Exchange rate regimes, institutional quality and Japanese firms' behavior: a panel data analysis[1]

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Abstract

In this paper we extend our previous study on Japanese outward Foreign Direct Investment (FDI) activities by examining the role of exchange rate (ER) level and volatility together with institutional factors (political environment (PE)) in determining Multinational Companies' (MNCs) investment decisions. First, we present a theoretical model that suggests MNCs response to ER level, ER volatility and PE adjustments. Second, we employ a panel data analysis of 56 developed and developing countries for the period of 1995-2011 for the country and industry level. An ER level and volatility as well as PE measure are included as additional explanatory variables. We augment the model to include ER expectations as well. Our preliminary results and expectations suggest a non-linear response of Japanese MNCs activities to different ER regimes and to different levels of institutional environment quality depending on the industry and the host country's stage of economic development.

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