Trade Liberalization and FDI Strategy in Heterogeneous Firms: Evidence from Japanese Firm-level Data

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Abstract: This paper tries to clarify the reasons for the rapid growth of FDIs to developing countries, particularly East Asian countries, compared with that of FDIs to developed countries. To do that, we examine the mechanics of HFDI and VFDI with shedding light on the role of trade costs. Our empirical analysis by the estimation of the multinomial logit model about Japanese firms’ FDI choice reveals that the reduction of trade costs between host and home countries attracts even not so productive VFDI firms but does not the HFDI firms. Since developing countries, particularly East Asian countries, experience a relatively rapid decrease of trade costs with Japan, our result indicates that the increase of VFDI through the trade cost reduction yields the recent relative surge of FDIs to developing countries.

Keywords: Multinational firm; Firm heterogeneity; Productivity

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