Multinationals and Structural Transformation*

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Abstract

We study the role of multinationals (MNCs) in driving structural transformation. We begin by developing a stylized two country three sector general equilibrium model with multinational production and trade. We show analytically that a decrease in FDI costs leads to an increase in the manufacturing employment share of the host country and a decrease in the source country, consistent with structural transformation. We test the model's firm-level predictions by using confidential microdata to study the response of Japanese MNC parents and affiliates to an exogenous change in China's openness to FDI. We find that Japanese MNC's China affiliates in industries where inward FDI was exogenously encouraged experienced increases in manufacturing employment. We also find that MNC parents in industries where inward FDI was encouraged experienced larger losses in home country manufacturing employment and increases in home country services and R&D employment. Finally, we expand our confidential microdata to cover several high and middle-income countries and implement an accounting decomposition separating the change in overall manufacturing employment shares into MNC and non-MNC components. We find a significant role for MNCs across all countries, suggesting the mechanism we highlight is an important driver of structural transformation.

Keywords: Multinational Firms, Structural Transformation, Manufacturing Employment

JEL Codes: F41, F44

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