

Outward FDI and Domestic Job Creation in the Service Sector^{*}

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Abstract

Japan's outward foreign direct investment (FDI) stock-to-GDP ratio, which has been relatively low by international comparison, has been rising steadily since the mid-2000s. A notable feature in this context is the rapid increase in FDI in the service sector. The impact of service sector firms' foreign activities on domestic employment is an important issue when considering the growth of the Japanese economy; yet, there are relatively few studies on the domestic employment impact of service sector FDI.

In this paper, using a firm-level dataset of Japanese listed companies covering the period 2000-2011, we show that FDI by service sector firms has had positive effects on their domestic employment growth. These results are obtained controlling for spurious correlation arising from reverse causality such as the fact that firms that are successful in the domestic market are more likely to invest abroad. The positive effects are clearest in the retail, construction, and personal and business services industries. This is probably because FDI by firms in these industries does not substitute for their domestic business activities but requires that they strengthen administrative and other support functions in their domestic headquarters. A positive employment effect of outward FDI is also observed in the wholesale and transportation industries. This result may reflect the effect that firms' strengthening of their international networks helps to attract stronger demand. In contrast, in the information and communications technology industry, FDI appears to be associated with a reduction in domestic employment, possibly because IT workers at overseas affiliates substitute for domestic ones. Overall, our results suggest that for the service sector as a whole, outward FDI has been beneficial for Japan's economy from the viewpoint of domestic job creation.

Keywords: FDI; Employment; Service sector.

JEL Classification: F14, F21, F23.

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