

**Vertical Foreign Direct Investment:
Evidence from Japanese and U.S. Multinational Enterprises**

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March 23, 2009

Abstract

Foreign direct investment (FDI) has rapidly increased in developing countries for the 1990s, but formal evidence for vertical FDI has been surprisingly mixed. This paper empirically reconsiders the factor-proportions hypothesis by exploring the role of host country's relative skill endowments in offshore production of multinational enterprises (MNEs). Using panel data on sales of foreign affiliates by Japanese and U.S. MNEs in the 1990s, I find that relative skill abundance has a large negative impact on Japanese affiliate sales, but little effect on U.S. affiliate sales. Robust to a wide variety of sensitivity checks, the results strongly support vertical FDI in the case of Japanese MNEs, but not U.S. MNEs. Because the dominant view in favor of horizontal FDI against vertical FDI in the previous literature emerged primarily from U.S. data, I empirically demonstrate that data sources on MNEs could partly explain weak evidence for vertical FDI.

Keywords: Multinational firms, foreign direct investment, skill endowments

JEL classification: F21, F23

* This paper is a substantially revised version of my dissertation chapter. I am deeply grateful to my professors at the University of Hawaii at Manoa: Theresa Greaney, Sang-Hyop Lee, Ilan Noy, Seiji Naya, and Jack Suyderhoud. I also thank to Jota Ishikawa, Toshiyuki Matsuura, and participants at One-Day Trade Workshop at Hitotsubashi University for valuable comments and suggestions.