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THE IMPACT OF FDI INFLOW ON EX-YUGOSLAV COUNTRIES' LABOUR MARKETS

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Abstract:

This paper models and discusses the effects of FDI inflow on the employment rate and average net wages in ex-Yugoslav countries. The sample of countries is chosen due to of the high legacy with FDI, both in transitional (Bosnia and Herzegovina, Macedonia, Montenegro and Serbia) and recently developed (Croatia and Slovenia) economies. This paper argues that FDI inflow should have positive effects on the employment rate and on average net wages in the countries examined. Performing linear mixed-effects models on 78 observations in the period 2003–2017, the empirical results indicate that FDI inflow has positive and significant effects on the employment rate and on average net wages, after 2 years and after 3 years, respectively.

Keywords:

average net wage, employment rate, ex-Yugoslavia, linear mixed models, random effects.

INTRODUCTION

Foreign Direct Investments (FDI) have grown rapidly worldwide during the last few decades, although in 2017 the global flow of FDI in developing countries decreased (UNCTAD, 2018). Not only is FDI inflow labelled as the key factor in global economic development, growth and integration (Bitzenis & Marangos, 2007), but it has also been adopted as a key strategy for the development of transitional economies (Dabla-Norris, Honda, Lahreche & Verdier, 2010).

The economic recovery and progress of ex-Yugoslav countries have been supported by different international institutions. Since the crash of the socialist and communist regimes in Yugoslavia, the emerging democracies have been quickly engaged in many aspects of globalization. FDI inflow is suitable for fighting the national economic dysfunction and recession after the recent wars and, according to Chandler (2007), after the Dayton agreement and migrations as well. Figure 1 presents trends in FDI inflow in the countries under examination.

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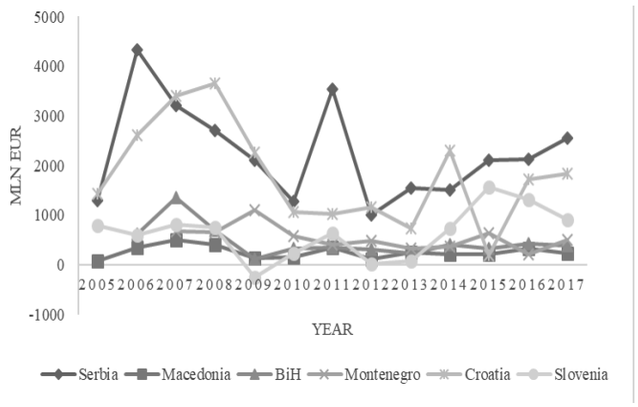
Figure 1 - FDI inflow in ex-Yugoslav countries: 2005–2017



Even as one of the key factors of globalization, FDI inflow creates employment and wage discrepancies (see part 2). In relation to this statement, the object of this research is to measure the effects of FDI inflow on labour market principal indicators. To the best of the author's knowledge, the relationships between FDI inflow and the employment rate, and FDI inflow and average net wages in the countries of ex-Yugoslavia have not been tested yet, and this research is about to cover this gap in the literature. The other reason for selecting this sample of countries is because of its high legacy with FDI (Hadžić & Pavlović, 2011).

The aim of this paper is to measure the impact of percentage point changes in FDI inflow on percentage point changes in the employment rate and on percentage point changes in average net wages in ex-Yugoslav countries in the period 2003–2017. The expected overall results are the positive and significant effects of FDI inflow on both the employment rate and average net wages.

The structure of this paper is as follows. The second part presents the empirical evidence of the impact of FDI on the labour market. The third part presents the data and econometric models applied. The fourth section shows the estimation of the results and their interpretation, followed by discussion and conclusions as the last section of the paper.

LITERATURE REVIEW

Table 1 represents a summary of nine empirical studies of the impact of FDI on the labour market. There are seven additional studies of the effect of FDI inflow on wage inequality, which are chosen as representative studies for the approaches used and the results found.

Table 1 - Impact of FDI on labour market indicators – empirical studies

Author	Methodology	The effect of interest and geographical scope	Results
Gopinath & Chen (2003)	OLS regression	Impact of FDI inward on wages in 26 countries	FDI inward was found to have negative effect on wage inequality
Taylor & Driffield (2005)	Fixed-effects and GMM estimators	Impact of FDI inward on manufacturing industries shifts in demand towards higher skilled labour in UK	FDI inward was found to have negative effect on wage inequality
Figini & Gorg (2006)	Fixed-effects and GMM estimators	Impact of FDI inward on wage inequality in 103 countries	FDI inward was found to have negative effect on wage inequality in developing countries, and positive effect in developed countries
Bhandari (2007)	OLS regression	Impact of FDI on wage inequality in transitional countries	FDI was found to have positive effect on average wages, and negative effect on wage inequality
Pajovic (2007)	Case study: analytical approach	Impact of Renault in Slovenia and the Slovenian government on the local economy	Positive spillover effects are: worker training, indirect job creation
Stanisic (2008)	Correlation analysis	Impact of FDI on economic growth in South European transition countries	FDI was found to have positive effect on employment
Driffield, Girma, Henry, & Taylor (2010)	GMM estimators	Impact of FDI inward on wage inequality in UK	FDI inward nationally tends to increase wage inequality, while the local FDI inward tends to decrease wage inequality

Halmos (2011)	OLS regression	Impact of FDI inward on wage inequality in CEE	FDI inward was found to have negative effect on wage inequality
Sabic et al. (2012)	Correlation analysis	Impact of FDI inflow on unemployment in Serbia	FDI inflow was found to have no significant effect on unemployment
Zulfiu (2014)	Simulation analysis	Impact of FDI inflow on wage inequality in transition countries	FDI inflow was found to have positive effect on domestic skilled wages, and negative effect on unskilled wages
Kurtovic, Talovic, & Dacic (2015)	OLS regression	Impact of FDI inflow on average net wages in Bosnia and Herzegovina, Montenegro, Macedonia and Serbia.	FDI inflow was found to have positive effect on net average wages
Jude & Silaghi (2016)	Fixed-effects and GMM estimators	Impact of FDI on employment in CEE	FDI was found to have short-term negative effect and long-term positive effect on employment
Peric (2016)	Case study: analytical approach	Impact of FDI inflow on wage inequality in Brazil	FDI inward was found to have negative effects on wage inequality
Zdravkovic & Martinovic (2016)	OLS regression	Impact of FDI on unemployment in transition countries	FDI was found to have no significant effect on unemployment
Grahovac & Softic (2017)	OLS regression	Impact of FDI inflow on unemployment rate in the West Balkan countries	FDI inflow was found to have no significant effect on unemployment
Peric (2019)	OLS regression	Impact of FDI inflow on employment and on average wages in Serbia	FDI inflow was found to have no significant effect on increase in employment or average wages

Source: Author's preparation

Authors argue about the positive or negative impact of FDI on the indicators of the labour market. Whilst Sabic et al. (2012), Zdravković & Martinović (2016), Grahovac & Softić (2017), and Perić (2019) stress that there is no significant impact of FDI inflow on employment, Stanišić (2008), Jude & Silaghi (2016), and Pajović (2007) claim that FDI inflow has a positive impact on employment growth. As far as average wages are concerned, Bhandari (2007) and Kurtović, Talović & Dacić (2015) claim that there is an increase due to FDI inflow. In relation to predictions, the Variance Decomposition Test developed by Kurtović et al. (2015) showed that over the next 10 years the growth of average net wages will lead to increased FDI inflow, but that the increase in FDI inflow will not have a significant effect on average net wages.

This section shows that FDI has a slight positive effect on the employment rate and on average net wages in transitional countries. However, FDI inflow tends to increase wage inequality, as reported by Gopinath & Chen (2003), Taylor & Driffield (2005), Figini & Gorg (2006), Driffield et al. (2010), Halmos (2011), Zulfiu (2014), and Peric (2016). The results from the empirical literature appear homogeneous: companies under foreign ownership pay higher wages and require a skilled labour force.

On the basis of the results presented in Table 1, the overall impact of FDI inflow on ex-Yugoslav countries remained unknown despite previous research. This study will informal in the literature and contribute to the knowledge about the impact of FDI inflow in the countries under examination.

The following section presents the data used for modelling, the econometric methodology and empirical results. The model specification convention is based on Anderson (2013) and Heck, Thomas & Tabata (2014).

DATA AND MODEL SPECIFICATION

This section presents the quantitative variables, a description of the data used for the analysis (3.1), and the specification of the chosen statistical models and the statement of the hypotheses (3.2).

DATA

For modelling FDI inflow in relation to the employment rate and average net wages in ex-Yugoslav countries, data was derived from secondary sources. Thus, the panel data for the period 2003–2017 is constructed with the information obtained from:

- Balance of payments, retrieved from the official site of each country's national bank in the statistical database for FDI inflow, and
- Labour market section, retrieved from the official site of each country's statistical office for both the employment rate and average net wages.

Table 2 presents the descriptive statistics for each factor of each country, produced in SPSS software based on 78 observations.

Table 2 – Desctiptive statistics

Descriptive Statistics								
	N	Range	Minimum	Maximum	Mean		Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic
Year	78	14	2003	2017	2010.94	.439	3.876	15.022
IFDI	78	4577	-253	4323	1011.37	110.583	976.643	953831.152
ΔIFDI	73	11.37	-1.91	9.45	.4539	.19529	1.66858	2.784
ΔIFDI_lag1	66	11.37	-1.91	9.45	.4621	.21391	1.73783	3.020
ΔIFDI_lag2	60	11.37	-1.91	9.45	.3739	.19633	1.52076	2.313
ΔIFDI_lag3	54	11.37	-1.91	9.45	.3939	.21615	1.58835	2.523
EMPL	78	37.60	24.50	62.10	43.2242	.99280	8.76819	76.881
ΔEMPL	72	1.26	-.42	.84	.0162	.01384	.11744	.014
ANW	78	856	206	1062	535.05	26.545	234.442	54963.249
ΔANW	72	.49	-.16	.34	.0425	.00836	.07091	.005
dev_st	78	1	0	1	.37	.055	.486	.237
Valid N (listwise)	54							

Source: Author's calculation

where:

IFDI – Foreign Direct Investment Inflow in million EUR,

ΔIFDI – Foreign Direct Investment Inflow change rate,

ΔIFDI_lag1 – Foreign Direct Investment Inflow change rate after 1 year,

ΔIFDI_lag2 – Foreign Direct Investment Inflow change rate after 2 years,

ΔIFDI_lag3 – Foreign Direct Investment Inflow change rate after 3 years,

EMPL – Employment rate,

ΔEMPL – Employment rate change rate,

ANW – Average Net Wages in EUR,

ΔANW – Average Net Wages change rate,

DEV_ST – Developmental stage (economies in transition or developed economies, according to the United Nation's World Economic Situation and Prospects (UN, 2018) country classification).

The above-listed abbreviations for the variables are used in the next subpart.

MODEL SPECIFICATION

Linear mixed-effects models (LMM) are used to estimate the overall impact of the changes in IFDI and DEV_ST on the changes in the employment rate (ΔEMPL) and on the changes in average net wages (ΔANW) in the ex-Yugoslav countries in the period from 2003 to 2017. The changes in variables are measured in percentage points. The lagged terms are used because of the theoretical assumption that IFDI requires time to show the real effects of performing in the country. A typical assumption here is that the regression coefficients have normal distributions, as well as unstandardized coefficients, which means that the coefficients are in their original metrics. The information criterion used to search for the best model fit is Akaike's Information Criterion (AIC). The Maximum Likelihood (ML) method is adopted because it allows inferences to be made on the covariance parameters of the model. The Hausman test is used to evaluate the consistency of the random effects in comparison with the fixed effects.

The author's intention is to determine whether there is a quantitative relation between the dependent and independent variables, based on the following two models:

$$\Delta EMPLti = \gamma 00 + \gamma 10\Delta IFDIt + \gamma 20\Delta IFDI\_lag1t + \gamma 30\Delta IFDI\_lag2t + \gamma 40\Delta IFDI\_lag3t + \gamma 50DEV\_STt + \mu 1i\Delta IFDIti + \mu 2i\Delta IFDI\_lag1ti + \mu 3i\Delta IFDI\_lag2ti + \mu 4i\Delta IFDI\_lag3ti + \mu 0i + \varepsilon ti \quad (1)$$

$$\Delta ANWti = \gamma 00 + \gamma 10\Delta IFDIt + \gamma 20\Delta IFDI\_lag1t + \gamma 30\Delta IFDI\_lag2t + \gamma 40\Delta IFDI\_lag3t + \gamma 50DEV\_STt + \mu 1i\Delta IFDIti + \mu 2i\Delta IFDI\_lag1ti + \mu 3i\Delta IFDI\_lag2ti + \mu 4i\Delta IFDI\_lag3ti + \mu 0i + \varepsilon ti \quad (2)$$

where:

γ00 – grand intercept capturing the variation amongst t in i,

γn0 – fixed effects across groups,

μ0i – between-country variation in intercepts – deviation from the average intercept,

μni – random effects capturing variation in individual slope coefficients,

ε_{ti} – individual-level residual in t within i.

The model estimations are expressed in the annual growth rate. The dependent variable is: ΔEMPL in model (1), and ΔANW in model (2). The independent variables are: ΔIFDI with its time lags (ΔIFDI_lag1, ΔIFDI_lag2, ΔIFDI_lag3) and DEV_ST for the six countries.

The hypothesis H0 is that changes in both ΔEMPL and ΔANW are not influenced by changes in ΔIFDI and its time lags and DEV_ST, while hypothesis H1 is that changes in both ΔEMPL and ΔANW are influenced by changes in ΔIFDI and its time lags and DEV_ST.

In the next section, model 1 is shown as (1), and model 2 as (2).

EMPIRICAL RESULTS

The estimation is by LMM, or between-groups and within-group estimation. Random effects, therefore, consider idiosyncratic qualifications of the units as non-observable and randomly distributed.

The purpose of the models is to estimate the overall impact of the changes in ΔIFDI on ΔEMPL in (1) and on ΔANW in (2). For both models, the dependent variable changes in time t by a certain number of percentage points (not the percent rate), after taking into consideration the level of the changes in ΔIFDI and DEV_ST of the country in that and previous periods. The outcomes of the Hausman test confirm that the use of random effects is justified, i.e., that the random effects are consistent with the fixed effects.

(1) Results of the Hausman test for (ΔEMPLti): chisq=0.3577, df=5, p-value=0.9964;

(2) Results of the Hausman test for (ΔANWti): chisq=3.0261, df=5, p-value=0.696.

Next, assuring the smallest possible value of AIC followed by the theoretical and analytical logic, the models are accepted and presented in Tables 3 and 4.

(1) Akaike's Information Criterion (AIC): -144.462;

(2) Akaike's Information Criterion (AIC): -214.973.

Table 3 - Modelling of employment percentage rate changes

Estimates of Fixed Effectsa							
						95% Confidence Interval	
Parameter	Estimate	Std. Error	df	t	Sig.	Lower Bound	Upper Bound
Intercept	-.005357	.001773	21.279	-3.021	.006	-.009041	-.001672
[dev_st=0]	.021609	.001925	14.786	11.225	.000	.017501	.025718
[dev_st=1]	0b	0					
ΔIFDI	.000867	.003700	19.766	.234	.817	-.006856	.008591
ΔIFDI_lag1	-.001613	.001916	24.429	-.842	.408	-.005563	.002337
ΔIFDI_lag2	.015300	.005566	5.986	2.749	.033	.001673	.028927
ΔIFDI_lag3	.025344	.005284	7.004	4.796	.002	.012850	.037838

a. Dependent Variable: ΔEMPL.

b. This parameter is set to zero because it is redundant.

Source: Author's calculation

Table 3 shows 0.015% and 0.025% increases in ΔEMPL for each additional unit of change in ΔIFDI after two (ΔIFDI_lag2) and after three (ΔIFDI_lag3) years of its performance, respectively, these are statistically significant for both developed and transitional countries. The strongest positive effect is represented by the ΔIFDI_lag3, so for the double increase in IFDI in time t there would be a 0.025% (p=.002) increase in ΔEMPL after 3 years of foreign investment performance in the country i. The model suggests that the DEV_ST has positive effects on the growth in ΔEMPL in transitional countries and it is statistically significant. The greater the foreign investment, the faster the growth in EMPL in transitional countries compared with developed countries, which is in accordance with the theoretical and empirical assumptions that in developed countries there is a lower increase in employment (because of the saturated labour market), while in transitional and developing countries there is more room for faster employment growth (because of the unsaturated labour market). As for model (1), each unit of increase in foreign investments in time t increases the average employment growth rate in the countries in transition by 0.02% (p=.000) per year.

Table 4 - Modelling of average net wages percentage rate changes

Estimates of Fixed Effectsa							
						95% Confidence Interval	
Parameter	Estimate	Std. Error	df	t	Sig.	Lower Bound	Upper Bound
Intercept	.010167	.003279	10.267	3.101	.011	.002887	.017446
[dev_st=0]	.004574	.003845	18.774	1.190	.249	-.003480	.012627
[dev_st=1]	0b	0					
ΔIFDI	.011896	.009812	6.113	1.212	.270	-.012006	.035797
ΔIFDI_lag1	.002940	.002064	4.915	1.424	.215	-.002393	.008273
ΔIFDI_lag2	.000675	.001147	7.751	.589	.573	-.001985	.003336
ΔIFDI_lag3	.002015	.000692	3.832	2.913	.046	6.079346E-05	.003969
a. Dependent Variable: ΔANW.							
b. This parameter is set to zero because it is redundant.							

Source: Author's calculation

Table 4 represents an increase in ΔANW due to ΔIFDI_lag3 in the observed period. In the countries in transition the amount is a 0.0046% increase, while in developed countries the increase in ΔANW due to the changes in ΔIFDI is almost null. This means that there is 0.0046% greater growth rate in ΔANW in the countries in transition, which justifies the logic explained in the previous model. The impact of the changes in ΔIFDI on ΔANW is positive and statistically significant after three years of its performance. The model suggests that the greater the foreign investment, the faster the growth in ANW. If foreign investments double in time t in country i, after three years the average growth rate of ΔANW will be 0.002% (p=.046).

Both models include the developmental stage effects. The findings suggest that the effect of DEV_ST of the countries is positive and statistically significant (p=.000) for the ΔEMPL. In both cases, there is a positive growth rate in all the countries, meaning that H0 is rejected.

DISCUSSION AND CONCLUSION

This research empirically estimated the impact of the changes in FDI inflow on the changes in the employment rate and in average net wages in the ex-Yugoslav countries, using linear mixed-effects models. The analysis shows the existence of a positive but still very low impact of FDI inflow on both the employment rate and average net wages, mainly after 3 years of FDI inflow performance. The analysis shows that the developmental stage of the country meters for positive changes in the employment rate but not for changes in average net wages.

FDI inflow showed a positive, even if very low, impact on the examined labour market indicators. Perhaps the four transition countries should look at Slovenia's economic strategies as well as thoroughly investigating the FDI inflow options before adopting it. Moreover, regional collaboration should be strengthened in order to stimulate foreign companies to invest and to communicate with the region. Finally, it is recommended to study how to attract investors that pay higher wages, which involves studying also the availability and skills of host country employees and any potential brain drain. Lastly, it is recommended to enhance the efficiency and competitiveness of the national economy along with the companies through the implementation of strategies in order to solve employment and wage problems.

The findings of this research, as regarding average net wagesaverage net wages, are consistent with Bhandari (2007) and Kurtovic et al. (2015), authors who applied OLS regression estimation instead of linear mixed models.

As for the impact of FDI inflow on employment, Jude & Silaghi (2016) would provide an effective comparison with this research if the authors had used FDI inflow instead of FDI stock, because both analyses claim the positive long-term effect on employment. The findings of this paper partially confirm the findings of Pajovic (2007) as well, while disagreeing with e.g. Peric (2019), presumably because of the larger sample used in this research.

The limitations of the research and recommendations are as follows. Since there is little empirical evidence of the impact of FDI inflow on labour market indicators in transition countries, this paper offers findings to stimulate further research. In the first place, it is recommended that more countries should be included in the model. In order to estimate the impact of FDI inflow in each individual country, one could conduct single regressions to estimate the supposed impact of FDI inflow on the employment rate and on average net wages. That would serve to confirm or deny the hypothesis that for one country the effect of FDI inflow comes sooner because it is invested in the service sector, but in some others that are invested in industry or the production sector it comes later. The distinction is because there is reason to believe that the effect of FDI inflow is not equal for all six countries.

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