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Editorial Note

Humor has a unique place in literature, particularly in English literature. Mark Twain, a great Humorist, stated that humor is a great thing, the saving thing, the minutes it crops up, all our irritations and resentments slip away and a sunny spirit it takes their place. Humor is the tendency of particular cognitive experience to provoke laughter. Humor is a broad term that refers to anything that people say or do that is perceived as funny and tends to make others laugh, as well as the mental processes that go into both creating and perceiving such as an imusal stimulus and also the affective response involved in the enjoyment of it stated by Rob H. Martain in his book Psychology of Humor.

The etymology of humor began as a Latin word humors means fluids or liquids. It has a medical connotation. Bharata Muni's Natya Shatra contains humor as one of the nine Navarasa in which it is known as 'Hasya'.

Whether we can use humor effectively in day today activities of the Management? The business cartoon caricatured by Scot Adams appeared in the name of Dilbert induces laughter at worker place. Some of his quotations are worth remembering. They are I can only please one person per day. Today is not your day. Tomorrow is not looking either good. Change is good but you go first. Another business cartoon worth remembering is Mario Mirands business cartoons.

Defiantly, humor has a place in practicing management. Humor has become a recognized asset in the work place. It facilitates communication, builds relationship, reduce stress and induces creativity.

Humor at a workplace is often associated with stress. Stressful employee cannot perform effectively. Humor is greatest stress reliever. Godbrey in the Journal of Women's Health Stated that, "Humor is potentially effective means of coping with the anger. Further he stated that, "One must be careful with its use". Sarcastic or hostile humor can incite additional anger.

A sense of humor is apparent among creative people. Research reflects that creativity and humor is associated with each other. Creative people display interest in humor and also capacity in producing original humor thought. Getzeles and Jackson stated that when ranking a series of desirable traits creative students placed a sense of humor second, whereas of the same intelligence but less creativity ranked it lowest among all the desirable traits. When both groups drew pictures of various themes, over half of the creative students made drawings judged as humorous, and their essay showed the same tendency.

Dr. Babu Thomas
Editor

Foreign Direct Investment Inflow and Socio Economic Development: A Review of Theoretical and Empirical Evidence

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Abstract
Foreign Direct Investment (FDI) has been well introduced globally as a bundle of capital, employment, knowledge and skills. Both, developed as well as developing economies are actively pursuing policies to attract FDI with varying degree of success. The degree of success in attracting FDI depends on the policy stance and other macroeconomic factors of the host economies. The effect of the FDI on the development process and the parameters has been controversial among different host countries. This paper examines some theoretical framework. Empirical evidence on FDI inflow and its impact on socio-economic development in host countries were reviewed. Conclusions were drawn on how the FDI supports the socio-economic development, which may be similar and carry lessons for other (host) countries. The review of literature on theoretical basis; country specific and cross country empirical evidence has been undertaken. This study has revealed that despite substantial research on FDI, there have been very few empirical studies on the linkages between FDI and human resource development, which needs to be addressed / covered by researchers in the future.

Keywords: Balance of Payment, Economic Growth, Employment, Foreign Direct Investment, Human Capital, Spillover Effects

1. Introduction

Foreign Direct Investment (FDI) as a source of private capital has been very common in developed as well as developing countries for the last three decades. FDI has witnessed an increasing trend globally over a period of time. The stock of FDI in developing economies as a percentage of gross domestic product (GDP) was as high as 27.0 in 2005 as compared to 9.8 in 1990 (UNCTAD, 2006). The world FDI inflows increased by 28% from US $558 billions in 2003 to US $711 billions in 2004 and US $916 billions in 2005. Similar trends have been observed in developed as well as developing economies.

FDI is preferred over other private capital resources due to its long lasting prospects and multiple purposes. Compared to "other capital flows" (commercial bank loans, portfolio flows and official flows), FDI flows have been emerging as the largest component of net resource flows to developing countries since 1994 (UNCTAD, 2006). Comparing benefits of private capital inflows Reisen and Soto (2001) suggested that the developing countries should not rely solely on national savings. They suggested recourse to foreign direct investment and portfolio equity inflows to stimulate long-term growth prospects. FDI provides not only the capital component, but is also source of employment, technology, skills and abilities. As compared with loans the special characteristic of FDI is that repayment is made only when the investors earn profit. The profits so earned may be reinvested in the host country. FDI also boosts confidence in the economic and investments environment of the host country. Further, it constitutes as useful component for production activities in the host country that are of much importance for development. Literature supports inward FDI the notion that it promotes trade in the host country.

FDI is also credited to have a positive impact on human capital formation in the host country. Blomstrom and Kokko (2003a) studied the relationship between FDI and human capital by reviewing the literature and concluded that there was a potential for significant "spillover effects" from FDI into the host country, if the level of human capital in the

host country is high. Host countries with high levels of human capital may attract technology intensive FDI which in turn may lead to further human capital development.

The above is one side of the picture. The other side of these views cannot be ignored. Marxist political and economic theory views multinational enterprises (MNEs) as an instrument of imperialist domination. The aim of MNEs is to earn profit and repatriate it to the home country and these MNEs have no role to play in technology transfer and employment generation. They have crowding out effects and are a threat for the host country firms. MNEs may also affect balance of payments negatively by importing more input and machinery into the host country. In fact, they may even pose a threat to national sovereignty and autonomy of the host country by influencing economic policies (Hill, 2005).

Despite these mixed arguments, the need for FDI grows continuously. A number of country level and cross countries studies have been conducted to investigate the impact of FDI on host countries from different perspectives. Their findings are mixed and cannot be generalized from country to country or from region to region. Their recommendations do not provide one cure-all problem solution. Here it is noteworthy to emphasize that impacts of FDI on host country are not an automatic process. There are many factors such as macroeconomic environment, political stability and FDI policy stance of the host country that account for maximizing the benefits of FDI. Review of theoretical literature and empirical evidence may help us enhance our understanding about of the effects of FDI in developing host countries. It may also lead to the development of a framework that may help if not for all but for most of the developing countries in capitalizing FDI.

The purpose of this study is to review the theoretical and empirical evidence related to FDI impacts on host countries and to summarize them. Moreover this study would be an endeavor to identify the factors that play a vital role in maximizing the socio economic benefits from FDI and provide guidelines for policy makers. It would also provide opportunities for further research by exposing multiple aspects of FDI.

The rest of the study would deal with:

(i) Section 2: impact of the FDI on economic growth of the host country;
(ii) Section 3: the spillover effects of the FDI on domestic firms;
(iii) Section 4 : the effect of the FDI on balance of payments;
(iv) Section 5: the role of the FDI in employment generation in the host country;
(v) Section 6: the effects of the FDI on human capital formation in the host country; and
(vi) Section 7: conclusions drawn from all previous sections with policy implications and further research.

2. FDI and Economic Growth

FDI in the form of green-field is said to increase competition among producers in the market. Currently this is being observed more for services e.g. telecommunication, retailing and financial services. State owned telecommunication monopoly companies found themselves facing severe competition from the FDIs which provided not only less costly services to the customers, but also led to increased business by providing quick and updated information. Under the pressure of competition, firms invest more in plant equipment and R&D in their endeavour to get advantages over rival firms. Such activity led to increase in productivity, product and process innovation, and economic growth.

In contrast, a subsidiary of a MNE might crowd out indigenous competitors due to its greater economic power and thus monopolize the market. Subsequently, it would be able to raise prices and harm the social welfare of the host economy. Such a monopoly may also be developed by a MNE when it acquires more than one firm and merge them to decrease the level of competition.

Busse and Groizard (2006) studied the linkages between growth rate and foreign direct investment focusing on regulations of the host country. This study indicated that more regulated countries were less able to take advantage of the presence of MNEs.

According to Agosin and Mayer (2000), FDI strongly crowded-in domestic investment in Asia, crowded out in Latin America; while

African countries showed a balanced effect. On the basis of econometric exercises they concluded that FDI does not always have positive effects on the host countries. It was contrary to the common assumption of the FDI's positive effect in developing countries. Only policies of liberalization were not sufficient to ensure positive effects from FDI. Technological infrastructure was essential for absorbing externally generated technology by MNEs. Otherwise the resultant effect would be that the domestic investment might be crowded-out and the local investors might not be able to compete with foreign investors.

Nations receiving large amounts of FDIs do not necessarily result in new capital formation when transnational corporations (TNCs) purchase the existing plant and equipment and reduce the control of domestic capitalist. Mexico is one of the top recipients of FDI where 71 percent of such investment was meant for purchasing already existing Mexican companies in 2001 (Gazcon, as cited in Cypher & Dietz, 2004). When TNCs use funds of host country banking sector, the domestic sector is deprived of the use of local resources. In this way, the FDI does not play a complementary role to domestic investment. It substitutes ownership and control.

In a country specific study conducted by Aitken and Harrison (1999), using panel data from Venezuela over the period of 1976 to 1989, two conclusions were drawn. First the foreign equity participation has positive correlation with productivity for small enterprises (number of employees less than 50). Second, an increase in foreign ownership negatively affected the productivity of wholly domestically owned firms in the same industry. By offsetting the opposite effects, net effects are quite small. Joint ventures' main contribution is in the net effects of foreign investment. Using the panel data in Morocco, Haddad and Harrison (1993) rejected the hypothesis that foreign presence accelerated productivity growth in domestic firms.

Sahoo and Mathiyazhangan (2003) examined the role of the FDI on the growth of the economy of India through export promotion. By using annual data from 1979-80 to 2000-01 and applying Johansen co-integration test, the study found long run relationships among GDP, FDI and export. Moreover export played a better role in economic growth than the FDIs. Therefore they suggested a policy that emphasizes more on open export oriented sectors. Studying the relationship among the FDI, trade and domestic output in Pakistan over the period of 1972 to 2001, Ahmad, Alam, and Butt (2004) detected long run relationship. The results of the study supported export-led growth hypothesis and indicated that domestic firms benefits derived from the FDI through spillover effects mechanism.

Using regional panel data in China, Wen (2007) found that due to different FDI orientation among different regions of China, east China attracted more FDI with resultant increased exports. In addition, there was a rise in FDI-GDP ratio, which led to an increase in east China's share in national industrial value added index. This was reflected in the regional income growth of east China which was affected positively. While in case of central China (which attracted less FDI), these effects were found to be negative. However, the contribution of improved in market mechanism to regional development was evidenced in attracting FDI, in promoting exports and directly contributing to regional income growth.

Zhang (2001) empirically analyzed the role of FDI in China's income growth by using a growth model for cross-section and panel data covering the period of 15 years (1984-1998) from 28 regional units for transitional economies. The study found positive effects of FDI on Chinese economy. Externality effects of FDI were significantly positive and supported the observations that the presence of multinational corporations (MNCs) not only resulted in technology transfer and diffusion but also facilitated China's transition toward a market economy. The findings also supported the assertions of FDI theories that the marginal product of FDI would be greater than that of domestic capital. However, uneven distribution of FDI between coastal and inland regions resulted in widening the regional income gap.

Djankov and Hoekman (2000) investigated the impact of foreign investment on productivity performance of firms in the Czech

Republic during the period (1992-96). This study tested the difference in the total factor productivity (TFP) growth rate of local firms from foreign owned firms (joint venture and directly acquired). TFP was used as an indirect measure of technology transfer. The results of the study suggested that TFP growth of foreign owned firms was higher than that of local firms. Moreover FDI appeared to have a greater impact on TFP growth than that of joint ventures.

Makki and Sumwaru (2004) analyzed the role of FDI and trade in economic growth of 66 developing countries within the endogenous growth theory framework. Using cross section data over the period 1971-2000, they found that FDI and trade contributed to enhance economic growth. The FDI seemed to encourage domestic investment.

A study conducted by Alfaro *et al.* (2006) focused on financial markets of the host countries while relating FDI with economic growth through backward linkages. In a small open economy, foreign and domestic firms compete for skilled and unskilled labour as well as intermediate products. In turn they go for innovated intermediate goods which imply capital cost. This cost must be financed through domestic financial institutions. Then these various innovated intermediate goods lead to positive spillovers to 'final goods' sector. These local financial markets resulted in the backward linkages to turn into FDI spillovers. The authors also found that the same amount of an increase in FDI generated three times more additional growth in the financially well developed host countries than in the financially poorly-developed countries.

Khan (2007) also examined the link between FDI, domestic financial sector and economic growth for Pakistan over the period of 1972-2005. It was found that FDI had positive effects on economic growth both in the short and the long runs if the financial system of host country was developed up-to certain minimum level. These better financial conditions not only attracted FDI in Pakistan but also helped in maximizing the benefits from foreign investment.

The MNEs may play a role in industrial development through FDI by raising the scale of operations in host countries industry upstream and downstream. This occurs due to the forward and backward linkages. Markusen and Venables (1999) in their model, state that the MNEs may affect domestic industry of the host country positively by linkages with local firms. Borensztein, De Gregorio and Lee (1998) found that the FDI has positive effect on the economic growth of the host country, provided that the host country has sufficient stock of human capital and absorptive capacity. According to Lall (1980), the MNEs have positive effect on local firms by demanding high quality inputs, and by providing technology, information and training, and market access.

Balasubramanyam *et al.* (1999) analyzed the role of the FDI in promoting economic growth. They suggest that the size of the domestic market and competitive climate related to local producers play an important role. Moreover, interactions of FDI and human capital have substantial influence on growth promotion.

Hang and Attaullah (2003) studied the impact of human capital on relationship between inward FDI and economic growth in ASEAN and Latin America during 1975-1995. Their results supported two hypotheses; first, there was two ways relationship between the FDI and economic growth, and second, human capital was a positive factor that facilitated this relationship as the FDI contributed to productive capacity and to the shift towards technology-intensive and value added production and exports. It could also help to attract those types of FDI that would promote higher economic growth.

In 2006, Baharumshah and Thanoon carried out an empirical study on the effects of various types of capital inflow on the growth process of East-Asian countries based on dynamic panel data. It was found that these countries felt the FDI's impact on growth, in the short as well as long run. The impact of the FDI was greater than that of the domestic investment. Moreover, countries that were successful in attracting FDI not only invested more but also grew faster than those that discouraged FDI.

Sahoo (2006) studied the impact of the FDI on economic growth, domestic investment and

export for five South Asian countries (India, Pakistan, Bangladesh, Sri Lanka and Nepal). The results showed that the FDI had a positive and significant impact on growth in four South Asian countries, except Pakistan. Other supporting factors to growth were exports, gross domestic capital formation and infrastructure.

In 2007, Basu and Guariglia examined the interconnectedness between FDI, inequality (in the level of access to technology in different countries), and growth, empirically as well as theoretically. They used panel data of 119 countries for the period 1970 to 1999 to explore the relationship between FDI and inequality, FDI and growth, and FDI and the share of agriculture in the GDP in the recipient countries. It was observed that FDI promoted both inequality and growth, and had a tendency to reduce the share of agriculture in the GDP in the recipient countries.

Lensink and Morrissey (2006) studied the effect of volatility in the FDI inflow on growth by using cross section, panel data and instrumental variable technique. They found that the volatility in the FDI had a negative impact on growth. Moreover, the evidence for positive impact of FDI on growth was not robust.

From the above, it can be concluded that the FDI can boost economic growth through export promotion, encouraging investment and developing linkages. This relationship can be enhanced if the host country had better stock of human capital, developed financial market, and competitive environment.

3. FDI and Spillover Effects

One of the most commonly discussed aspects in literature of FDI is the spillover effect of MNCs in the host economy. The FDI is considered a channel for transfer of technology from industrialized countries to the less developed countries. This new technology may be incorporated both in the production process and product. As far as the transfer of technology is concerned, the FDI is preferred over licensing when the technology is complex and when experience is required to make the technology operational.

For the purpose of the developmentof the host country an important indicator is the transfer of skills and technology from the TNCs. But this transfer is related to the degree of national linkages between the TNCs and the host economy. Though Mexico has been a major recipient of FDI, research does not suggest that Mexico's national base has either grown or diversified or has it deepened its capital and knowledge skill level to any significant extent (Cypher, as cited in Cypher *et al.*, 2004)

The views on technology transfer seem to be supported by Xu (2000) who investigated United States multinationals as a channel of technology diffusion in 40 countries using the data from 1966 to 1994 and found that technology transfer by the US MNEs contributed to productivity growth in developed countries but not in less developed countries (LDCs). In order to derive any benefit from the technology transfer, the basic requirement for the host country is to have a minimum human capital threshold level. However, most of the LDCs have not reached this threshold yet.

Makki *et al.* (2004) analyzing the role of FDI and trade on growth in 66 developing countries, recognized the FDI as the main channel for transferring technology to developing countries. They also found that stock of human capital might enhance these benefits.

While studying the effect of FDI, Yudaeva *et al.* (2003) compared the productivity of fully owned domestic firms with that of at least partially foreign owned firms in Russia to study the spillovers from foreign owned firms to domestic firms. Foreign owned firms were found to be more productive than the Russian firms owned due to access to technology and better management for the former. However, the productivity of foreign owned firms did not vary in proportion to the size of foreign stake. The reform orientations of the regions not only played the role as a determinant of foreign investment but also influenced productivity of the foreign firms. Firms were more productive in more reform-oriented regions than those in less reform oriented regions. Positive spillover effects of the technology and the management practices were observed on domestic firms in the same industry but the foreign firms had a

negative effect on firms in vertically related industry. Poor quality of supplies distorted the vertical relationship. This negative spillover on vertically related firms appeared less significant with the passage of time. Smarzynska (2003) examining the firm-level data from Lithuania supported the results that the positive productivity spillovers from the FDI took place in upstream sectors through linkages between foreign affiliates and local suppliers. But horizontally, there was found to be no indication of spillovers.

Using a large range of Chinese manufacturing firms, Liu (2008) showed that an increase in the FDI lowered the short term productivity level but raised the long term rate of productivity growth of domestic firms in the same industry. Investigating the effects of the FDI on productivity level, as well as the rate of productivity growth in domestic firms, he found that the level-effect resulted in a decline in the productivity level, and the rate effect led to a gain in productivity. But the rate-effect dominated the level-effects in the long run and the domestic firms benefited from the presence of foreign firms (intra-industry spillovers) in the same industry. Regarding vertical spillovers, he found that spillovers through the forward and the backward linkages had similar effects on the productivity of domestic firms. But the backward linkages seemed to be statistically a more important channel through which spillover occurred.

Aitken and Harrison (1999) using panel data from more than 4000 plants in Venezuela covering the duration 1976-1989, found no evidence supporting the existence of technology spillovers from foreign firms to domestic firms. Khan (2007) also observed similar results for Pakistan during the period 1972-2005. However, he attached positive externalities from the FDI, with the attainment of certain minimum level of development of domestic financial conditions.

Blomstrom and Kokko (2003a) reviewing the literature, concluded that there was a potential for significant "spillover effects" from FDI into most countries, but this potential was associated with the stock of human capital, the interest in local firms of promoting skills transfer, and a competitive environment.

Blomstrom and Kokko (2003b) suggested that investment incentives to foreign firms only were not an efficient way to raise national welfare. Spillovers of technology, the main motive for these incentives could be realized only when the local firms have necessary absorptive capacity. Therefore, it is necessary to support learning and investment in local firms as well.

In 2001, Hanson focused on whether spillovers associated with the production by multinationals justify FDI promotion policies. As far as the impact of the FDI on host countries is concerned, there are weak evidences that the FDI generates positive spillovers for host countries. Moreover, at plant level, there is little evidence that the FDI raises the productivity of domestic enterprises. Literature gives the impression that countries should be careful about claims that promoting FDI will raise their welfare.

Djankov and Hockman (2000) suggested that parent firms transferred more know-how to their affiliates than joint venture firms obtained from their partners. When joint ventures and FDI were taken together, they had a negative spillover effects on firms having no foreign partnership in each industry. But FDI separately had positive impact on all other firms in an industry. Negative spillover effect of joint ventures might be due to the absence of absorptive capacity in them.

Lipsey (2002) found mixed evidence for spillovers to local firms' productivity. It depended on host country policies and environments and on technological levels of industries. The impact of FDI in promoting the growth of the host country exports and linkages to the outside world was clearer. In some cases it has been shown that the FDI played a role in transforming host economies from being exporter of raw materials and foods to being exporters of manufactures (including in some cases, high tech manufacture). In simple words the FDI not only increased the exports quantitatively but also qualitatively.

Overall, however, the spillover impact of the FDI showed a blurring picture. From the evidence, it might be judged that transfer of technology depends on linkages between MNEs and locally owned firms, absorptive

capacity, human capital level and the policies of the host country, and interest displayed by the firms in promoting skills.

4. FDI Effects on Balance of Payments

The effect of FDI on the balance of payments of the host country has been seen to be controversial. One view is that the FDI might affect balance of payments positively by the inflow of the initial capital, substituting import and contributing to exports.

The capital account of the host country is positively affected by initial capital inflow. But this is a one-time-only effect because the FDI may subsequently lead to the outflows in the form of the earning to parent firm which could impact the capital account negatively. The FDI is considered as a substitute for imports for the host country and can help improve the capital account. However, the imports of input material and machinery offset the advantage of import substitution. For example, the FDI by the Japanese automobile companies in the United States and the United Kingdom can be taken as substitutions for the imports from Japan. But with import of many component parts from Japan, the positive impact of the FDI on the current account of the U.S. may not be as great as initially supposed (Hill, 2005).

Foreign exchange problems commonly restricts the less-developed nations from expanding into foreign markets. Widening the market (which is one of the functions of TNCs) can allow the firms to realize economies of scale in production. Lower cost may translate into lower prices and in turn the lower income consumers could be brought into the fold of the market. Consequently, the TNCs might impart export skills to domestic producers.

In the framework of the neoclassical theories, the FDI influenced China's manufacturing exports in terms of volume as well as in structure. China's rank in exports in the world improved from 26th in 1980 to 9th in 1998. During this period, the volume of China's exports increased from US $ 18 billion (47% of exports as manufactured goods) to US $ 184 billion (89% of exports as manufactured goods). Exports by Foreign-Invested Enterprises (FIEs) rose 66.7 percent annually over the period 1980-98 (SSB, as cited in Zhang, 2001).

Blomstrom and Kokko (1996) reviewed the empirical evidence on the FDI effects such as transfer of technology, trade performance, competition and industry structure in the host countries. They concluded that the MNCs could play a vital role for productivity and export growth in the host countries. They observed that the impact of the FDI varied from industry to industry and from country to country. According to Hill (1990) and Naujoks and Schmidt (1995), foreign owned firms tend to export a great proportion of their output than do their locally owned counterparts. Sahoo (2006) recognized the positive impact of the FDI on export growth through its positive spillovers in South Asian countries.

The empirical evidence suggests that the positive impact of the FDI on exports of host countries is more than that on imports. If the problems of balance of payments occur, it would likely be small (WTO, 1996). Khan and Kim (1999) empirically tested the impact of the FDI on exports from Pakistan and suggested that the FDI inflow was more towards import-substitution industries than towards export oriented industries. Consequently the FDI worsened the balance of trade in Pakistan.

The TNCs might use transfer pricing techniques in response to the restrictions imposed by the host country government on repatriation of funds. This technique might be more harmful for less developed nations where the tax collection system is weak (Cypher *et al.* 2004).

The parent companies from the developed would advance make loans to their subsidiaries in less-developed countries. Repayment of such loans with interest (an amortization) causes a potential drain on the balance of payments and foreign exchange earnings of a less developed country. Unless the subsidiary is earning foreign exchange via exports or by contributing to import substitution in the host country, the outflow of principal value and interest can exceed the original inflow of financial capital, thus creating a net outflow over time. (Cypher *et al.* 2004).

If the Japanese automobile companies in the United States and the United Kingdom (which are advanced countries technologically) could

not show remarkable positive impact on exports, then it is difficult to say that the FDI may have positive impact on the balance of payments in the developing countries, where, the machinery and the input material have to be imported. Moreover, the transfer pricing technique and other tactics of capital outflow seem to worsen the balance of payments in developing countries.

In Asia, China is an example of a success story of the FDI recipient countries. But it is worth mentioning that half of its FDI came from Hong Kong (neighbour) and China's capital outflow was channeled to Chinese firms located in Hong Kong and then back to China as the FDI.

5. The Role of MNCs in Employment

Employment is one of the issues that is discussed between the MNCs and the government of the host country. The FDI effect on employment can be observed directly when the MNCs employ a number of persons from the host country. With the presence of the MNCs, the production capacity of the local suppliers increases, leading to the creation of new jobs and so indirect effects arise. But the other side of the picture is different as Hill (2005) describes:

"Cynics argue that not all the "new jobs" created by FDI represent net additions in employment. In the case of FDI by Japanese auto companies in the United States, some argue that the jobs created by this investment have been more than offset by the jobs lost in U.S. owned auto companies, which have lost market share to their Japanese competitors. As a consequence of such substitution effects, the net number of new jobs created by FDI may not be as great as initially claimed by an MNE (p.246)."

When an MNC acquires an enterprise, initially it reduces employment for efficiency purpose during the restructuring period. When this duration is over, the growth rate in employment might increase at a faster pace than in the domestic enterprises. Hill (2005) supported this view as under:

"An OECD study found that between 1989 and 1996 foreign firms created new jobs at a faster rate than their domestic counterparts. In America, the workforce of foreign firms grew by 1.4 percent, compared to 0.8 percent per year for domestic firms. In Britain and France, the workforce of foreign firms grew at 1.7 percent per year, while employment at domestic firms fell by 2.7 percent. The same study found that foreign firms tended to pay higher wage rates than domestic firms, suggesting that the quality of employment was better (p.247)"

McDonald *et al.* (2002) investigating the role of the FDI in promoting employment in host region of the European Union (EU), developed a theoretical framework which suggested that the initial influence of the FDI on employment was weak and mostly created low skilled jobs with the loss of employment in host economies due to the displacement of domestic output by increased exports from parent companies of subsidiaries. However in the long run, operations of the subsidiaries were diversified and thereby induced a change in the pattern of jobs in the host country.

The world's top 100 non-financial MNEs employed 14.3 millions of total 1.8 billion people employed in the world as a whole in 2000 that is less than one percent of the total world employment (UNCTAD 2001). But at country level this percentage differed. The MNEs accounted for less than 10 percent of the manufacturing employment in Portugal, Turkey and Japan while this figure was over 40 percent in the countries like Hungary, Argentina and Ireland (Narula and Marine, 2003).

Fazekas (2000) examined the nature and determinants of regional distribution of foreign investment enterprise (FIE) employment in Hungary. It was concluded that regional distribution of the FDI inflows was strongly influenced by educational level of local population. A self-reinforcing process was observed there: the FDI was attracted to the regions where unemployment was lower due to better educational levels and geographical advantages (regions adjoining the Western-Slovakian, Austrian and Slovenian borders) while an increase in the FDI in turn created new job opportunities.

Structural economists argue that TNCs employ capital-intensive production system that is not favourable for labour abundant, poor nations, where real rate of unemployment and

underemployment may be alarmingly high. This capital-intensive production system increase unemployment and underemployment in urban areas. Moreover, some of the top level manager and university level graduates try to get jobs in TNCs. They leave local industrial and agricultural firms with relatively narrow cadre of management talent and perhaps may not always the best-trained (Cypher et al., 2004).

Jayaraman and Singh (2007) undertook an econometric study of the impact of the FDI in Fiji for the period of 30 years. They investigated the relationship between employment and foreign direct investment for Fiji through multivariate modeling strategy by including GDP. They found unidirectional long-run causality running from foreign direct investment to employment and unidirectional causality running from foreign direct investment to GDP in the short-run.

Export Promotion Zones (EPZs) have attraction for foreign companies. Nations develop Export Processing Zones (EPZs) to gain foreign exchange, labor-intensive manufacturing and assembly processes, creating new jobs which can be very important to the host nations (Cypher *et al.* 2004).

From the evidence discussed above it may be concluded with weak robustness that FDI may generate net employment in the host country. However, a high level of human capital may play positive role in enhancing this relationship.

6. Effect of FDI on Human Capital Formation

Human Resource as one of the determinants of the FDI inflow, is considered a vital factor for economic growth and development of a country. Human capital level is one of the factors that determine competitiveness of an economy for attracting the FDI. The stock of human capital is considered not only prerequisite for attracting the FDI but it also increases the absorptive capacity for technology, skills and abilities from multinational enterprises (MNEs).

Khan (2007b), analyzing the FDI in South Asian countries, indicated that countries with developed human resources attracted higher FDI. He also suggested that the South Asian countries needed to develop market-driven knowledge and skills to get benefit from the FDI flows by shifting preferences toward tertiary education, vocational and technical training and R&D.

Alfaro *et. al.* (2006) emphasized the importance of market structure and indicated the importance of the human capital as an absorptive capacity for the FDI to have an effect on economic growth. Yudaeva *et. al.* (2003) recognized the value of human capital for attracting FDI as well as for absorbing spillover effects.

As far as human capital formation from the FDI is concerned, some countries have been able to mobilize MNCs more effectively than others due to many reasons e.g. trade orientation, rates of employment, percentage of the FDI in domestic investment, the level of trade unionism and organized labour, training incentives and linkages between public and private sectors. It was also found that mere existence of the FDI would not result in transfer of technology and scientific skills. Cooperation among government, industry, academia, and labour would lead to creation and transfer of high quality and quantity of skills. Moreover, the FDI will be more beneficial when it comes after the developing countries have created a sufficient pool of human capital (Ritchie, 2002).

Evidence from the literature suggests that the FDI and human capital formation have complementary effects as supported by Zhang (2001). But a question "Do skills attract FDI or does FDI create skills?" remained debatable. Noorbakhsh, Paloni and Youssef (2001) found that the level of human capital was a significant determinant of FDI inflow. Similarly Xu (2000) argued that host country should have a minimum threshold of skills before the arrival of TNCs. It would enhance the absorption capacity and facilitate transfer of technology. Korea and Taiwan followed this pattern. But in Southeast Asia, MNCs came before the creation of a pool of intellectual capital. Was Southeast Asia trapped in a low-skill equilibrium? The answer seemed to be no. According to Slaughter (2002), there was strong evidence that MNCs increased demand for skilled workers through technology transfer from parent firms to their subsidiaries.

When a host country gets a continuous flow of the FDI through attracting higher value-added MNEs, it enhances skill level of preexisting MNEs in the host country and the domestic enterprises. These upgraded skills further attract the FDI and so it becomes a virtuous circle (Miyamoto, 2003).

Gachino (2006) examined the role of the foreign presence, the FDI and the firm level capabilities in human capital development in three manufacturing industries of Kenya. Human capital development was found to be different in each of the manufacturing industries. A high positive correlation was observed between the FDI and the human capital development. The countries which were technically backward like Kenya were likely to have the FDI play a positive and significant role in human capital development. Foreign firms that were large in size generated higher human capital development than that of locally owned firms. Foreign firms enjoyed higher level in process and product technology and marketing performance than that enjoyed by the locally owned firms. In the manufacturing sector in Kenya the FDI presence was seen to result in some technology spillovers being absorbed by domestic firms.

Aitken *et. al.* (1999) found no evidence in Venezuela in favor of the argument that over a long period, the FDI increased the stock of human capital through labour mobility. Mitchie (2002) studied the impact of the MNEs on human capital enhancement in developing countries. This impact appeared not to be a function of the MNEs, but it was found to be a result of the government efforts to attract the FDI by enhancing human capital. Literature has suggested that public education is the best way to enhance human capital. MNEs are not likely to provide such education.

Narula *et. al.* (2003) found that the MNEs subsidiaries in Argentina hired more professionals than the domestic firms of the same size; possessed a more skilled labour force overall; and spent more on training than similar domestic firms. Higher labour productivity and higher wages were observed to be prevalent in these MNEs subsidiaries. But when measured in terms of knowledge creation and utilization, little difference was found between the affiliates and the domestic firms. The benefit of the MNE activities in the Argentine economy was not reflected in the domestic firms' value added growth. Moreover, the results indicated that the domestic firms, which efficiently internalized more spillovers, had a larger investment in absorptive capacity.

Kapstein (2002) outlined some of the recent arguments made by economists regarding the relationship between the FDI, human capital formation and growth within the emerging market economies. The theory of FDI's contribution to the economic growth of the emerging economies via the human capital formation remained controversial due to two reasons. First, in most countries the FDI accounted for only a small share of the GNP and the total employment, and so its impact on national educational and economic performance was unlikely to be great. Second, the FDI increased wage disparities and that factor might undermine the contribution of the FDI to growth. It was argued that only political economy might lead countries away from sustained growth. In countries lacking well developed capital and education markets, many otherwise qualified citizens might be denied the basic skills they needed to contribute fully to the nation's economic development. As the demander and the supplier of labour, the multinational firms might influence educational outcomes in the market where these firms did business. Their interaction with local educational establishment would be largely a function of domestic political and economic forces.

Miyamoto (2003) concluded by reviewing the literature on the FDI and human capital formation that adult population of the host country should have at least basic schooling to attract any type of FDI. In order to attract high value-added MNEs, it seemed necessary to develop tertiary education sector with close collaboration with the industry so as to formulate demand driven programmes. MNEs can contribute to human resource development of the host developing country by providing training and supporting formal education. Large domestic firms and MNEs invested more in training as compared to small and medium size domestic firms. MNEs contributed to

technology transfer through horizontal and vertical linkages, labor turnovers and spin-offs. The host country efforts to improve absorptive capacity have also been observed to facilitate technology transfers. Government policies have been important to facilitate training, to minimize financial constraints and market failures and to promote MNEs to invest in human resource development (HRD) of the host economy. Little evidence of virtuous circle of inward FDI, HRD, and technology transfer was found. A government that emphasized flexible demand-driven HRD strategies targeted MNEs in high value-added areas, and coordinated education and training policies were more likely to lead the country into virtuous circle.

Empirical results by Slaughter (2002) on links between inward FDI and within industry skill upgrading for both developed and developing countries indicated robust positive correlation between skill upgrading and presence of affiliates of the US multinationals. This correlation was even stronger among the sub-sample of developing countries.

Majority of the evidence from above literature supports the argument that the FDI and human capital mutually interact. But host country intervention and many other factors are essential that may enhance this interaction.

7. Conclusions

Both the theoretical and empirical evidence reviewed in this paper reveal mixed views about the FDI impact on socio–economic development of the host countries. The critical analysis made by various writers/ researchers based upon the experience of different host countries indicated that FDI may enhance growth through promoting exports, encourages investment, and linkage effects. Better stock of human capital and developed financial markets may add to these effects. Moreover the FDI is likely to have spillover effects if the host country has absorptive capacity and the local firms have linkages with the MNCs. For the developing countries, the FDI impact on the balance of payments was found to be, more or less, lacking. There is evidence (with weak robustness) in favour of generation of net employment by the MNCs. However, higher level of human capital in the host countries does play a role in employment. The relationship between FDI and human capital was observed to be of an interactive nature, but interventions of government were found to have key role in it.

As far as policy implication is concerned, this paper suggests that the FDI impact on socio-economic development of the host countries is not an automatic process. The government of the host country however, has to intervene to control transfer pricing, monopoly of the MNEs, and outflow of capital. The government should direct the MNEs to take input from local contents and to export certain percentage of manufacturing. The government should open export oriented sectors for FDI, make arrangement for developing linkages between MNEs and the host country firms, encourage the MNEs for training of employees, provide MNEs with access to capital market, and coordinate with industry and academia to formulate demand driven human capital.

It is hereby suggested that this is a very vast field for further research and is context dependent. Different policies, macroeconomic environment, endowment of resources and competitiveness of a country encourage us to conduct studies empirically at regional and country level. The studies at sector, firm and plant level may enhance our insight about spillover effects, employment and training and development of human resources.

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