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Chapter Title: Comment on "How Japanese Subsidiaries in Asia Responded to the Regional Crisis: An Empirical Analysis Based on the MITI Survey"

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fiscal year 1996 was used as one of the independent variables in one of the regression runs. Was this based on a consolidated financial statement or did it exclude the contribution of the subsidiaries? These different measurements could have different impacts on the dependent variable.

By estimating equations using different representations of the variable CHAR, the variable in question could have picked up the effects of other variables. Why not estimate an equation using all the variables representing CHAR, except ASSET, which could be highly correlated with PROF or CAP?

References

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Comment Assaf Razin

An important aspect of FDI is that it is proven to be resilient during financial crises, in situations of international illiquidity, when the country's consolidated financial system has short-term obligations in foreign currency in excess of the amount of foreign currency to which the country has access on short notice. In this context, FDI flows provide the only direct link between the domestic capital market in the host country and the world capital market at large. Indeed, FDI flows to the East Asian countries were remarkably stable during the global financial crises of 1997–98. In sharp contrast, portfolio equity and debt flows, as well as bank loans, dried up almost completely during the same period. The resilience of FDI to financial crisis was also evident in the Mexican crisis of 1994 and the Latin American debt crisis of the early 1980s. This may reflect a unique characteristic of FDI, which is determined by considerations of ownership and control by multinationals of domestic activities, which are more long term in nature, rather than by short-term fluctuations in the value of domestic currency and the availability of credit and liquidity.

Kyoji Fukao has access to a unique data set that can shed light on the resiliency of FDI. He sets himself up to deal with one empirical hypothesis: Due to firm-specific skills and sunk (human and physical capital) in-

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vestment costs, employment will not drop as much as sales during the crisis.

Method and Findings

In the typical regression, the dependent variable is employment growth and the explanatory variables are (a) sales growth (interacting with business activity upswing and downswing dummies); (b) parent's firm characteristics; and (c) subsidiary firm's characteristics.

The hypothesis implies the existence of a kink in the employment-sales growth equation. When employment growth is positive, employment responds linearly to sales growth, while the employment response to negative sales growth is inelastic. Since the upswing (downswing) dummy is potentially endogenous, the estimation is carried out in two stages. In the first stage a Tobit model is implemented to estimate interactions between the dummy variable and sales growth. The second stage uses the predicted values of this interaction term in the employment-sales growth equation.

The author finds that the evidence supports a kink-shaped schedule for employment growth and sales growth. He also finds that the characteristics of the parent firm, such as parent firm profits and its ownership share in the subsidiaries (which are related to the incentive of parent firms to support employment in subsidiaries during crisis), are significant statistically in the regressions. He also finds that evidence that new subsidiaries and high-productivity subsidiaries tend to keep employment more than old and low-productivity subsidiaries, in line with the hypothesis.

Critique

My critique is threefold:

1. A key element of the crisis, the huge depreciation of the real exchange rate, is totally ignored. For example, the author does not differentiate between export-oriented and domestic-market-oriented firms, concerning their different behavior when the real exchange rate is stable versus when it is sharply depreciated.
2. Investment data are ignored. A plausible related hypothesis that could have been tested, if investment data were available, concerns the response of the ratio of human to physical capital to real depreciations. When the real exchange rate depreciates and human capital becomes relatively cheap compared to physical capital, there will be a substitution effect away from physical capital, which can help explain the finding of stable employment during the business downswing.
3. Evidently, the employment-sales relationship is a dynamic concept, but the author pursues only contemporaneous relationships between the variables. A longer time series and a dynamic analytical framework of the response of employment to sales is warranted in order to understand the nature of the effect of crises on the employment-sales relationship.