

Micro-level Determinants and Effects of FDI – the Example of Baden-Württemberg

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Using detailed plant-level data of the German state of Baden-Württemberg, we describe the patterns of foreign direct investment (FDI) on the micro-level. Using econometric methods, we analyze the determinants of firm-level FDI. Furthermore, we estimate the labor demand effects of FDI.

Labor demand regressions show that FDI tends to have a positive effect on the domestic employment on the firm-level. Separate regressions for horizontal and vertical FDI show that there is a positive effect on firm-level labor demand for horizontal FDI, but no significant effect for vertical FDI.

JEL: F21, F23

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1 Introduction

Today, proceeding globalisation is associated with hopes as well as with fears. The process of internationalisation does not only happen by means of trade of goods and services, but also, latest since the 1990ies, by foreign direct investment (FDI). The resulting multinational enterprises are often recognized as the major driving forces of globalisation.

Foreign direct investment is ,as well as “Offshoring“ and “Outsourcing“, often associated with rationalization and domestic job losses. The opening of the national borders of central and east European countries, their accession to the European Union and their proximity to Germany has once again exacerbated this discussion. It is often presumed that, since then, even small and medium enterprises can outsource some steps of their labor-intensive production. A decline of domestic labor demand could result in declining domestic wages or rising unemployment. At the same time FDI promotes new possibilities for market access, new growth possibilities and risk diversification for shareholders as well as employees of multinational enterprises.

When looking at the motives and structures of FDI Baden-Württemberg is of particular interest as it is characterised by an above-average share in foreign trade as well as by an above-average industry-density. Baden-Württemberg could therefore be affected more strongly than other federal states not only by the positive but also by the negative effects of internationalisation.

For this contribution we first analyse the 2006 wave of the IAB establishment panel for Baden-Württemberg with respect to the structure and determinants of FDI. Secondly we analyse the effects on employment on the firm level. In section 2 we summarize central aspects of the current status of the economic theory. In section 4 we present descriptive statistics on the patterns of FDI in Baden-Württemberg. Section 4 is dedicated to the econometric analysis of the micro-level determinants of FDI. Section 5 presents the results of the labor demand estimations that examine the effects of FDI on the occupation level of investing establishments. Finally, section 6 summarizes the article.

2 Theoretical foundations and Stylized Facts

2.1 Definition of FDI

By the definition of the OECD (1996) and the IMF (1993) FDI is characterized by the long-term interest of a domestic investor in a foreign company. This implies the existence of a long-term relationship between investor and foreign company as well as fundamental influence of the investor on the corporate management. By definition, this is the case if the voting share in the

foreign firm exceeds 10 percent. The definition of FDI in the IAB establishment panel does not unambiguously refer to the prevalent definitions of the OECD and the IMF. Instead question 87b of wave 2006 of the IAB establishment panel “How high was the total sum of FDI in 2005 and 2006?” enables us to calculate the amount of FDI of the establishments from Baden-Württemberg.

2.2 Types of multinational enterprises

The theory of multinational enterprises is closely related to foreign trade theory. On the one hand, horizontally integrated multinational enterprises emerge from intra-industrial trade (Krugman 1979), meaning the trade between firms of the same sector which is based on economies of scale and access to foreign markets. The foreign country produces the same goods that are produced domestically. This explains bilateral FDI flows between industrialised countries with similar factor endowments. The purpose of these international trade activities is to develop new markets and to supply the foreign market with locally produced goods.

On the other hand, vertically integrated multinational enterprises emerge from inter-industrial trade. The purpose of these international trade activities is to save production costs. Due to differences in factor endowments, and therefore in factor costs, the foreign and domestic country are assigned different production stages. This explains unilateral direct investment of countries with high capital endowment in countries with low capital endowment. Here the reference trade theory model is the classical Heckscher-Ohlin-model.

2.2.1 Horizontal multinational enterprises

Determinants of horizontal FDI

The theory of horizontal multinational enterprises describes under what circumstances firms invest in new foreign production facilities abroad in order to supply the foreign market.

According to Brainard (1993, 1997) every company that wants to sell goods to a foreign market basically has to make a choice whether to export domestically produced goods or to invest in a foreign production facility in order to directly supply the market with locally produced goods. In the first case the company accepts the transport costs (included tariffs and non-tariff trade barriers); in the second case the business has to accept the fixed costs for the foreign production. The probability of horizontal FDI increases with increasing transport costs and trade barriers between the two countries and with decreasing fixed costs for the production in the foreign country.

Barba Navaretti and Venables (2004) analyse the impact of economies of scale on the development of multinational enterprises. Economies of scale exist on the company level as well as on the level of the plant. On company level economies of scale arise, when the development of foreign markets increases total output without increasing headquarter-service costs.

The counterparts to economies of scale on the company level are economies of scale on the plant-level. If average costs decrease with output, bundling production activities pays off. Horizontal FDI is therefore more probable if returns to scale on company level are high and returns to scale on plant-level are low.

Employment effects of horizontal FDI

On a theoretical basis the effects of horizontal FDI on employment in the domestic country are not unambiguous. On the one hand the construction of a foreign plant could cause a loss of jobs in the domestic production, as it is possible that goods that have been exported before are now being produced abroad. On the other hand (qualified) labor demand, especially at headquarter-services, rises as the need of coordination grows and as sales increase due to the elimination of transport costs. If the multinational firm has not been exporting to the foreign country before, and therefore the horizontal FDI paves the way for the access of the foreign market, the employment effect is definitively positive.

2.2.2 Vertical multinational enterprises

Determinanten of vertical FDI

Vertical multinational enterprises are characterized by the fact that the value chain of the firm is split in different parts. This idea has been introduced to literature by Helpman in 1984 and as “slicing up the value chain” by Paul Krugman in 1995. Some steps of the value chain are completely shifted to foreign production facilities. This way differences in factor costs between different countries are being exploited. Therefore the probability of vertical FDI increases the more countries differ in their factor endowments (see Barba Navaretti and Venables 2004, chap. 4).

Baden-Württemberg is, compared to the rest of the world, endowed with comparatively much capital and high skilled labor, but with comparatively little low-skilled labor. From theory we can therefore conclude that Baden-Württemberg relocates those production steps to foreign countries which require a high amount of low-skilled labor. In the area of high skilled domestic labor, labor demand increases as vertical structures require more coordination.

Transport costs and trade barriers influence vertical activities in a different way than horizontal activities. The higher the trade costs, the less probable will be vertical FDI, as the import of intermediate products becomes more expensive.

Employment effects of vertical FDI

In comparison to horizontal activities, vertical FDI of German companies probably has a negative impact on labor demand on company level. This is combined with increased relative demand for high-skilled labor.

Feenstra and Hanson (2001) discuss the effects of outsourcing on the development of differences in income between high-skilled and low-skilled workers. Developed countries like Germany specialize in headquarter services and (partially) outsource production to foreign production facilities. If the firms can thereby save costs and increase their market shares, there is a positive employment effect for the headquarter services. This increases domestic demand for high-skilled labor. On the other hand low-skilled labor demand decreases and the employment level on the plant-level decreases.

2.2.3 Firm-level heterogeneity

Traditional theories of foreign trade are based on the idea of representative firms, that all have the same properties. But empirically we find important differences even between companies of the same industry. Recent theoretical studies stress the importance of differences in productivity between companies.

Based on the seminal work by Melitz (2003) Helpman, Melitz and Yeaple (2004) examine the decision between exports and horizontal FDI. They argue that horizontal FDI only pays off for the firms with the highest productivity, as fixed costs for FDI are higher than fixed costs for exports, and those again higher than fixed costs of firms that only produce for the domestic market. Only companies that are highly productive and that can therefore expect a larger market share and a larger output will accept an increase in fixed costs. Depending on their productivity companies decide whether to produce only for the home market, or to export, or to engage in FDI.

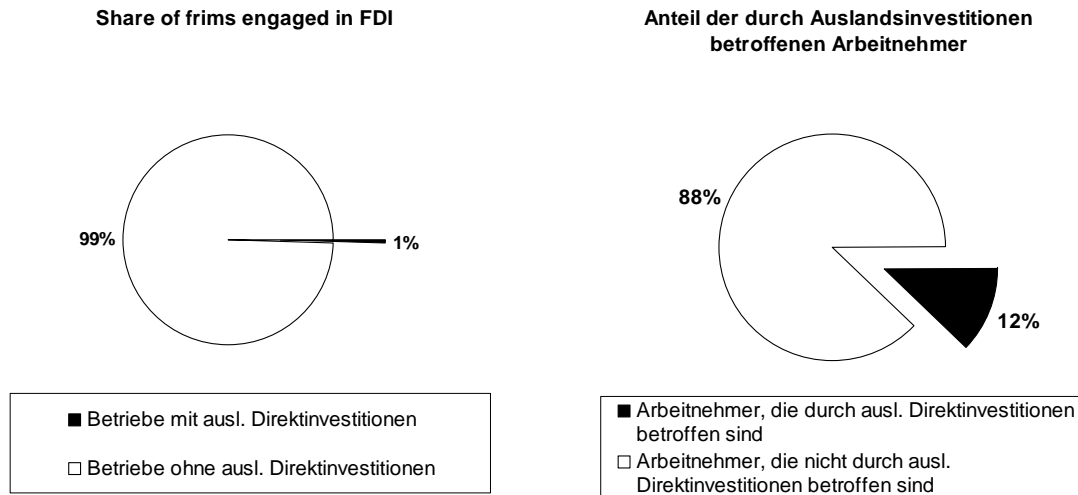
3 FDI on the plant-level: stylized facts for Baden-Württemberg

3.1 Share of firms engaged in FDI

Theoretical predictions from section 2 state that only a small number of highly productive firms engages in FDI. The empirical analysis of the IAB establishment panel shows that it is indeed

only a very small number of firms in Baden-Württemberg that set up or acquire subsidiaries abroad.

Figure 1: Share of firms in Baden-Württemberg with FDI and share of employees in Baden-Württemberg in these firms



Source: Own calculations, IAB establishment panel

Figure 1 shows that only about one percent of the firms in Baden-Württemberg are engaged in FDI in 2004 or 2005. However those firms employ 12% of all employees liable for social insurance in Baden-Württemberg. This shows that investing firms are significantly larger than non-investing firms and that a large share of all employees is affected by FDI. Even more employees are affected by indirect relationships such as competition-, supplier- and spill-over-effects.

FDI is highly concentrated even in the subset of investing firms. On the one hand there is a (relatively) large group of firms that invested less than one million Euros abroad (about 56% of all FDI-makers). On the other hand only a small share of the firms invested more than 10 million Euros (only about 5 % of all firms investing abroad). However, the impact of this small group on the total volume of FDI is important: Those 5 % of the establishments with more than 10 million Euros in FDI are responsible for almost half (49%) of the total FDI volume.

3.2 Underlying motives for FDI

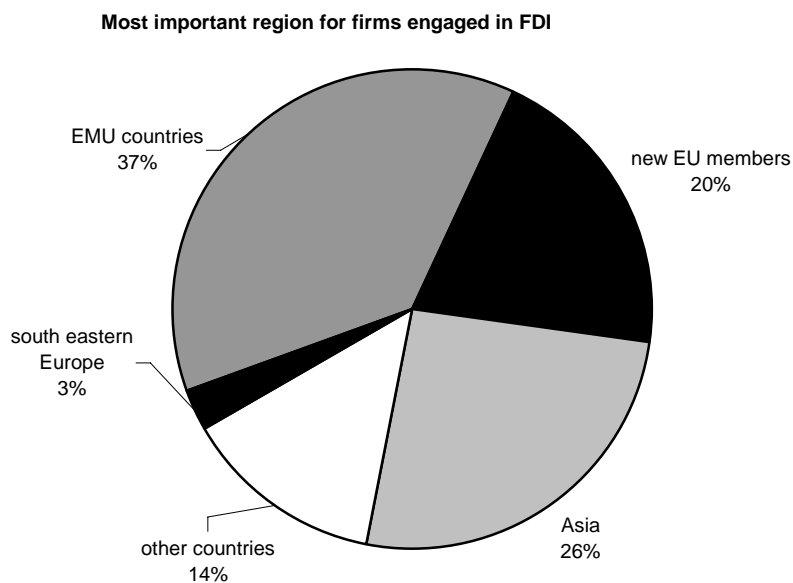
About 46 % of the firms in Baden-Württemberg have named market development as their only motive for FDI. 42% named market access as one of their reasons to engage in FDI. Therefore market access is for about 88% of the firms an important reason for their FDI activities. In contrast only 12% of the businesses state cost reduction as their only motive for their FDI

activities. The same reasons apply for the sub-sectors of the manufacturing industry as well as for the services sector.

3.3 Where do firms invest?

In the IAB establishment panel data is collected on which world region was the most important for firms engaged in FDI. Figure 2 presents data regarding the most important target areas. The target region that has been considered most frequently the most important target area is the European Union, named by 37 % of the firms investing abroad in 2004 or 2005, followed by Asia and the new European Union members since 2004 (each with 26 % and respectively 20 %). The remaining foreign countries follow with about 14 %, and south east Europe with about 3 %.

Figure 2 - most important region for firms engaged in FDI



Source: Own calculations based on the IAB establishment panel

3.4 Are firms engaged in FDI different?

It has to be assumed that productivity and the amount of knowledge capital are not only linked with the FDI activities, but at the same time influence the size and industry of the establishment. In order to make sure that, when comparing establishments with and without FDI, we do not attribute size and industry effects to FDI, table 1 controls for these effects (for a comparable

empirical approach see Bernard et al., 2007). Table 2 shows the partial influence of FDI on the establishments' characteristics. The FDI-premium has been estimated in 3 different versions. In column (1) the only regressor is a dummy for FDI-activities, in column (2) it has been controlled for industry effects and in column (3) it has been controlled for industry and establishment size effects (measured by the number of employees). A statistical test has been conducted in order to check for statistical significance.

Table 1 - FDI-premium: controlling for size- and industry-effects

	"FDI-premium"		
	(1)	(2)	(3)
Value added	386% ***	288% ***	100% ***
Labor productivity Value added per employee	83% ***	68% ***	45% ***
Wages, full time equivalent	49% ***	36% ***	18% ***
Employees, full time equivalent	283% ***	225% ***	-
Share of employees with college degree [Percentage points]	9 ***	10 ***	8 ***
Share of employees with simple activities [Percentage points]	-2	-8 ***	-7 ***
Sales	384% ***	290% ***	84% ***
Sales per employee	81% ***	63% ***	32% ***
Control for additional variables	None	Industry	Industry and size

Source: Own calculations based on the IAB establishment panel

4 Micro-level Determinants of Direct Investment

Depending on the level of aggregation there are different determinants relevant for FDI. These can be divided into analyses at the macro- and the micro-level. On the macroeconomic level, based on gravity equations, it can be shown that there is more FDI between two countries the bigger the target market, the higher the per capita income and the lower the geographical and cultural distance between the two countries.

But macroeconomic analysis ignores that in the end it is the individual firm that decides whether to invest abroad or not. In order to analyse relevant micro-level determinants of FDI, a probit-model based on the waves 2004 to 2006 of the IAB establishment panel has been estimated.

The micro-level determinants can be separated into four categories. On the one hand, emphasis is placed on *productivity*, which is modelled as a central determinant by Helpman et al. (2004). On the other hand market access plays an important role. In the classical theory of multinational enterprises horizontal direct investment are made to save transport costs in order to gain better access to foreign markets. A third motive is the *cost-reducing motive*. International establishments can minimize their production costs by exploiting differences in factor costs through their choice of production locations. Sometimes it is also mentioned that firms invest abroad because of a lack of highly qualified employees (skills shortage) and a bad innovation environment at home. These motives can be summarized under the concept of *scarceness of human capital*.

Productivity is calculated as labor productivity (revenue per employee). Therefore the number of employees is converted into its full-time equivalent in order to control for different shares of part-time employees in various companies and sectors. To control for varying optimal capital intensities in different industries industry-dummies are included into the probit estimation.

The market expansion access has been operationalised by the export share of firm-level sales.

The labor-cost-motive has been operationalised by two variables. On the one hand the establishments directly indicate whether high labor costs are a problem or not. On the other hand the share of low-qualified workers in each firm is included in the model. This is based on the hypothesis that the highest saving of labor costs can be achieved by offshoring of low-skilled production stages.

The motive of FDI due to the lack of specialised staff and innovative environment are operationalised by the variables “*skill shortage*” and “*impediments to innovations*”. The first one is a dummy variable, which has the value 1 for establishments, who declared having issues with recruiting suitable high-skilled employees. The second one takes the value one for establishments, which consider the innovation environment as insufficient.

Furthermore different kinds of control-variables are incorporated in the model. Two of them are the variables “industry” and the logarithmic “number of employees” to control for the size of the establishment. It is also controlled for a *workers’ council*.

It can be shown that there is a significant positive impact of the productivity of an establishment on the probability of a FDI. This effect can be observed in all specifications of the model. The results support the modern theory of the multinational enterprise, which considers firm-level productivity as the main driver for international activity. Establishments, which are engaged in research and development, are also engaged in FDI more frequently.

Table 2 – results of the probit-Model

FDI (2004 or 2005)	marginal effect	robust z-value
log labor productivity (2003)	0.004**	[2.53]
export-share of sales (%)	0.000**	[2.10]
(export-share of sales) ²	-0.000**	[2.34]
problems with labor costs (0/1)	-0.004*	[1.94]
share of low-qualified employees	-0.003	[0.63]
Lack of specialised staff (0/1)	0.004	[1.44]
R&D in the firm (0/1)	0.013**	[2.34]
problems with innovative activities (0/1)	-0.003**	[2.06]
workers’ council exists (0/1)	0.002	[0.67]
log employees (in full-time-equivalents)	0.003***	[3.21]
sector-dummies	yes	
observations	400	
Pseudo-R2	0.5151	

* significant at 10%; ** significant at 5%; *** significant at 1%

Standard errors were estimated robustly with respect to autocorrelation and heteroscedasticity using method of Huber and White.

Source: Own calculations based on the IAB establishment panel, waves 2004 - 2006

Furthermore the export-share of the total revenue has a significant positive influence. This results reveal jointly with the firms` stated motives for investment activities that gaining access to new markets und therefore horizontal FDI play a major role.

Variables illustrating the cost-reducing motive don’t support this conclusion. The variable “problems with labor costs” is weakly significant, but does, contrary to the hypothesis, have a

negative sign. This means that firms which suffer from high labor costs, invest less frequently abroad than other firms. The share of low-skilled employees of all employees is insignificant.

The motive of FDI due to the lack of specialised staff and innovative environment cannot be confirmed either. The influence of skills shortage on direct investment is not significant. Establishments with problems in the innovation environment however are involved in FDI less frequently.

The number of employees as a control variable has a significantly positive impact on the probability to engage in FDI. The existence of a workers' council seems to be irrelevant in this context.

5 The impact of FDI on firm-level labor demand

5.1 Econometric difficulties

In the last section we showed empirically that it is primarily highly productive firms that are engaged in FDI. Their main motivation for FDI is market development. In this section we address the question what effect FDI has on the labor demand of the investing firms. As discussed in section 2.2 the direction of the effect on labor demand is unclear from an theoretical point of view. We expect positive effects on the case of horizontal FDI and negative effects in the case of vertical FDI. We will briefly discuss the methodological problems of our analysis using the *IAB establishment panel*.

There are several different methodological ways to analyze the labor market effects of FDI empirically. Besides applying matching approaches it is practical and common to estimate labor demand regressions.

The matching approach considers pairs of otherwise identical firms, one firm of each pair randomly “treated” with exposure to FDI and the other firm in the pair untreated. In this way the counterfactual condition – what would have happened, if the firm hadn't engaged in FDI – can be modelled (for an application of this technique in the case outward FDI see e.g. Becker and Muendler (2007), for the case of inward FDI see e.g. Arndt and Mattes (2008)).

In the following section we estimate labor demand regression based on a theoretical foundation. Using econometric methods we estimate the *ceteris paribus* partial effect of engagement in FDI in 2004 or 2005 on the firm-level labor demand in 2006.

5.2 Estimation strategy

Our empirical analysis is based on different previous studies. The basic idea is to transform a Cobb-Douglas production function by taking the logarithm and to obtain a solvable estimation equation (see e.g. Sarget 1978 or Breitung 1992). We follow the empiric studies on the estimation of labor demand regression on the basis of the IAB establishment panel by Kölling (1998) and Bellmann and Pahnke(2006).¹ In analogy to Bellmann und Pahnke (2006) who augment the equation of Kölling (1998) with information on wages, we add data on firm-level FDI that is taken from the wave 2006 of the IAB establishment panel to the labor demand equation.

Data on engagement in FDI is only available in the cross-section for 2006. Because of this we lose several advantages one can usually enjoy when working with the IAB establishment panel data. For example we cannot employ IV-methods for the estimation of dynamic labor demand equations. In the next section we compare our results with results obtained from GMM estimations. This enables us to evaluate the possible bias we have to accept because of our simplified estimation strategy in the cross-section.

5.3 The baseline regression equation in the cross-section

As basis for several estimation approaches in this section we use following baseline regression equation for the year $t = 2006$:

$$\log L_{it} = \alpha_1 \log L_{i,t-1} + \beta_0 + \beta_1 \log Y_{it} + \beta_2 \log w_{it} + \gamma \text{FDI}_{t-1} + \varepsilon_{it}, \text{ mit } t = 2006. \quad (1.1)$$

$\log L_{it}$ denotes the number of employees (in logs) of firm i in year t , $\log Y_{it}$ denotes the logarithmized sales volumes and $\log w_{it}$ stands for the monthly wage per capita (also in logs). FDI_{t-1} is a dummy variable indicating whether the firm was engaged in FDI in 2004 or 2005. In an alternative regression approach we use a different set of dummy variables that distinguishes between different kinds of international activity (exporting vs. FDI) and different motives for FDI. ε_{it} denotes the error term that includes the idiosyncratic error and possible errors that are due to an inaccurate approximation of the theoretical labor demand function (cp. Kölling 1998).

¹ For an overview of studies on the estimation of dynamic labor demand cp. Kölling (1998), S. 641ff.

In equation (1.1) we use the lagged FDI dummy variable from t-1 in order to avoid a problem of contemporaneous endogeneity of the FDI variable.

For reasons of comparison we estimated a labor demand equation without the FDI-variable for the period of 2003 to 2006. In this estimation with the structured error term $\varepsilon_{it} = \mu_i + \nu_{it}$ we test the significance of the individual effects μ_i and obtain a positive result.² Unfortunately we cannot control for these factors in the cross-section, so we have to accept results that are somewhat biased due to omitted variables.

Furthermore, the Hausman test statistic is significant. So we have to accept as another constraint that the fixed effects induce endogeneity in the dynamic baseline model (cp. Nickell 1986). As a consequence the coefficient $\hat{\alpha}_1$ and the coefficients of the other independent variables are biased upwards in the case of the OLS-estimation.

The comparison of the coefficients obtained from our results with different GMM panel estimations shows that our theoretical expectations are met (see table 3). The coefficients of $\log L_{i,t-1}$ and $\log w_{it}$ are - compared to Kölling (1998) and Bellmann und Pahnke (2006) – biased upwards as expected (we also showed a comparable *within*-estimation that is biased downwards, cp. Breitung 1992)

Table 3 – results of comparable regressions

coefficient (see eq. 1.1)	Kölling (1998)	Bellmann und Pahnke (2006)	Breitung (1992)	Baden- Württemberg
estimation strategy	Anderson und Hsiao (1982)	Arellano und Bond (1992)	Panel <i>within</i>	cross-section
$\hat{\alpha}_1$	0,4*** to 0,7***	ca. 0,3***	0,27***	0,9***
$\hat{\beta}_1$	0,00 to 0,04***	0,03 to 0,05*	0,21***	0,08***
$\hat{\beta}_2$	-0,06** to -0,04***	-0,5*** to -0,3	-0,59***	-0,04 to 0,05

Source: Own calculations based on the IAB establishment panel and Breitung (1992), Kölling (1998) as well as Bellmann and Pahnke (2006).

² Both, the Breusch-Pagan LM-Test in the random effects model, as well as the F-Test in the fixed effects model.

5.4 Employment effects of FDI: results

In table 4 we display the results of different labor demand regressions that build on our baseline equation (1.1).

Firstly, the coefficient $\hat{\gamma}$ of the FDI dummy variable is only significant in the baseline regression [1] and loses its significance if sector dummies [2] and other control variables [3] are added. So we fail to find a significant firm-level employment effect of FDI in general. With a high probability we can state that there is no positive effect in general.

We gain highly interesting results that go in line with our theoretical predictions from section 2 if we replace the simple FDI dummy variable by the modified set of FDI variables. The dummy variable for exporting firms takes the value 1 if the firm was an exporter in 2005 but did not engage in FDI in 2004 or 2005. The dummy variable for the motive of market access takes the value 1 if a firm that is engaged in FDI reported only market development reasons. The same applies to the (labor) cost reducing motive. Finally we created a dummy variable for firms that reported both, market access and cost reducing motives.

Columns [4] and [5] in table 4 show that the partial effect of FDI on labor demand is significantly positive in the case of market seeking FDI. This goes in line with our theoretical expectations. In the case of cost reduction motives, there is no significant effect of FDI on labor demand. So we cannot find a theoretically expected negative effect.

Table 4 – labor demand regressions with FDI (2006)

	[1]	[2]	[3]	[4]	[5]
	FDI	FDI + sector dummies	FDI expanded	motives	motives expanded
<i>main variables:</i>					
$\log L_{t-1}$	0,92*** [0,03]	0,90*** [0,03]	0,89*** [0,04]	0,90*** [0,03]	0,89*** [0,04]
$\log Y_t$	0,06** [0,02]	0,08*** [0,03]	0,08*** [0,03]	0,08*** [0,03]	0,08*** [0,03]
$\log w_t$	-0,03 [0,03]	-0,05 [0,03]	-0,04 [0,03]	-0,05 [0,03]	-0,04 [0,03]
FDI_{t-1} (dummy)	0,04* [0,02]	0,04 [0,03]	0,04 [0,03]		
<i>motives:</i>					
exporter ($t-1$)				0,01 [0,03]	0,02 [0,03]
market access($t-1$)				0,06** [0,03]	0,07** [0,03]
cost reduction ($t-1$)				0,04 [0,03]	0,06 [0,04]
market and cost red. ($t-1$)				0,04 [0,03]	0,04 [0,03]
<i>control variables:</i>					
work council (t)			0,07* [0,04]		0,07* [0,04]
share if highly qualified (t)			-0,08 [0,08]		-0,09 [0,08]
foreign ownership (t)			0,00 [0,01]		0,00 [0,01]
constant	-0,36* [0,19]	-0,57** [0,24]	-0,56** [0,24]	-0,55** [0,24]	-0,55** [0,23]
sector dummies	no	yes	yes	yes	yes
observations	777	777	777	777	777
R^2	0,98	0,98	0,98	0,98	0,98

In this table we present the results of our baseline equation (1.1) and the extensions: [1] baseline regression, [2] sector dummies added, [3], more control variables added, [4] FDI by motives, [5] extension of [4] by control variables. OLS estimation in cross-section with robust standard errors in parentheses.

Source: Own calculations on the basis of the IAB establishment panel, waves 2005 and 2006.

The cross-section regressions show that there is no effect of FDI on the firm-level demand in general. The effects of FDI on labor demand differ with the underlying motives for FDI and seem to go in line with the theoretical predictions. The results should be interpreted with caution

because there could be a bias due to the outlined methodological problems. But our result support the theoretical prediction that there are positive effects of horizontal FDI on firm-level labor demand. We cannot support the hypothesis that there are negative effects in the case of vertical FDI.

5 Conclusions

This contribution examined micro-level determinants of foreign direct investment on the basis of Baden-Württemberg micro-level panel data. Furthermore we analysed the effects of this FDI on domestic employment at the firm-level.

It turns out that only a very small share of all establishments carries out FDI. Only about 1 % of all firms declare to have invested abroad in 2004 or 2005. The investing firms differ significantly from the rest of the firms. They are larger, more innovative and most importantly more productive. The main target regions are western European countries, followed by Asia and the new EU member countries since 2004.

The econometric analysis of the micro-level determinants of FDI shows, that mainly productive and innovative firms invest abroad. Market access turns out to be the most important motive for FDI, while reducing costs and wages through foreign production facilities is only a secondary motive.

The analysis of the effects of FDI on micro-level domestic employment confirms the conjecture that market-driven FDI has a positive impact on employment. Market-seeking FDI has a significantly positive effect on domestic employment. There is no significant effect of vertical FDI on firm-level labor demand.

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