Do international investment agreements attract foreign direct investment in knowledge intensive industries?

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Keywords: international investment agreements, foreign direct investment, knowledge intensity, intellectual property rights.

Abstract

This study empirically analyzes the industry-specific effects of international investment agreements (IIAs) on foreign direct investment (FDI) by focusing on the knowledge intensity of industries. Based on the theoretical model of horizontal FDI with a stochastic component in the fixed costs of FDI, we hypothesize that FDI from industries in which intellectual properties are intensively used (i.e., knowledge-intensive industries) is more likely to be attracted by IIAs, particularly in low-income countries or in countries with weak intellectual property rights (IPR) protection. Moreover, to capture the heterogeneous effects of IIAs by industry, we create host country-industry-level IIA dummies by exploiting the information on the lists of reserved obligations in IIAs in the form of a "negative list". We use data on US outward FDI to 56 host countries in 12 industries for the period 1999–2018. We address the endogeneity of IIAs using the fixed effects of countries and industries and generalized method of moments (GMM) as an estimation method. Consistent with our hypothesis, we find that the positive effects of IIAs on FDI from knowledge-intensive industries appear mainly in low-income countries or those with weak IPR protection.

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