Pandemics as a potential threat to the wide-ranging gains from FDI

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The Corona Effect: Structural Shifts and International Trade
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Covid-19 global pandemic...

- This health crisis unleashed a global economic shock that has caused a drop in trade and foreign direct investment (FDI) flows.
- United Nations said last week that FDI flows decreased by up to 35% in 2020 and would bottom out in 2021 and recover some lost ground with an increase of 10% to 15%.
- Countries at all levels of development make considerable efforts to attract foreign multinational corporations (MNCs).
- They expect to not only receive high productivity performers but also to help improve the outcomes of domestic firms and workers.
- The fall in FDI caused by the global pandemic could plausibly have a long-lasting impact on developing nations where high-wage and high-performance firms are scarce.

Effects on suppliers (AMV1)

- Four years after their first sale to an MNC, domestic firms have (relative to the year before becoming suppliers to MNCs)
    - 33% higher sales,
    - 26% more employees,
    - **Sizable and lasting gains in measures of total factor productivity (TFP), such that their TFP is 4 to 9% higher.**

Effects on suppliers (AMV1)

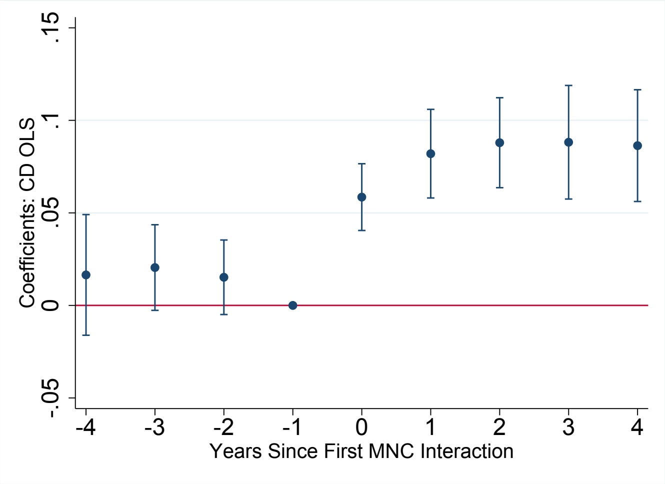

Figure: TFP (Cobb–Douglas, OLS)

Effects on suppliers (AMV1)

- Not only explained by the demand shock received from the MNC buyer.
- Once the firm starts supplying to an MNC, its sales made to both other MNC and non-MNC buyers increase as well (2/3 from the increased number of buyers and 1/3 from the increase in average sales to others).
- Largest effect in manufacturing (true for both sides of the supplying relationship).

Effects on workers (AMV2)

- The wages of workers who move from a domestic firm to an MNC increase 9% more on average than those of workers who move from one domestic firm to another.

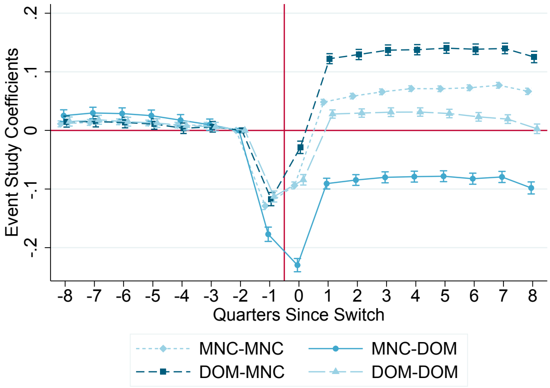

Figure: Worker Moves from Domestic Firms to MNCs Yield the Highest Wage Gains

Effects on workers (AMV2)

- This MNC premium varies greatly across industries and is higher for workers with a college education than for those without (12% vs. 8%).
- We find that MNC workers enjoy better in-kind and monetary benefits than workers in domestic firms (while working a similar number of hours).
- Our survey results indicate that MNCs pay a higher wage to the same worker than domestic firms to avoid worker turnover, motivate the worker, and ensure cross-country pay fairness within the MNC.
- Workers indirectly exposed: our estimates imply that the growth rate of annual earnings of a worker experiencing a one standard deviation increase in either the labor market or the firm-level exposure to MNCs is 1.1 pp higher than that of an identical worker with no change in either MNC exposure.

Post-pandemic implications

- AMV1 and AMV2 results show that FDI flows could be an effective tool for developing countries to improve the outcomes of their firms and workers.
- Halting FDI flows to developing countries is likely to slow down the performance gains of domestic firms and wage improvements for workers.
- Public policies aimed to **reboot** FDI flows and **redirect** a higher proportion to developing countries have the potential to alleviate the sizable welfare losses experienced in the aftermath of the pandemic.
- These policies could be particularly powerful in the near future when both new and incumbent firms use the resources freed up by firms that shut down during the pandemic.

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