

# How much does policy uncertainty affect foreign direct investment?: Micro-evidence from Japan's International Investment Agreements

Mitsuo INADA\*

Naoto JINJI<sup>†‡</sup>

## Abstract

In this study, we empirically investigate the impact of policy uncertainty (PU) on foreign direct investment (FDI) by using micro data of Japanese multinational enterprises (MNEs) and their foreign affiliates during the period 1995–2016. The focus of this study is on how activities of Japanese MNEs and their foreign affiliates are affected by Japan's forming International Investment Agreements (IIAs) with their host economies. We exploit differences in PU at the industry level by distinguish between industries included in the negative lists for the reservation of some obligations in IIAs and other industries. To identify causal effects of a change in PU on FDI, we employ the difference-in-differences approach based on the information on industries and reserved obligations in the negative lists of 22 Bilateral Investment Treaties (BITs) and Economic Partnership Agreements (EPAs) that Japan formed in 2002–2016. We find evidence that PU actually matters for Japanese outward FDI. In particular, we find that signing an IIA stimulates FDI through a reduction in PU, though the impact depends on the content of the IIA. We also find that an IIA may affect MNEs' FDI to the partner country in their global FDI strategy.

*Keywords:* policy uncertainty; international investment agreements; foreign direct investment.

*JEL classification:* F15; F21; F23.

---

\*Faculty of Humanities, Miyazaki Municipal University

<sup>†</sup>Corresponding author. Faculty of Economics, Kyoto University

<sup>‡</sup>Research Institute of Economy, Trade and Industry (RIETI)