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THE EFFECTS AT HOME OF INITIATING PRODUCTION ABROAD: EVIDENCE FROM MATCHED FRENCH FIRMS

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NON-TECHNICAL SUMMARY

For years, concerns have repeatedly been expressed about the potential negative employment impact of the relocation of production abroad, often referred to as offshoring. Fears have been heightened further by the feeling that service activities, often considered to be relatively skilled, are no longer invulnerable to the offshoring phenomenon.

Assessing the real impact of outward foreign direct investment upon domestic employment is difficult, because firms that invest abroad differ strongly from the typical firm. We confirm their strong specificities using French firm-level data for manufacturing and services for the period 1987-1999, by distinguishing between: (i) non-exporters; (ii) exporters without foreign affiliates; (iii) new investors abroad; and (iv) pre-existing multinational firms. Going from category (i) to (iv) one can observe strongly increasing levels of employment, capital intensity, total factor productivity and export orientation. According to the economic literature, these differences largely reflect the self-selection of firms into international activities.

Assessing the effects of going global on a firm's domestic activities therefore requires separating out cause and effect. Ideally, the outcomes of firms investing abroad for the first time should be compared to their counterfactual outcome had those firms not decided to become a multinational. While this counterfactual outcome is unobservable, a substitute is to compare foreign investors to firms with ex-ante the same probability to invest abroad, but did not do so. This is done here using matching techniques. This involves using all observable information

available to create statistical twins that only differ in terms of their foreign investment decisions. To take account of unobservable differences between our statistical twins, these techniques are combined with a difference-in-difference estimator.

As the domestic effects of investing abroad are likely to depend on the motives of firms to go global, we propose a simple typology of international investment strategies based on sector affiliation and location choice. Our premise is that investment in high-income countries in comparative-advantage sectors reflect market-seeking strategies ("horizontal" investments), while the polar case of investment in low-income locations by firms in comparative-disadvantage sectors reflects factor-seeking motives ("vertical" investments). Hybrid cases are assumed to reflect mixed investment strategies.

This typology proves useful in identifying the impact of the decision to invest abroad for manufacturing firms. Market-seeking investments abroad are found to be associated with a significant positive impact on domestic employment in the parent firm, by 16% on average after three years, without a significant impact on exports, TFP or the input mix. In contrast, no significant impact is found on employment at home as a result of factor-seeking investments. This may suggest that vertical FDI is an efficient strategy to withstand competitive pressures. There is some evidence that this type of FDI is associated with technology effects, in the form of greater capital-intensity and efficiency, as well as larger exports.

As the typology above is explicitly designed for manufacturing firms, this is not used in the case of services. FDI in the services sector is associated with significant positive employment effects, which may reflect the possibility that FDI in this sector is predominantly motivated by market access. Service FDI is also found to lower capital-labour ratios in the parent firm, perhaps due to new management and co-ordination needs arising from production complementarities between the parent firm and its affiliate.

This firm-level analysis thus shows that the employment impact of foreign investment on the parent firm, while heterogeneous across underlying strategies, is never negative and is strongly positive when the investment is mainly aimed at acceding new markets. To say the least, this result does not lend support to the widespread fears about the employment impact of foreign investment. Still, this study does not pretend to give an exhaustive answer to this question. In particular, the analysis does not cover the possible impact of foreign investment on other firms; in addition, it focuses exclusively on first-time foreign investments.

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