Troubled Banks, Impaired Foreign Direct Investment: The Role of Relative Access to Credit

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Abstract

During the 1980's, theories were developed to explain the striking correlation between real exchange rates and foreign direct investment (FDI). However, this relationship broke down for Japanese FDI in the 1990's, as the real exchange rate appreciated while FDI plummeted. We propose the relative access to credit hypothesis and show that unequal access to credit by Japanese firms contributes to the explanation of declining Japanese FDI. Using bank-level and firm-level data sets, we find that financial difficulties at banks were economically and statistically important in reducing the number of FDI projects by Japanese firms into the United States. (JEL G21, F36)

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JEL Classification

F21 International Investment; Long-term Capital Movements

F23 Multinational Firms; International Business

G21 Banks; Depository Institutions; Micro Finance Institutions; Mortgages