

Productivity and Decision to conduct Vertical FDI: Evidence from Japanese Firm-level Data

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Abstract: This paper attempts to clarify the reasons for the rapid growth of foreign direct investment (FDI) in developing countries, particularly East Asian countries, compared with that of FDI in developed countries. To do this, we examine the mechanics of vertical FDI (VFDI) to shed light on the role of trade costs. Our empirical analysis using logit estimation or a multinomial logit model of Japanese firms' FDI choices reveals that a reduction in tariff rates attracts even less productive VFDI firms. This result is consistent with a different definition of VFDI. Because developing countries, particularly East Asian countries, have experienced a relatively rapid decrease in tariff rates, our results indicate that the increase in VFDI through tariff rate reduction led to the recent relative surge of FDIs in developing countries.

Keywords: Multinational firm; Firm heterogeneity; Productivity

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