Labor Market Flexibility and Inward Foreign Direct Investment

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Abstract

Are inward FDI and its increase related to the labor market conditions in the host economy? This is still an open question, as the literature to date provides mixed evidence. This paper addresses this question on the debated relationship between inward FDI and the host country's domestic labor conditions empirically by testing whether the labor market flexibility—or strictness—in a host economy contributes to an increase in inward FDI, using publicly accessible macro-level data. The results of a set of estimations show that a host country with relaxed employment protection tends to attract more inward FDI, which is consistent with the findings in some recent studies. The analysis also indicates that the detected relationship between more flexible employment protection and FDI increases should chiefly be the case in "traditional" OECD members but may not apply to other countries.

Keywords: Foreign direct investment, labor market flexibility, labor conditions, employment protection

JEL classification: F16, F21, F66, J80

1. Introduction

Does foreign direct investment (FDI) interact with labor conditions? How does the promotion of inward FDI relate to the domestic labor market in the host economy? As the impact of economic globalization on labor is a matter of public debate and concern, the link between FDI and the host country's domestic labor market conditions is of growing interest to both academics and the public. The views on this issue vary. On the one hand, there are concerns about a possible "race to the bottom," where countries compete to attract inward FDI by loosening their local labor market conditions and regulations. On the other hand, foreign investors or multinational enterprises may be more attracted to host countries with sounder social institutions and a compliance system that includes stricter labor market regulations or labor standards.

Additionally, the evidence in the literature on the FDI-labor relationship is mixed. Earlier studies tend to identify no systematic relationship or find an association between FDI and higher or stricter labor conditions in the host country. For instance, Aggarwal (1995) finds no evidence of a concerning negative association between FDI and several domestic labor conditions and standards. Rodrik (1996) also examines the relationship between domestic labor standards and FDI and finds a positive relationship between stricter labor standards and FDI inflows. Kucera (2002) focuses on workers' rights, specifically freedom of association and collective bargaining (or FACB rights) and finds that FDI is likely to flow more into countries with higher FACB rights protections, whereas an extended test by Teitlebaum (2010) finds no evidence of a relationship between larger FDI inflows and stricter FACB rights in the host countries. Neumayer and de Soysa (2006) also examine the relationship but find no significant relationship between a country's FDI inflow and the strictness of FACB rights in the host country, though Mosley and Uno (2007) find a positive relationship between inward FDI and strict(er) FACB rights in developing countries.[1] However, some recent

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[1] For extended literature reviews, see Kamata (2014, 2018).

empirical studies find an opposite association or evidence of a possible race to the bottom. Olney (2013) examines the relationship between domestic labor market conditions in 26 OECD countries using the OECD's indicator of employment protection regulation and US FDI in terms of the aggregate sales of US affiliates in the host country, and find more US FDI in host countries with less strict employment protection regulations. The study also finds that the strictness of employment protection regulations in a host country is correlated with those in its neighboring countries, which the author interprets as competition (or a race) in labor conditions. Davies and Vadlamannati (2013) finds similar evidence of possible competition in labor conditions among FDI host economies in an empirical analysis using a composite labor rights index provided by Mosley and Uno (2007) for a larger variety of countries. Javorcik and Spatareanu (2005) use firm-level data on new investment among 19 European countries and labor market flexibility indices from the *Global Competitiveness Report*. The authors find higher inward FDI in host economies with more flexible labor markets than that in the investor's home country. Dewit, Görg, and Montagna (2009) obtain a similar finding from an estimation using the OECD's employment protection indicators.[2]

Thus, whether inward FDI and its increase are related to the host country's labor market conditions is an open question. This study addresses this question by empirically investigating the relationship using the OECD's indicators of employment protection legislation and other publicly accessible macro-level data provided by international institutions and academic institutes. The empirical analysis tests whether relaxing the labor market regulations in an FDI host country contributes to an increase in inward FDI to that country. The estimation results show that a host country with more flexible (or less strict) employment protection regulations tends to attract more inward FDI. The results also indicate that this relationship should chiefly be the case in the "traditional" OECD members, but may not necessarily apply to other countries.

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[2] Dewit, Görg, and Montagna (2009) also find that FDI *outflow* is smaller from a source country with *stricter* employment protection regulations.

This paper contributes to the empirical literature on FDI and domestic labor market conditions or standards by including a wider variety of countries in its sample than existing studies do, especially compared to the recent studies utilizing the same OECD employment protection data and that focus mainly on OECD countries. Although the overall result of the analysis is consistent with the findings of recent studies, the current paper also demonstrates the potential heterogeneity between developed countries (or "traditional" OECD members) and developing or emerging economies in terms of the relationship between labor regulation flexibility and inward FDI.

The rest of the paper proceeds as follows. Section 2 explains the model and empirical approach for the analysis and Section 3 describes the data and sources for the analysis. Section 4 presents the estimation results and Section 5 concludes.

2. Empirical Model

2.1. Hypothesis

For the current analysis, I build a hypothesis that a host country with more flexible labor regulations or lax labor standards attracts more inward FDI, based on the race-to-the-bottom concerns mentioned in the Introduction. Flexible labor regulations or standards will contribute to lower labor costs in the host country, and cost-conscious multinational enterprises will choose a country with lower labor costs as the destination for their FDI.[3] The race to the bottom will occur when the governments of FDI host countries follow this hypothesis and compete against each other by loosening their domestic labor regulations or standards.

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[3] The opposite could be the case if, as also mentioned in the Introduction, multinationals seek a host country with sounder social institutions. In this case, a host country with stricter labor regulations or standards will attract more inward FDI because they help create appealing, sound social institutions in the host country.

2.2. Specification

To test the hypothesis on labor market regulations and inward FDI, I employ the following specification or empirical model, based on that in Olney (2013):

$$\ln(\text{iFDI})_{c,t} = \beta_1 \ln(\text{EP})_{c,t\text{-}1} + X_{c,t\text{-}1} \beta_2 + \lambda_c + \theta_t + \varepsilon_{c,t}. \tag{1}$$

In this equation, $\text{iFDI}_{c,t}$ is the stock of inward FDI to host country c in year t. $\text{EP}_{c,t}$ on the left-hand side is a measure of the domestic labor market regulations in country c in year t, for which I employ the OECD's indicator of employment protection described in the next section. $X_{c,t}$ is the vector of other controls in natural logarithms, for country c in year t, including: real GDP, population,[4] trade costs, labor skill level, real wages, and the measures of overall political rights and civil liberty conditions.[5] Note that the EP measure and all other control variables on the right-hand side of the equation are lagged by one period to examine whether labor market regulations (and other factors) in the previous year t-1 affect inward FDI in the present year t. Equation (1) also includes the dummies for host countries λ_c that capture other time-invariant host-specific factors, year dummies θ_t that capture time-specific factors that are common across host countries, and random errors $\varepsilon_{c,t}$.

I first estimate Equation (1) using OLS regression. In addition, to address the potential endogeneity of labor market regulations, I also adopt an instrument variable approach to estimate the equation. Following Besley and Burgess (2004) and Olney (2013), I use the unionization rate or labor union density, defined as the share of union members in the total number of wage and salary earners. Governments may face

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[4] Note that including the natural logs of real GDP and population is equivalent to including the log of a host country's real income level (GDP/cap).

[5] Following Olney (2013), I also consider other specifications of Equation (1) that include a commercial tax rate and investment costs (in log) in the control variables $X_{c,t}$. However, these specifications significantly reduce the number of observations for the estimation due to limited data availability. Moreover, the results of the estimation with these alternative specifications indicate that the additional controls are not significant. Therefore, I consider only the benchmark specification with the seven control variables mentioned above so I can maintain as many observations as possible for the estimation.

demands to protect workers through regulations as the presence of labor unions declines, as Olney (2013) argues. On the other hand, unions cannot directly regulate or control the employment practices of multinational enterprises, and union density is thus not likely to impact inward FDI directly.[6] By the same token, I also use collective bargaining coverage, defined as the number of employees covered by collective agreements as the percentage of the total number of wage and salary earners, as the second instrument variable for employment protection regulations.

Furthermore, as the stock of inward FDI on the left-hand side persists over time, I also employ a dynamic panel approach in estimation. That is, following Olney (2013), I add the one-year lagged inward FDI stock on the left-hand side of Equation (1) and estimate the first-differenced equation, which is presented as Equation (2) below:

$$\Delta \ln(\text{iFDI})_{c,t} = \alpha \Delta \ln(\text{iFDI})_{c,t-1} + \beta_1 \Delta \ln(\text{EP})_{c,t-1} + \Delta X_{c,t-1} \beta_2 + \Delta \theta_t + \Delta \varepsilon_{c,t}. \quad (2)$$

Equation (2) is estimated using the Arellano-Bond generalized method of moments (GMM).

3. Data

For the empirical analysis in the current paper, I construct a dataset by collecting country- or macro-level data from public sources or databases provided by international organizations or research institutes.

The variable for labor market conditions or employment regulations is a key variable in the current study. As the measure of labor market regulations, I use an OECD indicator of employment protection. The OECD's indicators are synthetic indicators that evaluate the strictness of employment protection regulations based on multiple factors such as notice periods and compensation to dismissed employees. The indicators express the evaluation in scores ranging from 0 to 6, with 0 indicating the

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[6] Olney (2013) argues that labor unions are more common in sectors with less inward FDI typically, so union density is unlikely to affect FDI directly.

least strict (most flexible) and 6 indicating the strictest. The OECD provides indicators for 72 countries, including both OECD members and non-member countries. The indicators are available from 1985 to 2015, the most recent year with data available, though the countries vary in the number of years with data available. I employ the "EPR_V1" indicator that measures the strictness of employment protection for individual dismissals of employees on regular contracts.[7]

I source data on inward FDI mainly from the UNCTAD.[8] I use the stock of FDI rather than the flows, as FDI flows in data fluctuate considerably, sometimes taking large negative values. To compute a measure of FDI in real values, I use the shares of inward FDI stock in GDP sourced from the UNCTAD and multiply the shares by real GDP in constant 2010 US dollars, taken from the World Bank's *World Development Indicators* (WDI).[9]

The data for the other control variables in the empirical model and their sources are as follows. I source the following data from the WDI: the real GDP measured in constant 2010 US dollars; population as the total population; and trade costs measured as the inverse of "trade openness" or the ratio of total trade to GDP. I measure labor skill level with the human capital index in the Penn World Table (PWT) 9.0. I compute the measure of real wages by dividing total labor compensation, which is obtained by multiplying the share of labor compensation in GDP sourced from the PWT 9.0 to GDP in constant 2010 US dollars from the WDI, by the total economy-wide work hours obtained by multiplying the average annual hours worked by persons engaged to the number of persons engaged,[10] both sourced from the PWT 9.0. To measure overall

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[7] The ILO also provides similar data on employment protection legislation (EPLex), which covers a slightly wider variety of countries than the OECD's data. However, because the ILO's data cover only a recent and short period (2009-2013), and because the data are available only for one year for many countries, I do not use the ILO's data for the current analysis.

[8] *UNCTADSTAT*: https://unctadstat.unctad.org/EN/Index.html.

[9] WDI Database Archives: http://datatopics.worldbank.org/world-development-indicators/#archives.

[10] The PWT 9.0 records the number of persons engaged in millions, and I multiply the relevant PWT data by one million (1,000,000).

political rights and civil liberty conditions in FDI host countries, I use the indexes on Political Rights (PR) and Civil Liberties (CL) provided by the Freedom House's annual survey *Freedom in the World* (FIW). The indexes rate the degree in overall freedom by scores ranging from 1 (freest) to 7 (least free / not free).

Finally, I collect data on labor union (or trade union) density and collective bargaining coverage, which I use as instruments for employment protection regulations in the estimation, primarily from the OECD, and from the ILO for the countries and years for which the OECD data are unavailable.

The constructed dataset covers 51 host countries for 1985 to 2015. The data period is limited by the availability of the OECD's employment protection indicators (EP), and the number of countries is limited by the availability of data for some of the control variables besides EP. Additionally, the dataset is an unbalanced panel; that is, the observations are not available for all 51 countries in every year in the 31-year period. Table 1 presents the descriptive statistics of the variables contained in the dataset, and Table 2 shows the correlations between the variables.

4. Estimation Results

I estimate the empirical model specified in Equation (1) using the OLS regression (OLS-FE) and an instrument variable approach through a two-stage least square (2SLS) regression with instruments for the EP measure (IV). I also perform the GMM estimation of the dynamic panel model specified in Equation (2). From the hypothesis in Section 2.1, I expect a negative sign for the coefficient β_1 on EP.[11]

Table 3 presents the results of the estimation. The first column of the table reports the result of the OLS-FE, the second shows that of the IV, and the third shows the result of the GMM estimation (for the GMM, the variables are all in the

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[11] However, if the opposite possibility mentioned in footnote 3 applies, then the sign of the estimated β_1 should be positive.

first-differenced form). The coefficient estimate on the EP indicator is negative (-1.20) and statistically significant at the one percent level in the OLS-FE estimation result, implying that a host country with more flexible (or less strict) employment regulations is likely to attract more inward FDI in the following year, which supports the hypothesis. The estimate indicates that the average effect of a *decrease* in the host country's EP indicator by one percent will be an increase in real inward FDI stock by 1.2 percent.[12] The IV estimation to address potential endogeneity in EP gives a negative and significant estimate that indicates an even greater impact, as the second column shows. The result of the first-stage regression of the 2SLS estimation with the instruments for the EP indicator is presented in Table A1. The F-statistic exceeds 10, which indicates that the instruments should not be weak.[13] In addition, the first-stage regression gives a negative and significant estimate to the coefficients on both instruments, union density and collective bargaining coverage. This result is consistent with the expectation since, as discussed in Section 2.2, governments may react to a decrease in the unionization rate as well as the collective bargaining coverage rate by strengthening labor protection regulations.[14,15]

Finally, the result of the GMM estimation in the third column of Table 3 also indicates that the coefficient estimate on EP is negative and significant, which is consistent with the results from the other two estimation methods.

Regarding the impacts of the controls besides the EP indicator, the OLS and IV

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[12] As Table 1 reports, the mean and standard deviation of the EP index are 2.20 and 0.835, respectively. If the EP indicator value decreases by one standard deviation from its mean, which is equivalent to a decrease by $(0.835)/(2.2) \simeq 38$ percent, the stock of inward FDI will increase by 46 percent.

[13] See Staiger and Stock (1997).

[14] Olney (2013) also obtains a negative and significant coefficient estimate on union density in terms of the impact on the employment protection regulations.

[15] I also performed the 2SLS estimation using each of the two instruments separately. The results are qualitatively the same as those in Tables 3 and A1; that is, the instrument (union density or collective-bargaining coverage) has a negative and significant effect on EP in the first-stage regression, and in the second-stage regression the instrumented EP has a negative and significant impact on inward FDI. In both cases, the F-statistics of the first stage are above 10.

estimations overall agree with the positive impact of real GDP and the negative impact of population, which should imply that a host country with a higher income level is more likely to attract inward FDI. However, the positive coefficient on population in the GMM estimation does not agree with this result. In addition, the estimation results from the three methods agree that the overall freedoms regarding political rights and civil liberties in host countries contributes to an increase in inward FDI,[16] while the significance of the coefficient estimates vary across the estimation methods. For the other variables (trade costs, labor skill levels, and real wages), the estimations yield opposing signs or statistically insignificant estimates for the coefficients, and thus the contributions of these factors to inward FDI are not clear.

"Traditional" OECD Members vs. Other Countries

Is the estimated impact of employment protection regulations on inward FDI a common trend among countries, or is it different across country groups? To address this question, I divide the sample countries into two groups: "traditional" OECD members and other countries, and examine whether the impact of employment protection regulations on inward FDI can differ between the two groups. The "traditional" OECD members are those countries that joined the OECD as of 1985, which is the first year in the sample period.[17] This separation is chosen for two reasons. First, investors may have different motivations for FDI when the destination is a developed economy compared to a developing or emerging economy. Second, previous studies that use similar data on labor market regulations and obtain similar results focus primarily on OECD countries. Table 4 lists the 24 "traditional" OECD members and the other 27 countries in the current sample.

For this purpose, I extend Equation (1) by adding the interaction term between

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[16] Note that a smaller score/value means a higher degree of freedom in the PR and CL indexes.

[17] Indeed, these members joined the OECD by the early 1970s. The current OECD members that are not included in this "traditional" group are Mexico (joined in 1994) and the countries that joined after Mexico.

the EP indicator and a dummy indicating the "traditional" OECD members (OECD24), as well as the analogous interaction terms with all of the other control variables, as in the following equation:

$$\ln(\text{iFDI})_{c,t} = \beta_1 \ln(\text{EP})_{c,t-1} + \beta_{12} \{\ln(\text{EP})_{c,t-1} \times \text{OECD24}\}$$

$$+ X_{c,t-1} \beta_2 + (X_{c,t-1} \times \text{OECD24}) \beta_{22} + \lambda_c + \theta_t + \varepsilon_{c,t}. \qquad (3)$$

The coefficient estimate β_{12} on the interaction term between EP and the OECD24 dummy will capture the potential difference in the impact of employment regulations for the "traditional" OECD members compared to the other countries.

The results of the estimation of Equation (3) are reported in Table 5, where the first column shows the result of the OLS-FE estimation and the second column reports the IV (2SLS) estimation result. As indicated, both estimations provide a coefficient estimate on the interaction term between EP and the OECD24 dummy that is negative and significant economically and statistically.[18] In contrast, the coefficient estimate on the EP indicator itself is negative but insignificant. This result implies that lax employment regulations yield an increase in inward FDI for the "traditional" OECD members, whereas that effect or relationship is not clear for the other group of countries. In other words, the estimation results with the whole sample in Table 3 are primarily driven by these "traditional" OECD countries.[19,20]

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[18] The OLS-FE estimate of the coefficient on the interaction term (β_{12}) nearly reaches the 10-percent significant level. The p-value of the estimate is 0.105.

[19] I also perform a similar exercise for the group of 30 OECD countries that joined by the year 2000 and the group of other countries. The estimation result provides no evidence indicating a difference in the effect of employment regulations on inward FDI between these two groups.

[20] Regarding the control variables besides EP, the IV estimation result in Table 5 indicates that the contributions of a *lower* labor skill level and more freedom in political rights (lower value in the PR index) to an increase in inward FDI are also significant only for the traditional OECD countries but not for other countries.

5. Conclusion

Are inward FDI and its increase related to the labor market conditions in the host economy? This is still an open question, as the literature on this topic to date provides mixed evidence: some studies indicate that an increase in inward FDI is associated with looser labor market conditions or regulations in the host country, other studies find a correlation with stricter labor market conditions, and some find no systematic relationship between FDI and the host country's labor market conditions. This study, using publicly accessible macro-level data, addresses this question on the debated relationship between inward FDI and the host country's labor conditions empirically by testing whether the labor market flexibility—or strictness—in a host economy contributes to an increase in inward FDI. The results of a set of estimations show that a host country with relaxed employment protection tends to attract more inward FDI, which is consistent with the findings in some recent studies. Moreover, the extended analysis indicates that the relationship between more flexible employment protection and FDI increases should chiefly be the case in "traditional" OECD members but may not apply to other countries, which previous studies that examine the relationship between employment regulations and inward FDI do not detect.

The factor that explains the indicated difference between the traditional developed economies and developing/emerging economies in the contribution of more flexible employment regulations to an increase in inward FDI is not immediately clear. It may be that, as Davies and Vadlamannati (2013) point out, OECD countries tend to compete with each other in terms of labor rights laws, whereas non-OECD countries compete in terms of labor rights practices[21] (recall that the EP indicator in the current study captures the strictness of rules and regulations on employment protection). It may also be due to differences in investors/multinationals and their motivations for FDI

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[21] Although they do not directly test the relationship between labor conditions and FDI, Davies and Vadlamannati (2013) examine the spatial correlation of domestic labor rights conditions (mainly in terms of FACB rights) among neighboring countries.

between the groups of host economies. However, it is difficult to examine this question further in the current study, which focuses on aggregate inward FDI and host countries' labor and economic conditions. It is thus worthwhile to analyze the relationship between labor conditions and FDI in a bilateral context between the source and host economies of FDI, which is a potential extension of this study.

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Table 1. Summary Statistics of Variables

Variable	# obs.	Mean	Std. Dev.	Min	Max
EP	834	2.20	0.835	0.26	5
ln(iFDI)	834	25.4	1.38	21.38	29.17
ln(real GDP)	834	27.0	1.33	22.24	30.39
ln(population)	834	16.8	1.37	12.55	20.95
ln(trade costs)	834	0.434	0.521	-1.25	1.831
ln(skill level)	834	1.11	0.154	0.587	1.317
ln(real wages)	834	2.99	0.763	-0.4049	4.169
PR index	834	1.26	0.749	1	6
CL index	834	1.53	0.868	1	5
union density	749	0.326	0.205	0.034	0.8887
collective-bargaining coverage	777	0.579	0.306	0.014	1

Notes: The summary statistics are based on the observations included in the dataset constructed and used for the estimation. EP denotes the OECD indicator of employment protection, and iFDI denotes the stock of inward FDI, as indicated in the main text.

Table 2. Correlations between the Variables

	ln(EP)	ln(iFDI)	ln(rGDP)	ln(pop.)	ln(tr.cst.)	ln(sk.lv.)	ln(r.wg.)	ln(PR)	ln(CL)	ln(u.d.)	ln(cb.cv.)
ln(EP)	1.000										
ln(iFDI)	-0.474	1.000									
ln(real GDP)	-0.460	0.670	1.000								
ln(population)	-0.342	0.539	0.897	1.000							
ln(trade costs)	-0.385	0.094	0.667	0.685	1.000						
ln(skill level)	-0.406	0.286	0.129	-0.105	-0.139	1.000					
ln(real wages)	-0.205	0.267	0.213	-0.220	-0.039	0.410	1.000				
ln(PR index)	0.138	-0.102	0.011	0.286	0.123	-0.454	-0.618	1.000			
ln(CL index)	0.215	-0.136	0.124	0.407	0.253	-0.476	-0.605	0.721	1.000		
ln(union density)	0.136	-0.331	-0.307	-0.492	-0.133	0.089	0.441	-0.248	-0.305	1.000	
ln(collective-brg. coverage)	0.382	-0.108	-0.174	-0.396	-0.177	-0.055	0.611	-0.493	-0.398	0.583	1.000

Notes: The variable correlations are based on the observations included in the dataset constructed and used for the estimation. EP denotes the OECD indicator of employment protection, and iFDI denotes the stock of inward FDI, as indicated in the main text.

Table 3. Results of Estimation: Impact of Employment Protection on Inward FDI

Dependent variable: iFDI stock, real	(1) OLS-FE	(2) IV	(3) GMM
EP	-1.20***	-3.47***	-0.457**
	(.435)	(.574)	(.197)
Real GDP	0.433	0.439*	0.030
	(.619)	(.255)	(.216)
Population	-1.46	-1.03*	1.08**
	(.781)	(.574)	(.497)
Trade costs	-0.265	0.208	-0.085
	(.178)	(.194)	(.108)
Labor skill level	-1.04	-3.95***	0.739
	(2.08)	(.952)	(.731)
Real wages	-0.032	0.403*	0.078
	(.350)	(.232)	(.213)
PR	-0.364*	-0.158	-0.023
	(.184)	(.113)	(.064)
CL	-0.063	0.042	-0.105**
	(.124)	(.061)	(.051)
iFDI stock, lagged			0.749***
			(.046)
Country dummies	Yes	Yes	(suppressed)
Year dummies	Yes	Yes	Yes
R^2, within (overall)	.877 (.006)	.867 (.176)	
No. of observations	833	714	780

Notes: The notations of the variables and estimation methods are as explained in the main text. The standard error (the clustered for the OLS-FE estimation) is reported in parentheses below each coefficient estimate. All the explanatory variables are of that in one previous year (lagged). The variables for the GMM estimation are all first-differenced. *, **, and *** indicate the significance at the level of 10%, 5%, and 1%, respectively.

Table 4. List of Sample Countries, "Traditional" OECD Members vs. Other Countries

"Traditional" OECD Members (24 countries)	Other countries (27 countries)
Australia	Argentina
Austria	Brazil
Belgium	Barbados
Canada	Chile
Switzerland	Colombia
Germany	Costa Rica
Denmark	Czech Republic
Spain	Ecuador
Finland	Estonia
France	Hungary
United Kingdom	Indonesia
Greece	India
Ireland	Israel
Iceland	Jamaica
Italy	South Korea
Japan	Lithuania
Luxemburg	Latvia
Netherlands	Mexico
Norway	Malaysia
New Zealand	Peru
Portugal	Poland
Sweden	Russia
Turkey	Slovakia
United States	Slovenia
	Thailand
	Uruguay
	South Africa

Notes: The "traditional" OECD members are the countries that had acceded to the OECD by 1985, the first year in the current dataset.

Table 5. Results of Estimation with Interaction Terms with a Dummy for the "Traditional" OECD Members

Dependent variable: iFDI stock, real	(1) OLS-FE	(2) IV
EP	-0.290	-0.414
	(.375)	(.958)
EP * OECD24	-1.09	-4.40***
	(.658)	(.978)
Real GDP	0.585	0.256
	(.373)	(.613)
Real GDP * OECD24	-0.365	0.127
	(.749)	(.649)
Population	0.157	1.12
	(1.03)	(1.37)
Population * OECD24	-1.47	-1.65
	(1.58)	(1.50)
Trade costs	0.027	0.109
	(.225)	(.313)
Trade costs * OECD24	-0.180	0.383
	(.311)	(.317)
Labor skill level	-1.48	-0.707
	(2.56)	(1.90)
Labor skill * OECD24	-0.397	-5.06**
	(3.07)	(2.01)
Real wages	0.362	0.454
	(.339)	(.486)
Real wages * OECD24	-0.520	0.215
	(.602)	(.528)
PR	-0.245	0.183
	(.267)	(.173)
PR * OECD24	0.093	-0.520**
	(.372)	(.213)
CL	-0.137	0.026
	(.138)	(.147)
CL * OECD24	0.130	0.054
	(.190)	(.155)
Country dummies	Yes	Yes
Year dummies	Yes	Yes
R^2, within (overall)	.883 (.039)	.903 (.007)
No. of observations	833	714

Notes: OECD24 indicates the dummy indicating 24 "traditional" OECD members. The notations of other variables and estimation methods are as explained in the main text. The standard error (the clustered for the OLS-FE estimation) is reported in parentheses below each coefficient estimate. All the explanatory variables are of that in one previous year (lagged). *, **, and *** indicate the significance at the level of 10%, 5%, and 1%, respectively.

Table A1. Result of the First-stage Regression of the IV (2SLS) Estimation

Dependent variable: EP indicator	
Instrument variables:	
Union density	-0.118***
	(.023)
Collective-bargaining Coverage	-0.077***
	(.022)
Control variables:	
Real GDP	-0.182***
	(.053)
Population	0.384***
	(.114)
Trade costs	0.266***
	(.028)
Labor skill level	-1.06***
	(.142)
Real wages	0.052
	(.047)
PR	0.006
	(.024)
CL	-0.009
	(.013)
Country dummies	Yes
Year dummies	Yes
R^2, within (overall)	.399 (.036)
No. of observations	714
F-statistics	10.99

Notes: The notations of the variables are as explained in the main text. All variables are in logarithmic scale. The standard error (the clustered for the OLS-FE estimation) is reported in parentheses below each coefficient estimate. *, **, and *** indicate the significance at the level of 10%, 5%, and 1%, respectively.