



N° 2010 – 03

March

WAGE BARGAINING AND THE BOUNDARIES OF THE MULTINATIONAL FIRM

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NON-TECHNICAL SUMMARY

In this paper, we ask how the cross-border organization of firms is affected by bargaining in the labor market. In particular we analyze the case of a multinational firm importing intermediate inputs from unionized markets.

We develop a theoretical model to study the organizational responses of global firms to the labor market imperfections of the countries where they operate. We show that the relative profits of sourcing inputs at arms'-length versus vertical FDI increase with the bargaining power of workers. The fragmentation of the value chain allows the firm to lower labor costs by strategically reducing the revenues that are available for workers to extract. We further show that the effects of wage bargaining depend on the sectoral affiliation of the firm. Under quite general conditions, the relative attractiveness of subcontracting in the light of wage bargaining is stronger for firms operating in capital intensive industries.

Our econometric analysis supports the idea that multinational firms are less likely to import intermediate goods within their boundaries from countries with strong organized labor. This effect is strong for firms operating in capital intensive industries. We use trade data obtained from the comprehensive dataset on the imports by multinational firms located in France. We merge it with a new dataset presented in Botero et al (2004). These authors have gathered information on different categories of labor law for a cross-section of countries as of 1997. We

use an index that captures the power of workers by the extent to which industrial actions are allowed by the law.

Our empirical results are robust to the inclusion of other well-known determinants of intrafirm imports such as contract enforcement, factor endowments and of measures regulations that can restrain multinational entry such as FDI restrictions or the costs of setting up a business and to different robustness checks.

JEL Classification: F10, J52, L22.

Keywords: wage bargaining, trade unions, sourcing, multinational firms.