

LABOR MARKET RIGIDITY AND FOREIGN DIRECT INVESTMENT: THE CASE OF EUROPE

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Abstract: This paper examines whether the impact of labor market regulation on Foreign Direct Investment is stable across time. We use firm-level data for European Multinational Enterprises investing in 41 European countries for the years 2004 – 2008. Using a conditional fixed effect logit and Tobit estimations, we are able to confirm that more flexible environments in terms of allowing firms to determine working hours and a reduction in the cost of dismissing workers has a consistent positive effect on the decision to invest in those host countries, but we also find an unstable and counterintuitive effect of the difficulty of hiring index on the decision invest in a given host country. While these results are consistent to the specification of the labor market indicators (in levels or in relative differences), we are able to find some evidence of the expected relationship between the difficulty of hiring index and FDI once we account for inherent characteristics of the host markets (like transition and EU characteristics).