

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

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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. We employ a panel data analysis of 56 developed and developing countries for the period of 1995-2011 on the country and industry level. Our benchmark model is constructed on the basis of the knowledge-capital models, and includes traditional control variables such as market potential, wages, skilled workforce endowments, investment cost and openness. ER level and volatility as well as various measures of PE are included as additional explanatory variables. 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. These results have important implications for future policy considerations of the host countries and for research on Japanese outward FDI.

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