

# Heterodox views on economics and the economy of the global society

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# Outward foreign direct investment: is it a good thing?

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## Abstract

In this survey, first the theoretical pros and cons of outward FDI are analysed. The empirical evidence generally suggests a positive effect of FDI, in particular of the vertical variety, on exports. Outward FDI has been negatively correlated with domestic investment generally. Furthermore, FDI leads to a shift from lower-skilled to higher-skilled jobs. The impact of FDI on technology in the home country finally is very diffuse and hard to establish. Whatever the result, without outward FDI a country would generally not be better off. What counts is an environment conducive to Schumpeterian 'new combinations'.

**JEL classification:** F 21, F23, L23.

**Keywords:** Foreign Direct Investment, multinational firms, international investment

## 1. Introduction

Much of the research on the contribution of Foreign Direct Investment (FDI) to the economic development of host countries has been motivated by fears of job losses from outward FDI<sup>1</sup>. In order to find out whether these fears are well-founded and whether outward FDI is a blessing or a curse for the home economy, we first turn to economic theory and distil the potential pros and cons of outward FDI. Next, we discuss the empirical literature, and finally we draw conclusions.

A caveat is in order with regard to the empirical studies. These shed light on the immediate consequences of outward FDI for a firm or an industry, but generally they are silent on the effects on longer-term growth and development. It should be realised that market economies are subject to an unrelenting dynamism that makes the structure of production change all the time. Old industries decline, new industries grow. Jobs are lost and new jobs are created. In the longer term, this dynamic process of, in Schumpeter's words, creative destruction is the driving force behind continuing growth of per capita income (Schumpeter, 1950). This process is hard to capture in empirical research, but even if it was found in empirical studies that FDI causes job losses, it would not follow that FDI is a negative force. Serious problems only arise if an economy is not sufficiently dynamic to produce new entrepreneurs who introduce Schumpeterian 'new combinations' (Schumpeter, 1969).

<sup>1</sup> See for a survey of the empirical literature on the motives for FDI: Blonigen, 2005.

## 2. Theory

### 2.1. *The frictionless neoclassical world*

Economic models are metaphors. We use metaphors in order to get a mental grip on the world around us (Klant, 1987). One such model is provided by neoclassical theory. The 'classic' analysis of FDI from this neoclassical point of view was provided by MacDougall (1958). Such a neoclassical model is not meant to give a true description of the world, but to probe into the mechanisms that one suspects are at work behind the myriads of events that occur every day.

The MacDougall model is represented by a diagram of a two-country world with one product and given amounts of the two factors of production, labour and capital. Capital is internationally mobile, labour is not. Capital is measured along the abscissa. The ordinates measure the marginal products of capital in the two countries. We start from a situation with an amount  $O_A-C$  of capital in country A and an amount of  $O_B-C$  in country B. The marginal productivity of capital  $MPC_B$  in B is higher than in A. After capital liberalisation, capital will migrate from A to B until  $MPC_A$  equals  $MPC_B$ . An amount of SC of capital moves from A to B. Production in A falls by SCWT, production in B increases by SCVT. World production consequently increases by TWV.

This is not the whole story, however, as capital owners in A are paid the value of the marginal productivity of the capital exported to B. This yields a capital income from country B represented by the area SCZT. A-production falls, but A-income rises by TWZ and country B sees its income increase by TZV. This means that income distribution changes. In country B it's the other way round. Labour has become relatively more scarce and receives higher wages (see on the effect of taxes: Caves, 1982).

In the MacDougall model, capital flows, whether in the guise of FDI or as portfolio capital flows, make both countries' income increase, but the production factor that becomes relatively less scarce sees its income fall, not only as a share of total income but also in an absolute sense.

In the MacDougall one-product model, FDI is required to maximise world production. Other neoclassical models yield other results. In the basic Heckscher-Ohlin two-product international trade model, for instance, trade and FDI are substitutes and trade leads to identical results for world production and national income as FDI, if we abstract from taxes.

## Outward foreign direct investment: is it a good thing?

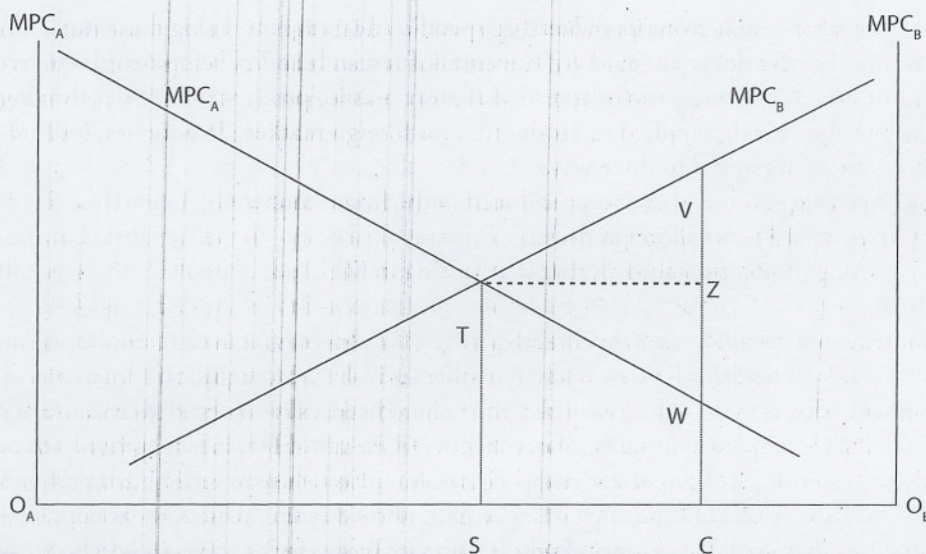


Figure 1. The MacDougall diagram: reallocation of capital in a two-country world.

Note: This is an extension of the original MacDougall diagram, which pictured the situation in one country only.

### 2.2. Market imperfections

FDI in the real world is done by multinational enterprises (MNEs). They can hardly find a place in the models just discussed. They are incompatible with perfect competition, but require market imperfections.

The market imperfections underlying the existence of MNEs are highlighted in Dunning's famous 'eclectic' or 'OLI' paradigm of international production (Dunning, 1993). This paradigm focuses on:

- ownership specific advantages of firms (the 'O' in OLI);
- location specific advantages of countries (the 'L' in OLI);
- internalisation advantages (the 'I' in OLI).

Ownership specific advantages mainly concern technological knowledge, including management and marketing knowledge, that creates scale economies on the level of the firm but not of the plant.

Location specific advantages are those advantages that explain the comparative advantage analysed by traditional trade theory, including artificial advantages stemming from trade restrictions, subsidies and low taxes.

A firm can often profit from its ownership specific advantages by using these not only in production for the domestic market. The costs of research and development incurred in generating these advantages can be spread over more units of production if these advantages, this knowledge, are also applied to production for foreign markets. Production for foreign markets can be organised in three ways:

1. by exporting goods and services produced in the home country;
2. by granting licenses to foreign firms;
3. by starting production abroad, that is, resorting to FDI.

If another country has location specific advantages, the choice is reduced to one between (2) and (3). FDI presents itself as an attractive solution if there are significant internalisation advantages. This is mainly the case if the granting of licenses is unattractive because of the problems of incomplete contracts. The world of MNEs and FDI is characterised not only by scale economies and imperfect competition, but also by asymmetric information. An associated benefit of FDI and thus of a presence abroad is the market knowledge that is obtained in that way. This knowledge can help to increase sales abroad and also to spot sources of supply.

Dunning (1993) also gave a useful classification of firms' motives to engage in FDI. He distinguishes between four groups:

- Resource seekers, who set up shop in other countries in order to make use of resources such as primary commodities, cheap labour and technology.
- Market seekers, who want to be near their customers in order to best fulfil their special wishes, or because the foreign government has put up trade restrictions.
- Efficiency seekers, who want to benefit from economies of scale and risk spreading or from differences in factor proportions, culture, institutional organisation and so on between countries.
- Strategic asset seekers, who resort to mergers and acquisitions in order to safeguard their long-term competitiveness.

This classification is not watertight and Dunning himself adds three other motives. These are: (1) Escape investments, made to escape restrictive legislation or macro-organisational policies (such as a controlled-investment policy) by home governments; (2) support investments, made to support the activities of the rest of the enterprise (*e.g.*, investments in marketing and distribution); (3) passive investments, with little involvement in the management of the acquired company (*e.g.*, investments in hotels, in the expectation of a rise in property values). All the motives in the four groups mentioned above concern the exploitation of location advantages, though perhaps less strictly so in the case of strategic asset seekers, who are rather out to stay ahead of their competitors.

Another useful distinction is between horizontal and vertical FDI (see, *e.g.*, Markusen and Maskus, 2001). Under horizontal FDI, similar goods are produced by an MNE in

## **Outward foreign direct investment: is it a good thing?**

various countries. Under vertical FDI, some stages of the production process are shifted abroad. Some parts of a product may be imported from a foreign branch, or a product is shipped abroad to be processed there and sent back to the home country at a later stage to be finished.

In both variants of FDI, scale economies may figure prominently. The scale economies associated with ownership-specific advantages are largely found on the level of the firm rather than on the level of the individual plant. Often, technical knowledge can, once it has been developed, be applied at low marginal cost at different locations. Horizontal FDI will in such cases be attractive as an alternative to exports if the costs of transport or trade costs in general are high, apart from trade restrictions (Helpman *et al.*, 2004). Markets seekers, but also efficiency seekers will be involved. If scale economies are found on the level of the plant, vertical FDI will present itself as an attractive option. Under vertical FDI, parts of the production process are shifted to countries where costs are lower. Efficiency seekers and resource seekers will be active in this kind of FDI. Again, it is a classification that lacks sharp demarcation lines. Under horizontal FDI, for instance, foreign branches will often go on using the services of the head office as far as research, design, finance and marketing are concerned.

FDI may take the form of building new production facilities (greenfield investment), but also of mergers and acquisitions. In the view of Schenk (1999), mergers and acquisitions often are not motivated by the prospect of improving productivity and increasing profits, but by a strategy of managers to minimise the danger of conflicts with shareholders. In his concept of a 'minimax-regret game', managers prefer to follow the crowd once their competitors start mergers and acquisitions activities, even if the prospects of success are dim, rather than staying aloof and running the risk of seeing their competitors succeed and their own strategy proven wrong. Another strand in the literature emphasises pre-emptive actions by managers who become active as acquirers in order to increase the size of their companies and in doing so prevent being taken over themselves (Gorton *et al.*, 2005). In these two cases we have variants of the strategic asset seekers.

Still, international mergers and acquisitions activities can also be motivated by a wish to have better access to markets and resources, in particular technological knowledge.

### **3. Potential pros and cons for the home country**

From this theoretical analysis a number of potential benefits of outward FDI can be identified:

- FDI brings in capital payments that result in a higher national income, even if domestic production may fall (as in the MacDougall case).
- FDI contributes to a better division of labour on a world scale and thus to higher productivity.

- FDI implies a presence in the host country that may be used to good advantage not only for the sales process but also for purchases.

FDI carries some potential costs with it as well:

- FDI may imply a loss of jobs and of income. To the extent that FDI takes place according to comparative advantage (non-artificial location advantages), the international division of labour improves, but there will be costs of adjustment. A higher mobility of capital and high-skilled labour, which could make it more difficult to levy taxes and social security contributions and might result in a 'race to the bottom'. So far, this danger does not yet seem to have materialised (Tanzi, 2002; Navarro *et al.*, 2004).
- Higher production and incomes abroad, plus better technology. This may lead to a fall in importance of the home country in the global political arena and a loss of political clout. Restricting FDI would, however, at best result in some delay in this process.

We now give a survey of the empirical literature, shedding light not only on the effects of FDI on jobs and income, but also on related entities, such as exports and the structure of labour demand.

## 4. Empirical studies

### 4.1. Introduction

Empirical research of the effects of FDI on the home country's economy has often been motivated by a fear of job losses. Many studies have been devoted to the relationship between employment at MNE's affiliates abroad and at the home country offices and factories. In this way, however, only first-round effects of FDI are captured. These are important for employment developments in the short term, but hardly relevant for the longer period. Nonetheless, in our roundup of the findings of empirical research the impact on employment will not be neglected. The findings on the impact of FDI on exports, investment, the structure of labour demand and investment will also be reviewed. Before we turn to these studies, a discussion of the problems associated with empirical research in this field is in order.

### 4.2. Problems of empirical research

There is not one universally accepted definition of FDI, and one needs a definition before setting out to measure its effects. Lipsey (2002) distinguishes between two concepts of FDI:

1. FDI as a particular form of international capital flows that gives rise to a particular form of international assets for the home countries, specifically, the value of holdings in entities, typically corporations, controlled by a home country resident or in which a home country resident holds a certain share of the voting rights.



2. FDI as a set of economic activities or operations carried out in a host country by firms controlled or partly controlled by firms in some other country (the home country). These activities are, for example, production, employment, sales, the purchase and use of intermediate goods and fixed capital, and the carrying out of research.

Balance-of-payments statistics provide information on (1), but not on (2). From the balance of payments we cannot see, for instance, whether new production facilities have been built. A takeover of a firm in country B by a firm in country A enters the balance of payments as FDI in the year of the takeover. There is only a change of ownership. If the new foreign affiliate builds new factories with the proceeds of a loan taken out in country B, no entry in the balance-of-payments statistics follows.

What balance-of-payments statistics do provide is information on the yield of FDI in the guise of primary income (capital payments, wages) and services (intellectual property). But this information is incomplete. If we try, for instance, to calculate the contribution of FDI income of Dutch firms to Dutch national income, we should subtract the capital payments of these firms to non-residents, which generally is not possible.

For the effects of FDI on home-country employment and exports, the second concept of FDI is the one to use. Here, too, it is difficult to draw conclusions on the basis of statistical evidence. A statistical relationship between FDI and employment within a firm or an industry does not say much about causality. If the location advantages of foreign production increase and a home country firm shifts part of its production abroad, there is no guarantee that home country employment would not have suffered in the absence of FDI. The question is what the counterfactual would have looked like.

### ***4.3. The findings of empirical research***

This section provides a survey of the empirical research of the effects of outward FDI on exports, employment, investment, the structure of labour demand, technology and on incoming capital payments. It should be realised that there is no guarantee that any pattern observed in the past will be repeated in the future.

#### ***4.3.1. Exports***

In the Heckscher-Ohlin model, FDI and exports are full substitutes. In contrast, a 1998 OECD study found that FDI and exports are complementary, as each dollar of FDI from the member countries brought in two additional dollars from exports (OECD, 1998). In his survey, Lipsey (2002) often could find no clear relationship between exports and FDI at the industry level, but in the cases where it could, the relationship was positive most of the time. Similar results were found by others (Andersen and Hainaut, 1998; Blomström and Kokko, 1994, 2000; Kim, 1998; Pfaffermayr, 1996; Svensson, 1996; Van Beers *et al.*, 1999). There does not seem to be a fixed relationship. Possibly, vertical FDI with mainly a positive

relationship more or less balances horizontal FDI with mainly a negative relationship. This would square with the findings of Barba Navaretti *et al.* (2004), who generally found complementarity between foreign production and exports in the case of vertical FDI, but not always in the case of horizontal FDI (see also Head and Ries, 2001; Blonigen, 2001; Brainard, 1997).

Research by Jordan and Vahlne (1981) on FDI by two Swedish MNEs is worthy of special attention, as they estimated the market shares and the licence payments that would result in the cases of exporting, licence granting and minority participations in joint ventures, respectively. This means that they modelled the counterfactual. Exports, and employment for that matter, increased as a result of FDI, as those FDI led to higher market shares abroad and to exports of semi-finished products to foreign subsidiaries (see in this vein also Blomström and Kokko, 1994).

*Conclusion:* If there is a relationship between FDI and exports, it tends to be positive rather than negative. In so far as a negative relationship has been found, this was mainly in cases of horizontal FDI. With vertical FDI, the relationship was mainly positive.

#### 4.3.2. Employment

Even if exports increase as a result of (vertical) FDI, employment may still suffer. This is because goods may be sent abroad at some stage in the production process and return after having been processed at a foreign subsidiary. Both exports and imports increase, but domestic value added and employment fall. The end result may well be a cheaper end product, leading to higher market shares. That in its turn may check the fall in employment.

There is research that directly focuses on the relationship between FDI and employment. Brainard and Riker (Brainard and Riker, 1997; Riker and Brainard, 1997) were able to use U.S. Department of Commerce data on individual firms (for the 1983-1992 period) and found a very low degree of substitution between employment at the parent company and employment at foreign daughters after a change in wages. The degree of substitution was much higher between daughters in different foreign countries. A similar study by Braconier and Ekholm (2000) for Sweden again found a low degree of substitution between the home country and developing countries, but a higher degree between Sweden and other rich countries (see Forfás, 2001 for Ireland; Konings and Murphy, 2001 for the European Union; Van Beers *et al.*, 1999; Haverhals *et al.*, 2004; Anonymous, 2005 for the Netherlands; Barba Navaretti and Castellani, 2004 for Italy).

Van Beers *et al.* mention Belgian research by the Federal Planning Bureau, done by means of questionnaires, revealing that ten percent of the foreign subsidiaries of Belgian MNEs were associated with production shifts from Belgium to the host country, implying an initial loss of employment (Bernard *et al.*, 1997). The authors fail, however, to provide information on the effects on employment at the Belgian headquarters. On balance, it need not decline, as

is shown by the fact that in the German automobile industry three new jobs abroad are said to create one new job at home, on average (Klodt, 2004).

Research has taken place on the level of firms and industries in the first place. Macroeconomic data may give an impression of the effects of FDI on aggregate employment in an economy. For Korea, an increase in outward FDI as a percentage of GDP went hand in hand with a fall in unemployment (Kim, 1998). As those outward FDI remained below one percent of GDP, strong conclusions cannot be drawn. In the same way, the fact that employment and real incomes rose more in the United States than in Mexico after NAFTA (the North American Free Trade Agreement) started working, at the very least suggests that this FDI did not result in a serious loss of jobs in the United States (cf. Stanford, 2003).

*Conclusion:* Research on the level of the firm and the level of the industry so far has not shown a systematically negative effect of outward FDI on employment. A flaw in this research is the neglect of FDI on supplier firms. Macroeconomic studies do not, however, point in another direction.

#### 4.3.3. Investment

Apart from the direct effects of FDI on employment, there are indirect effects. One such indirect effect is the impact of FDI on domestic investment. We start with two studies on the industry level. In a study of FDI by Dutch MNEs, Belderbos (1992) found a weak negative correlation between FDI (as a stock) and domestic investment. If causality runs from FDI to investment, this means that outward FDI might cost domestic jobs. Often, however, FDI takes place because of a change in location-specific advantages and the investing firm would have lost market share if it had refrained from FDI, with a higher loss of investment and jobs in the end.

Braunerhjelm *et al.* (2004) found for Swedish MNEs that in industries with horizontal FDI, domestic investment suffers, whereas vertical FDI was positively correlated with domestic investment. Industries with horizontal FDI are strongly dependent on research and development, with scale economies on the level of the firm and not the level of the plant. Industries with vertical FDI by contrast are more dependent on comparative advantages based on relative factor availability. They tend to be less knowledge-intensive. The empirical data were found to be consistent with this theoretical approach.

On the macroeconomic level, Feldstein (1994) found for OECD countries over the 1970s and 1980s that outward FDI went hand in hand with a fall in domestic investment by roughly the same amount (see also Svensson, 1993; Andersen and Hainaut, 1998 and Desai *et al.*, 2005). Feinstein's results only pertained to the share of FDI financed by the home country. The macroeconomic character of his research implies that the effects of FDI on the amount of funds available for other firms were included. Blomström and Kokko (1994) refer to the Swedish controversy over the question whether the low level of domestic investment

in the early 1990s could be a result of the high level of debt with which Swedish MNEs were saddled since their FDI activities in the 1980s. Stevens and Lipsey (1992) saw a connection running from FDI by American firms through lower capital ratios and higher costs of finance to a fall in domestic investment (see also Wellink, 2004).

*Conclusion:* According to some research, the relationship between FDI and domestic investment is negative on a macro scale, whereas other research finds that domestic investment is not sensitive to (net) outward FDI. On the level of the firm or the industry, there are indications of complementarity in the case of vertical FDI, but there are opposing forces from the side of finance. A statistical relationship in itself says little about causality and one cannot be sure about the level in the level of domestic investment had there been no FDI.

#### 4.3.4. The impact of FDI on the structure of labour demand

There do not seem to have been many studies on spillovers of outward FDI on other domestic firms, that is, on the consequences for, *e.g.*, suppliers and clients or the demand for infrastructure. There is, however, some empirical evidence of FDI on the structure of the demand for labour, even if this cannot always be separated from the effects of globalisation in general.

According to Lipsey (2002), outward FDI leads to a shift of low-skilled activities to host countries and high-skilled activities to the home country (see for similar results for the Netherlands Haverhals *et al.*, 2004; Anonymous, 2005). In a number of cases, employment in manufacturing plants fell whereas employment at the firm's head office rose. This points to a shift to higher-skilled jobs. Blomström *et al.* (1997) found, using American data in individual firms, that a rise in sales by \$1 million in developing countries involved a loss of 12 to 18 jobs in the United States, keeping total sales constant. This was seen by them as a shift to more capital-intensive production in the U.S.A. A relatively high cost of low-skilled labour was seen as the probable culprit. In Sweden, this effect was absent, presumably because Swedish MNEs were predominantly market seekers with branches in rich countries. American MNEs by contrast mainly were efficiency seekers producing where costs were lowest and exporting on a large scale from foreign branches.

Interestingly, in a number of cases employment in manufacturing production in the home country fell when it rose abroad, with employment at headquarters increasing. This again points to a shift to higher-skilled jobs.

In Swedish research, a shift in the home country to semi-finished products with low value added, and thus to a fall in labour productivity, has been found. Possibly, a comparative advantage for raw materials accounts for this. Research and development, however, remained concentrated at the parent companies in Sweden.

One problem in empirical research is that the effects of outward FDI on suppliers in the home country generally are neglected. This subject was studied by Mariotti *et al.* (2003). In their view, vertical FDI goes hand in hand with a shift in the home country from low-skilled labour to capital and high-skilled labour, both at the MNE itself and its suppliers.

FDI and the associated changes in the structure of trade and production may thus lead to an increase in the demand for high-skilled labour and a fall in demand for low-skilled labour (cf. Tokarick, 2002; Strauss-Kahn, 2003). This may lead to higher wage inequalities and, if wages are sticky downward, higher unemployment among the low-skilled (little effect was, however, found by Slaughter, 1995, 2000; Gorter *et al.*, 2005). It is a moot point to what degree FDI and trade are responsible. Technological developments are another important cause.

FDI makes it easier for firms to shift production abroad at short notice, in particular in the case of horizontal FDI. According to Rodrik (1997), this has perhaps not so much resulted in a lower demand for low-skilled labour but in a higher price elasticity of the demand for low-skilled labour. This has given firms a stronger position in wage negotiations and may have contributed to relatively lower wages of low-skilled labour.

*Conclusion:* The empirical evidence suggests that FDI provides an additional impulse to the existing shift from low-skilled to high-skilled jobs.

#### 4.3.5. Technology

As we have seen, MNE's may resort to FDI in order to obtain foreign technology. This has often been the case for Korean firms (Kim (1998) and for Japanese firms that have invested in the U.S. (Blonigen, 1997). Irish firms in the food industry have transferred technology acquired abroad and adopted in their foreign plants back to Ireland (Forfás, 2001). For Swedish industrial MNEs, by contrast, Braconnier *et al.* (2001) were unable to detect any link between outward FDI and technological spillover, measured by changes in productivity.

According to the research surveyed by Barba Navaretti *et al.* (2004), in some cases there are spillovers of foreign technology to the home country, in other cases not. Technology acquired abroad may, however, be imported in the guise of a higher quality of imported semi-finished products, that is, through vertical FDI. This effect is hard to establish empirically (see Keller, 2004: 764). Barba Navaretti and Castellani's research on Italy reveals another effect of outward FDI on technology: firms that open their first foreign branch see their productivity increase at a fast pace (Barba Navaretti and Castellani, 2004).

Earlier research, reviewed by Blomström and Kokko (1994), revealed a positive correlation between FDI and an MNE's profits. Higher profits in their turn stimulate expenditure on research and development, which also benefits from the fact that FDI enables MNEs to

grow. In so far as research and development remains concentrated in the home country, the demand for high-skilled labour is likely to grow. This may have positive externalities, such as the establishment of more and better educational institutions. More generally, it may contribute to endogenous growth.

*Conclusion:* Firms may resort to FDI expressly in order to get access to foreign technology. In other cases it is hard to find empirical evidence on the effects of outward FDI on technology. Still, there are clear indications that firms opening their first foreign affiliate see their productivity increase at an above-average rate.

#### 4.3.6. The yield of FDI as a capital flow

Outward FDI should generate capital income, as emphasised in the MacDougall model. But we live in a world characterised by uncertainty in the sense of Knight and investments may turn sour. According to calculations by Boonstra (2003, 2004), the cumulative balance on the current account of the balance of payments of the Netherlands over the 1986-2002 period amounted to some €170bn, but net foreign assets deteriorated by more than €165bn, which means that roughly €335bn has disappeared into thin air. These losses cannot all be attributed to FDI, as the figures include portfolio investment, but poor results of FDI certainly played a role.

*Conclusion:* Outward FDI do not always fulfil their promises. Dutch MNEs have suffered a number of spectacular debacles, in particular, it seems, from mergers and acquisitions. This does, however, not detract from the positive impact of FDI in the form of real investment on growth and profits.

### 5. Conclusions

The research on the effects of FDI on exports generally shows a positive effect of FDI, in particular of the vertical variety. Outward FDI has been negatively correlated with domestic investment generally, especially in the case of horizontal FDI, but that does not say much about causality and the relationship does not hold for FDI financed from foreign sources.

FDI generally leads to a shift from lower-skilled to higher-skilled jobs. The impact of FDI on technology in the home country finally is very diffuse and hard to establish. There are indications of 'learning by doing'. Positive externalities are plausible but hard to measure empirically.

The results of outward FDI should be looked at with the counterfactual in mind. Many firms would not have been able to survive, or at least not have been able to maintain their market share, without FDI. Scale economies on the level of the firm and both natural and artificial trade barriers easily combine to make FDI a necessity, the more so if a firm is based in a small country. It would, then, be counterproductive to try and restrict outward FDI,

even in cases where FDI in the first instance goes at the cost of domestic production and employment.

If we look at the outcomes of the empirical research on FDI in a wider context, they lose much of their significance. The research throws light on first-round effects, but these are of minor importance to economies that are dependent on Schumpeterian creative destruction and 'new combinations' for their long-term growth. In the same way as international trade, FDI contributes to the international division of labour, and with it to productivity growth and ongoing economic development.

Restrictions on outward FDI are a form of protection. They reduce the benefits a country receives from the international division of labour. These benefits not only include the effects of a reallocation of production, given technology, but also a constant improvement of technology. It is no use deploring a shift of production and jobs abroad. The receiving countries will see their production and income grow. Their import demand increases, creating new opportunities for the home countries of the MNEs involved, both directly and indirectly: those opportunities may be found in the host countries, but also in third countries that profit from the new-found growth in the FDI destination countries. The home country will in the end profit from shifting production to a cheaper place and replacing it with jobs that create higher value added. The government's first concern should be to create an attractive business climate, in order to induce sufficient entrepreneurial activity to absorb any labour set free by outward FDI.

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### *Outward foreign direct investment: is it a good thing?*

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