

## **THE ELUSIVE IMPACT OF INVESTING ABROAD FOR JAPANESE PARENT FIRMS: CAN DISAGGREGATION ACCORDING TO FDI MOTIVES HELP?**

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### **NON-TECHNICAL SUMMARY**

Previous findings on Japanese data (Hijzen, Inui and Todo, 2007; Ando and Kimura, 2007) show that the claim of industrial hollowing-out following the expansion of operations abroad is unwarranted. They suggest limited effects of investing abroad on the parent firm's performance. These results may however be explained by the aggregation of heterogeneous effects depending on the FDI motives, sectors and locations. We rely on a new dataset for the period 1994-2004 that combines information on manufacturing and non-manufacturing internationalizing Japanese firms with characteristics of their subsidiaries. These data will allow us to investigate the heterogeneity of the effect of moving abroad on employment, investment, productivity and trade performance. While much is known about parent firms characteristics (Greenaway and Kneller, 2007), little is known about characteristics of subsidiaries in international economics literature. Our data set gives us new interesting insight into characteristics of the affiliates and their relation with the parent firms that will help us to discriminate between the various investment strategies of the Japanese firms and to study their specific impact at home.

One first sign that the FDI impact on domestic performance of Japanese firms' internationalization is context-specific comes from the cross-country variation in the allocation of affiliates' sales. While 81% of the sales of manufacturing Japanese affiliates located in North America is made locally, in China, it is only 47%. The shares of sales back to Japan are respectively 30 and 45% for those two countries. In contrast, the share of purchases that are

local is 57% in North America and 66% in China. These characteristics tend to show that Japanese firms are looking for low cost production sites in China (vertical division of labor), while they are following horizontal or market-seeking motives in the context of North American markets.

The impact analysis is based on propensity score matching techniques to construct a valid control group. Following Barba Navaretti and Castellani (2004) among others, we combine the propensity score matching with a difference-in-difference (DID) estimator to evaluate the causal effect of establishing a foreign affiliate on a set of domestic outcome variables. We focus on firms that switch from being a purely domestic firm to being a multinational firm. Our aggregate results confirm previous findings that on average Japanese outward FDI has limited effects (whether positive or negative) on the activity of internationalizing firms. Fears of huge production employment losses or hopes of massive TFP gains associated with outsourcing are rejected both on average and on our different sub-samples indicating that the lack of consideration for heterogeneity does not explain previous findings of the elusive impact of investing abroad.

We nevertheless find that FDI in manufacturing is associated with a faster labour productivity growth and reduced exports growth, while evidence of positive administrative employment gains is found for FDI in services, presumably reflecting the operational complementarities between the affiliate and the parent. Fears of “Hollowing out” effects seem to be more justified in the case of FDI to low income countries, for which a contraction of production employment, investment and exports is observed. We find that positive labour productivity gains essentially derive from FDI in manufacturing in high GDP countries and notably non-Asian countries, presumably reflecting learning by doing and technological spillovers shared between the parent and the affiliate.

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