happened as countries “graduated” from the middle- to the high-income category. Thus, a number of countries that had been classified as middle-income in 1985 were reclassified as high-income countries by 1995. This could bias upward the observed share of FDI in high-income countries in the later years. Figures 4.3 and 4.4 therefore use the 1985 income classifications for the entire period. (In addition, appendix A lists which countries fell into which categories for both 1985 and 1995.)

As one would expect, this reduces somewhat the percentage of FDI flows going to the high-income countries, because some countries are

41. A small amount of this investment (\$4.4 billion, or about 0.6 percent of the total) is classified as “international,” that is, not allocated to any specific country. In table 4.3 and figures 4.1 through 4.8, this investment is omitted.

**Table 4.4 Countries in the sample by income category in 1985 and 1995**

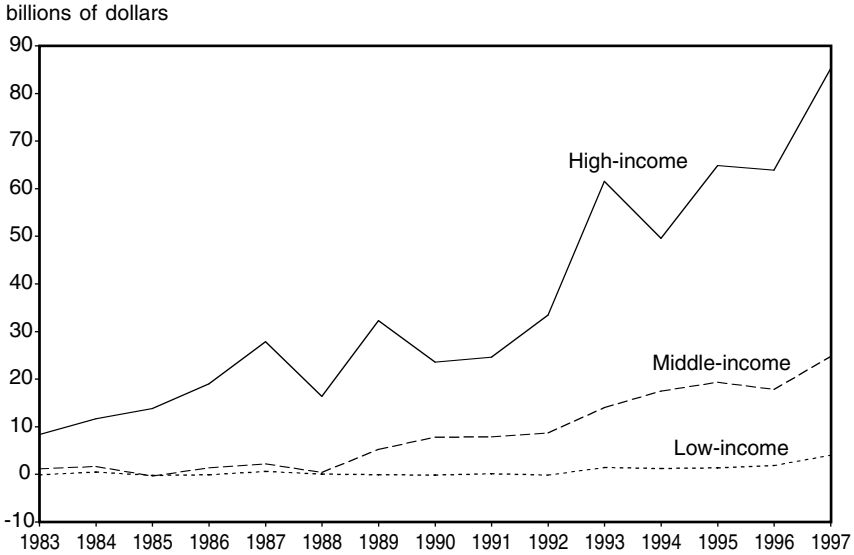
High-income countries		Middle-income countries		Low-income countries	
1985	1995	1985	1995	1985	1995
Australia	Australia	UK islands	UK islands	China	China
Austria	Austria	Argentina	Argentina		Honduras
Bahamas	Bahamas	Barbados	Barbados	India	India
Belgium	Belgium	Brazil	Brazil		Nigeria
Bermuda	Bermuda	Chile	Chile		
Canada	Canada	Colombia	Colombia		
Denmark	Denmark	Costa Rica	Costa Rica		
Finland	Finland	Dominican Rep.	Dominican Rep.		
France	France	Ecuador	Ecuador		
Germany	Germany	Egypt	Egypt		
	Hong Kong	Greece	Greece		
Ireland	Ireland	Guatemala	Guatemala		
	Israel	<i>Honduras</i>			
Italy	Italy	<i>Hong Kong</i>			
Japan	Japan	Indonesia	Indonesia		
	South Korea	<i>Israel</i>			
Luxembourg	Luxembourg	Jamaica	Jamaica		
Netherlands	Netherlands	<i>South Korea</i>			
Neth. Antilles	Neth. Antilles	Malaysia	Malaysia		
New Zealand	New Zealand	Mexico	Mexico		
Norway	Norway	<i>Nigeria</i>			
<i>Saudi Arabia</i>		Panama	Panama		
	Portugal	Peru	Peru		
	Singapore	The Philippines	The Philippines		
Spain	Spain	<i>Portugal</i>			
Sweden	Sweden		Saudi Arabia		
Switzerland	Switzerland	South Africa	South Africa		
	Taiwan	<i>Singapore</i>			
UAE	UAE	<i>Taiwan</i>			
United Kingdom	United Kingdom	Thailand	Thailand		
		Trinidad & Tobago	Trinidad & Tobago		
		Turkey	Turkey		
		Venezuela	Venezuela		

Note: Countries that switched groups between 1985 and 1995 are in italics.

Source: World Bank, *World Development Report*, various issues.

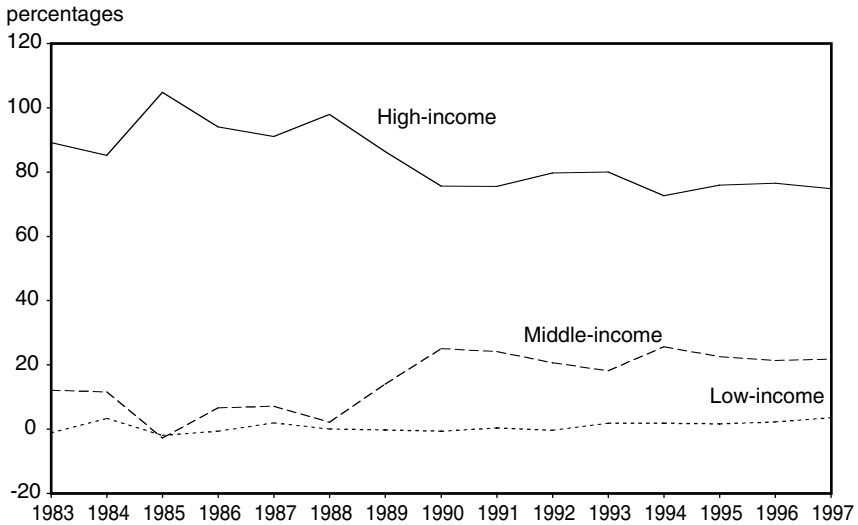
classified in the middle-income category throughout the period that were in the high-income category in figures 4.1 and 4.2. But the basic message is the same. In particular, even with the reclassification, the share of US direct investment flows to high-income countries fell during the 1980s but has been quite stable during the 1990s. The middle-income countries received a growing share of these flows from roughly 1988 through 1991, but that share stabilized thereafter. And even with the reclassification,

**Figure 4.1 Outflows of US foreign direct investment by host-country income (1995 income categories)**



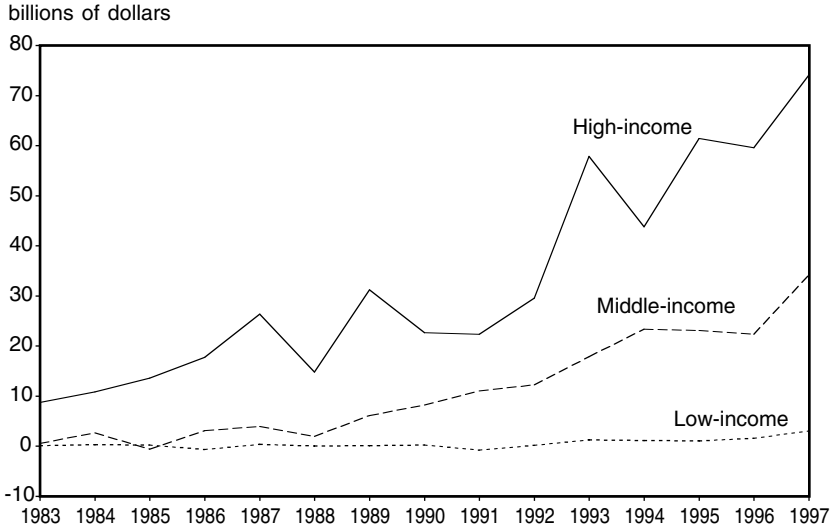
Source: Bureau of Economic Analysis (1998).

**Figure 4.2 Shares of US foreign direct investment outflows by host-country income (1995 income categories)**



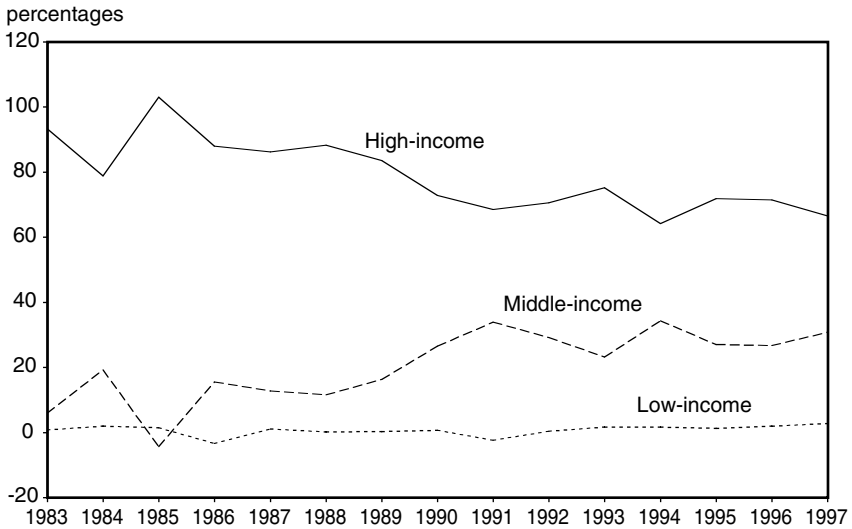
Source: Bureau of Economic Analysis (1998).

**Figure 4.3 Outflows of US foreign direct investment by host-country income (1985 income categories)**



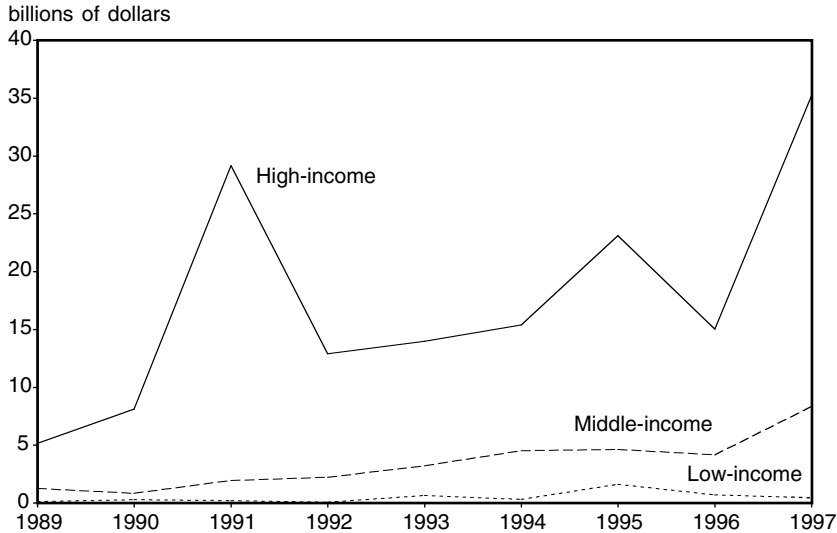
Source: Bureau of Economic Analysis (1998).

**Figure 4.4 Shares of US foreign direct investment by host-country income (1985 income categories)**



Source: Bureau of Economic Analysis (1998).

**Figure 4.5 Outflows of US equity capital by host-country income (1995 income categories)**



Source: Bureau of Economic Analysis (1998).

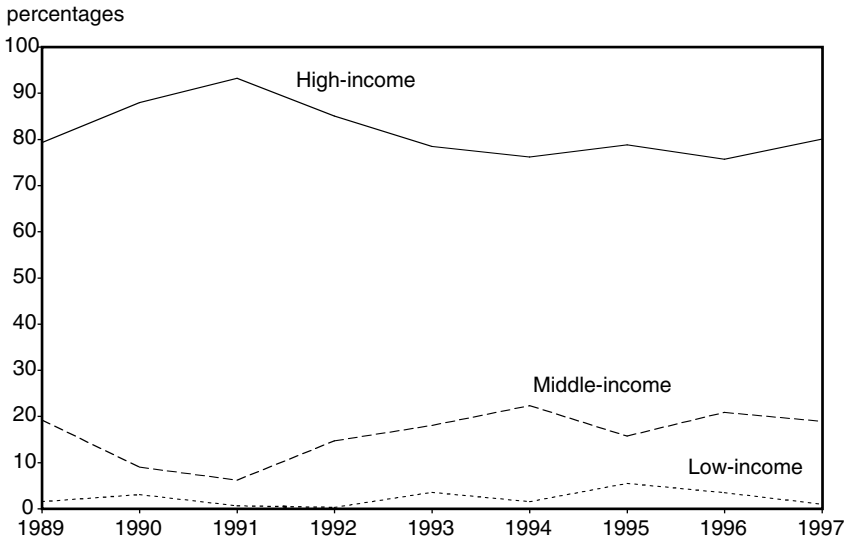
there is no suggestion of a growing share of US direct investment flows into low-income countries in recent years.

The direct investment flows depicted in all four of these figures are total flows, which consist of three components: equity flows, retained earnings, and intracompany loans. It might be argued that the second and third of these components are at least in part determined by a country's historic stock of direct investment, and that this might also bias the picture of where new US direct investment is flowing. Hence, figures 4.5 through 4.8 show only equity flows by country income category. These flows represent, to the best the aggregated figures are capable of showing, new direct investment abroad by US firms.<sup>42</sup> (Figures are shown only after 1989 because the 1980s saw significant divestment of equity abroad by US firms and this distorts the numbers. In fact, in 1985, 1986, and 1988, this divestment exceeded equity outflows.)

Again, the bottom line is that the vast majority of US equity flows have gone to other high-income countries. From 1991 to 1994 there was some slight trend toward an increased share going to both middle- and low-income countries. Even so, the share of the high-income countries in these equity flows has remained close to 80 percent, more than went to these

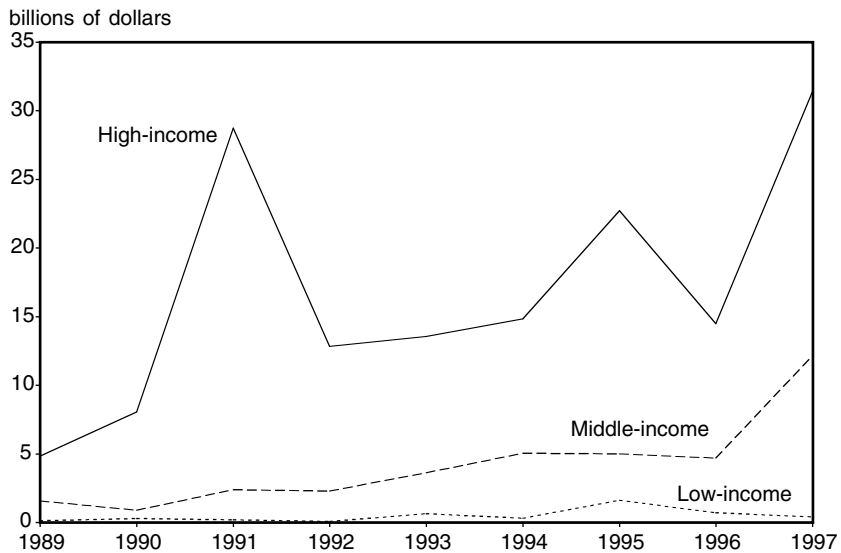
42. The correspondence is not exact. The figures include new equity to existing affiliates as well as equity flows to finance the establishment or acquisition of new affiliates. However, in most years the former is a small fraction of the latter, because the greater part of internal financing of existing affiliates comes from retained earnings rather than new equity.

**Figure 4.6 Shares of US equity capital outflows by host-country income (1995 income categories)**



Source: Bureau of Economic Analysis (1998).

**Figure 4.7 Outflows of US equity capital by host-country income (1985 income categories)**



Source: Bureau of Economic Analysis (1998).



**Figure 4.8 Shares of US equity capital outflows by host-country income (1985 income categories)**



Source: Bureau of Economic Analysis (1998).

countries in the early 1980s.<sup>43</sup> Also, this share seems to have stabilized since 1994, although it is too soon to say for sure.

It is clear, then, that US direct investment abroad does not flow to any significant degree to countries where the average income is very low. Indeed, US direct investment abroad is not to any great extent a story about closure of plants in the United States in order to ship the activities of these plants to low-wage countries. Bolstering this observation is the following. It was once conjectured that US direct investment abroad should occur largely in labor-intensive activities. The reasoning was that the United States, with its capital-intensive, high-wage economy, would have comparative advantage in the production of capital-intensive goods, that is, goods whose efficient production requires the use of a large amount (or, more correctly, a large value) of capital goods per worker. Labor-intensive goods—those requiring relatively less capital per worker—would be more efficiently produced elsewhere. US firms making these goods would find it worthwhile to move offshore, to countries where the costs of labor are relatively lower<sup>44</sup> than in the United States, whereas firms producing capital-intensive goods would remain at home, where the cost of capital is relatively lower than overseas.

43. In 1983, for example, only 60 percent of US equity outflows went to other high-income countries (using the classification based on 1995 income levels), and in 1984 this figure was 69 percent.

44. The adverb “relatively” is necessary here because, strictly speaking, the requirement is that the cost of labor *relative to capital* be lower in the offshore location.

**Table 4.5 Net fixed assets of foreign manufacturing affiliates of US multinational corporations and of US manufacturing firms, by host-country income, 1996**

	Thousands of dollars per employee
All foreign manufacturing affiliates	51.06
High-income countries	62.20
Middle-income countries	26.64
Low-income countries	18.95
US manufacturing firms	81.71

*Source:* Bureau of Economic Analysis (1996, table III.B.7; 1998).

Of course, the data presented in table 4.3 and figures 4.1 through 4.8 do not support this conjecture. US direct investment abroad flows mostly to other rich countries, where the relative costs of capital and labor are roughly the same as in the United States (and where, in some cases, wages are actually higher than in the United States). Indeed, as is shown in appendix B, there is a strong correlation between per capita income of a country and US direct investment in that country. What this shows, above all else, is that US direct investment is attracted to countries with affluent markets, not ones with low wages.

Table 4.5 shows much the same result from a different perspective. In this table, the fixed assets per employee—a crude measure of the capital intensity of operations—of overseas affiliates of US firms in the manufacturing sector are compared with the fixed assets per employee of manufacturing operations in the United States. As can be seen, net fixed assets per employee are indeed lower in the overseas affiliates of US firms than in the domestic manufacturing sector. Some of this difference, especially with respect to affiliates in high-income countries, is due to “selection bias”: US direct investment abroad in the manufacturing sector is distributed differently among sectors overseas and domestically.<sup>45</sup> Even so, it is clear that fixed capital per worker is significantly lower in affiliates of US firms located in middle- to low-income countries than in domestic US operations, and that this difference is not likely to be accounted by selection bias. This indeed does suggest that operations transferred to these areas tend to be, on balance, more labor intensive than those retained at home.

Given all of this—that US direct investment abroad does not to any great extent flow to low-wage countries but, when it does, it seems to entail relatively labor-intensive operations—what are the effects of US direct investment abroad on overall US employment? The answer is, precisely none. It is in fact fundamentally wrong to impute any overall effect of di-

45. Alas, publicly available data are not sufficiently detailed by industry to allow one to calculate how much of the difference results from selection bias.

rect investment on the total number of jobs in the US economy, because the level of employment, in the long run at least, is driven by the supply of labor and not the demand for labor. If the supply of labor, at prevailing wages, does exceed demand (i.e., if there is net unemployment), the Federal Reserve Board can boost demand by increasing the money supply. What constrains its ability to do so is, of course, the Fed's obligation also to control inflation. It is generally accepted by economists that there exists a nonaccelerating-inflation rate of unemployment (NAIRU) below which additional monetary stimulus cannot be applied without sending prices upward. It is the NAIRU, rather than US direct investment abroad or any other factor, that constrains job creation in the United States. Remarkably, however, even this constraint does not appear to be a binding one today. Unemployment in the United States in mid-2000, as this book went to press, is remarkably low, well below the level that as little as five or six years ago would have been considered the lower bound of the NAIRU.

More telling for this discussion is the fact that, between 1992 and 1999—years during which the stock of US outward FDI grew rapidly—US unemployment fell significantly, from 7.4 percent of the domestic workforce in 1992 to 4.7 percent at year-end 1997 (table 4.6).<sup>46</sup> Since then, unemployment has continued to decline. Thus, recent evidence would suggest, if anything, an inverse relationship between outward direct investment and overall domestic unemployment.<sup>47</sup> However, consistent with theory, it is safer to postulate that there is no such relationship at all.

Advocates for the labor unions might concede that US direct investment abroad has no effect on overall US employment—the total number of workers employed—but assert that such investment does affect the quality of those jobs. In other words, it is alleged that US investment abroad reallocates employment opportunities away from high-paying to low-paying ones through effects on the sectoral composition of employment. In fact, as will be shown shortly, the evidence supports rather the opposite conclusion, that US outward direct investment actually stimulates the creation of high-paying jobs at the cost of suppressing lower-paying ones. This comes about as a consequence of the effects of this investment on US trade.

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46. Adam Posen (forthcoming) conjectures that in fact the increased globalization of the US economy has had a salutary effect on the NAIRU, actually reducing the minimum level of unemployment that is consistent with noninflationary economic growth.

47. In particular, this analysis is not meant to suggest that outward direct investment actually creates jobs, on net, in the United States. The point is, rather, that outward FDI has no effect on domestic employment once certain adjustments are made (these adjustments, again, include both job creation and job destruction). The recent experience suggesting an inverse relationship between outward FDI and unemployment might, however, suggest that labor scarcity in the United States has induced firms to locate certain activities abroad. If this is so, then the direction of causality would be the opposite of that argued by many critics (and indeed even some proponents) of FDI.

**Table 4.6 US FDI and US unemployment (percent)**

	1990	1991	1992	1993	1994	1995	1996	1997
FDI growth <sup>a</sup>	12.8	8.7	7.3	12.4	8.6	14.1	11.2	10.7
US unemployment <sup>b</sup>	6.3	7.3	7.4	6.5	5.5	5.6	5.4	4.7

- a. Figure is an annual growth rate of US FDI abroad measured at historical cost bases.  
b. Unemployment is the end-of-year figure.

Sources: US Department of Commerce, <http://www.doc.gov>, and the US Department of Labor, <http://www.dol.gov>.

Brief reflection should suffice to show that, if US direct investment abroad has any effect on the composition of US employment, that effect must come largely through trade.<sup>48</sup> If this investment were, for example, to stimulate US exports, the effect would be to create jobs in the industries where these exports originate. In that case, US direct investment abroad and US exports would be, in a sense, complementary. If, by contrast, direct investment abroad were to supplant US exports, jobs would be destroyed in these industries. In that case, US direct investment abroad and US exports would be substitutes. Likewise, if direct investment were to stimulate imports, it would destroy jobs in those industries that compete with these imports. Finally, if direct investment were to supplant imports (a very unlikely possibility), it would create jobs in the import-competing industries.<sup>49</sup>

All these statements have little bearing on whether outward direct investment increases or decreases the total number of jobs in the United States. Rather, they bear upon the sectoral distribution of jobs created or lost, without considering whether there are offsetting effects in other sectors. It could be, for example, that direct investment has the effect of creating jobs in the export sector but that other, offsetting effects cause jobs to be lost in other sectors. In the parlance of economics, what we are considering here are the “partial equilibrium” effects of outward direct investment.

As for the effect of direct investment on exports, in principle it could go either way: it is theoretically possible that direct investment creates exports, but it is also theoretically possible that it displaces exports. Suppose, for example, that a US firm currently produces widgets in the

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48. Another possibility is that, all else equal, US direct investment abroad represents an outflow of saving that, if not offset by increased saving elsewhere, could result in higher real interest rates and hence lower desired levels of investment in the domestic economy. Over time this could suppress the capital-labor ratio and depress real wages. This effect, however, is likely to be very small; in 1996, US equity capital outflows represented less than 2 percent of gross domestic saving. Also, this flow of US direct investment abroad *has* been largely offset, by foreign FDI *into* the United States during the past 15 years or so. Thus, the net effect on US saving of all direct investment, outward and inward, has been practically nil.

49. These statements all assume that there is no effect on the level or composition of US aggregate demand.

United States and exports them to France. If this firm were to find that it could produce those widgets more cheaply in France and therefore decided to open a plant there, the result would be to substitute production in France for these US exports. And all else remaining equal, US jobs would indeed be destroyed in the widget industry.

Of course, all else might not be equal. The reason the firm wishes to produce in the foreign location might be to meet new local competition. Without the local plant, it might lose some or all of its local market share. In this case, the jobs destroyed in the US widget industry would have been destroyed anyway, whether or not the firm built the plant in France. Indeed, if the plant enables some exports to continue that otherwise would have been lost, it is difficult to claim that the plant caused any US job loss—it might be more plausible to argue that the plant has saved US jobs.

Furthermore, to build the plant in France and to produce widgets there, this company might find it necessary to buy the necessary capital goods in the United States. Once the plant is built, the firm might also find it economical to ship certain necessary inputs from the United States to the French plant rather than obtain them locally. The exports of these items—the capital goods needed to build the plant, and the intermediate goods necessary to produce widgets there—would be complementary with the direct investment abroad.

Which of these effects would dominate: the substitution of widget exports by production abroad, or the generation of complementary exports? It is hard to know. A first calculation might suggest that the value of the widgets displaced must be greater than the value of the intermediate goods. After all, the latter are inputs to the former, and if the end product is to be sold at a profit, the value of all inputs must be less than the value of the output. Thus, if the volume of goods sold in the overseas market were to remain unchanged from what it was before the direct investment was made, the substitution effects must dominate the complementary effects. However, because the direct investment reduces the total cost of delivery of the goods to the foreign market—after all, this presumably is why the investment was made in the first place—the firm might well be able to increase the volume of goods sold in this market. And if that increase in volume is sufficiently great, the resulting total value of US exports could be greater than before the direct investment was made. In that case the complementary effects of the direct investment would dominate the substitution effects.

The direct investment might stimulate US exports in other ways. For example, distribution and after-market service facilities might be created as a result. These might in turn enable the firm to sell other products in the French market that it could not have sold there before, including products shipped from the United States. On the other hand, some of the output of the overseas facility might be shipped back to the United States,

**Table 4.7 Trade in goods among foreign affiliates, their US parents, and unaffiliated firms by host-country income, 1995 (billions of dollars)**

Host-country income category	With US parents	With unaffiliated firms	Total
All countries			
Exports	145.5	24.5	170.0
Imports	123.9	19.4	143.3
Balance	21.6	5.1	26.7
High-income countries			
Exports	129.0	20.8	149.9
Imports	94.0	15.1	109.1
Balance	35.0	5.7	40.7
Middle-income countries			
Exports	28.9	5.4	34.3
Imports	31.5	1.9	33.4
Balance	-2.6	3.5	0.8
Low-income countries			
Exports	1.6	0.2	1.8
Imports	1.8	0.4	2.2
Balance	-0.2	-0.2	-0.4

*Source:* Bureau of Economic Analysis (1998, table 19.2).

displacing domestic output. In this case, the direct investment would complement both increased US imports and increased US exports.

Which effect will dominate—the substitution of US exports and/or creation of US imports, or the creation of complementary exports—cannot be determined on theoretical grounds. Rather, it must be determined empirically. Let us therefore turn to the facts.

The first question to ask is whether or not US parent firms actually trade with their overseas affiliates. The facts on this score indicate that such trade is substantial. Table 4.7 shows US exports and imports of goods to and from majority-owned affiliates of US firms overseas in 1995; once again, the figures are disaggregated by income category of the host countries. These data show that US exports to overseas affiliates of US firms were almost \$170 billion in that year, or about 29.5 percent of all US goods exports. That same year US imports of goods from these affiliates were \$143 billion, or about 19.1 percent of all US goods imports. Thus, in the aggregate, the United States ran a surplus in goods trade with the overseas affiliates of US firms (that is, exports exceeded imports) totaling \$27 billion in 1995. By contrast, the United States ran an overall trade deficit in goods of \$174 billion in that year. The surplus with overseas affiliates was registered entirely in the high-income countries. The United States did run a small trade deficit with affiliates of US firms in the middle- and low-income countries. This deficit, however, at \$1.52 billion, was well below 1 percent of the total US trade deficit in goods.

Furthermore, Bergsten, Horst, and Moran (1978) found that US industries that were highly unionized but whose firms invested abroad tended to export a higher percentage of their US output than did industries that were highly unionized but whose firms stayed at home. This result still seems to hold today (Moran 2000).

These facts and figures are of some considerable interest. Critics of FDI, however, would argue that the main issue is not the level of the current trade balance created by intrafirm trade, but rather the counterfactual, that is, the value of US exports that have been lost because of overseas production. As is always the case with counterfactuals, hard data to prove or disprove this claim are lacking. In other words, we cannot say for sure whether or not the direct investment that created these overseas affiliates has, on a net basis, substituted for US exports or complemented them.

More sophisticated analysis can, however, yield a plausible answer, and such an analysis is presented in appendix B. Table 4.8 presents some summary results from this analysis. The calculated regression coefficients in the table can be interpreted as follows: if the coefficient is positive in sign, there is a complementary relationship between US direct investment abroad and US exports (or US direct investment abroad and US imports), whereas if the sign of the coefficient is negative, there is a substitutive relationship. The figure in parentheses below each coefficient indicates the statistical significance of the coefficient.<sup>50</sup> If this number is greater than 2.0, the coefficient is usually deemed significant. Coefficients are shown for all countries, and for countries by level of income.

What this analysis shows is that US direct investment abroad and US exports are net complements. This is true whether the direct investment is located in high-income countries or low- and middle-income countries. Indeed, the magnitudes of the regression coefficients are similar, which suggests (along with the supporting *t*-statistics) that the relationships between US exports and US direct investment abroad are not greatly different for any income group. Put simply, US direct investment abroad seems not to displace US exports but rather to create them. (The coefficients indicate that of two effects that happen simultaneously—in this case the displacement of some exports and the creation of others—the latter dominates the former.)<sup>51</sup>

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50. In this instance, the issue is whether the sign on the coefficient can be trusted. A *t*-statistic greater than 2.0 indicates that the sign is correct as indicated to a degree of confidence of 95 percent or greater.

51. Other analyses have produced results consistent with these. See Chedor (2000) for France; Graham (1999b), Urata (1995), and Buiges and Jacquemin (1994) for Japan; Pearce (1990) for 458 large multinational firms; Blomström, Lipsey, and Kulchysky (1988) for Sweden; and Lipsey and Weiss (1984 and 1981) for the United States, using different data and methodology than reported here.

**Table 4.8 Coefficients indicating relationship between US exports or imports of manufactured goods and US direct investment abroad**

	All countries		Income category of host country						
	Coefficient	t-value	Low		Medium		High		
			Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	
US direct investment abroad and US exports	4	.67	2.04	1.30	1.92	1.59	3.34	1.59	18.91
US direct investment abroad and US imports		-2.97	1.18	0.79	1.91	0.33	1.03	-0.39	-4.51

Note: See appendix B for detailed explanation.

Source: Author's calculation.



The analysis also suggests that US direct investment abroad is a net substitute to US imports from both low- and high-income countries. In other words, an increase in direct investment in these countries seems to generate a modest decrease in imports from these countries. This result, however, does not make much sense from an economic perspective; there is no plausible reason why this should happen. The result is thus probably best interpreted as a spurious correlation. In fact, if this result is interpreted to mean that there is no relationship between US outward investment and US imports of manufactured goods, this interpretation is likely wrong. Rather, the result is better interpreted as indicating that the imports from developing countries can be well-explained by factors other than FDI. But, even so, it is clear that US firms have indeed established operations in some developing countries such as Mexico as a means to outsource production of labor-intensive products, including both intermediate and final goods. Some imports from these countries thus are directly linked to direct investment.

These results are consistent with the proposition advanced earlier, that US outward FDI simultaneously creates and destroys jobs in the US domestic economy. The good news in this regard is that the jobs thus created are concentrated in export-generating activities, where a wage premium prevails. But the bad news is that those jobs that are destroyed are concentrated in import-competing activities. The net effect might be to increase the demand for high-skilled workers, the kind that typically are in demand in export-generating activities, but to reduce the demand for lower-skilled workers whose services are demanded in import-competing activities. These workers might not readily find reemployment in other activities.<sup>52</sup>

These results, along with the raw figures on intrafirm trade, bear on one of the more sensitive issues raised by the US labor movement, that of outsourcing of input components by US firms. The story as told by some US unions is that outsourcing creates a net job loss within the US economy. But the results presented here are more consistent with a story of worldwide integration of operations by multinational firms, where specific plants specialize in the production of certain goods (including components) and ship these to other locations so as to reduce total costs of the final products. The point behind this story is that outsourcing is reciprocal from the point of view of the United States: on intrafirm account, at least, US multinationals export as much if not more intermediate and final product than they import.

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52. On the basis of careful empirical work, Slaughter (1995) finds little evidence that outsourcing by US multinational corporations has directly contributed to wage divergence within the US economy. The main source of this divergence seems rather to be technological advance. Leamer (1997) notes, however, that this advance itself might be in part a by-product of increased global competition.

This analysis provides no reason to believe that outward FDI either creates or destroys domestic jobs on a net basis.<sup>53</sup> On the other hand, there seems little question that FDI can contribute to a redistribution of jobs among activities. But generally, this redistribution is from lower-paying to higher-paying jobs. That, of course, is good news for US workers as a group.

However, there is also little question that this process has a downside: it adds to the difficulties faced by less skilled workers, whose lot in the US economy is, by virtue of a number of trends, not a very happy one. In particular, it is demonstrable that the earnings of less-skilled workers in the United States have fallen relative to those of more-skilled workers. But how much of this is due to outsourcing? This issue, as it turns out, is not easy to answer and, indeed, it has led to something of an intellectual food-fight among economists, including some of the most prominent.<sup>54</sup>

At the heart of the controversy is the fact that there are plausible reasons why increased trade could reduce the relative wages of unskilled workers, even if there were no changes in occurring in the domestic economy. But there are equally plausible reasons why changes in the domestic economy could have much the same effect even if there were no changes occurring in patterns of US trade. Furthermore, it is clear that there have been significant changes both in the domestic US economy and in the patterns of US trade that potentially could affect relative wages. And it is difficult to sort out, on the basis of actual data, which of these sets of reasons is dominant.

The change in the domestic economy that is most likely to be a cause of growing wage inequality is technological change. At issue is whether this change is “factor biased” or “factor neutral.” Factor-biased change, as it occurs, changes the relative demand for differing factors of production, holding constant the relative prices of these factors. For example, if, as is generally supposed, technical changes in today’s US economy have the effect of increasing demand for workers with university-level education relative to demand for workers with high school or less education, given today’s relative wages the result will be that, in order for labor markets to clear, the relative wage of well-educated workers must rise. But factor-neutral change has no such effect. Unfortunately, there is no direct way to measure whether technical change is factor biased or factor neutral, although for the United States the case can be made that certain facts strongly suggest that recent changes have been factor biased. These facts are that (i) the supply of well-educated workers relative to the supply of

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53. See also Brainard and Riker (1996). FDI by at least some other countries also seems to have little effect on employment in the home country: see Blomström, Fors, and Lipsey (1997) for results for Swedish FDI.

54. For the most recent outbreak of this food fight, see Leamer (2000), Krugman (2000), Dearnorff (2000), and Panagariya (2000).

less-educated workers has sharply risen over the past thirty years or so; and (ii) the wages of the former relative to the latter have also risen. These facts would indeed virtually nail shut the case that technical change has been factor biased were it not for the fact that imports of manufactured goods into the United States from developing nations have risen as well.<sup>55</sup>

But imports can figure. To see why, let us assume (wrongly, of course, but in order to conduct a “thought experiment”) that there has been no technological change in the US economy nor any other domestic changes that might affect relative wages but that there has suddenly opened a new source of imports from outside the United States of manufactured goods that require intensive inputs of less-educated (hence, presumably, less-skilled) labor, and that these imports are priced below those that prevail in the United States at the time of this opening. Although why this opening has occurred is not really relevant to the thought experiment, we could assume that this has been the result of outsourcing of this good by a US-based multinational firm. Price of this good, relative to other goods, would fall. It is easily analytically shown that, under plausible assumptions, this implies a drop in the relative price of the factor used intensively in the good, in this case unskilled labor, in the United States.<sup>56</sup> This is because these imports, in effect, increase the supply of unskilled workers available to make goods that are purchased in the United States.

To summarize at the risk of some oversimplification, factor-biased technological change in the United States would increase the demand for well-educated workers, whereas new sources of imports of low-priced, non-skill-intensive goods effectively would increase the supply of less-educated workers. The effects of both are to reduce the relative wages of the latter.

But which is correct? Most economists would agree that both factor-biased technological change and changes in trade have had an effect on relative wages, and that the remaining issue is to measure the relative impact of each. But the food fight alluded to above is still on—economists cannot fully agree on how to do this measurement. One approach that has been widely taken is to calculate what is the net factor content of US trade (how much net skilled and unskilled labor is embodied in the total of US exports and imports), to add this net factor content to domestic supplies of the same factors, and then to estimate what would be the factor prices implied by autarkic production of the same bundle of goods and services consumed by the US economy given this augmented supply of factors. The difference between the estimated relative factor prices and those actually observed are then adduced to be caused by trade. Any residual

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55. See Lawrence and Slaughter (1993).

56. See, e.g., Krugman (2000). This is an example of the well-known “Stolper-Samuelson” effect. For the original, see Stolper and Samuelson (1941).

change is adduced to be due to changes in the domestic economy, e.g., technological change.<sup>57</sup>

Is this a valid technique? The answer is, it might be but no one is really sure. Economists have developed models that, if correct, would suggest that this technique is indeed valid, but these models do embody certain restrictive assumptions that might not hold in the real world.<sup>58</sup> Alas, whether these assumptions are really necessary (as opposed to sufficient) for the model to correctly depict reality is still not wholly resolved.

Using a souped-up version of such an approach, Feenstra and Hanson (1999) look at this issue of factor-biased technical change, outsourcing, and wage inequality. Their techniques in fact enable them to consider the former, to the extent that it has been associated with growing expenditures in the United States on computers. They conclude that factor bias created by computers has had about double the impact on wage inequality as has outsourcing, a conclusion shared by others.<sup>59</sup> This conclusion—that the major impact on growing wage inequality over the past thirty or so years has come from technical change rather than trade (including, of course, trade created by FDI)—is accepted by a majority of economists but rejected by a minority. And the food fight is not over.<sup>60</sup> The consensus thus is that the main difficulty less-skilled US workers face is that technological advance in the US economy is reducing the demand for low-skilled workers while increasing the demand for more highly skilled workers, and this places downward pressure on the wages of the less skilled. The logical remedy to this problem would be, if possible, to upgrade the skills of the less-skilled workers, but for a variety of reasons (the age of many of these workers, their innate aptitudes, lack of funding for training programs), this is not easily done. Thus what to do about the problems faced by this category of workers is a vexing issue. Defenders of direct investment must recognize that this downside does exist and that remedies must be found.

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57. Thus, for example, suppose that for a nation, between the years  $t$  and  $t'$ , relative wages of skilled workers rose by 50 percent. Using the factor content approach as described, economists calculate that, in year  $t'$ , at autarky, relative wages of skilled workers would be only 10 percent higher than with trade as actually took place in that year. It is adduced that trade (note: not necessarily changes in trade that took place between  $t$  and  $t'$ ) has caused a 10 percent relative wage differential. The residual observed change (40 percent differential) must be caused by other things, e.g., changes in factor demand occasioned by technical change. As is apparent (and for reasons that are not so apparent but are covered in the references), this calculation is not airtight, hence the food fight. The issue comes down to, is this not-airtight calculation allowing large drafts to occur, or is it tight enough to give a useful approximation?

58. Deardorff (2000) details these.

59. For example, Autor, Katz, and Krueger (1997) find that the computer revolution alone explains from 30 to 50 percent of the increase in wage inequality in the United States since the early 1980s.

60. See also Cline (1997) for an extended discussion of these issues.

As noted in the introduction to this chapter, even if US direct investment abroad does create jobs in the higher-paying export sectors, the possibility remains that the threat by firms to relocate operations abroad alters the bargaining position of firms relative to labor, to the latter's disadvantage. Thus, even though jobs are created in the export sector, and these jobs are relatively high paying ones, it is still possible that the wages received by workers are less than they would have been if globalization had not eroded the bargaining position of workers in general. We address this issue next.

## **Does Globalization Reduce Workers' Bargaining Power?**

The quick answer to this question is probably yes. But this quick answer must be carefully nuanced. The extent to which a firm can use the threat of relocation as a bargaining ploy depends to some degree on the structure of the market in which the firm operates.<sup>61</sup>

To see why this is so, let us begin by noting that multinational firms tend to be more prevalent in certain industries than in others, and that these industries are most often ones characterized as oligopolistic.<sup>62</sup> An oligopolistic industry (or, more precisely, an oligopolistic market) is one in which the number of sellers is small, but greater than one (that is, the market is not a monopoly). In such a market, firms typically make major decisions, especially investment decisions, based in part on their expectations of what their rivals will do in response to these decisions.

The behavior of firms in oligopolistic markets can vary widely. At one extreme, such a market can be characterized by highly rivalistic behavior of sellers, where firms constantly try to outdo each other in bids to achieve higher market share or some other gain in performance. Such a market might have a high degree of price competition and rapid rates of innovation in product and process technologies. But at the other extreme, firms in an oligopoly might collectively behave almost like a monopolist (in which case they may be termed a cartel). Prices in such a market will tend to be high and relatively inflexible, and rates of introduction of new technology will be quite low.

The extent to which any oligopolistic market tends toward either of these extremes depends in large measure upon whether the market is contestable. A contestable market is one in which new firms can be expected to enter if the incumbent firms raise prices in an attempt to earn monop-

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61. On this same issue, see Rodrik (1997). The conclusions reached here, however, are somewhat different from Rodrik's.

62. This was noted by Hymer (1976). Caves (1995) surveys the evidence.

oly rents, that is, higher-than-normal profits.<sup>63</sup> The degree of contestability of any market depends on a number of factors. An important one is whether or not there are government-imposed barriers to entry, including regulatory barriers. Another is the magnitude of the costs that must be expended up front in order to gain entry. (These costs may in turn depend upon whether there are governmentally imposed barriers.)

The main issue here is the effect of an oligopolistic market structure on wages. No general answer is possible. There is no general reason to expect that firms operating in such a market will pay lower wages than those operating in a more competitive market. Even if the market in which a firm sells its product is oligopolistic, the market in which it buys labor may be competitive, and the firm must hence pay labor its marginal product in order to attract workers (see appendix A).

However, the opposite might be true: firms selling in the oligopolistic market might pay higher than prevailing wages. Suppose, for example, that a market is oligopolistic because it is not highly contestable. There might be large upfront costs associated with entry that serve as a bound on the number of firms that can participate in the market. Under such circumstances, incumbent firms might be expected to earn rents. But suppose further that these firms are unionized, and that the unions restrict membership, so that firms also face barriers to new hires. Under these circumstances, the workers might well be able to appropriate a portion of the rents for themselves, and their wages thus would be higher than normal. As long as the return to the firms' shareholders on their investment in the firm remains satisfactory,<sup>64</sup> the firm might have little reason to resist this capture of part of its rents.

This brings us to the main issue: Can globalization reduce these workers' wages by altering their bargaining positions relative to the firms that employ them? As indicated earlier, the answer is probably yes. A firm that has the option of relocating its operations offshore can use that threat to bargain wages down to competitive levels, if these wages include an element of oligopoly rent.

As argued earlier, however, such a threat, to be effective, must be credible. And a minimum condition for credibility is that the expected cost savings from relocation must exceed the costs of relocating. Further, if the firm's market position is such that its oligopoly rents are secure, it has little incentive to relocate even if the potential cost savings would seem to warrant such a move—it does not have to lower its costs to remain prof-

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63. On this, see Graham and Lawrence (1996).

64. If capital markets are efficient then, indeed, the return to new shareholders should be a market-determined "normal" return even if the firm does earn rents. This is because any expected rent accruing to shareholders will result in the share prices of the firm's stock being bid up until the returns on these shares (adjusted for risk) are equal to those on other firms' shares.

itable. Thus, as long as an oligopolistic firm is confident about retaining its market position, it might be willing to allow its workers to appropriate some portion of its rents, even if it could regain these rents by threatening to move offshore.

Globalization itself, however, can threaten a firm's rents.<sup>65</sup> For globalization is a two-way street. The same phenomenon that allows a particular firm's operations to be transferred more easily to other locations also implies lower barriers in that firm's own market to entry by firms headquartered elsewhere. If the incumbent firm's home market was heretofore an oligopoly, the newly created competition can act to bid away its rents. Indeed, if the new entrant does not pay its workers wages that embody some share of a rent, its labor costs will be lower, and it might therefore be able to supply the market at lower cost than the incumbent firm. This in turn could force the incumbent firm to try to reduce its own costs, and this might include playing the card of threatening to relocate if its workers do not accept lower wages. The net result could very well be reductions in wages in certain sectors.<sup>66</sup>

Is this an argument against globalization? The answer depends largely on one's point of view. From the point of view of a worker employed by a firm that was earning oligopoly rents, it certainly is: the loss of these rents implies a loss of future income, for which no amount of benefit from globalization may be able to compensate. In the United States in the second half of this century, workers in two major industries, steel and automobiles, almost surely have been compensated at rates that embodied an oligopoly rent. In 1950, in the steel industry, production workers were paid wages that averaged 124 percent of the average wage of production workers in the manufacturing sector as a whole. That figure rose to 157 percent by 1980. In the automobile industry, the comparable figures were 126 percent and 143 percent. One of these industries, automobiles, has been characterized by considerable amounts of outward US direct investment, but the other, steel, has not.<sup>67</sup>

Thus US direct investment abroad did not cause wage erosion in autos relative to steel. Hourly compensation of unionized workers in both industries thus did grow, in fact, to exceed by far average compensation in

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65. This is in fact the main theme of Whitman (1999). Whitman, a former General Motors executive, notes that a globalized economy carries more risk for established firms, and that one major consequence is reduced commitment of such a firm to its workers.

66. How great are these wage reductions? This is impossible to estimate because of the problem of establishing the counterfactual, a matter touched upon below.

67. See Vernon (1971) on the reasons behind this outcome. Outward direct investment by US automobile firms has a long history that predates unionization of this sector in the United States. US automotive FDI began in the 1920s. By the 1950s and 1960s, the two largest domestic manufacturers, General Motors and Ford, were also among the largest manufacturers in Europe. Both firms began extending their operations into developing countries during the 1970s. The early FDI activities of Ford are chronicled by Wilkins and Hill (1964).

the US manufacturing sector.<sup>68</sup> But since both industries became increasingly contestable over the past twenty years or so, some of the rents have disappeared. Domestic firms in these industries have thus been increasingly unable to compensate their workers at levels well above those that prevail in the rest of the manufacturing sector. Thus, by February 2000, the average wage in the US steel industry had fallen to 135 percent of the US manufacturing average, and the figure in the automobile industry was 134 percent. Further, the greater contestability of both industries has doubtless been due in large measure to globalization, as measured by the share of the relevant US markets captured first by imports and later, during the 1980s, by the product of local subsidiaries of foreign-controlled firms.

Workers might not be the only losers from the loss of rents. Communities in which the workers reside stand to lose tax revenue as these workers' incomes fall. Local merchants might suffer from workers' reduced spending, as they adjust to take into account their lower disposable income.

But there are also winners from the increased contestability of markets. The oligopolistic firms acquire their rents by raising prices and reducing output. As the markets served by these firms become more competitive, prices will fall and output will increase, benefiting consumers. Furthermore, as already noted, oligopolistic firms operating in noncontestable markets often tend to be slow to introduce new product and process technologies. Increasing competition in their markets can serve to increase the rate at which new technology is developed and deployed, to the further benefit of consumers. In fact, in many cases, improvements in the rate at which new technology is created and utilized can increase the productivity of workers and thus restore at least some of the real wages that were lost with the firm's rents. In the case of the steel industry, for example, labor productivity has increased sharply during the past twenty years. Would this have occurred without the increased competition brought on first by imports and later by the entry of mini-mills and the takeover of laggard domestic firms by foreign rivals? It is hard to know for sure, but it is quite plausible that it would not have happened.

As noted previously, significant outward direct investment from the United States has occurred in the automobile industry but not in the steel industry. For both industries, however, the case can be made that globalization has had a depressive effect on domestic wages, in the sense that differentials between wages in these industries and other US manufacturing industries have eroded over the past twenty years, and that globalization has had something to do with this. In both industries, in fact, domestic oligopolies were eroded, first, by significant import penetration into the US market and, later, by significant *inward* direct investment into the United States.

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68. Both industries, however, were unionized only during the late 1920s and early 1930s. Significant wage premiums over the average US manufacturing sector wage in both these industries were recorded in 1932, the earliest year for which data are available.



But was the erosion of the wage differential greater in automobiles than in steel, given that outward investment occurred in the former but not in the latter?<sup>69</sup> The answer seems to be no. Although such erosion has occurred in both industries, it has, if anything, affected steelworkers more than auto workers. From 1980 to 2000, the wage premium in the steel industry fell from 57 percent to 35 percent, a fall of 14 percent of the total wage. In automobiles, this fall was only about 6 percent. Thus, in the end, whether or not outward US direct investment has resulted in lower US domestic wages than would otherwise have prevailed in the automobile industry remains controversial. The even greater fall in the wage premium of steelworkers suggests that greater competition accounts for this erosion (in both industries) and that the erosion has little to do with outward investment by the US automobile producers.

To sum up, the issue is whether outward direct investment by US firms serves to diminish the bargaining position of the US workers who work for these firms and, hence, to reduce their compensation. In cases where firms have historically been able to garner economic rents, and workers have been able to appropriate some of these rents, this line of argumentation is not implausible. But the experience of the US steel industry shows that direct investment is certainly not the whole story behind this erosion. There the erosion of wage premiums created by the capture of rents has been among the most pronounced of any industry, even though US steel firms have neither engaged nor threatened to engage in any significant direct investment abroad.

## Summary and Conclusion

Much of the opposition to the MAI, in the United States especially, has come from the organized labor movement. This opposition reflects a long-held position of organized labor that FDI, or at least US direct investment abroad, hurts both the interests of US workers and the interests of workers that are employed by US firms overseas.

To hear some US labor activists speak, one would think that US investment abroad flows mostly to low-wage countries, that the overseas affiliates of US firms pay less than prevailing wages in those countries, and that large numbers of jobs in the United States are eliminated as a result of this investment. The facts, however, argue strongly against the first two of these claims. With respect to the third, although the empirical evidence does not yield completely unambiguous results, the case is stronger that US direct investment overseas in net creates jobs in the United States than that it destroys US jobs. The analysis in this chapter in fact shows strong

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69. And noting that, as far as can be determined, US steel firms have never even threatened to relocate their activities abroad if US steelworkers would not accept lower wages.

evidence that outward US direct investment creates jobs in higher-paying sectors, and somewhat weaker but still credible evidence that it reduces jobs in lower-paying sectors.

Another position often taken by organized labor, that outward investment and associated outsourcing weaken the bargaining position of unions relative to the management of multinational firms, is more plausible than the argument that outsourcing actually reduces domestic jobs. This weakening might in fact be symptomatic of a number of social ills created (or at least fostered) by the increased competition brought about by globalization.

Whatever the merits of its case, the labor movement does seem to have succeeded in capturing much of current US policy with respect to international trade and investment issues. This is especially true with respect to US policy on whether or not there should be multilateral rules on investment. This is a subject to which we return in chapter 7.