
Multinational enterprises and the welfare state*

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Abstract

This paper presents an empirical analysis on the extent to which a country's welfare spending influences foreign direct investment (FDI) decisions, particularly as they relate to relocations. We argue, and subsequently empirically test, that higher welfare spending by governments attracts foreign investment. Moreover, multinational enterprises (MNEs) located in high welfare spending countries have a lower likelihood of relocating to foreign markets compared with MNEs in countries with lower levels of welfare spending. Using data for MNEs in 27 OECD countries, our results show that MNE location decisions are positively related to welfare spending. These findings appear to be more pronounced for MNEs operating in high-tech rather than in low-tech manufacturing industries. Our results suggest that high welfare spending does deter FDI in the case of host developing economies, but that these effects are small. We suggest that this is a result of firms being more hesitant to invest in developing countries where they will be expected to contribute to welfare. This suggests that a degree of trust between firms and host country governments is required on institution building and the delivery of welfare. Our results suggest that the conventional wisdom of firms avoiding or relocating away from locations due to the associated additional costs of high welfare spending is questionable, but that firms need to be confident on the efficacy of this welfare expenditure.

Keywords: globalization, institutions, multinational enterprises, relocation, welfare state

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1. Introduction

Developed countries have experienced a rapid increase in international integration, as well as growing public sectors and expanding welfare states since the end of the Second World War. However, welfare support has declined in many developed countries since the global financial crisis (GFC) of 2008 following reductions in public spending. This *austerity* has partly been justified by the argument that high welfare spending is unsustainable in the context of globalization. More specifically, according to current conventional wisdom, large-scale public provision of social insurance and progressive systems of redistributive taxation are considered to be incompatible with globalization as they reduce the international competitiveness of countries. It is further argued that generous welfare state policies, as well as the taxation necessary to finance them, reduce international competitiveness as, among others, they contribute to additional costs to firms (Alesina and Perotti, 1997). Thus, a larger welfare state with higher tax rates is seen as detrimental to international competitiveness, and particularly a country's ability to attract and retain multinational enterprises (MNEs). Moreover, the risk that an MNE could leave or relocate increasingly mobile factors of production constrains national policy autonomy by reducing a governments' control over tax revenue (OECD, 1998; Sinn, 1997). We seek to challenge this orthodoxy by exploring the relationships between the most obvious facets of globalization, FDI decisions and welfare spending.

We argue that welfare state provisions impact the likelihood of a domestic MNE's relocation activity in a manner that runs counter to conventional wisdom. Thus, we challenge the conventional view and argue that welfare states and globalization are compatible as it enables firms to perform well in a stable environment which, in turn, helps to retain existing firms and attract new ones to high welfare locations.

We seek to challenge this common narrative, and aim to inform policymakers on the relationship between welfare spending and decisions relating to firm's location. We argue that common narrative that firms seek to avoid high welfare locations is misguided, but rather that welfare spending may attract firms, particularly in industries facing global shortages of talent. We compare the effects of welfare spending in influencing relocation away from a firm's country, as well as in terms of the importance of welfare spending in attracting inward investment in potential host countries. The increasing lack of welfare support in developed countries is similar to research that links international business and institutional voids (Cuervo-Cazurra, 2006; Habib and Zurawicki, 2002; Zhao et al., 2003). This literature (e.g. Khanna and Palepu, 2010) considers the extent to which voids are an additional cost to business, or if they compound business risk. Similarly, we argue that a lack of welfare provision also adds costs to business operations.

By changing the economic environment in which governments operate and exposing all economies to new but *common* pressures, globalization is seen as leading to a downward convergence to *similar* policy outcomes, e.g. a lower provision of redistributive and welfare state programmes and lower tax rates (Mishra, 1998 and 1999).¹ At its most extreme, this argument foresees a “race-to-the-bottom”, resulting in the de-facto disappearance of nation-states as independent sovereign entities (Ohmae, 1990).

The response to such issues within the international business literature is to employ the ideas developed by Hall and Soskice (2001), and their institutional analysis of varieties of capitalism (VOC). The VOC framework classifies countries as either liberal market economies (LMEs) or coordinated market economies (CMEs) according to various economic, social and institutional dimensions. While this framework places the firm at the centre of the analysis, in terms of the strategy being shaped by its institutional environment, Hall and Soskice (2001) also argue that the welfare state is more developed in CMEs than in LMEs. Therefore, one can argue that the nature of a country’s welfare state is likely to impact a firm’s location decisions. For example, Witt and Jackson (2016) link differences in countries’ comparative advantage across various sectors to the VOC framework, arguing that more liberal economies have higher levels of more radical innovation but also possibly lower levels of welfare spending.

We seek to develop this line of argument further and argue that welfare state provisions are another unique aspect of the institutional environment of countries which, in turn, contribute to their attractiveness to foreign MNEs. We also examine how welfare spending influences the location decisions of firms, with a particular focus on relocations away from the home country.

A unique set of firm-level data is used to define relocation events and link them with welfare spending in both a firms’ home and host countries. For reasons explored in more detail below, we provide empirical results for two distinct sub-samples before the GFC of 2008 and up to the period in which social expenditure expanded dramatically before the COVID-19 pandemic. In this way, we seek to extend the

¹ These premises are embedded even in those arguments that put forward more complex accounts of the relationship between globalization and the welfare state. The two foremost examples of this are: (i) the *compensation hypothesis* (Rodrik, 1997 and 1998), which explains the continued expansion of the welfare state as a response to the rising demands for social insurance resulting from exposure to the increasing external risk and economic dislocations caused by growing international openness; and (ii) the “varieties of capitalism” argument (Esping-Andersen, 1990), which stresses that the impact of globalization on welfare states are mediated through the national institutions and structure, such as the nature of the socio-political representation system (e.g. type of electoral representation), the nature of the welfare state (e.g. its degree of universalism) and the characteristics of the labour market (e.g. the degree of wage setting centralization). All point to the possible emergence of a small number of different *regime-specific* outcomes.

work of Cuervo-Cazzura and Dau (2009) who explore the link between institutional quality and firm performance, and the importance of welfare spending and an MNE's relocation decisions. To the best of our knowledge, this is the first paper to do this.

Our results show that a larger welfare state does not push MNEs to relocate activity away from the home country, and that overall, welfare spending serves to both attract and retain international investment. This result is stronger for high-tech MNEs than for low-tech MNEs. We also suggest that high welfare spending in developing countries in recent years has acted to deter FDI, although the effect is very small. This, we believe provides several insights into the relationship between international business and many current issues. For example, the United States is in the process of scaling back the provision of publicly funded healthcare, while similar debates on health and welfare spending were at the centre of the Brexit debate in the United Kingdom and the French presidential election of 2022. The common mantra is that countries need to have low taxation to remain competitive, and that this implies lower welfare spending.

The rest of this paper is organized as follows. In the next section, we provide an overview of the relevant theoretical framework and previous literature from which we develop several testable hypotheses. The subsequent section describes the data and research design. Section four presents the results followed by a discussion. The final section concludes and provides some takeaways for policymakers.

2. Literature review and hypotheses

2.1 Importance of welfare for international business

Welfare spending is as an important indicator within the VOC literature in the post-GFC period (Hall and Soskice, 2001; Jackson and Deeg, 2008). However, while the VOC literature provides a framework for examining this issue, it is narrowly concerned with classifying or grouping economies. The work of Hall and Soskice (2001) identifies the five key areas used for distinguishing between VOCs, namely: (i) industrial relations; (ii) corporate governance; (iii) financial markets; (iv) inter-firm relations; and (v) the management of employees and their contribution to the firm. It is our assertion that the existence – or otherwise – of a suitable welfare system is a crucial element of this aspect of employee management, and that insufficient attention has been paid to this, particularly in the context of the role of the state. Thus, we aim to move beyond merely characterizing or classifying countries by their levels of welfare support, and go on to explore how these variations lead to different firm responses.

Various strands of literature examining institutional quality adopt different approaches, which range from co-evolutionary concepts (e.g. Volberda and Lewin, 2003) to the importance of institutions in supporting firm development and local innovation systems (e.g. Dosi, 1999). For example, Rodrik (1998) argues that increasing globalization gives rise to a riskier environment, which is compensated by a welfare state. Similarly, De Grauwe and Polan (2003) find that social spending increases competitiveness via the contribution made by welfare to worker mobility and productivity. In general, these findings run counter to the conventional wisdom of larger welfare states acting as a barrier to competitiveness, as espoused by Alesina and Perotti (1997).

Witt and Lewin (2007) argue that a country's ability to attract and retain internationally mobile capital is not only an important aspect of globalization, but also a good indicator of its international competitiveness. Görg et al. (2009) argue that FDI flows are relatively liquid ex-ante, and characterized by significant immobility ex-post, which favours a long-lasting ownership stake in a host country. This would suggest a positive relationship between social expenditure and inward FDI. We build on this view and suggest that welfare spending, in addition to presenting reduced risk to the firm, illustrates the development of the economy and support for its citizens, and that this stability acts to attract and retain MNEs. This framework has its roots in the analysis of transition economics and institutional development, and MNE location choices in transition economies more generally (e.g. Henisz and Zelner, 2005; Meyer and Peng, 2005; Peng and Heath, 1996). In its original setting, this framework focuses on institutional quality and the attractiveness of locations (Agarwal and Ramaswami, 1992; Brouthers, 2013).

Welfare expenditure needs to be seen in the same context as other institutions and other business support mechanisms. There will always be “winners and losers” in any competitive process. Welfare spending encourages people to take risks or to be innovative; if these incentives prove unsuccessful, individuals relying on them have a safety net (Leonard and Van Audenrode, 1996). It also ensures that the intrinsic human capital belonging to such people is not lost to society. Along with limited liability, people are supported back into employment, or self-employment, and continue to contribute to the economy (Taylor-Gooby et al., 2004). Moreover, welfare spending reduces the potential risk to existing firms from the absence of any safety nets for their workers in case of old age, sickness or parenthood, which may increase social cohesion, worker productivity and contentment (Andreotti et al., 2012).

In addition, one could argue that welfare spending reduces the risks to a firm's investment. If workers are better supported when they fall ill or lose their jobs, their spending power is only likely to fall by a lesser extent. Equally, key workers are less likely to go on extended periods of absence, either through illness or because they

need to look after family members. Apart from reducing the risk associated with the absence of social safety nets, welfare spending also underpins labour market efficiency. Javorcik and Spatareanu (2005) show that location choice and the volume of FDI are positively related to labour market flexibility in the host country. Such labour market flexibility attracts firms, not with the prospect of lower wages, but with lower unit labour costs through higher productivity and a better allocation of resources.

An analysis of the Danish labour market (Bredgaard et al., 2005) is also instructive here. This analysis attributes the success of the Danish labour market in generating employment protection and flexibility as resulting from occupational mobility and long-standing policies designed to assist the unemployed to re-enter the labour market. This strategy of “flexicurity” in the labour market benefits firms, particularly MNEs wishing to benefit from the greater flexibility it affords and from the international division of labour; however, welfare spending is needed for it to function properly. In their search for locations MNEs will implicitly link welfare spending to the reduction of risk in securing flexible working patterns within their own business, and elsewhere in the supply chain. Also, welfare spending helps to cope with agency problems that apply to firms’ responses to changing environments before as well as after the investment.

Of course, high tax rates are needed to sustain welfare spending. This then implies that firms prefer locations with low levels of welfare spending and low tax rates (Görg et al., 2009). However, we argue that this is a partial view, and that a distinction needs to be made between tax and welfare.² It is important to see welfare as an important host country *institution*, as well as one that can determine a country’s ability to attract and retain foreign investors.

From an MNEs’ perspective, such interventions to promote institutional quality and reduced transactions costs can have an impact on firm performance. Indeed, international business literature shows a clear link between institutional characteristics and firm performance. An early contribution to this relationship was developed by Wan and Hoskisson (2003) who show how macro-environments at the country level can influence the performance outcomes of the diversification strategies of MNEs. Since then, more detailed and disaggregated firm-level data also shows how improved institutional quality (e.g. lower levels of corruption, lower risks of expropriation, and easier access to improved capital markets) reduces

² The relationship between tax rates and firm location is not addressed, although much of the recent evidence suggests that there is only, at most, a weak relationship between overall corporate tax rates and firm location. What is more important to the firm is the treatment of allowances for licensing and other deductions, which are agreed with tax authorities on a case-by-case basis (de Mooij and Ederveen, 2003; Devereux and Griffith, 1998; Gordon and Hines, 2002; OECD, 2008).

uncertainty and transactions costs. This improves firm-level investment decision-making through market efficiency which, in turn, affects a subsidiary's performance (Cuervo-Cazurra and Dau, 2009; Dau and Cuervo-Cazurra, 2014; Driffield et al., 2013, 2014 and 2016; Gaur, et al. 2007). As welfare spending is, in our view, yet another aspect of institutional quality, we expect a similar link between the welfare state and firm performance.

An expansive body of literature on welfare spending and social cohesion builds on the work undertaken by Hicks and Swank (1992), as well as the more recent work by Andreotti et al. (2012) on Europe, and Kaufman and Segura-Ubierno (2001) on Latin America. This literature, which has its roots in both sociology and political science, argues that welfare spending is required to maintain the rule of law and limit corruption. The argument is essentially that, in contexts where a safety net exists, crime is less likely to occur, corruption levels are likely lower, and bureaucratic quality has improved. Such safety nets not only improve the business environment, but also increase the likelihood of firms locating or retaining activities within a given country. This is a common finding in work that explores the link between FDI and corruption (e.g. Cuervo-Cazurra, 2006). As alluded to above, the importance of welfare in supporting business was highlighted in a survey of MNEs where a "stable social and political environment" was found to be an important factor in determining the attractiveness of an investment location. Hence, welfare spending plays an important role in signalling a government's commitment to social stability. This leads us to the following hypotheses:

Hypotheses 1: Higher welfare spending by a country is negatively related to the likelihood of relocation away from a country.

Hypothesis 2: Higher welfare spending by a country is positively associated with its ability to attract relocating firms.

Our final hypothesis concerns the type of activity in which firms are engaged in and the location of core technology. The two forces at play here suggest that welfare spending will impact the location decisions of high-tech and low-tech firms differently. Firms are increasingly engaged in a global war for talent (Beechler and Woodward, 2009). The extent to which leading firms experience significant skill shortages, particularly in senior scientific, technical and managerial positions, has been known for about 20 years, following the famous McKinsey report (Chambers et al., 1998). Many locations are looking to build on existing clusters and chasing the same high-tech industries, which they perceive as engines of growth and new technology. There is a well-developed literature in economic geography, dating back to Porter (1990), which links the siting of high-tech activity to that location's economic performance. We argue, therefore, that if welfare spending improves the performance of firms, it will disproportionately attract or retain high-tech firms.

We nuance the above argument by considering the respective attitudes of the two types of firms to risk. Viewing welfare as an important institution, we borrow from the analysis of Driffield et al. (2014) who highlight the risk aversion that firms attach to the location of their core technology and strategic assets, both in terms of capital and labour. Higher welfare spending reduces the risk of social unrest or instability, and is therefore positively associated with high-tech activity. As such, a country's high welfare spending reduces the risk associated with a location, as it signals a government commitment to social contentment and stability (Görg et al., 2009). As high-tech firms use state-of-the-art technology, which may require a workforce with a particular skill set, it may be costly for them to lose employees and to have to search again for similarly skilled individuals who may be difficult to find. Hence, firms become less likely to locate high-tech activity away from high-quality welfare support protecting workers.

The second aspect of this argument is based on the literature on institutional voids, and the extent to which firms find themselves taking on roles to fill certain voids. For example, high-value employees, typically expatriate workers, are provided with private healthcare, private education and private security, as part of what the human resources and practitioner-based location marketing literature refer to as the "war for talent" (Beechler and Woodward, 2009). This typically only occurs where firms perceive the need to protect strategic assets, and does not extend to more basic activities.

In contrast, low-tech firms are potentially less concerned about the protection offered to individual employees. They likewise are less to use sophisticated production techniques requiring special skill sets. They do not offer private welfare support to their employees and tend to locate in places where such labour is abundant. Hence, if workers were to leave the firm, they could easily rehire similarly skilled individuals. This leads to our third hypothesis:

Hypothesis 3: Welfare spending is more important in the location decisions of high-tech firms than low-tech firms.

3. Data and empirical model

The dataset is collected from ORBIS,³ which is a comprehensive and rich firm-level dataset provided by Bureau van Dijk.⁴ The latter collects financial, economic and other firm-level information from various sources, including official bodies, such as Companies House in the United Kingdom and similar commercial and official registries in other countries. We use financial data for every MNE included in the database. An MNE is defined as having an ownership of greater than 10 per cent in a foreign affiliate. The ORBIS database provides information on a MNE's characteristics, e.g. location, output, employment, labour intensity, productivity, and industry classification on an annual basis. This provides crucial information on whether they have reduced their operations at home, and concurrently set up new affiliates in host countries.

Data is considered for two distinct periods: the first of these is from 1997 to 2007 and ends at the onset of the GFC of 2008 as the data is somewhat volatile towards the latter end of the period. The second period is from 2013 to 2019 and covers the period between the recovery from the GFC and the onset of the dramatic expansion of welfare expenditure during the COVID-19 pandemic. All monetary values are deflated using GDP deflators to take account of inflation. The countries covered in the data are shown in table 1. As pointed out above, the conventional wisdom generally holds that economic globalization invariably leads to retrenchments of welfare state provision. Data providing a measure of total public social expenditure by country and as a percentage of GDP for the period 1997–2019 (Görg et al., 2009) is used to investigate the development of welfare state provision. These data from the OECD's Social Expenditure Database provides internationally comparable statistics on public and (mandatory and voluntary) private social expenditure. The social policy areas covered in the data relate to expenditure on: (i) old age; (ii) incapacity-related benefits; (iii) health; (iv) family; (v) unemployment; (vi) active labour market programmes; (vii) housing; and (viii) other social policy.⁵ As no data on social expenditure to GDP are available for developing host countries, we therefore use a very similar OECD measure, namely total government expenditure as a percentage to GDP. Table 2 contains the correlation matrix for the sample of manufacturing MNEs. Definitions of the variables used in the analysis are provided in the following sub-sections.

³ ORBIS reports firm accounts in either consolidated or unconsolidated form. We only include unconsolidated accounts as they represent the domestic activities of firms and exclude any information from affiliates at home or abroad. In contrast, consolidated accounts aggregate the activities of all firms belonging to a group worldwide, regardless of location and industrial affiliation.

⁴ For further details, including access issues, see www.bvdinfo.com.

⁵ Further information is available at www.oecd.org/social/expenditure.htm.

Table 1 shows the development of welfare state provision for the OECD countries in our sample. We show the level of expenditure in 1997 and compare it with the level in 2007, 2013 and 2019. In general, we find a wide variety of welfare expenditure. As one may expect, Scandinavian countries, e.g. Denmark Finland and Sweden, top the welfare expenditure list across our observation period, while Mexico, the Republic of Korea and developed countries, such as the United States, have the lowest levels between 1997 and 2007. It is also worth noting that Belgium, France and Italy reach similar levels as the Scandinavian countries during the second period. A mixed picture emerges in the change of expenditure over time. Sweden shows some evidence of reductions in total expenditures in the latter period, whereas Hungary and Ireland experience falls in 2019, compared to 2013 values. Nevertheless, a majority of countries on the list report increases, including Belgium, Italy, Norway and Spain which enjoyed the strongest growth. Hence, there is no strong evidence in these data to support suggestions that a “race-to-the-bottom” is occurring.

The remaining columns in the table show the distribution of MNEs in each country that have decided to either relocate or not over the two periods. In our sample, 13.1 per cent of all MNEs decided to relocate between 1997 and 2007, and the share is 9.1 per cent for the latter period but these mask significant heterogeneity across the various countries.

3.1 Dependent variable

A “relocation” in our empirical analysis is defined as a firm reducing their operations at home by more than 10 per cent of their size, as measured in the number of employees, while concurrently opening up a new foreign affiliate or acquiring an existing firm abroad. This definition is similar to Pennings and Sleuwaegen (2000). The establishment of a foreign affiliate is based on its date of incorporation. A firm owns a foreign affiliate if it holds at least 10 percent of voting shares. Our dependent variable is captured as a dummy variable equalling 1 if a firm reduces its operations at home by more than 10 per cent of their size (as measured in number of employees), and at the same time opens up a new foreign affiliate or acquires an existing firm abroad.⁶

⁶ Note that a firm may have more than one foreign affiliate and may therefore potentially engage in multiple relocations in different countries. Our definition implies that the relocation dummy will be 1 for the home country under these conditions, irrespective of how many new investments there are abroad. It does not matter whether the reduction in operations at home is accompanied by one or many new investments abroad.

Table 1. Distribution of MNEs and welfare expenditure, by OECD country, 1997–2007 and 2013–2019

	1997–2007				2013–2019 ^a			
	Welfare state expenditure as % of GDP in 1997	Welfare state expenditure as % of GDP in 2007	Number of firms relocating	Percentage of firms that relocate (%)	Welfare state expenditure as % of GDP in 2013	Welfare state expenditure as % of GDP in 2019	Number of firms relocating	Percentage of firms that relocate (%)
Austria	26.2	25.9	528	11.7	28.3	26.9	60	11.7
Australia	15.9	16.3	40	2.5	21.3	21.8 ^d	22	31.8
Belgium	25.2	25.4	801	16.2	29.2	28.9	147	10.9
Canada	17.0	16.2	477	2.3	17.0	18.0 ^c	..	..
Czechia	17.5	17.9	242	20.2	21.1	19.2	42	7.1
Denmark	26.9	26.0	321	10.3	32.6	28.3	20	5.0
Estonia	15.2	12.7	44	27.3	15.6	17.7	..	..
Finland	27.5	23.7	316	25.9	29.5	29.1	99	19.2
France	29.3	28.8	1 494	11.0	31.7	31.0	207	9.7
Germany	26.1	24.8	1 959	7.7	27.2	25.9	346	9.8
Greece	18.0	21.5	28	3.6	25.9	24.0	..	..
Hungary	21.2	22.9	31	3.2	22.2	18.1	7	14.3
Ireland	15.8	16.6	53	5.7	21.5	13.4	6	33.3
Italy	22.9	24.8	2 644	19.9	29.1	28.2	506	7.9
Japan	14.5	18.6	422	14.7	22.7	22.7 ^d	545	5.7
Korea, Republic of	3.6	7.6	54	18.5	9.5	12.3	..	..
Mexico	4.0	6.7	47	10.6	7.6	7.5	..	..
Netherlands ^b	21.8	21.1	–	–	24.1	16.1	7	28.6
Norway	21.6	20.0	220	16.4	23.2	25.3	44	18.2
Poland	21.8	19.4	72	5.6	20.5	21.3	11	18.2
Portugal	16.6	22.4	161	7.5	25.8	22.6	24	4.2
Slovenia	22.6	20.0	95	22.1	23.8	21.1	..	..
Slovakia	18.0	15.6	113	17.7	17.7	17.7	..	..
Spain	20.6	21.3	1 454	12.2	25.7	24.7	211	6.2
Sweden	30.2	27.0	744	20.4	27.4	25.5	47	10.6
Switzerland	18.0	17.7	1 017	10.7	26.1	27.4 ^c	..	..
United States	14.4	15.8	1 006	1.9	18.8	18.7	..	..
United Kingdom	18.3	20.1	523	18.0	23.3	20.6	125	11.2
Total	-	-	14 906	13.1	-	-	2 476	9.1

Source: Authors' compilation based on data from OECD social expenditure database (for welfare state expenditures); ORBIS and the Orbis crossborder investment database (for firms that are relocating).

Note: The sample from 2013 to 2019 may not contain the same companies covered in 1997–2007 given that the latter sample is generated using Orbis cross-border investment database. However, we do not believe that this can be a problem because results for the latter period remain largely the same and they present a robustness test for the earlier period.

– Nil.

- Not applicable.

.. Not available.

^a For welfare state expenditure, countries are included for a restricted period due to information availability. For the number of firms and percentage of relocation, several countries did not enter the regression sample because there is no complete data coverage for each year in the 2013–2017 period.

^b For the period 1997–2007, we did not observe any firms relocating from the Netherlands, which means that this country did not enter the regression sample for this period.

^c Latest available information in 2018.

^d Latest available information in 2017.

3.2 Independent variables

We include several independent variables in our empirical estimation model. One of the main variables of interest is “home welfare spending”, which is defined as the total public social expenditure by country as a percentage of GDP for every home country in our sample. Firm size is measured via the natural logarithm of a firm’s total turnover. Labour intensity is included as the ratio of the number of employees to turnover. We also include a measure of productivity, namely unit labour costs which is the ratio of a firm’s average wage over turnover level. Host welfare spending is included as the total public social expenditure by country, and as a percentage of GDP for every host country in our sample. Industry differences are captured by including NACE two-digit sector dummies. Eurostat classifies high-tech industries in accordance with the following 2-digit NACE industry codes: 24, 29, 30, 31, 32, 33, 34 and 35; and low-tech industries are classified by the following 2-digit NACE

Table 2a. Descriptive statistics for key variables, 1997–2007

Variable	All manufacturing industries				
	Mean	Standard deviation	Minimum	Maximum	Number of observations
Home welfare spending	24.691	3.986	5.140	30.400	47 945
Firm size	5.426	1.785	0.693	12.141	47 945
Labour intensity	0.004	0.006	0.000	0.130	47 945
Unit labour costs	0.043	0.046	0.000	0.638	47 945
Host welfare spending	21.393	5.491	3.707	30.400	47 945

Source: Authors' calculations.

Note: The detailed variable definitions are provided in section 3.2.

Table 2b. Descriptive statistics for key variables, 2013–2019

Variable	All manufacturing industries				
	Mean	Standard deviation	Minimum	Maximum	Number of observations
Home welfare spending	26.354	3.286	13.590	32.570	169 799
Firm size	12.369	1.815	2.794	15.197	169 799
Labour intensity	0.003	0.003	0.000	0.130	169 799
Unit labour costs	0.003	0.024	0.000	0.601	169 799
Host welfare spending	21.121	6.089	7.237	32.901	169 799

Source: Authors' calculations.

Note: The detailed variable definitions are provided in section 3.2.

industry codes: 15, 16, 17, 18, 19, 20, 21, 22, 23, 25, 26, 27, 28, 36 and 37. Descriptive statistics are provided for our main variables in tables 2a and 2b.

3.3 Empirical model

We estimate the propensity to relocate for firm i , $Pr(D)_{it}$, is conditional on the levels of social expenditure in the home and the host country, as well as other control variables:

$$Pr(D)_{it} = \beta_1 Welfare_{st} + \beta_2 Welfare_{ht} + \beta_3 X_{it} + \varepsilon_{it} \quad (1)$$

where $Welfare_{st}$ is the share of social expenditure in GDP in firm i 's home country s at time t and $Welfare_{ht}$ is the equivalent in the host country. X_{it} is a vector of explanatory variables at the firm level, as explained above. The model also includes full sets of industry, year and country dummies.⁷

We estimate equation (1) using marginal effects Probit models for the manufacturing sector, as well as high-tech and low-tech manufacturing industries, separately. We begin by estimating the relocation activity to all destinations and distinguish between activities in developed and developing countries. All independent variables are lagged over one period to reduce simultaneity problems. Tables 3a and 3b provide correlation matrices. The individual correlations between the explanatory variables are low and after conducting variance inflation factor (VIF) measurements, they seem not to suggest any multicollinearity problems.

Table 3a. Correlation matrix for key variables, 1997–2007

Variable	All manufacturing industries				
	Home welfare spending	Firm size	Labour intensity	Unit labour costs	Host welfare spending
Home welfare spending	1	-	-	-	-
Firm size	0.0848	1	-	-	-
Labour intensity	0.0008	-0.0006	1	-	-
Unit labour costs	0.0249	-0.0951	0.0003	1	-
Host welfare spending	0.0259	0.0107	0.0026	-0.0025	1

Source: Authors' calculations.

Note: The detailed variable definitions are provided in section 3.2.

⁷ One may argue that our model should include more country-level controls (e.g. taxation or labour market regulations) to improve the accuracy of the estimation. Our assumption here is that such effects would be at least partially captured by a country's fixed effects.

Table 3b. Correlation matrix for key variables, 2013–2019

Variable	All manufacturing industries				
	Home welfare spending	Firm size	Labour intensity	Unit labour costs	Host welfare spending
Home welfare spending	1	-	-	-	-
Firm size	-0.2748	1	-	-	-
Labour intensity	0.0131	-0.2174	1	-	-
Unit labour costs	0.0316	-0.3287	0.3305	1	-
Host welfare spending	-0.0023	0.0045	-0.0001	-0.0014	1

Source: Authors' calculations.

4. Results

The relationship between welfare spending and location is presented in table 4. The table presents the regression results for the whole manufacturing sector during the periods of 1997–2007 and 2013–2019. The negative coefficient on *home welfare spending* indicates that MNEs are less likely to relocate when the home country's welfare state is well developed. While the coefficient is only statistically significant for the 1997–2007 period, it is also negative – although less precisely estimated – over this period. Overall, this result does not support the conventional wisdom that welfare state expenditure pushes MNEs to invest more abroad at the detriment of expanding at home. At the same time, the coefficient on *host welfare spending* is positive (and statistically significant in both cases), indicating that MNEs are more likely to relocate to host countries with generous welfare state provisions.

Taking these results together, we can confirm our first and second hypothesis, namely that welfare spending tends to support MNEs and that firms are both attracted and retained by welfare spending. This suggests that while one can interpret welfare spending as an institution, one could also extend it to the importance of welfare spending to labour markets voids which would otherwise deter FDI.

The subsequent estimates, reported in table 5, distinguish between technology levels and offer a test of hypothesis 3, which states that welfare spending may be more important for relocation decisions in high-tech industries. The results for the two periods are in line with this hypothesis when considering *home welfare spending*. While home welfare spending matters for relocations in both high- and low-tech manufacturing industries in the 1997–2007 period, the estimated coefficient size for the high-tech industries is almost twice that of the low-tech industries. In the 2013–2019 period, we find that home welfare spending only returns the expected negative coefficient for the high-tech industries.

Table 4. Relocation and social expenditure, baseline results

	All manufacturing industries	
	1997–2007	2013–2019
	Relocate	Relocate
Home welfare spending_{t-1}	-0.0179*** (0.0036)	-0.0001 (0.0001)
Firm size_{t-1}	-0.0133*** (0.0050)	0.0000 (0.0001)
Labour intensity_{t-1}	0.0001 (0.0003)	0.0089*** (0.0027)
Unit labour costs_{t-1}	-0.0116** (0.0053)	-0.0009 (0.0042)
Host welfare spending_{t-1}	0.0003** (0.0001)	0.0001*** (0.0000)
Home country	Yes	Yes
Industry (NACE Rev. 2 digit)	Yes	Yes
Year	Yes	Yes
Predicted probability	0.0315	0.0014
Pseudo R-squared	0.046	0.052
Log pseudolikelihood	-71 838.449	-1 738.325
Observations	47 945	169 799

Source: Authors' calculations.

Note: Average marginal effects from Probit Model estimation of equation (1) are reported. Explanatory variables are lagged one year. All specifications include a full set of country, industry and year dummies. Standard errors (clustered at the country level) in parentheses, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

In these high-tech manufacturing industries, the focus on the “war for talent” is particularly fierce (Beechler and Woodward, 2009). In such contexts, labour market voids created through the absence of welfare support deter high-tech firms and encourage their relocation. While the issue of skill shortages among high-tech firms has been known for some time, no one appears to have considered it in the context of welfare spending and FDI. The results further suggest that welfare expenditure reduces the likelihood of relocation away from a country. Hence, it seems that firms attach value to a home country’s welfare state.⁸

⁸ One may argue that, if the main point of hypothesis 3 is about the “war for talent”, then the main variable of interest should be public expenditures in education and R&D. While this appears reasonable, we should stress that the “war for talent” is only one aspect of hypothesis 3, the other important point being the avoidance of labour market risks for high-tech firms (see section 2.1).

Table 5. High-tech versus low-tech manufacturing

	High-tech manufacturing	Low-tech manufacturing	High-tech manufacturing	Low-tech manufacturing
	1997–2007	1997–2007	2013–2019	2013–2019
	Relocate	Relocate	Relocate	Relocate
Home welfare spending_{t-1}	-0.0214*** (0.0051)	-0.0128*** (0.0049)	-0.0004** (0.0002)	0.0003 (0.0003)
Firm size_{t-1}	-0.0126*** (0.0046)	-0.0127* (0.0075)	0.0000 (0.0001)	0.0000 (0.0001)
Labour intensity_{t-1}	-0.0004 (0.0007)	0.0002 (0.0002)	0.0071 (0.0060)	0.0093** (0.0039)
Unit labour costs_{t-1}	-0.0129*** (0.0050)	-0.0087 (0.0080)	0.0001 (0.0058)	0.0040 (0.0058)
Host welfare spending_{t-1}	0.0002 (0.0002)	0.0005** (0.0002)	0.0001** (0.0000)	0.0001*** (0.0000)
Home country	Yes	Yes	Yes	Yes
Industry (NACE Rev. 2 digit)	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes
Predicted probability	0.0294	0.0324	0.0013	0.0016
Pseudo R-squared	0.0641	0.0398	0.064	0.053
Log pseudolikelihood	-34 045.174	-37 364.158	-848.755	-875.217
Observations	23 265	24 638	89 615	78 580

Source: Authors' calculations.

Note: Average marginal effects from Probit Model estimation of equation (1) are reported. Explanatory variables are lagged one year. All specifications include a full set of country, industry and year dummies. Standard errors (clustered at the country level) in parentheses, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

The weaker results for the low-tech industries may be because production in these industries is generally quite labour intensive. Hence, labour costs may matter more in location and relocation decisions than a social and economic environment that may be characterized by welfare expenditure. Importantly, however, results for the low-tech industries also do not support the conventional wisdom that would postulate a statistically positive relationship between a home country's welfare expenditure and inward FDI.

Our results are less clear cut when considering *host welfare spending*. Here we find that in the early period, home welfare spending has the expected positive effect on attracting relocating MNEs in both the high-tech and low-tech industries, though the effect is stronger (and statistically significant) in the low-tech industries. In the latter period, there is no discernible difference in the size of the effect across the two manufacturing industries.

Investing firms are all from the 27 OECD countries and relocate to both developed OECD and non-OECD countries. In an extension to the analysis, in table 6 we distinguish these relocations to developed and developing economies. These two groups of countries may be considered different in terms of their level of development and institutional quality.

Our empirical results concerning the role of *home welfare spending* do not show any strong differences across country groups. However, this is different for *host welfare spending*. In low-tech sectors we find that the positive effect of host welfare spending on attracting MNEs only holds for relocations to developed countries and not to developing markets for both periods. This is somewhat similar for the high-tech industries, where a statistically significant and positive effect for relocations to developed economies was only found for the 2013–2019 period. Interestingly, however, we also find that relocations to developing countries are negatively affected by higher host welfare spending for this period. Taken together, these results may suggest that a certain level of institutional quality, i.e. of a type available in developed countries, is needed for firms to be attracted by high welfare spending. In the absence of such a level of institutional quality, higher welfare spending may be ineffective and potentially deter new firm locations, as suggested by our results for 2013–2019.

Table 6. Developed versus developing countries

	High-tech manufacturing		Low-tech manufacturing		High-tech manufacturing		Low-tech manufacturing	
	1997–2007	1997–2007	1997–2007	1997–2007	2013–2019	2013–2019	2013–2019	2013–2019
Home welfare spending _{<i>t-1</i>}	Relocate to developed countries -0.0227*** (0.0059)	Relocate to developed countries -0.0165*** (0.0046)	Relocate to developed countries -0.0120** (0.0052)	Relocate to developed countries -0.0183** (0.0078)	Relocate to developed countries -0.0004** (0.0002)	Relocate to developed countries -0.0034* (0.0019)	Relocate to developed countries 0.0003 (0.0003)	Relocate to developed countries 0.0018 (0.0023)
Firm size _{<i>t-1</i>}	-0.0137** (0.0058)	-0.0084* (0.0044)	-0.0089 (0.0077)	-0.0319*** (0.0059)	0.0000 (0.0001)	0.0005*** (0.0001)	0.0000 (0.0001)	0.0006** (0.0003)
Labour intensity _{<i>t-1</i>}	-0.0004 (0.0008)	0.0005 (0.0009)	0.0002 (0.0002)	-0.0003 (0.0015)	0.0075 (0.0070)	-0.1949 (0.4980)	0.0109** (0.0046)	0.0055 (0.0041)
Unit labour costs _{<i>t-1</i>}	-0.0144** (0.0062)	-0.0089* (0.0048)	-0.0048 (0.0081)	-0.0307*** (0.0066)	0.0003 (0.0067)	-0.1408 (0.1441)	0.0047 (0.0067)	-0.0328 (0.0920)
Host welfare spending _{<i>t-1</i>}	0.0001 (0.0002)	-0.0001 (0.0002)	0.0004* (0.0003)	0.0002 (0.0002)	0.0001** (0.0000)	-0.0010*** (0.0001)	0.0001** (0.0001)	0.0001 (0.0004)
Home country	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry (NACE Rev. 2 digit)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Predicted probability	0.0339	0.0147	0.0343	0.0230	0.0015	0.0028	0.0017	0.0026
Pseudo R-squared	0.0636	0.1082	0.0361	0.1052	0.0630	0.2340	0.0540	0.0470
Log pseudo likelihood	-27 701.061	-58 017.816	-30 203.199	-66 573.851	-778.992	-42.16	-779.05	-79.724
Observations	17 205	5 885	19 164	5 161	73 097	2 863	64 102	4 718

Source: Authors' calculations.

Note: Average marginal effects from Probit Model estimation of equation (1) are reported. Explanatory variables are lagged one year. All specifications include a full set of country, industry and year dummies. Standard errors (clustered at the country level) in parentheses; ***, $p < 0.01$, **, $p < 0.05$, *, $p < 0.10$.

5. Conclusion and policy considerations

The majority of contributions to the debate on the effects of economic globalization do not question the fundamental premises of the conventional wisdom that economic integration has contributed to the retrenchment of public sectors. However, and for the first time, this paper challenges this view and offers evidence that does not support the conventional wisdom that the welfare state hinders firm competitiveness, or that social expenditure (financed through corporate taxation) deters inward FDI. Instead, we find that welfare expenditure may be attractive to inward investors and may also act to keep MNEs in the home country.

Taken together our findings offer several contributions to the dominant international business paradigms. Firstly, we contribute to the literature on the importance of institutions in international business, both in terms of explaining firm- and national-level competitiveness and show that welfare is an important institutional context. Secondly, this extends the literature on varieties of capitalism, offering a more detailed understanding of the standard distinctions applied by those seeking to operationalize Hall and Soskice (2001).

More generally, however, we believe our findings to be part of the wider debates which the international business community must engage in. Ghemawat (2016) sets out clearly how international business scholars need to address bigger questions within the various debates on globalization. For example, Europe and the United States have seen various populist and anti-globalization movements culminating in, for example, the recent Brexit vote in the United Kingdom. While many of the arguments are offered as negative consequences of globalization, they are in essence responses to perceived falling living standards among the middle classes in developed countries, and the lack of a perceived safety net. Similarly, other countries, such as Switzerland, have engaged in discussions on whether to set a basic income level guaranteed by the state. Our work highlights the role that international business research can play in contributing to these debates. It also helps policymakers understand how, with capital mobility threatening the incomes of relatively immobile labour, the state can underpin productivity, and both retain and attract internationally mobile capital.

Finally, we offer some interpretations for policymakers. The first fundamental finding is that welfare spending works to retain investments that a country has already won, and is not in any sense associated with relocation away from a “high-tax, high-spend” country. We argue that this is due to the importance of welfare spending encouraging labour mobility in industries where labour markets are tight, and where there are skill shortages.

We argue that welfare state provisions impact the likelihood of domestic MNE relocation activity in a way that runs counter to conventional wisdom. Thus, we

challenge the conventional view, and argue that welfare states and globalization are compatible as it enables firms to perform well in a stable environment, which in turn retains existing firms and attracts new ones to high welfare locations.

Further, we argue that welfare spending is an important indicator of how a state supports its workers when they are ill. While countries, such as the United States, continue to attract investment, firms recognize that the additional cost of employing people in countries with low public welfare, i.e. in contexts where people need health and dental insurance, not just for themselves but also their families. This has to be set against the higher taxes sometimes associated with high welfare locations, e.g. in places where taxes can be significant, especially in sectors with high proportions of skilled, internationally mobile workers. At the lower end of the income distribution scale, welfare spending may encourage labour mobility, with workers less concerned about “last-in first-out” re-deployment decisions if a welfare net exists.

Finally, our results suggest that the significance of unit labour costs in explaining relocation has declined over time, suggesting that add-on labour costs, such as national insurance or health provision, do not influence relocation decisions. However, we do have some tentative evidence that for the later period at least, relocations by firms in high-tech industries to developing economies may be deterred by welfare spending in host countries. While the estimated effect is small, it nevertheless suggests that host-country governments may need to persuade firms of the value of this spending, showing that it is associated with, among others, health care or better functioning labour markets, rather than merely reflecting a bloated government sector.

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