

DOCTORAL THESIS

Bilateral trade effects of Japan's outward direct investment in East Asian manufacturing industries

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**Bilateral Trade Effects of Japan's Outward Direct
Investment in East Asian Manufacturing Industries**

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**A thesis submitted in partial fulfillment of the requirements
for the degree of
Doctor of Philosophy**

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ABSTRACT

Japan's foreign direct investment abroad has boomed over the past few decades, with many Japanese companies setting up production facilities overseas. This has prompted much debate on whether the Japanese economy is "hollowing out." The growing amount of trade that is linked with FDI and foreign production is integrating the Japanese economy more closely with other labor-rich countries in East Asia.

This dissertation studies the bilateral trade effects of Japan's outward direct investment in East Asian manufacturing industries. It begins with an overview of the characteristics of Japan's direct investment and bilateral trade pattern with other East Asian countries. The hollowing out of Japan's industries is basically due to the comparative advantage shifting to other East Asian countries of the parts of production operations in which Japanese firms are losing comparative advantage. Chapter 2 reviews and criticizes the literature on the relationship between FDI and trade, and argues FDI is the agent of this shift in comparative advantage.

As reverse importation is a clear consequence of the shift in comparative advantage, Chapter 3 attempts to derive a theoretical model that puts the reverse importation phenomenon into general functional forms. Without a model for the comparative advantage-shifting process, the causal relationship between the different variables is subject to debate. Using the conclusions drawn from this model, an empirical study is presented in Chapter 4. However, unlike previous empirical studies, an attempt is made to study the trade effects of Japan's outward direct investment by individual industry. This choice of setting is based on the argument that the effects of Japan's outward direct investment on bilateral trade and consequential output prices varies with the relative factor-intensity of a given industry.

The dissertation ends with a discussion of several important economic implications arising from the hollowing out of Japan's industries and the phenomenon of reverse importation, in which the market dynamics of direct investment and trade activities in East Asia are used to explain the recent proliferation of Free Trade Agreements. Finally, concluding remarks and the limitations of the analyses in the dissertation are presented, and future research directions in this area are suggested.

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