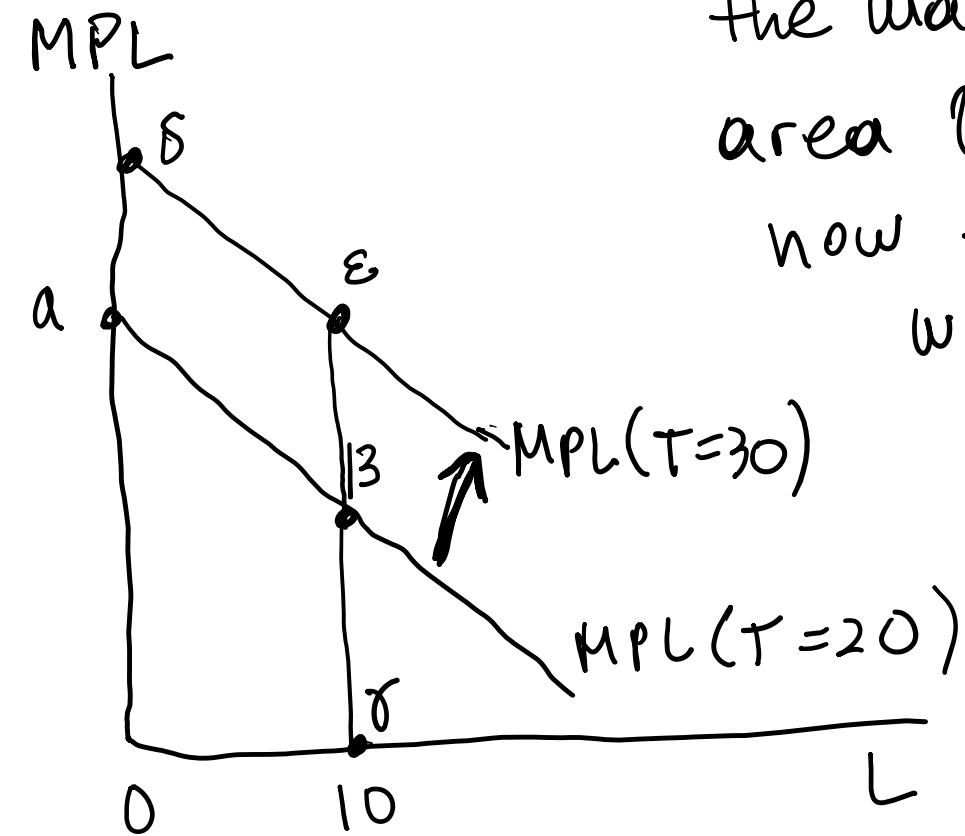


EXPLAINING FDI EFFECTS (Lecture 3, slide 33)

Assume that a good is produced with labour (L) and land (T). Initially, when $L=10$ and $T=20$, assume that 50 units of output are produced ($Q=50$). In the diagram where MPL is the marginal product of labour when $T=20$, the area $Oa\beta\gamma$ is equal to 50 units of output. Consider now that T rises and becomes $T'=30$. Wouldn't we expect that with more land at their disposal the same number of workers (10) would be able to produce more output (say 70)? This is shown in the diagram as an upward shift of the MPL curve, and total output produced now by the 10 workers is area $O\delta\epsilon\gamma = 70$ units



of output. Thus, a rise in the quantity of the factor with which labour cooperates to produce output, results in an upward shift of the marginal product of labour (MPL) curve. The same would happen if capital (K) was cooperating with labour to produce output. Again, a rise in the quantity of K would shift the MPL curve upwards. This is the reason that the LDM curve (which is the labour demand curve) shifts upwards when the capital stock increases due to the addition to the capital stock

that is caused by FDI (slide 33). Continuing with slide 33, we see that employment in the M sector increases (from $O_M E_0$ to $O_M E_1$), and it decreases in the A sector (by the same amount). Since prices do not change (by the assumption of a small country), the rise in nominal wages (from w_0 to w_1) means that real wages also rise. So in the new equilibrium the marginal product of labour will also be higher, which in turn implies that the MPK will be lower (see parantima stir 2n dialexi), and so the return

per unit of capital. Given that the amount of capital that is available to domestic capitalists is the same, the decline in their income per unit of capital will cause the total income received by domestic capitalists to decrease. Total income of (domestic) landowners will decrease as well. (for the same reasons).