



You are cordially invited to

UCLouvain Economics Seminar

On Thursday February 15, 2018, from 12:45 to 14:00
Doyen 22, Place des Doyens, 1

Sebastian Krautheim
(University of Passau)

Will give a presentation on

The International Organization of Production in the Regulatory Vacuum

Abstract

Multinational firms can exploit cross-country differences in environmental and labor regulation in ways that some civil society actors consider 'unethical'. This may trigger advocacy NGO campaigns and consumer boycotts, a threat for demand and reputation many firms faced over the last decades. We introduce an 'unethical' technology, ethically concerned consumers and consumer boycotts into a property rights model of the firm. A headquarter contracts with a foreign supplier for the production of a customized input. Contracts are incomplete, so the headquarter can neither control the supplier's investment nor whether the 'ethical' or 'unethical' technology is implemented. We show that international outsourcing and 'unethical' production are linked through a novel unethical outsourcing incentive. Moreover, we find cases in which the headquarter would prefer 'ethical' sourcing, but, somewhat paradoxically, incentivizes the supplier to expand 'unethical' production. We provide empirical support for a central prediction of our model: a high cost advantage of 'unethical' production and a low regulatory stringency in the supplier's country favor international outsourcing (as opposed to vertical FDI). We also provide a microfounded model of investment and pricing under incomplete contracts when the production technology is a credence characteristic of the final good and an NGO may initiate a consumer boycott.

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