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SOCIAL COMPETITION AND FIRMS' LOCATION CHOICES

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NON-TECHNICAL SUMMARY

One of the most notable changes OECD countries have experienced over the last decades is the increasing liberalization in international good markets and in the financial area. It has notably induced a globalization of firms' production process, which is now taken on a worldwide basis in a large number of sectors. In industrialized countries, recurrent debates have emerged on the "good" way to deal with the risk of unemployment, that the reorganization of firms on a worldwide basis may induce. Globalization therefore forces policy-makers to re-think the design of labor market policies. The other way round, national labor market institutions per se are likely to affect location decisions of firms across alternative countries. If so, this link has to be taken into consideration in the design of labor market policies, so as to assess all their expected effects on the national economy.

The paper takes part to the debate empirically. It focuses on the way labor market institutions (LMI hereafter) affect foreign direct investments (FDI), using a database describing French firms' investments abroad over the period 1992-2002. The estimated equation explains the probability for a French firm to invest in a given country by a set of country- and sector-specific variables. The set of potential determinants used in the regressions is explicitly derived from a model inscribed in the new economic geography literature. Furthermore, we include features borrowed from the labor market literature, so as to explicitly relate labor market institutions to location decisions.

Our results can be summarized as follows. First, the design of labor market institutions does affect the attractiveness of a country from the firm's viewpoint. Stringent employment protection laws, a generous unemployment benefits system, high labor taxes, strong minimum wage constraints, powerful trade unions and a highly-centralized wage-bargaining process significantly reduce the propensity of firms to locate in a country. Second, the estimated effects depend on the sample of countries considered as potential locations. We put into evidence an "OECD country-group" effect. French firms are found to be much more sensitive to the design of labor market institutions when only OECD countries are considered in the country choices.

This likely reflects an heterogeneity of FDI motives correlated with the spatial distribution of investments. These results deliver an interesting message with regards to the design of labor market policy. The globalization process at work over the last decades has weakened welfare-state institutions in industrialized countries. The rising competition from low-wage emerging countries strengthens the critics towards highly-regulated labor markets, in particular in European countries. Our results put this view into perspective. They suggest that making labor market reforms to engage in social competition with emerging countries would be little efficient in attracting more FDI. What matters the most to attract investors is less the labor market situation relative to that of emerging countries, than the one relative to other OECD countries: social competition could be a successful strategy in attracting foreign investors that contemplate to settle within OECD countries. As a corollary, maintaining ambitious welfare-state institutions, notably in Europe, calls for coordination between countries.

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