European Commission

JRC SCIENCE FOR POLICY BRIEF

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Top R&D investors' location decisions: How to succeed in the global regulatory contest?[1]

Headlines

- **Product regulation policies and employment policies show strong combined effects** on decisions regarding top R&D investment locations. The higher the level of product market regulation (PMR), the higher the negative effect of employment protection legislation (EPL), and vice-versa.
- **Reforms in these two policy areas should therefore be coordinated** to be more efficient. Scientific evidence suggests a threshold of product regulation above which existing employment policies can start *deterring* investment decisions. Some Member States would particularly benefit from diminishing current levels of product regulation.
- **Lowering barriers to trade and investment** is more effective for attracting knowledge-intensive foreign investment than reducing the cost of starting a business or reducing the corporate income tax rate.

Policy context

A new boost for jobs, growth and investment is the first of President Juncker's policy priorities as set out in the ten-point-plan for his term as President of the European Commission. A crucial part of the related **Jobs, Growth and Investment Package** is about reforming labour and product markets policies and red tape barriers to positively affect the investment decisions of knowledge-intensive multi-nationals.

The EU 2020 Strategy allows such reforms to be addressed through **country-specific recommendations,** guiding the EU Member States on growth, investment and jobs.

Attracting foreign direct investments from knowledge-intensive multinationals is very important in this regard: To do so successfully, the EU and its Member States must position themselves pro-actively in the global regulatory contest aiming at boosting their productivity, sustaining economic growth and creating new jobs.

Scientific evidence

ECFIN and JRC researchers now have modelled how **product market regulation** and **employment protection regulation** influence the decisions of knowledge intensive multinational companies where to

[1] This brief is based on a joint ECFIN-JRC research, which has been published on the JRC site: https://ec.europa.eu/jrc/sites/default/files/JRC100807.pdf; as well as on the DG ECFIN site: http://ec.europa.eu/economy_finance/publications/eedp/pdf/dp031_en.pdf.

invest and where to locate their subsidiaries.

For that purpose, they linked a **sample of the world top 2500 corporate R&D investors** as identified in the 2014 EU Industrial R&D Investment Scoreboard with two statistical indicators from the OECD, representing the product market regulation and employment protection situation in the EU Member States:

Product market regulation and related policy activities were represented by a quantitative composite indicator from OECD. This PMR indicator is based on three components: (1) state control, (2) barriers to trade and investment, and (3) barriers to entrepreneurship.

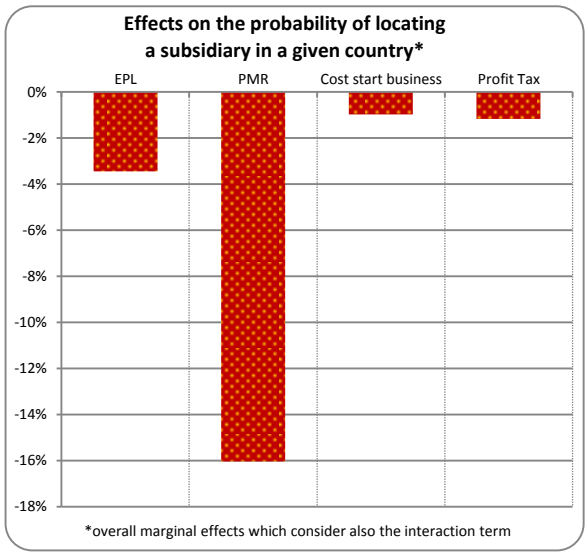
Employment protection legislation and related policy activity was represented by the EPL composite indicator, also from OECD. This indicator, inter alia, measures the procedures and costs involved in dismissing individuals or groups of workers and the procedures needed to hire workers on fixed-term or temporary work contracts.

The **ECFIN-JRC study** based on the above modelling input, confirms previous empirical evidence that R&D-intensive multinational companies tend to locate their international activities in countries with greater market potential, better opportunities and openness to trade. In addition, the JRC study shows that product and labour market regulations, as well as the cost of starting a business (as a measure of red tape) and profit taxes, negatively affect such location decisions and that among the different components of the PMR index, **barriers to trade and investment** have the greatest impact on location decisions.

The study also compares the effect that PMR, EPL, red tape and profit tax may exert on investment and location decisions, and the graph shows that **the negative effect of PMR is by far the largest**: a one-point increase of the PMR index leads to a 16% decrease of the probability of having subsidiaries located in a given country.

EPL ranks second in terms of relative importance, followed by the tax rate on profits and the cost of starting a business.

The study also shows that an **individual look at different impact factors is not sufficient**: When the combined effect of PMR and EPL is not taken into account, the average effect of a one-point increase of the PMR index on the location probability is much lower (-7.5%), while EPL is not even significant.



The ECFIN-JRC model further allows **identifying a threshold value of the PMR index** above which EPL starts deterring location decisions. By comparing this threshold with the respective values in the EU countries for 2013 (latest data available), the study shows an opportunity for Bulgaria, Cyprus, Croatia, France, Greece, Latvia, Lithuania, Malta, Poland, Romania, Slovenia and Sweden to strongly increase their attractiveness in terms of top international R&D investment.

Key conclusions

It is essential to take a **holistic look at product and labour market regulation** to understand decisions on top R&D investment locations. This is a particularly important case where the silo-breaking approach, the Juncker Commission had promised at the beginning of its term, pays off.

The ECFIN-JRC study shows that these two forms of regulation are mutually reinforcing, so **more policy attention should be devoted to coordinating reforms** in the respective policy areas.

Any **country-specific analysis of individual EU Member States** should, therefore, take this link between product regulation and labour policies into consideration more strongly. Special emphasis should be put on those Member States which could particularly raise their attractiveness in terms of top international R&D investment.

The **Country-specific recommendations under the Europe 2020 Strategy** provide the policy framework under which the results of our analyses can be put into policy recommendations efficiently.