

# The Impact of Policy Uncertainty on Inward Foreign Direct Investment: Evidence from Japan's International Investment Agreements

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## Abstract

This study examines the effects of policy uncertainty (PU) on inward foreign direct investment (FDI). We contribute to the literature by addressing a key empirical challenge inherent in the staggered nature of signing international investment agreements (IIAs). We use microdata on foreign affiliates in Japan, combined with information on 27 IIAs between Japan and its partner economies that entered into force during 1995–2019. We find that PU primarily affects the intensive margin of inward FDI. Specifically, current reservations regarding most-favored-nation (MFN) treatment, when combined with national treatment (NT), reduce the ownership shares of parent firms. We also find that current NT reservations, as well as combined NT and MFN reservations, reduce employment by foreign affiliates. These results are robust, particularly for the subsample of foreign affiliates in the service sector. Finally, and in contrast to previous studies, we find no effects on the extensive margin—namely, affiliate entry and exit.

*Keywords:* policy uncertainty; IIAs; negative list; inward FDI.

*JEL classification:* F15; F21; F23.

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