

**Re-estimating the Knowledge-Capital Model:
Evidence from Japanese and US Multinational Enterprises**

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Abstract

The knowledge-capital model (KC model) by Markusen (2002) encompasses market access and factor-price motives of the multinational enterprises (MNE) and receives mixed support in a sense that evidence on the effect of relative factor endowments is weak. This paper re-estimates the KC model using new panel data on foreign affiliate sales of Japanese MNE for the period 1989-2002 with US data. We find little evidence for the effect on Japanese and US MNE activity of relative skill endowments. Rather, US MNE activity is substantially higher in the skilled-labor-abundant country while total affiliate sales of Japanese MNE are not related to skill endowments. Both Japanese and US MNE respond strongly and positively to the market size but differently to other variables such as trade costs, regional trade agreement, and bilateral investment and tax treaties.

Keywords: Multinational firms, foreign direct investment, factor endowments

JEL classification: F21, F23