

**FOREIGN DIRECT INVESTMENT  
AND  
ITS EFFECT ON WAGES AND WORKING CONDITIONS**

by

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## **Abstract**

The activities of multinationals abroad have inspired both praise and criticism: Praise for the potential benefits they impart and criticism for social concerns they arouse. Do multinationals largely exploit their workers abroad with regard to wages and working conditions or are these criticisms unfounded? This paper surveys the existing literature on this subject in order to evaluate the impact of foreign direct investment on host countries, most particularly in the area of wages and working conditions. The final analysis concurs with previous research and suggests that, on the whole, multinational enterprises have a positive effect on wages, albeit more in developing countries than in developed countries. The evidence regarding working conditions is not as clear. While there is some evidence to demonstrate that multinational companies provide better working conditions than their domestic counterparts, opposing evidence demonstrating poor conditions or comparable conditions to that of domestic firms is much stronger.

**Keywords:** Multinational enterprises; wages; working conditions; developing countries

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# 1. Introduction

Multinational corporations (MNCs), foreign owned businesses (FOBs) or transnational corporations (TNCs), also called multinational enterprises (MNEs), are defined as corporations or enterprises that manage production or deliver services in multiple countries. For the purpose of this paper, MNC shall include reference to MNE, TNC and FOB but these terms may be utilized interchangeably.

Foreign direct investment (FDI) is considered a driving force in economic development and plays an important and increasing role in global business today (Graham & Spaulding, 2005). The benefits accrued by firms investing abroad include the attainment of new marketing channels, access to low cost production facilities, innovative technologies, products and skills as well as different financing options (Graham & Spaulding). For the host country receiving the investment, FDI has the potential to create jobs, increase productivity and facilitate the transfer of skills, capital, technology and management know-how (OECD, 2008b). The benefits with respect to development are considered greater for developing countries as FDI is often the biggest source of external finance for these countries (OECD, 2008b). With these potential benefits, both developed and developing countries are competing more than ever to leverage it for development (OECD, 2008c) forecasting further FDI growth in the future. While the potential benefits of FDI and Multinational Companies (MNCs) are considered favourable for development, especially for developing countries, they have also been the subject of a great deal of controversy and social concern

(OECD, 2008b). Opponents argue that MNCs have been largely harmful to societies as they take advantage of lax local trade laws and regulations concerning labour and working conditions and exploit foreign workers, providing inadequate wages and or working conditions (See, for instance, Brown, Deardorff, & Stern, 2004). With the great likelihood of further MNC growth in the world economy (UNCTAD, 2007), it is important to evaluate this controversy through an analysis of current research. The aim of this paper is to use existing literature to explore the impact of FDI in host countries, with a particular focus on the effects of FDI on wages and working conditions. To this end, the paper seeks to address two main questions. First, how does FDI contribute both directly and indirectly to host countries? Second, does FDI have a positive impact on wages and working conditions in these countries?

The paper is structured as follows. Section 1 provides an introduction to the thesis topic, followed by Section 2 presenting an overview of the development of FDI over recent decades in both developing and developed countries. Section 3 looks at how countries compete for FDI and the benefits and costs associated with this competition. Section 4 summarizes existing evidence concerning foreign ownership and wages followed by some explanations of wage differentials. Section 5 summarizes the literature on the indirect effects of FDI on host countries. Sections 6 and 7 review the evidence regarding labour standards and working conditions in foreign operations of MNEs as well as enforcement of labour laws, and are followed by the conclusion in Section 8.

## **2. Foreign Direct Investment (FDI): Growth and Trends**

According to the United Nations Conference on Trade and Development (UNCTAD), foreign direct investment “is an investment made to acquire a lasting interest in enterprises operating outside of the economy of the investor” (UNCTAD, 2002). UNCTAD specifies that 10% or more of company shares must be owned by the foreign affiliate for an investment to be considered as FDI (UNCTAD, 2002). With a direct relationship between the foreign subsidiary and the parent company, FDI allows for the creation of multinational enterprises (EconomyWatch, 2007).

Over the past 15 years, foreign direct investment in the world economy has shown a consistent increase, with the total stock of FDI growing from 8% to 26% of the world’s GDP between 1990 and 2006 (Organisation for Economic Co-operation and Development [OECD], 2008c). Global inward FDI demonstrated a 38% growth between 2005 and 2006 reaching \$1,306 billion, the second highest record of global inward FDI (UNCTAD, 2007). Global FDI Inflows grew again by 30% in 2007, reaching \$1,833 billion dollars – well beyond previous records (UNCTAD, 2008). This growth was observed in developed economies, developing economies as well as transition economies, albeit at different levels (UNCTAD, 2007). The United States, United Kingdom, France, Canada and the Netherlands respectively are the largest recipients of FDI inflows in developed countries, with China, Hong Kong (China) and the Russian Federation the highest recipients in developing and transition economies (UNCTAD, 2008). In 2007, developed countries attracted an estimated

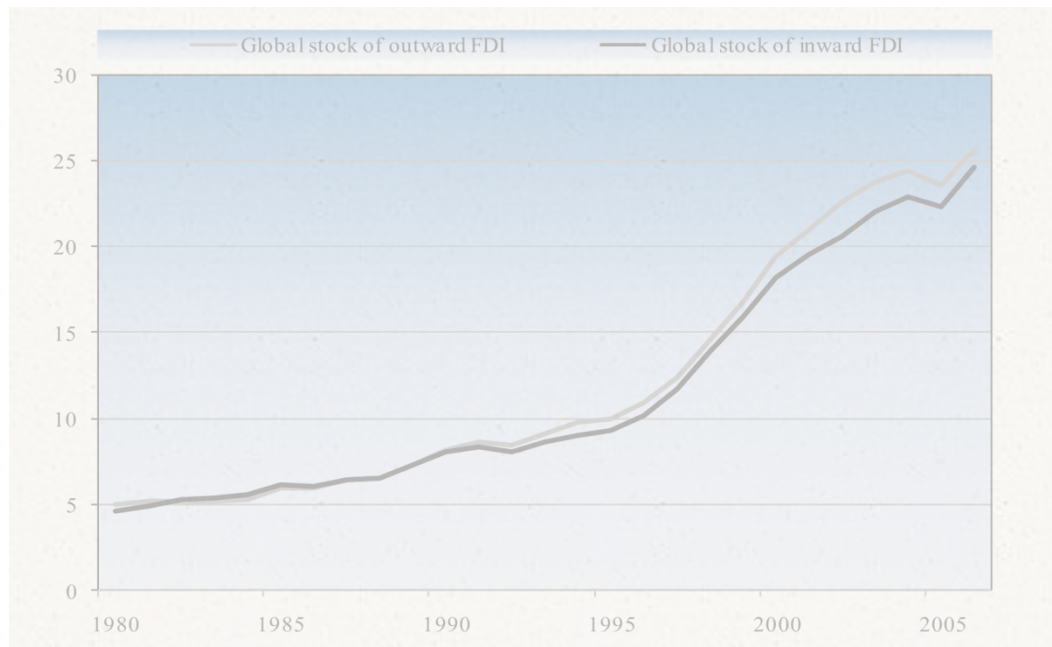
\$1,248 billion in FDI inflows, while developing countries inflows reached an all time high of \$500 billion dollars. The least developed countries realized record highs as well, bringing in \$13 billion dollars (UNCTAD, 2008).

According to the 2008 report by the Organisation for Economic Co-operation and Development (OECD), the majority of FDI continues to take place in OECD countries<sup>1</sup>, but there has been a significant increase of FDI in developing countries as well (OECD, 2008c). This increase for the most part reflects the assimilation of emerging economies such as Brazil, Russia, India and China into the world stage (OECD, 2008c). The share of inward FDI stock in non-OECD countries rose from 22% to 32% between 1990 and 2005 while the share of outward FDI rose from 10% to 17% during the same period. The rise of both inward and outward FDI demonstrate that developing countries are not only receiving more investments but are increasingly partaking in the activity as well, albeit mainly with other non-OECD countries (OECD, 2008c). Figure 1 shows the growth trend of both inward and outward FDI from 1980 to 2005.

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<sup>1</sup> OECD countries: Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Republic of Ireland, Italy, Netherlands, Luxembourg, Portugal, Norway, Sweden, Spain, Switzerland, Turkey, United Kingdom, United States, Japan, Finland, Australia, New Zealand, Mexico, Check Republic, South Korea, Hungary, Poland and Slovakia.

**Figure 1 Foreign Direct Investment, 1980-2005**  
**(Global FDI stocks as a percentage of world GDP)**



FDI stocks and world GDP are expressed in current US Dollars

Source: UNCTAD, FDI statistics as cited in "The Social Impact of Foreign Direct Investment," a Policy Brief of the OECD Observer, 2008.

The observed growth in global FDI is closely related to the increase in value and number of transactions of cross border mergers and acquisitions (M&As) and reflects the growing internationalisation of production (UNCTAD, 2006). Merger and acquisition deals in 2006 increased by 23% as did the number of transactions by 14% amounting to \$880 billion and \$6, 974 dollars respectively (UNCTAD, 2007). This growth was largely made possible by the positive effects of liberalisation programs in support of FDI promotion (UNCTAD, 2006).

FDI creation has been facilitated by continuous liberalisation of trade and investment policies lowering restrictions on foreign investment and acquisition, privatization and de-regulation of numerous industries, technological advancements (Graham & Spaulding, 2005), as well as fiscal and regulatory

concessions. UNCTAD's (2008) annual survey report of changes to national laws and regulations related to FDI demonstrated that in 2008, 85 out of 110 policy amendment FDI-related proposals presented were encouraging of FDI (UNCTAD, 2009).

## **2.1 MNEs: Investment and Employment**

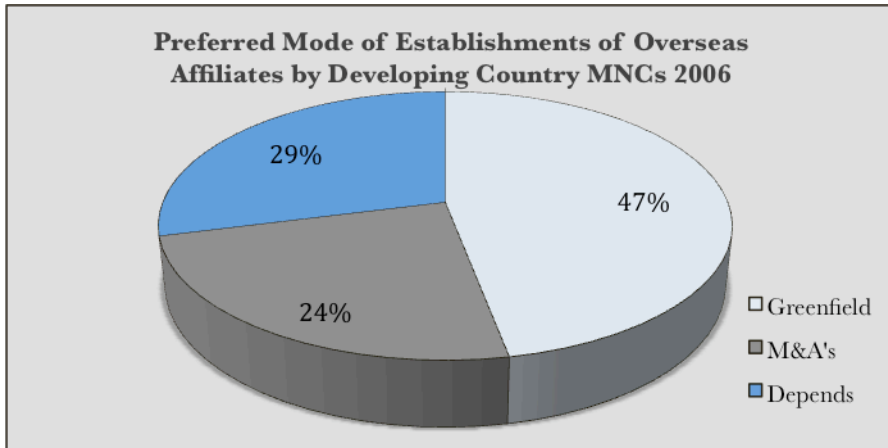
Multinational Companies play a substantial role in international production (UNCTAD, 2006). According to the 2006 World Investment Report, the 100 largest MNCs in the world account for a great proportion of total FDI growth. Altogether, these companies represent 11% of foreign assets, 16% of sales and 12% of employment of all MNCs operating in the world (UNCTAD, 2006). The majority (73 out of 100) of these companies are headquartered in developed countries such as France, Germany, Japan, the United States and United Kingdom with only 5 firms from developing countries in Asia making the top 100 list (UNCTAD, 2006).

In 2006, multinational enterprises and their affiliates represented 3% of the global labour force, a threefold increase since 1990, employing an estimated 73 million employees (OECD, 2008b). This number increased to some 83 million employees in 2007 (UNCTAD, 2008). A large percentage of this workforce is employed by foreign partners of MNEs in transition and developing economies, with jobs more concentrated in the manufacturing sector (OECD, 2008b).

The degree to which multinationals and their foreign partners really contribute to job creation seems to be influenced by whether the investment

pursued by the multinational is attained through mergers and acquisitions (M&A) investment or Greenfield investment (OECD, 2008b). M&A investments and Greenfield investments are two important modes of entry utilized by multinationals to enter a new market (UNCTAD, 2006). Cross border mergers and acquisitions involve fractional or complete takeovers of existing firms in foreign countries resulting in the integration of capital, assets and liabilities. In essence, the foreign firm experiences a change in ownership with no substantial change in amount of capital invested in the enterprise. Greenfield investments on the other hand result in the construction of new operational facilities (i.e., buildings, plants, offices and factories). Capital flows between the direct investor and the enterprise receiving the investment allow for the purchase of goods, fixed assets and services ensuing in the advancement of the host country's production capacity and generating employment (UNCTAD, 2006). While Greenfield investments are believed to have a greater impact on job creation, a 2008 OECD report (2008b) suggests that M&As also demonstrate a positive and significant impact on employment in some countries. A 2006 survey of preferred modes of establishment of overseas affiliates showed the distribution in Figure 2, where Greenfield investments represented almost half of investments made.

**Figure 2 Preferred Modes of Entry of Overseas Affiliates by Developing Country MNCs**



Depends on the individual investment case: If the host country is considered as a Least Developed Country (LDC), Greenfield investments are the only option; whereas, the choice of investment is broader in developed and developing countries. Adapted from: "World Investment Report 2008. FDI from developing and transition economies: Implications for development" by UNCTAD, 2006.



### 3. Competing for FDI

As discussed previously, FDI is linked to development and its potential benefits have created competition amongst both developed and developing countries (OECD, 2008c). This section discusses some of the ways in which different economies compete for FDI and explores the costs and benefits associated with this competition.

Host country governments attract FDI with instruments such as “tax holidays, investment credits, import duty exemptions, the provision of low-cost land facilities and wage subsidies” (Greenaway, Sousa, & Wakelin, 2004, p. 1028). Some examples of government-induced incentives to attract FDI include privatization in Czech Republic, Estonia and Hungary (Coolidge, 2001); the government of Alabama offering 150,000 per job to attract Mercedes to the state (Head, 1998); the British government offering 30,000 per job to draw Samsung and 50,000 per job to draw Siemens to the North East of England (Girma, Greenaway & Wakelin, 2001); the State of Rio Grande in Brazil, privatizing its local port and phone company and using the earnings to create incentives to draw in car plants (Christiansen, Oman, & Charlton, 2003); and General Motors as well as Ford receiving state sales tax exemptions for 15 years to establish their new factories in Porto Alegre, Brazil (Christiansen et al.).

With regard to the costs and benefits associated with incentive competition between countries, there are a number of arguments on both sides of the spectrum. On the positive side, Tiebout (1956) proposes that incentive competition may lead to greater spending on public goods and Wilson (2005)

argues that spending more money on incentive programs may reduce wasteful government expenditures. Furthermore, incentive competition, typically in developing countries may also facilitate in effectively distributing capital (Christiansen et al.); and result in job creation, especially in places where there are higher rates of unemployment (Bartik, 1991).

On the other hand, critics argue that investment incentives may inadvertently reduce public goods spending due to fiscal failures (Zodrow & Mieszkowski, 1986). Another argument is that subsidization of foreign firms with incentives is economically inefficient for the host country and results in waste (Rodríguez-Pose & Arbix, 2001). These risks are recognized by host countries, however political need to create jobs and attract investment leads them to gamble by overbidding subsidies and incentives in hopes of attaining a multitude of positive spillovers, which cannot be reliably quantified (Biglaiser & Mezzetti, 1997). Finally, incentive competition provides firms with the flexibility of mobility, that is to say that with greater number of incentives spread out across different locations, firms may reduce the depth of their investment in any one location or in some cases completely relocate their investments to capitalize on newer incentives elsewhere, thereby inadvertently creating excessive turnover (Wilson, 1996).

## **4. Foreign Ownership and Wages: Existing Evidence**

Having provided a more macro-level view of FDI and its effects on host countries, this section will focus on the effects of FDI at the firm level and explore whether FDI has a positive impact on wages in host country firms.

Do multinationals support a better wage premium? While there is some evidence to show the contrary, most particularly from developed countries, there is a large body of literature that concludes that multinationals do provide a wage premium to their employees compared to local firms. These findings are presented in the following sub sections.

### **4.1 Supporting Research**

A 2008 report by the Organisation for Economic Co-operation and Development (OECD) illustrates that on average multinationals pay up to 40% more to their employees compared to their local counterparts (OECD, 2008b). This wage premium is bigger in low-income countries but lessens when comparing local and multinational firms competing in the same markets (Hijzen & Swaim, 2008). Similar findings are reported by earlier studies. Aitken, Harrison and Lipsey's 1996 study of this phenomenon in Mexico, United States and Venezuela found that multinationals paid 30% higher wages than domestic firms and that this wage premium remained true for Venezuela and Mexico even after controlling for location, firm size, skill mix and capital intensity.

In examining whether a higher wage premium existed in foreign firms in Vietnam, Paul Glewwe (1999) using Vietnamese household level data surveys

conducted in 1992-1993 as well as 1997-1998 used three different approaches to compare the status of workers in foreign owned businesses (FOBs), Joint ventures and wholly Vietnamese owned businesses. In the first of these approaches, Glewwe analyzed the consumption spending levels of the households of workers within each category to ascertain whether workers in FOBs were financially more or less capable of supporting their families as compared to workers in the other categories. Table 1 shows the results attained from the analysis; it presents the per-capita consumption spending of all households in Vietnam on the first line of the table, with the rest of the lines demonstrating the per-capita expenditures of employee households in each of the other categories. Contrary to what many anti-globalization critics contend, the table illustrates that workers employed in foreign owned businesses have per-capita expenditures two times higher than those of the average Vietnamese household. Similarly, results show that Vietnamese workers employed by textile FOBs (303), leather goods FOBs (371) and those employed by joint ventures (251), had greater spending power as compared to the average Vietnamese household, albeit to a lesser extent.

**Table 1 Relative Status of Worker: Vietnam, 1998**

<b>Type of Worker</b>	<b>Annual Per-Capita Expenditures (US dollar equivalent)</b>
<b>General population</b>	205
<b>People working in FOBs</b>	420
<b>People working in joint ventures</b>	251
<b>Workers in textile FOBs</b>	303
<b>Workers in leather-goods FOBs</b>	371

The second approach Glewwe used to examine the status of employees in FOBs was to focus on their wages. Table 2 shows the results of this analysis, and demonstrates that while the average wages earned by Vietnamese workers are low in comparison with those earned in the United States, hourly wages earned by workers in FOBs are again almost twice as high as those earned by the average Vietnamese wage-earner.

**Table 2      Distribution of Employed People by Occupational Category in Vietnam, 1998**

<b>Type of Worker</b>	<b>Percent of All Responses</b>	<b>Wage (US dollar equivalent)</b>
<b>Farmers (self-employed)</b>	58.7	-
<b>Self-employed non-agricultural work</b>	20.4	-
<b>Wage or salary workers</b>	20.9	0.23
-- Wage or salary workers employed by:		
<b>Government</b>	4.2	0.24
<b>State enterprise</b>	3.4	0.27
<b>Small household enterprise</b>	6.0	0.21
<b>FOB</b>	0.4	0.42
<b>Joint venture</b>	1.1	0.19
<b>Other</b>	3.6	0.19

The third approach Glewwe used to address the question of whether FOBs pay better wages to their employees was to look at official poverty statistics and categorize employees in terms of whether they were considered to be poor or not. In order to adequately categorize workers using this data, the Vietnamese government definitions for “poor” and “very poor” were incorporated in to the analysis. According to the Vietnamese government, “very poor” indicates that a household’s total consumption spending is less than what is necessary to

purchase a minimal basket of goods and food items required to meet the daily calories in each household members diet. Whereas the government's definition of "poor" households indicates that the households' spending is inadequate in purchasing a basket of goods as well as having an allowance for other non-food purchases. Overall, in 1998 data reveal that 15% of the population were considered to be "very poor;" whereas, 37% were considered to be "poor". The study shows that the poverty rate was a great deal lower for those employed by joint ventures; specifically, 6% of households were considered to be very poor and 18% to be poor (See Table 3). Additionally, workers employed by foreign owned businesses showed the lowest rates of poverty as none were categorized to be very poor and only a small percentage were classified as poor.

**Table 3 Poverty Status: Vietnam, 1998 Incidence of Poverty (%)**

Type of Worker	Very Poor	Poor
General population	15.0	37.4
People working for joint ventures or FOBs	6.1	18.3
People working for joint ventures	8.0	21.4
People working for FOBs	0.0	8.4
People working for textile FOBs	0.0	17.3
People working for leather-goods FOBs	0.0	8.6

Lastly, the study also evaluated the changes in the economic status of these households over a five-year time span. This was facilitated by the fact that several of the households that participated in the previous survey in 1993 also took part in the latter survey in 1998, thus allowing the researcher to follow any changes in economic status of these workers over time. Table 4 outlines the

results observed by the researcher and demonstrates that the overall per-capita consumption spending for Vietnamese households improved by 41% after adjustments to inflation. These increases were most dramatic for individuals employed by FOBs and joint ventures. The per-capita spending of workers in joint ventures increased to almost 53 and most notably, workers employed by FOBs enjoyed the highest increase in expenditures, namely 70%.

**Table 4      Change in Economic Status for Workers: Vietnam, 1998**

Type of Worker	Mean Per-Capita Expenditures (US dollar equivalent)		Inflation Adjusted-Change (%)
	1993	1998	
Entire population	125	205	+41.1
Joint ventures and FOBs	143	261	+57.5
Joint ventures	131	232	+52.8
FOBs	189	372	+69.7

A study by Lipsey and Sjöholm (2001) in assessing the effects of foreign ownership on wages in Indonesia, demonstrated analogous results. The researchers were interested in establishing whether Foreign Owned Businesses (FOBs) provided higher wages to their employees as compared to local firms. Additionally, the researchers investigated whether the presence of FOBs had a positive impact on increasing overall wages in local firms. In order to adequately answer these questions the researchers analyzed 1996 survey evidence of all plants in Indonesia. Cross-sectional data of Indonesian manufacturing establishments were created using a sample of 19,911 survey responses by managers of plants. Data collected included information on each

firm's energy inputs, location and labour characteristics. The researchers analysed the data controlling for a number of different factors including plant size, energy inputs, productivity, gender, industry, age of facility and regional characteristics (Lipseý & Sjöholm). Although the study demonstrated different outputs of wage differentials according to the control variables used, the researchers concluded that foreign firms still paid a higher wage premium as compared to domestic firms. Additionally, the study further demonstrated that the presence of FOBs in the host country led to an increase in wages in local firms (Lipseý & Sjöholm).

A later study by Lipseý and Sjöholm (2004a) further looked at the qualitative differences in the makeup of the work force of multinationals and domestic firms to ascertain whether worker quality accounted for higher wages in multinationals. After comparing plant level data with information on the composition of workers, the researchers found that even though labour quality accounted for a large proportion of the wage premium, wages were 12% higher for production workers and 20% higher for non-production workers after controlling for labour quality (Lipseý & Sjöholm, 2004a).

Te Velde and Morrissey did a similar study in 2004, focusing on the manufacturing industry in five Sub-Saharan African countries. Using survey data from five countries, Cameroon, Ghana, Kenya, Zambia and Zimbabwe between the years 1990 and 1993, the researchers tried to determine whether a higher wage premium existed for equivalent workers in foreign and domestic firms (Te Velde & Morrissey). Results showed that after controlling for observable



workers characteristics, foreign ownership was related to a range of 20 to 37% higher wage premium for all workers in all five African countries. This wage premium was reduced to 8 to 23% respectively after the researchers controlled for firm-specific effects such as size and location of the firm. The study further concluded that while foreign firms do pay higher wages to comparable workers, skilled workers benefited most from foreign ownership (Te Velde & Morrissey). Zhao's (2001) study of 5,345 state owned firms and 188 foreign firms in China provided complementary results. More specifically, employees in foreign owned firms were paid almost twice as much as their counterparts in state-owned firms even though they had similar levels of education and skills.

Researchers have also tried to address the wage premia phenomenon by looking at changes that occur in a firm after a cross-border takeover. With the assumption that worker composition is not effected by a cross-border takeover, researchers can ascertain whether a foreign takeover has any effect on wages of workers in the acquired firm (OECD, 2008b). A study by Sjöholm and Lipsey (2006) using Indonesian panel data was able to assess changes that occurred both in firms having undergone a domestic takeover and in those having undergone foreign takeover. The data analyzed was based on statistical records of Indonesian manufacturing plants between the years 1975 to 1999. They found that during this period real wages had grown by nearly 200% and 130% for white-collar and blue-collar workers respectively, with wage differentials greatest in the early 1980s when the Indonesian government, due to an economic crisis, liberalized its FDI regime. In 1999, wages while less than previous records were

still 44% and 68% higher for blue-collar and white-collar workers, respectively, in foreign firms.

In researching this hypothesis, Sjöholm and Lipsey (2006) tested whether the differences in wages in firms that had undergone a foreign takeover were correlated with foreign firms' selective acquirement of already high-wage firms. Results demonstrated that wage differentials were not related to the acquisition of high wage plants and after taking into account firm specific assets, industry and time controls, foreign ownership was still related to higher wages. More specifically, results showed that foreign owned firms as well as foreign takeovers brought about a 30% higher wage rate for blue-collar workers and 40% higher rates for white-collar workers as compared to plants that remained domestically owned. Of note, the researchers concluded that domestic acquisitions of foreign plants did not result in any changes.

Girma and Görg (2007) addressed similar questions in a recent study. The researchers tried to ascertain if there existed a causal relationship between foreign acquisition of domestic UK firms and corresponding increases in wages of skilled and unskilled workers. The study further tested whether the nationality of the foreign acquirer had any influence on the final outcome. In an interesting twist, the study demonstrated an 8 to 13% wage increase for both skilled and unskilled workers when the host firm was acquired by a U.S multinational but no wage effects if firms were acquired by EU multinationals. A 2008 study by the Organisation for Economic Co-operation and Development (OECD) also showed that foreign firms had a positive effect on wages albeit at different levels across

countries (OECD, 2008b). More specifically, the study demonstrated that foreign takeovers of domestic plants increase wages by 5% in the United Kingdom, 8% in Portugal, 11% in Brazil and 19% in Indonesia while having no significant effect on wages in Germany.

## **4.2 Opposing Evidence**

While the aforementioned studies show a positive and significant wage effect in foreign owned firms, there are a number of other studies that challenge this idea. With regard to wage increases after foreign takeovers, there are a number of studies that show only small wage effects. Almeida (2007) found only a 2 to 4% wage increase after a foreign takeover in Portugal and Moller, Markusen and Schjening (2007) only 1% increase in Denmark. As well, Conyon, Girma, Thompson, and Wright (2002) and Andrews, Bellman, Schank, and Upward (2007) found only a 3% wage increase after a foreign takeover in United Kingdom and Germany respectively.

Furthermore, some studies also dispute the conventional belief that foreign firms provide premium wages as compared to domestic firms, showing instead only small positive effects on wages of workers in foreign firms and in some cases negative effects on wages as a result of foreign ownership. A study examining the effect of foreign ownership on wages in the Swedish private sector establishments by Heyman, Sjöholm, and Gustavsson Tingvall (2007) found significantly smaller wage effects than previously reported. The study was based on data accumulated on Swedish firms between the years 1990 to 2000 with information on more than two million employees. By matching employer-

employee data, the researchers examined the foreign ownership wage effect while controlling for individual and firm differences as well as acquisition biases. As a final control, foreign multinationals were compared with Swedish multinationals and local firms. The results showed that while foreign firms pay higher wages than local firms these wage differentials were not great after controlling for selection bias and worker heterogeneity. The study further concluded that the wage premium effect was null when comparing foreign firms with Swedish multinationals. Additionally, foreign acquisitions of Swedish firms demonstrated no change in the wages of workers in the acquired firm and in some cases resulted in a decrease in wages of medium and skilled workers by 4 to 6%.

Similar findings were reported by Martins (2006). By matching employee-employer panel data with information on over five million workers in Portugal between 1991 and 1999, the researchers investigated the difference in compensation between employees of multinationals and those of domestic firms. They found that there existed no causal relationship between foreign ownership and higher wage premiums and while foreign firms provided better wages compared to their domestic counterparts, results were greatly deflated after controlling for worker and firm characteristics. Furthermore, as with the study by Heyman et al. (2007) the researchers found that foreign takeovers of Portuguese domestic firms had a negative impact on individual wages.

It is important to note that opposing evidence of the wage premia phenomenon are largely based on findings in developed countries and may thus

not provide equivalent comparisons with findings in support of this phenomenon occurring principally in developing countries. Nevertheless, these findings are important to consider as they provide further insight into the debate and more specifically give credence to the belief that the phenomenon is more prevalent in developing countries.

### **4.3 Some Explanations for Wage Differentials**

With the large body of evidence in support of a higher wage premium in MNCs especially in developing countries, the following subsection provides an overview of a number of theories that have been put forward to elucidate why foreign firms may pay higher wages than their domestic counterparts. One such theory is based on the hypothesis that foreign firms have access to more innovative technologies and operate more productively, accordingly being able to pay higher salaries (Te Velde & Morrissey, 2004). Additionally, the complex technology that most foreign firms employ necessitate superior operating skills or employees that have a greater skill mix. Foreign firms may be forced to pay higher wages to attract and or maintain employees with these skills (Te Velde & Morrissey).

Other explanations propose that the MNCs provide higher wages in order increase employee productivity and improve worker confidence (Brown et al., 2004). This view is supported by 'Efficiency wage theory' which postulates that firms pay premium prices in order to advance the health of their employees which would purportedly lead to an improvement in their productivity (Brown et al.). Similar versions of this theory consider the higher rate of payment in comparison

to market wages as a result of firms desire to reduce turnover rates and costs associated with retraining (Brown et al.).

Higher wages can also be attributed to “ bargaining theory” which suggests that skilled workers because they may be in short supply are better able to negotiate higher wages (Te Velde & Morrissey, 2004). Some foreign firms may also lack knowledge of the local labour market and the quality of workers in the host country and concentrate their hiring on workers with higher level of education and skills (Te Velde & Morrissey). Local firms on the other hand, due to their greater knowledge of the local labour market are able to better identify and attract skilled workers without necessarily increasing wages. As well skilled workers are in a better position to bargain for higher wages than those that are less skilled (Te Velde & Morrissey).

Firm specific effects such as the location of the foreign entity may offer some further explanations as to why foreign firms pay higher wages. Foreign firms may choose to establish themselves in specific industries or regions that allow for better wage rates (Aitken et al., 1996). Higher wages may also be due to selectivity bias otherwise known as cherry picking whereby foreign firms acquire existing high wage establishments in the host country (Sjöholm & Lipsey, 2006). It is common for foreign firms to establish themselves in the host country by acquiring an existing company rather than beginning anew and there is some of literature that shows that at least in developing countries takeovers of existing firms result in wage increases (Sjöholm & Lipsey). An explanation for this may lie in the fact that new owners increase wages in order to avoid losing employees as

well as firm-specific knowledge to the competition (Heyman et al., 2007). Moreover, acquisitions create occasion for renegotiation of contracts and are a time of organizational change within the company, so workers may demand a wage premium to stay on with the company during this time (Bertrand & Mullainathan, 2003; Shleifer & Summers 1988).

The size of a firm has also been suggested as a reason for higher wages. Foreign firms are larger than domestic firms and large firms on average pay better than smaller ones for comparable work (Te Velde & Morrissey, 2004). A study of five large foreign firms in Sub-Saharan African (SSA) countries demonstrated that after controlling for observable worker characteristics, large firms paid an average of 20 to 30% higher wages than smaller firms (Strobl & Thornton, 2001). This wage premium was also reported by Schmidt and Zimmerman (1991) in their study of size wage effect in West Germany. Wages were higher in large firms even after controlling for a number of variables such as worker characteristics, tenure, firm activities and industry. Albaek, Arai, Asplund, Barth, and Madsen (1998) reported similar findings in their study of Scandinavian establishments, as did Bayard and Troske (1999) in their U.S study.

A more recent study of size-wage effect of Belgium private sector establishments demonstrated significantly higher wages in larger firms after controlling for working conditions and individual worker characteristics. The researchers in this study concluded that the higher wage premiums were largely related to the sector the firms were established in, as well as due to the greater productivity and stability observed in workers of larger firms (Lallemand, Plasman

& Rycx, 2005). Other explanations of why this size wage effect occurs are related to the fact that larger firms, due to their greater productivity are more profitable and thus more able to share profits with their employees. This is confirmed in the study by Blanchflower, Oswald, and Sanfey (1996), which found a positive correlation between foreign firms' profitability and employee wage gains. In addition, bigger firms may pay a wage premium because they hire workers that have more experience and may be part of a union (Winter-Ebmer & Zweimüller, 1999) and research shows that on average, unionized workers in both developed and developing countries enjoy higher pay as compared to workers that are not part of a union (Aidt & Tzannatos, 2002).

Lastly, external driving factors and influences from anti-globalization protests, NGO groups and anti-sweatshop campaigns place a great deal of pressure on MNCs to follow appropriate regulations with regard to safety standards and wage provisions (Brown et al., 2004). Thus, MNCs, especially those that are most visible, have an incentive to provide higher wages than that of the market, as a strategic and pre-emptive move to avoid loss of reputation and sales due to accusations of safety violations (Spar, 1999). An example of this can be seen in Indonesia during the 1990s when anti-sweatshop activism was at an all-time high. Due to external pressures, the Indonesian government increased minimum wages and foreign textile, footwear and apparel plants raised production worker wages by 10 to 20% (Harrison & Scorse, 2008). As well, consumers today are increasingly basing their purchasing decisions of products and brands on how much respective companies are committed to supporting



social and environmental sustainability as well as their commitment to treat workers fairly (Fair Labour Association [FLA], 2009). According to the FLA (p. 6), “Consumers want assurances that the brands they buy are not produced in sweatshop conditions.”

#### **4.4 Wage Increases: A Practical Consideration?**

While most of the literature discussed in the previous subsections indicate that MNCs do promote higher wages in their foreign operations, anti-globalization activists argue that wages are still insufficient and exploitative (Brown et al., 2004). In response to these accusations, opponents argue that activists in making these accusations fail to consider that wages cannot simply be increased and may be as they are for good reason (Spar, 1999). More specifically, they argue that activists fail to differentiate wages between skilled vs. unskilled work and further fail to take in to account quality of work, productivity of employees and local market conditions and how these factors are related to specific wage rates (Spar). But, are further wage increases by MNCs a practical consideration? There is some economic evidence that shows that workers may suffer as a result of wage rises above their level of productivity and the market value (Terrell & Švejnar, 1989). The case of Latin America exemplifies this effect, as higher levels of severance pay resulted in companies hiring less than they previously did (Heckman & Pages, 2000). In Senegal, attempts to produce a more equitable and secure employment code resulted in less long-term employment and more short-term contract type of employment for a larger share of the workforce (Terrell & Švejnar). Furthermore, Stern and Terrell (2003) propose that pressures

to impose higher wages and labour standards that are much higher than the respective productivity of workers may adversely drive more workers into the informal sector, which is less regulated (with poorer wages and working conditions), and away from the formal sector which have higher labour standards. This may occur because the gap between investment benefits and costs become too small for foreign firms and employers.

## 5. Indirect Effects of FDI

In evaluating the effects of FDI on host countries, most particularly in the area of wages and working conditions, it is important to note the potential indirect benefits of FDI on host country firms. Indirect effects of FDI are said to occur when the productivity advantage and efficiency benefits of multinationals' spillover to local firms (OECD, 2008b). There are typically four different channels through which these spillovers may take place: Imitation; Skills Acquisition; Competition; and Exports (Görg & Greenaway, 2003). (See Table 5 for spillover channels and productivity gains, which will be discussed in more detail in this section.)

**Table 5 Spillover Channels and Productivity Gains**

Driver	Sources of Productivity Gain
Imitation	<ul style="list-style-type: none"> <li>• Adoption of new production methods</li> <li>• Adoption of new management Practices</li> </ul>
Competition	<ul style="list-style-type: none"> <li>• Reduction of inefficiencies</li> <li>• Faster adoption of new technology</li> </ul>
Human Capital	<ul style="list-style-type: none"> <li>• Increased productivity of complementary labour</li> <li>• Tacit knowledge</li> </ul>
Exports	<ul style="list-style-type: none"> <li>• Scale economies</li> <li>• Exposure to technology frontier</li> </ul>

Source: "Much Ado About Nothing? Do domestic firms really benefit from foreign direct investment?" by H. Görg & D. Greenaway, a Discussion Paper for the Institute for the Study of Labour, 2003.

Imitation occurs when local firms improve their productivity by emulating practices of foreign firms. The ability to imitate practices of foreign firms largely depends on the absorption capacity of domestic firms (i.e., their ability to identify valuable information and integrate this information constructively to increase the

firm's productivity) (Hamida, 2006). In order to imitate foreign firms efficiently, local firms need to invest in their own research and development (Hamida). Wang and Blomström (1992), show that spillovers via FDI are positively correlated to the level of local firms' learning capacity in terms of investment and absorption and propose that the degree and rate of spillovers can be accelerated by domestic firms increasing efforts to learn from MNCs. However, multinationals in order to protect their superior technology and knowledge from leakage to local competitors may take measures to reduce this possibility, thus making it difficult for local firms to imitate (Gertler & Garrick, 2008).

Spillovers can also take place as a result of competition (Wang & Blomström, 1992). Competition instigated by foreign presence may accelerate the rate and degree of adoption and imitation of new technologies introduced by foreign firms (Görg & Greenaway, 2003; Wang & Blomström) and further encourage domestic firms to independently develop new innovative technologies (Narula & Marin, 2003). Competition may further result in positive spillovers in the area of wages. More specifically, competition produced by foreign firms in the host country may indirectly lead to wage increases in domestic firms (Görg & Greenaway). This may occur as a result of foreign firms influencing the local labour market (i.e., new foreign firms establishing in a host country raise the demand for labour and pay premium wages as compared to their domestic counterparts; Aitken & Harrison, 1999), domestic firms in order to maintain their workforce and remain competitive may raise wages accordingly (OECD, 2008b). While this is supported by a number of studies (Driffield & Girma, 2003; Lipsey &

Sjöholm, 2001; 2004b) others report no wage spillover effects (Aitken & Harrison, 1999) or negative wage effects (Aitken et al., 1996; Girma et al., 2001).

Additionally, MNC production typically competes directly with that of domestic firms (Görg & Greenaway), domestic firms faced with competition from foreign firms with superior technology and/or practices are frequently forced to improve production processes and use of existing technology (OECD, 2008b; Gorg & Greenaway). However, some local firms incapable of competing with their foreign counterparts may find their survival threatened as a result of the shift in demand towards foreign firms and the subsequent reduction in profitability (Aitken & Harrison, 1999; Görg & Strobl, 2005). Even if some plants are able to withstand this competition, a decrease in demand may reduce productivity of local firms and result in a reduction of production leading to increased costs (Aitken & Harrison).

Another indirect channel where spillovers may occur is through exports (Aitken, Hanson, & Harrison, 1997). There is some evidence to indicate that domestic firms gain knowledge of export market penetration from subsidiaries of multinationals and are able to exploit this knowledge to increase their own export propensity (Görg & Greenaway, 2003). Greenaway et al. (2004) in their study of export spillovers of UK firms found that the likelihood of exporting by domestic firms was positively correlated with foreign firms' production and export activities in the host market. As well, they found that competition produced as a result of foreign presence greatly influenced the export propensity of domestic firms (Greenaway et al.).

One of the most important channels of spillovers result from the acquisition of human capital or through worker mobility (Fosfuri, Motta, & Ronde, 2001). Spillovers channelled through worker mobility occur when previous employees of foreign owned firms move to domestic firms (Pesola, 2007) or start their own business, and take with them the management know-how and knowledge of modern techniques utilized in foreign firms (Görg & Strobl, 2005). While worker mobility from multinational companies to domestic firms takes place in both developed and developing countries, it is more prevalent in the former where multinationals lack significant advantage over host firms (Glass & Saggi, 2002). In a study of spillover effects through worker mobility in Ghana, Görg and Strobl found that previous experience with a foreign multinational was correlated with higher productivity once in a domestic firm in the same industry. Hale and Long (2006) find similar results in their study of labour mobility in China. Analysis of 1,500 Chinese firms confirmed that labour mobility is associated with multinational productivity spillovers. Furthermore, management experience with multinationals had a significant and positive effect on the local firms' productivity, and was also related to the incidence of FDI in the same industry. A related study of labour mobility in Norway found that workers of multinationals who moved to domestic firms were 20% more productive than workers without this experience (Balsvik, 2006). Additionally, previous employees of multinationals enjoyed wages 3% higher as compared to their colleagues (Balsvik). Domestic firms may offer higher wages to previous employees of multinationals in order to access knowledge that they do not possess (Pesola). This knowledge does not

necessarily need to come from formal training, as Poole (2006) suggests that on-the-job training in itself facilitates the absorption and transfer of technology.

It is worthwhile to note that Andrews et al. (2007), in a study of takeovers in West and East Germany, found that positive wage effects upon mobility from a multinational firm to a domestic firm were small as compared with the wage effects of workers moving from domestic firms to foreign firms. Martins (2005) further reports that while previous employment with a foreign firm may result in relatively higher wages in comparison with local employees upon mobility to a local firm, these workers typically experience a significant wage cut from their MNC wage. Moreover, Martins (2005) suggests that while there is some evidence correlating the transfer of knowledge as a consequence of labour mobility, there is also evidence of mobility from foreign firms to local firms that reveals contradictory results.

Finally, there is growing literature indicating that spillovers may occur through backward linkages (i.e., through the connections between foreign firms and their local suppliers) (Javorcik, 2004). Positive spillovers can take place through backward linkages when multinationals influence domestic suppliers with regard to appropriate labour practices and quality standards (OECD, 2008b; Narula & Marin, 2003), as well as through the direct transfer of knowledge from foreign customers to local suppliers (Javorcik). According to Blalock and Gertler (2008), foreign firms have an incentive to aid local suppliers in becoming more efficient and developing high quality products since it is only with the procurement of high quality inputs at a low cost that these firms can reap the full

benefits of their investment abroad. Evidence of strategic technology transfer from multinationals to local suppliers has been reported by Blalock (2002) in Indonesia and Javorcik (2004) in Lithuania. Moreover, a 2008 study by the OECD found that domestic firms that interacted with MNCs through supply chains or which employed previous managers of foreign firms demonstrated greater productivity, had a greater propensity to offer training programs and paid higher wages to their employees as compared to those that did not have any affiliation with foreign firms (OECD, 2008a). However, Alfaro and Rodriguez-Clare (2004) consider that backward linkages may not always transpire as multinationals may choose to substitute sourcing inputs from local firms by importing from the home base instead. As well, in their study of vertical spillovers through backward linkages, evidence from Brazil, Chile, Mexico and Venezuela, little evidence was found in support of positive vertical spillovers through backward linkages even though foreign firms in these countries demonstrated greater linkage potential than domestic firms.

## 5.1 Implications

While there exists considerable evidence supporting the incidence of positive spillovers from foreign firms to their domestic counterparts<sup>2</sup>, counterevidence demonstrating inconclusive or negative effects<sup>3</sup> leaves the

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<sup>2</sup> See Haskel, Pereira, & Slaughter (2002) and Driffield & Girma (2003) for evidence in the United Kingdom; See Keller & Yeaple (2003) for evidence in the United States; And see Javorcik (2004) for evidence in Lithuania.

<sup>3</sup> Non-significant or negative spillovers. See evidence by Haddad & Harrison (1993) for evidence in Morocco; Aitken & Harrison (1999) in Venezuela; Braconier, Ekholm, & Knarvik (2001) for Sweden; Chung (2001) for the United States; Konings (2000) for Bulgaria and Romania; and Djankov & Hoekman (2000) in the Czech Republic.



debate open and pending further analysis. Some possible explanations for the disparity of results in existing literature should be noted and taken into account for new analyses. For example the likelihood, rate and degree of spillovers may be influenced by local firm characteristics (Hamida, 2006). Wang and Blomström, (1992) found that only firms with high technological competence were able to benefit from FDI spillovers, while firms without this technological competence were unable to take advantage of MNC presence. Additionally, different channels of FDI spillover (Hamida), differences among industries and their respective characteristics as well as differences between countries and their respective policies and capabilities may influence the possibility of spillovers occurring and should be considered (Lipse, 2002). Finally, while the evidence of spillovers is mixed, the potential positive effects of spillovers and benefits accrued by host country firms should at the very least influence these economies not to restrict FDI (Blalock & Gertler, 2008).

## 6. MNEs: Labour Standards and Investment Decisions

Before addressing the literature pertaining to multinationals' activities abroad and their subsequent effects on working conditions and employment, it may be useful to first consider some of the reasons why multinationals choose to invest abroad. Two key motivations drive foreign investment: the first, 'market seeking', is a practice of finding new markets to supply a local market at lower cost and the second is 'efficiency seeking' which seeks cheaper production of goods and services (Shatz & Venables, 2000). In pursuing these motivations, foreign firms have an incentive to look for locations with greater human capital (Narula & Marin, 2003). That is to say that FDI inflows are significantly related to the level of human capital available in the host country (Noorbaksh, Paloni, & Youssef, 2001) and as discussed previously, multinationals will often pay higher wages for workers with higher education and skill-mix. Having said that, there are cases where foreign direct investment is directed to locations where the labour force is unskilled and suitable for simple assembly-type or resource extractive activities (Narula & Marin). Narula and Wakelin (1998) suggest that importance of skilled human capital as a determinant of FDI is not significant in developing countries but an important determinant of FDI inflows in developed countries. With this in mind and considering the growth of inward FDI into developing countries one cannot help but come across the accusation put forth against multinationals that they actively seek markets with low labour costs and standards (Naghavi, 2003). But in making their investments in one location versus another, do multinationals really pursue markets with lower labour

standards and costs? The evidence seems to prove otherwise (OECD, 2008a). According to Hatem (1997) there are a number of factors other than lower labour costs and wages that attract FDI. More specifically, he found that political and social stability; labour quality; legal and regulatory environment; market size and infrastructure were all more important in deciding where to invest. A later study by Kucera (2001) confirms this finding, indicating weak support for the association between weak labour standards and FDI, instead finding that political stability, social environment and stronger worker rights are greater drivers of FDI. As well, Naghavi provides evidence that MNCs are reluctant in some instances to base their activities within countries with low labour standards; a finding that is supported by Rodrik (1997), who reported that multinationals tend to establish themselves more in countries where labour standards are imposed. More recently, Hasnat (2007) in a study of FDI and worker rights, analyzed data from 145 countries between the years 2000 and 2004 and found that higher levels of worker rights were associated with higher FDI inflows and not the other way around. Moreover, Cooke and Noble (1998), in their study of U.S MNC operations in 33 developed and developing countries, showed that host countries with a stronger record of ratification of ILO conventions regarding worker rights were much more attractive as locations to invest by these firms. Finally, Daude, Mazza, and Morrison (2003) report that greater rights with regard to freedom of association and collective bargaining (FACB) as well as greater gender equality are correlated with higher levels of FDI.

Nevertheless, it is important to note that while the evidence above shows that host countries with better labor practices may be more attractive to investors, foreign firms may continue to invest in countries that lack these practices and are unlikely to export their own positive labor practices to their foreign affiliates, instead adapting to local practices (Almond & Ferner, 2006). The next subsection will explore evidence on MNC labour practices in order to evaluate whether foreign firms have a positive impact on working conditions in host countries.

## **6.1 MNCs: Labour Standards**

For assessing the behaviour of multinationals abroad, two types of standards are typically employed. The first of these standards (*home-country standards*) compares multinationals' activities abroad with those in the home country and the second, according to internationally accepted norms regarding labour and human rights (*universal standards*) (OECD, 2008a). MNCs have been criticized for their violations on both these fronts and are accused of infringing on local labour laws in developing countries as well as breaching safety standards and working conditions (see Bhagwati, 2004). Labour activists further argue that multinationals in taking advantage of lax labour trade laws often engender the production of sweatshops (most notably in textile and footwear industries) where workers, who are typically female, are often mistreated and forced to work in harsh conditions (Graham, 2000).

While the literature pertaining to the effects of FDI on working conditions is less abundant and more ambiguous than that concerning wages, there is some

evidence that multinationals provide better working conditions than their domestic counterparts. Idson and Oi (1999) argue that foreign firms, in particular larger foreign firms, typically provide cleaner and safer working conditions for their employees and as well additional fringe and time-off benefits. Lim (2001) in her analysis of a number of studies found little evidence for the criticism that multinationals operate sweatshops in low wage countries. She argues that 'sweatshops'<sup>4</sup> with poor working conditions and low wages are exceptions rather than the rule, and that most foreign firms pay higher wages and institute higher labour standards than the norm in the country. A 2006 study by the Asia Monitor Resource Centre (AMRC), commissioned by the International Metalworkers Federation (IMF) investigated working conditions in 27 factories producing for 12 transnational corporations in 5 regions of China. The factories investigated included 2 chemical plants, 18 electronic and appliance factories and seven automobile factories. The study concluded that working conditions in these factories were typically in line with standards delineated by Chinese Labor Law and in some cases superior to it. Moreover, the study showed that on average, working conditions in these factories were superior to those of other factories in the area and suggest that this is largely due to the fact that these are partially or fully-invested foreign factories. The study did, however report low unionization rates and also found that a number of factories allowed workers to work overtime beyond that permitted by law and thereafter failed to compensate these workers appropriately for overtime work. A 2008 OECD report (2008a), based on an

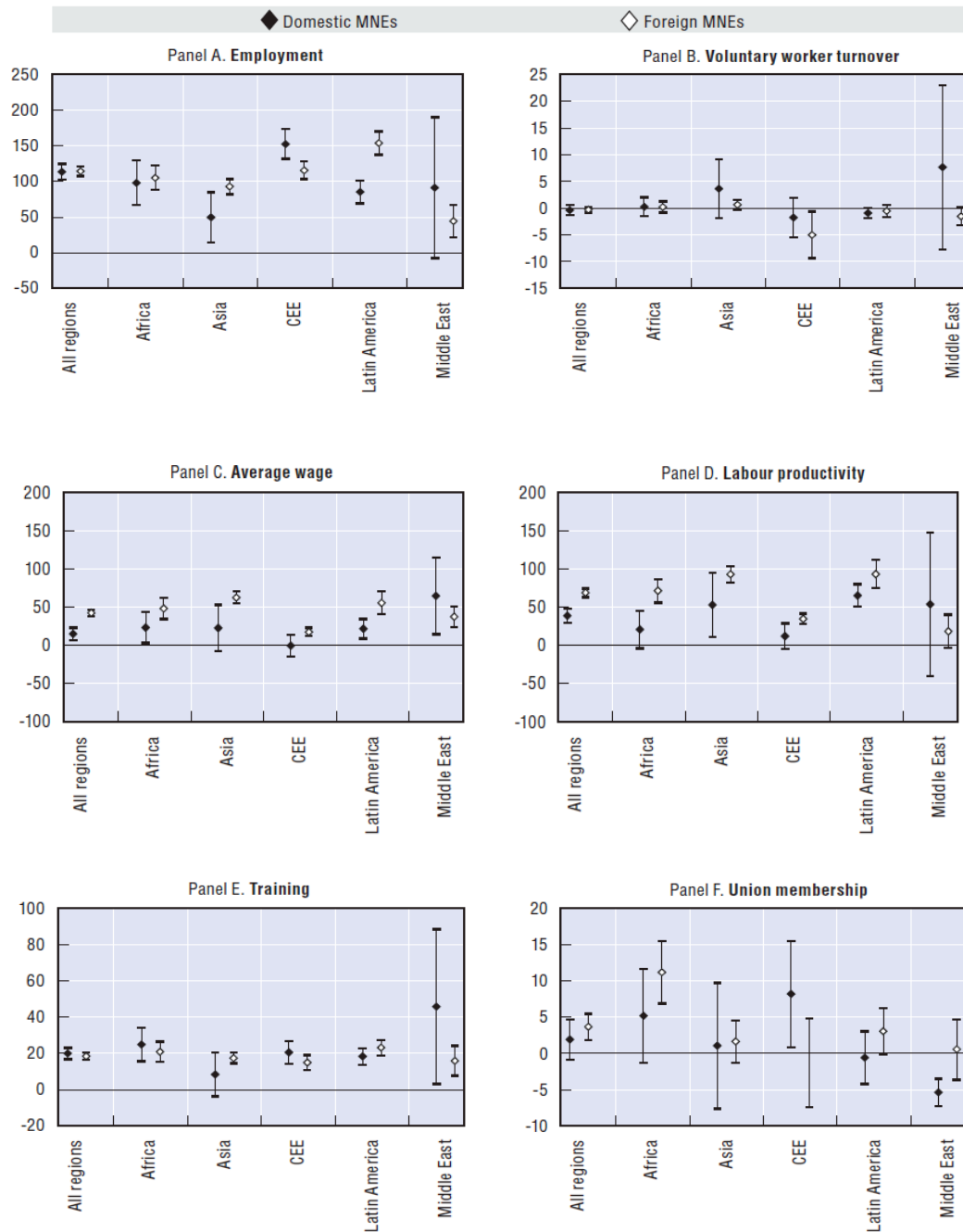
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<sup>4</sup> Sweatshops are defined as a shop or factory in which employees work long hours at low wages under poor conditions.

analysis of World Bank survey data comparing foreign MNCs with domestic MNCs, as well as local domestic firms, established similar findings. In looking at differences amongst these firms with regard to the following: employment; voluntary worker turnover; average wages; labour productivity; union membership and training, they found that work conditions are often better in foreign firms as are the quality of jobs. Additionally, the results indicate that foreign multinationals as well as domestic multinationals have higher rates of unionization and are more prone to providing training opportunities for their workforce than are local firms [Refer to Figure 3 to view graph results]. Nevertheless, the report cautions against interpreting these results at face value, as a number of biases were not accounted for and were likely to have prejudiced results in support of MNCs.

Even with little evidence in support of the positive link between MNCs and better working conditions, the evidence from cases of multinationals' wrongdoing, especially in developing countries, are enough to cast doubt on the validity of any positive findings. A 2000 in-depth investigation of 16 factories in China, manufacturing automobile parts and electronics as well as producing clothing and accessories for some of the largest and most recognized U.S. companies, found that Wal-Mart, Nike, Huffy and other reputable companies and their contractors in China, continuously violate universal human rights standards and worker rights, while paying low wages that are hardly enough to live on (Kernaghan, 2000). The investigation further reported that these companies and their suppliers often in partnership with corrupt local government operate

**Figure 3 Comparison of Employment Conditions and Productivity between MNCs and Local Firms**



CEE: Central and Eastern Europe) The diamond reflect the average percentage differences between MNEs and domestic firms within countries by host region. The vertical segments reflect the 95% confidence interval. If the vertical segment crosses the zero-axis, the differences between MNEs and domestic firms are not statistically significant.

Source: “Do multinationals promote better pay and working conditions?” in the OECD Employment Outlook – 2008 Edition.

as they do, exempt from any punishment (Kernaghan). More evidence of poor working conditions and bad labour practices in China are reported by Roberts and Bernstein (2000). An investigation of the Chun Si factory in China, where Kathie Lee handbags were being made for sale at Wal-Mart stores led to the discovery of dismal working conditions and evidence of beatings, confiscation of identity papers, lack of compensation for overtime work and illegal collection of fines (Roberts & Bernstein). Kernaghan reports on related issues at the Qin Shi factory in China, another factory dedicated to producing Kathie Lee handbags, where workers earn on average 3 cents an hour and are expected to work 12 to 14 hour days, 7 days a week with an allowance of simply an hour and a half per day outside factory premises. The story continues in El Salvador where workers are forced to work overtime to make jerseys for the National Basketball Association and in Mexico where factory workers producing jeans for companies abroad are forced to work overtime locked inside factories guarded by security (Global Exchange, 2007). Investigations also show that protests against these conditions and of treatment by workers typically result in mass firing rather than any positive change. This was found to be the case in the Qin Shi factory mentioned previously, whereby protests led to the termination of 800 jobs. Likewise, an inquiry into the Lizhan factory in China, where New Balance sneakers are produced found that protests of overtime hours and low pay resulted in the firing of all workers involved in the protest with the remaining workers of the factory lectured by managers on their zero tolerance policy regarding unions, strikes, bad behavior or the raising of complaints (Kernaghan).



Finally, Greenhouse (2001) found that Vietnamese workers in the Daewoosa factory in the American Samoa producing clothing for JC Penny, Target and other U.S. multinationals, were abused and punished by managers by way of food rationing and starvation (Greenhouse). Criticisms of multinationals regarding human rights violations such as these have also been centered on export processing zones (EPZs) and will be discussed in the next subsection.

## **6.2 Export Processing Zones (EPZs)**

Export Processing Zones (EPZs) are defined by the International Labour Organization (ILO) as "industrial zones with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being re-exported" (Sectoral Activities Department [SECTOR], 2007). Some examples of special Incentives offered include but are not limited to exemption from: export taxes; duties on imports and; national foreign exchange controls (Milberg & Amengual, 2008).

Export processing zones (EPZs) have evolved over the years to take many forms and designations and it is not uncommon for these zones to be referred to as free trade zones, special economic zones, bonded warehouses, free ports, customs zones and maquiladoras as well (SECTOR, 2007). While EPZs and their respective activities have evolved over time, they are for the most part still concentrated on low-tech/ low-skill activities and predominantly in the textile, clothing and electronic sectors (Milberg & Amengual, 2008). Singa Boyenge (2007) reports on the dramatic growth of EPZs and corresponding growth in employment in these factories between the years 1975 and 2006 (See

Table 6). China is seemingly the forerunner in EPZ activity but by 2006 all regions in the world have a fairly large presence of EPZs in terms of employment (Milberg & Amengual). A more detailed overview of EPZ activity by geographical zone is illustrated in Table 7.

**Table 6 The Development of Export Processing Zones, 1975-2006**

Year	Number of countries with EPZs	Number of EPZs	Employment in EPZs (millions)
1975	25	79	n/a
1986	47	176	n/a
1997	93	845	22.5
2002	116	3,000	43.0
2006	130	3,500	66.0

Source: "ILO database on export processing zones (revised)" by J.-P. Singa Boyenge in a Working Paper (No. 251) for the International Labour Office, 2007.

**Table 7 Export Processing Zones: Geographical Area and Employment**

Geographical Area	Number of Employed	Number of Zones
Asia	55,741,147	900+
Central America and Mexico	5,252,216	155
Middle East	1,043,597	50
North Africa	643,152	65
Sub-Saharan Africa	860,474	90+
United States	340,000	713
South America	459,825	43
Transition Economies	1,400,379	400
Caribbean	546,513	250
Indian Ocean	182,712	1
Europe	364,818	50
Pacific	145,930	14
<b>Total (Estimated)</b>	<b>65,980,763</b>	<b>3,500+</b>

Source: "ILO database on export processing zones (revised)" by J.-P. Singa Boyenge in a Working Paper (No. 251) for the International Labour Office, 2007.

So what is it about working conditions and labour rights in EPZs that draws the scrutiny and concern of the ILO and Non-governmental organizations (NGOs) alike? Concerns regarding EPZs are the same if not greater as those mentioned in the previous section. Multinational firms are criticized for taking advantage of lax labour laws, for violating domestic laws and breaching universal standards concerning safety and working conditions (Bhagwati, 2004).

In response to these criticisms, economist Jagdish Bhagwati in his 2004 book 'In Defense of Globalization' argues that domestic laws regarding safety and work conditions are typically absent if not insignificant within many poor countries where these firms are established and thus are unlikely to be infringed upon.

Furthermore, Bhagwati questions these objections and the attempt to insist that MNCs should effectively enforce that which the government of the host country is unable to do. He argues that less demanding regulations in poor countries may be as they are for good reason, to create jobs that would otherwise not be there and reminds opponents of the important fact that work in much of these thought to be low paying and unsafe EPZs are voluntary. But in the absence of better options regarding employment, should the alleged harsh labour conditions and abusive treatment of workers in these factories be tolerated? A consensus report on "sweatshop" conditions by the Massachusetts Institute of Technology (MIT) argues the following:

While accepting that a bad job might be better than nothing, we should continue to fight the abuse of human lives, and even a basic study of history reveals that most human progress as a society has occurred through such struggles for progress, not through maintenance of the status quo. If we justify abuse under the premise that is better than the worst alternative, we create a

slippery slope leading down to the complete devaluation of human life. (Anonymous, 2001, p. 1)

### **6.3 EPZs' Working Conditions**

An investigation by the International Confederation of Free Trade Unions (ICFTU) 2004, reports that EPZs in a number of countries namely, China, Bangladesh, Guatemala and Madagascar just to name a few, have demonstrated poor working conditions for their employees. Poor work conditions in these countries included issues from harassment of female workers and excessive overtime hours to forced captivity within factories. The study of a Bangladeshi EPZ factory highlighted in the report, found that employees were often locked inside factories, as a measure against employee theft. Regrettably these factories were often prone to fires, and as a result of this captivity, numerous workers lost their lives. Additionally, a number of country studies in the report illustrated that workers in EPZs were consistently forced to work overtime with only one allowable bathroom break every four hours (Perman, Duvillier, David, Eden, & Grumlau, 2004). Cases of compulsory overtime work, often in violation of domestic laws, have been reported in Sri Lanka (Jayaweera, 2003), Cambodia (International Labour Organization [ILO], 2007) and Vietnam (Wang, 2005). Interestingly, companies following more strict guidelines with regard to overtime, occasionally lose employees to other companies that do not adhere to these betterment policies. Lim (2001) also found that workers liked to work overtime to earn additional income, often choosing to work in factories with worse conditions to do this since employers such as Nike subcontractors would not allow them to do so.

Reports of EPZ work conditions have also demonstrated gender discrimination in factories. The majority of workers in EPZ factories are women because employers of EPZs purportedly prefer women over men for the routine, repetitive work that is practiced in EPZs. As well, women seem to be favoured because they are considered to be more conforming, disciplined and diligent as compared to men (Milberg & Amengual, 2008). This favouritism has enabled many women to enter into the formal economy once inaccessible to them (ILO, 2005) and further offered some women a way to gain independence and status (Moran, 2002). However, the benefits of employment for these women are at times overshadowed by the difficulties they face on the job which include harassment, forced pregnancy testing and discrimination (Loewenson, 1999). According to Human Rights Watch, women in EPZs in Mexico have to undergo the illegal and demeaning procedure of proving frequently that they are menstruating since managers want to avoid paying costs associated with worker maternity benefits (Global Exchange, 2007). The same report also demonstrated that pregnancy tests were mandatory for all female workers in EPZs in El Salvador, whereby a positive test result would lead to illegal job terminations. Moreover, health and safety standards are inferior in many of these factories. Studies have shown that workers in EPZs suffer greater rates of machine-related accidents, are often exposed to toxic chemicals and work environments that are poorly ventilated, excessively dusty and noisy (Loewenson). These problems in conjunction with the high stress work environment in EPZs have been linked with higher rates of cardiovascular and psychological disorders and have been found

to have a negative impact on women's reproductive health often resulting in complications during pregnancies and poor fetal health (Loewenson). Similarly, a study of EPZs in the Dominican Republic found that female workers in EPZs were hospitalized more frequently compared to non-EPZ workers (Liberato & Fennell, 2007). The greater risks and problems associated with some EPZs are often correlated with unrealistic production quotas and inadequate controls on overtime (Loewenson).

Even so, there is some evidence in support of the positive impact of EPZs. Evidence from a study in Costa Rica found that employees are treated fairly well and enjoy better working conditions in these factories than those of local firms (Jenkins, 2005). A report by the ILO (2008) also showed that, while overtime work was customary and worker rights of freedom of association and collective bargaining weaker in these factories, workers still enjoyed more social security and health care benefits as compared to those available in other sectors of the economy. Additionally, there is some evidence that workers in EPZs fare better than workers outside these zone, at least where wages are concerned. Studies of EPZ factory wages in Bangladesh, Madagascar, Honduras and Sri Lanka demonstrate higher wages than in other similar jobs (Milberg & Amengual, 2008). As well, Madani (1999) found that EPZ workers, especially female workers, receive better pay than workers in the informal sector but not necessarily better than those in the formal sector. Finally, a study of Cuban EPZs by Willmore (2000) established that EPZs wages in Cuba were higher than Cuban standards but much lower than wages in EPZs in the Dominican Republic, Trinidad, Costa

Rica, El Salvador and Jamaica to name a few. Regardless of this evidence, Milberg and Amengual point out that these purported higher wages and or compliance of existing wage standards by EPZs do not necessarily denote that these wages are sufficient for workers to live on.

## **7. Enforcement of Labor Laws in Foreign Operations of MNCs**

Having discussed wages and working conditions in different foreign operations of MNCs in previous sections, it is important to now look at the evidence concerning the degree to which universal labour rights and standards are included in labour legislation laws as well the degree of enforcement and compliance of these laws. In order to do this, it is useful to consider the extent to which countries adopt International Labour Organization (ILO) Principles and conventions regarding labour standards. The ILO Declaration on Fundamental Principles and Rights at Work adopted in 1998 and supported by a myriad of governments, employers' and workers' organizations, represents the most widely accepted effort to define and promote labour rights and principles around the world. The Declaration commits member States regardless of their level of societal or economic development to respect and promote principles and rights in the following four categories:

- Freedom of association and the effective recognition of the right to collective bargaining (Conventions 87 and 98)
- The elimination of forced or compulsory labour (Conventions 29 and 105)
- The abolition of child labour (Conventions 100 and 111)
- The elimination of discrimination in respect of employment and occupation (Conventions 138 and 182)

Member states that ratify conventions are obliged to report on its application at regular intervals. Member States that have not ratified one or more of the core conventions report annually on the status of the relevant rights and



principles within their borders and further report on impediments to ratification (In Focus Programme on Promoting the Declaration, 2009). Most countries have formally pledged to follow some or all of these conventions and as of February 2008, 89% of member states on average had ratified the majority of conventions under the Declaration (OECD, 2008a). This suggests that poor labour practices in foreign operations of MNEs are not necessarily related to insufficient protection of formal labour rights in host countries (OECD, 2008a). Ratification under the Declaration by region for 2008 is illustrated below in Table 8, which shows that ratification is greatest in Europe and Africa and lowest in Asia.

**Table 8 Ratification of Fundamental Human Rights Conventions by Region**

Region	Freedom of association and collective bargaining		Elimination of forced or compulsory labour		Elimination of discrimination in respect of employment and occupation		Abolition of child labour	
	Conventions		Conventions		Conventions		Conventions	
	87	98	29	105	100	111	138	182
<b>All Regions (187)</b>	150	160	174	171	167	169	154	171
<b>Africa (53)</b>	48	52	53	53	50	53	47	50
<b>Americas (35)</b>	33	32	33	35	33	33	30	34
<b>Asia (44)</b>	19	25	37	32	33	32	27	37
<b>Europe (55)</b>	50	51	51	51	51	51	50	50

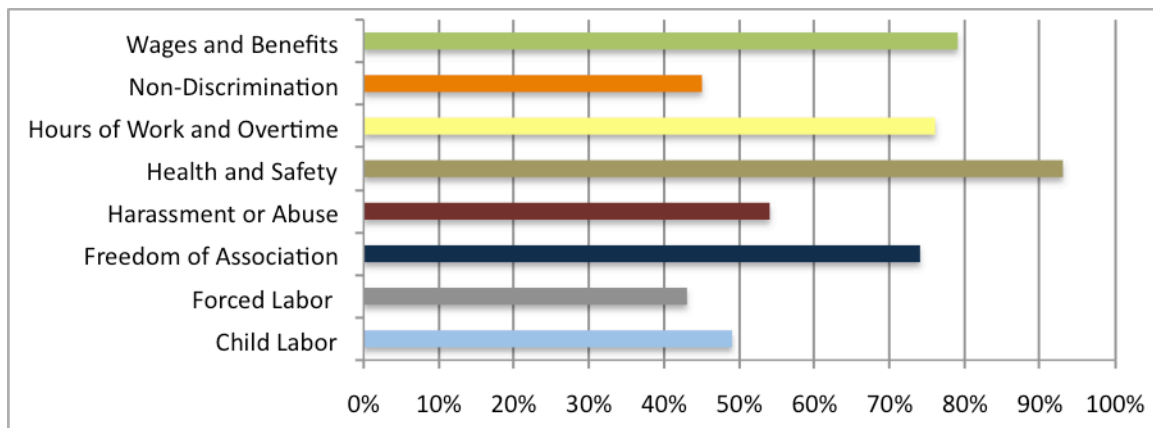
Source: ILOLEX

In looking at labour enforcement practices and compliance of codes of conduct, findings by the Fair Labour Association (FLA) will be discussed. The FLA, established in 1999, is a cooperative endeavor of socially responsible companies, educational institutions and civil society organizations centered on improving working conditions in factories around the world. Based on ILO labour

standards and principles, the FLA developed its own workplace codes of conduct and complementary benchmarks to define the degree of compliance necessary for companies to meet FLA standards. In order to achieve its goals, the association is engaged in monitoring FLA member companies, responding to workplace labour violations and assisting companies that work with factories to ensure that violations of its Code are corrected through a remediation plan.

While the FLA, since its establishment in 1999 finds that progress has been made concerning working conditions and child labour in factories, the association's 2008 report published interesting findings of non-compliance with codes by its members'. More specifically, an investigation of 120 companies in 5 regions, found 619 cases of breached conduct of codes, up from 501 cases in 2007. Violations by respective code are presented in Figure 4.

**Figure 4 2008 Non-Compliance of Codes, FLA**



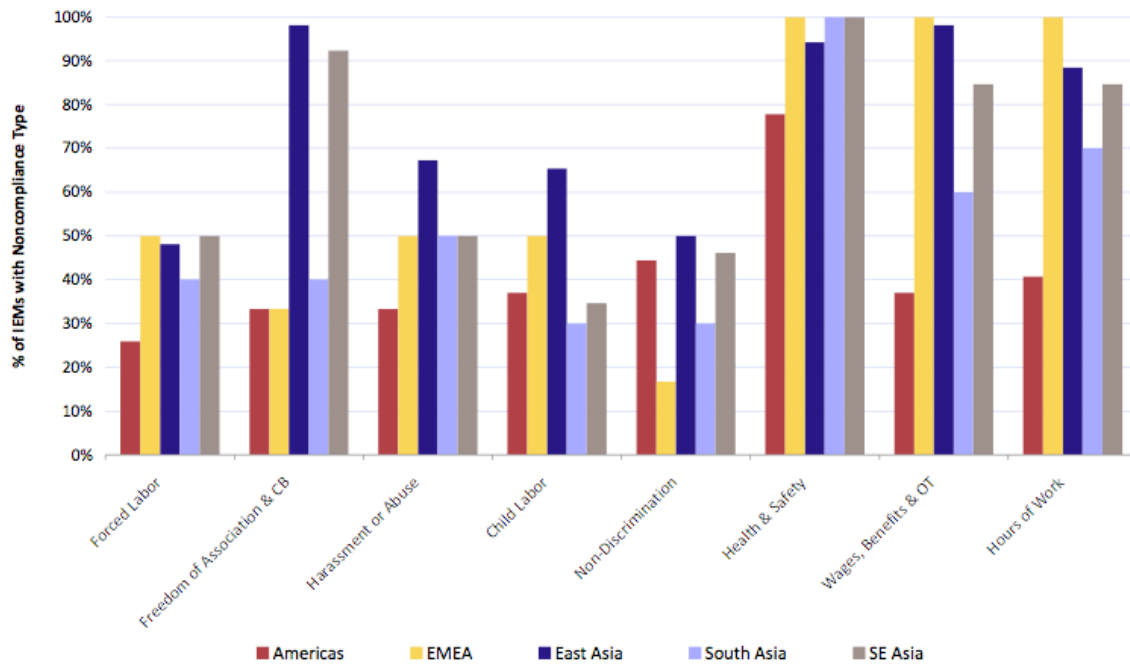
Source: Fair Labour Association 2008 Annual Report.

Moreover, an FLA analysis of code violations by region demonstrates further that simply having higher labour standards in a company does not

necessarily connote that companies adhere to these standards. This can be illustrated by FLA non-compliance findings in Asia, the Americas and EMEA (Europe, Middle East and Africa) regions. More specifically, from 52 audits in East Asia, 881 cases of non-compliance were found with 98% of violations concerning non-compliance of codes related to worker rights of Freedom of Association and Collective Bargaining and Overtime. In the Americas, 27 audits of factories produced 450 findings of non-compliance with the bulk of breaches concerning breach of Health and Safety standards. Audits of South East Asian and South Asian factories, demonstrated 100% rate of violations with regard to Health and Safety standards and in South East Asia, 96% of breaches related to Freedom of Association and Collective Bargaining and 80% breaches related to Wages, Benefits and Overtime. Finally, results of 6 EMEA audits demonstrated 60 cases of non-compliance with breaches of Wages, Overtime and Health and Safety codes found in all 6 audits. An overview of these results is illustrated in Figure 5.

Additionally, an OECD (2008a) analysis of World Bank Survey data concerning labour law- enforcement practices finds that there is evidence of weak labour enforcement laws, particularly in developing countries. As a result of analyzing two aspects of labour law enforcement (the probability of receiving an inspection and the probability of receiving fines due to violations), they found that 1) labour inspections were more prevalent in developed countries than developing countries, and 2) labour inspections in the latter, when carried out,

**Figure 5 Regional Non-Compliance By Code, FLA**



Source: Fair Labour Association 2008 Annual Report.

were less thorough. To support this, they point out the relative low incidence of inspections leading to fines in both Asia and Africa (See Table 9) adding that while this may imply compliance with labour laws in these regions, it more likely indicates ineffective government enforcement of laws. Evidence presented by the FLA 2008 report in this section gives further credence to this notion. Table 9 presents World Bank data analyzed by the OECD (2008a) and shows that the probability of receiving an inspection and receiving a corresponding fine for a violation is greatest in the Middle East, with lowest rates of fines occurring in Africa and Asia even though inspections are high in these regions.

**Table 9 Enforcement of Labour Laws**

Region	Probability of receiving at least one public inspection per year		Probability of receiving a fine conditional on getting a visit	
	Mean	# of Observations	Mean	# of Observations
<b>Africa</b>	0.62	2,197	0.05	1,088
<b>Asia</b>	0.61	10,062	0.04	4,369
<b>Central and Eastern Europe</b>	0.82	7,373	0.12	614
<b>Latin America</b>	0.46	5,583	0.13	1,706
<b>Middle East</b>	0.92	1,977	0.37	63
<b>Western Europe</b>	1.00	1,041	-	-
<b>Brazil</b>	0.52	1,639	0.16	833
<b>China</b>	0.66	3,841	0.02	2,495
<b>Indonesia</b>	0.16	711	0.18	113
<b>Russia</b>	1.00	229	-	-
<b>South Africa</b>	0.59	584	0.01	337

- indicates data not available or insufficient number of observations.

Source: OECD estimates based on World Bank Enterprise Survey, 2008a.

## 8. Conclusion

Foreign Direct Investment is considered a catalyst to economic progress and development in both developed and developing economies, even more so in the latter. As countries vie for these investments in hopes of boosting the quality of their human capital as well as increasing capital assets and investments in the country, they engage in measures with calculated risks that may or may not lead to their exact desired outcomes. That is to say, calculation of the possible benefits of investment projects are dependent on quantifying 'positive spillovers', a concept that is difficult to achieve. As well, as presented in the paper, literature on positive spillover effects demonstrate mixed results, with more evidence to support spillovers through channels such as backward linkages and worker mobility than direct technology transfer through imitation or competition.

What is certain, is that FDI equates to job creation for both skilled and unskilled workers and provides avenues for women to enter the formal economy. What type of job and in what conditions is less clear. As well, anti-globalization criticism of multinationals embracing developing countries for their lax regulations and lower standards does not seem to be supported by existing literature. Much of the evidence instead presents a more sophisticated outlook of multinationals, illustrating that these companies consider a myriad of issues before opening a subsidiary in another country, many of these having nothing to do with lax labour standards in the host country. Additionally, an overview of extensive literature concerning wages in foreign operations of MNCs in both developing and developed economies illustrate that on the whole, MNCs provide higher

wages to their workers as compared to local firms. However, it should be noted that wage gains are greater for skilled workers, workers employed in larger foreign firms and in firms established in countries where the technological gap is greater between the host and home country (i.e., developing countries).

Finally, while evidence of higher wages in MNCs accumulates, countering anti-globalization sentiments, evidence of poor working conditions and weak labour enforcement practices remains consistent with the anti-globalizers' case, most particularly in developing countries. These issues will definitely continue to be addressed and further improved upon by undertakings of organizations such as the FLA and ILO, involved in monitoring and enforcing labour standards around the world. Moreover, pressures from anti-globalization protests as well as from consumers on companies to improve labour standards will complement these efforts.

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