Japan's Direct Oversea
And Its Impact on Domestic Indu

Mitsuhiko Yamada, born in 1928, is director for special research of Nikko Research Center Ltd. A graduate of the University of Tokyo, he was an economic correspondent with Kyodo News Service before joining the center as an economics analyst in 1970. He has conducted various studies on Japan's overseas investment and development assistance.

Introduction

Direct overseas investment by Japanese corporations began to increase rapidly in the latter half of the 1970s, with the result that Japan has become one of the world's principal investor nations. The Japan External Trade Organization (JETRO) estimates that as of the end of 1980 the stock of direct foreign investment in the world was $455.5 billion, of which nearly half, or $213.5 billion, was made by the United States. The United States was followed by the United Kingdom with $75.6 billion, West Germany $37.9 billion, France $29.6 billion and Japan $19.6 billion. Thus, Japan ranks fifth in the world in the amount of direct investment overseas.

Japan accounted for only 4.3% of the world stock of direct investment. Its overseas investment is still small compared to European countries, which have a long history of investment overseas, and much smaller compared to the United States, whose direct investment overseas increased tremendously after World War II. Japan was a late-starter in the field; it was only in the 1970s that Japanese corporations began investing abroad in earnest.

Japan's GNP ranks second in the Free World, next to the United States. Japan's exports and imports rank third, next to the U.S. and West Germany. Considering this, it is probably natural that Japan still ranks low in the amount of direct investment. According to the Bank of Japan's statistics on assets and liabilities vis-a-vis non-residents, Japan's stock of direct investment at the end of 1981 stood at $24.5 billion, while foreign countries' stock of direct investment in Japan was $3.9 billion, showing a big net surplus for Japan. Japanese investment in foreign countries has increased sharply in recent years, making Japan a big exporter of capital as well as goods (Table 1).

Japan's export of capital, consisting of direct investment, portfolio investment and loans, now has significant impact on industrial activities and on the financial and capital markets of the world. Having attained high economic growth by the early 1970s, Japan has become a mature advanced country full of vitality. Since the start of the 1980s, it has become capable of exporting capital and technologies to developing countries as well as to advanced countries which have lost their vitality.

Although Japan ranks only fifth in the stock of direct investment overseas, its annual investment flow is growing by a wide margin. There is a great possibility of

s Investment
stry

By Mitsuhiko Yamada

the stock of Japanese direct investment overseas catching up with the level of the European countries in the 1980s.

By increasing its direct investment, Japan has contributed greatly not only to the development of resources in developing countries (and, as a consequence, to the expansion of their export capabilities) and their industrialization, but also to the revitalization of the industries of advanced European countries and the U.S. and to the easing of trade friction. The transfer of capital has been paralleled by a transfer of technology and knowhow.

In the meantime, direct investment made in Japan by the U.S. and other advanced countries has been increasing at an accelerated pace. The current decade will likely see gross investment between Japan and the other advanced countries expand at a fast pace. As a result of the growing international disparity in the productivity of the manufacturing industries, trade friction among the advanced countries is worsening. Although protectionism in world trade is a problem that cannot be resolved easily, an increase in gross investment by multinational enterprises is suggestive of one possible solution to protectionism. Japan welcomes foreign capital investment, while increasing its investment overseas. This is a big change from 10 years ago. Investment by Japan and investment in Japan are almost completely liberalized.

Overview

First, we will attempt an overview of direct investment overseas by Japan. In studying this subject, we were puzzled first by the absence of statistics on Japan's stock of investment usable for international comparison. The figures given above are from data compiled by the Bank of Japan on the basis of balance of payments statistics. They do not show the stock of investment that includes earnings reinvested. From these figures we cannot learn the detailed breakdown of the stock of investment by type of industry or by region.

In order to supplement the shortage of information, we have to look to the statistics compiled by the Ministry of Finance on the basis of licenses granted or reports received. These statistics, however, do not show the exact amount of investment actually made, although they show the amount of investment either approved by the Finance Ministry or the amount of investment for which Japanese corporations filed reports with the ministry in compliance with the law. They neither show withdrawals of investment nor reinvestment of earnings. These figures, therefore, are considerably different from Japan's actual stock of overseas investment.

According to the statistics referred to above, the cumulative amount of Japanese direct investment up to the end of fiscal 1981 (March 31, 1982) was $45.5 billion (Table 2). The $45.5 billion is close to double the $24.5 billion which was the outstanding balance of Japan's assets and liabilities vis-a-vis non-residents at the end of 1981 mentioned earlier. The actual stock of investment is considered to be halfway between the two figures.

The breakdown by region of the cumulative amount of investment shows that investment in Asia accounted for 29% of the total investment. This is most natural in view of Japan's close economic relations with Asian countries, especially with the nations of Southeast Asia. Next, investment in North America accounted for 27%. This is evidence of the strong postwar ties between Japan and North America in trade and investment. Investment in Latin America comes next. Up to the first oil crisis of 1973, a greater portion of Japan's investment, particularly by the manufacturing industries, was concentrated in the developing countries of Asia and Latin America. However, in recent years investment in the U.S. and other advanced countries is increasing far more conspicuously, mirroring changes in the world's political and economic situation.

By type of industry, investment in the manufacturing industries amounted to $14.9 billion, 33% of Japan's total overseas investment. This percentage, however, is still low compared with 43% in the case of American investments.

In Japan's case, the percentage of investment made in mining (21%) for development of resources and that of investment made in trade-associated service industries, such as commerce (14%) and financing (7%), are high. Regional breakdown of investment made in the manufacturing industries shows that 35% was concentrated in Asia, and much of the investment was in the steel, nonferrous metals, textile, chemical and electric equipment industries. Twenty-three percent of the investment was in North America, mostly in the electric machinery, steel, nonferrous metals, lumber, pulp, and machinery industries. Investment in Latin America accounted for 20% and it was mostly in the steel, nonferrous metals, chemical and transport machinery industries (Fig. 1).

As much as 62% of the investment in commerce and 43% of the investment in financing were concentrated in North America, demonstrating the closeness of the trade relationship.

Investment in Europe accounted for 12% of the total, and the amount involved in manufacturing industries was still small.

History

It was in 1951 that Japan resumed direct overseas investment after World War II. West Germany's overseas investment was also resumed around this time. The history of direct investment overseas since plainly reflects the changes that occurred in Japan's industrial structure.

For Japan, the 1950s were a period of industrial reconstruction when its balance of payments was in the red and imports of

Table 1. Japan as a Capital Exporting Country

Year	Current Balance	Long-term Capital		
		Balance	Direct Investment	
			Outward	Inward
1971	5,797	−1,082	360	210
1972	6,624	−4,487	723	169
1973	−136	−9,750	1,904	−42
1974	−4,693	−3,881	2,012	202
1975	−682	−272	1,763	226
1976	3,680	−984	1,991	113
1977	10,918	−3,184	1,645	21
1978	16,534	−12,389	2,371	8
1979	−8,754	−12,618	2,898	239
1980	−10,746	2,394	2,385	278
1981	4,770	−6,449	4,894	189
Stock-end 1981			24,506	3,915

(Source) Bank of Japan, *Balance of Payments Monthly*, March 1982

Table 2. Japan's Overseas Direct Investment

Amount and Unit / Area	Total FY 1951-1981*	Percentage Distribution	(Manufacturing)	(Percentage Distribution)
	$ million	%	$ million	%
North America	12,295	27.1	3,408	22.9
Europe	5,270	11.6	1,042	7.0
Asia	6,858	29.0	5,258	35.4
Middle East	2,355	5.2	1,094	7.4
Africa	2,018	4.4	154	1.0
Latin America	7,349	16.2	795	20.4
Oceania	2,949	6.5	862	5.8
Australia	2,512	5.5		
Total	45,403	100.0	14,853	100.0

(Source) Ministry of Finance
(Note) Cumulative amount of direct investment authorized by the MOF, as of end of Fiscal 1981 (March 1982).

Sony's video tape production plant in Dothan, Alabama, U.S.A.

Fig. 1. Cumulative Total of Direct Investment Overseas by Industry (As of March 31, 1982)

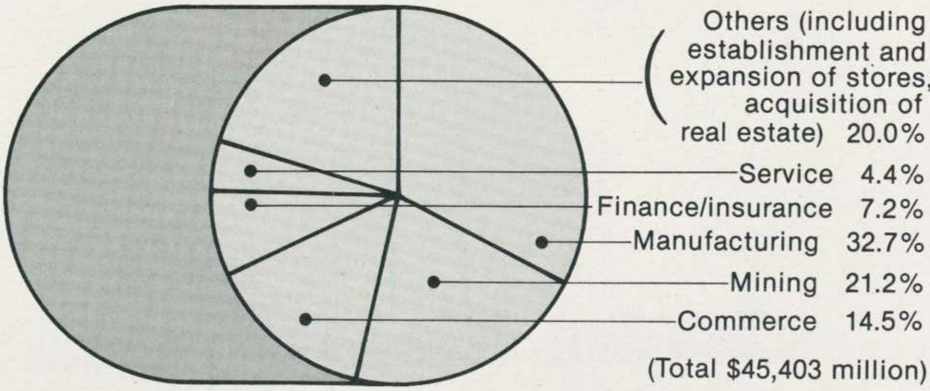
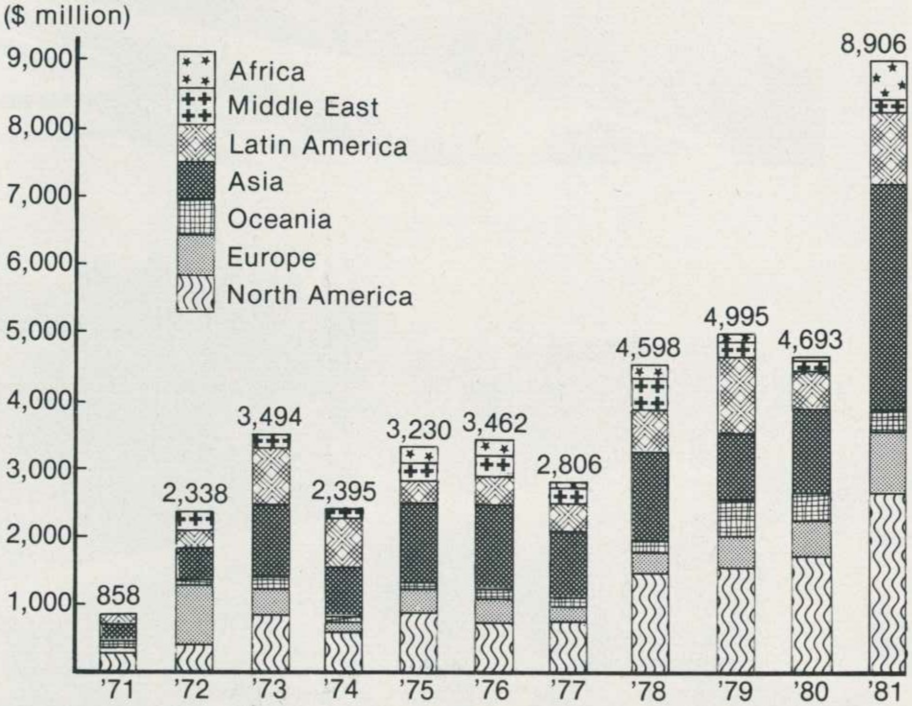


Fig. 2. Flow of Direct Investment Overseas by Japanese Corporations (Fiscal 1971-81)



(Source) Data of Ministry of Finance
(Note) Amount authorized/reported in accordance with the Foreign Exchange Law. Fiscal year base.

Workers at LSI's testroom at Toshiba Semiconductor (U.S.A.) Inc., in Sunnyvale, California

capital and technology were needed. Consequently, investment overseas was strictly restricted. But a resources-scarce country had to import oil, iron ore and other industrial raw material. Thus, through the 1950s and into the early 1960s, most of Japan's overseas investments were related to such developments. Typical of this type of investment were the iron ore development project in Goa, India in 1951, the Alaska pulp project in 1953, the establishment of Arabian Oil Co., Ltd. in 1958 and the North Sumatra oil project in 1960.

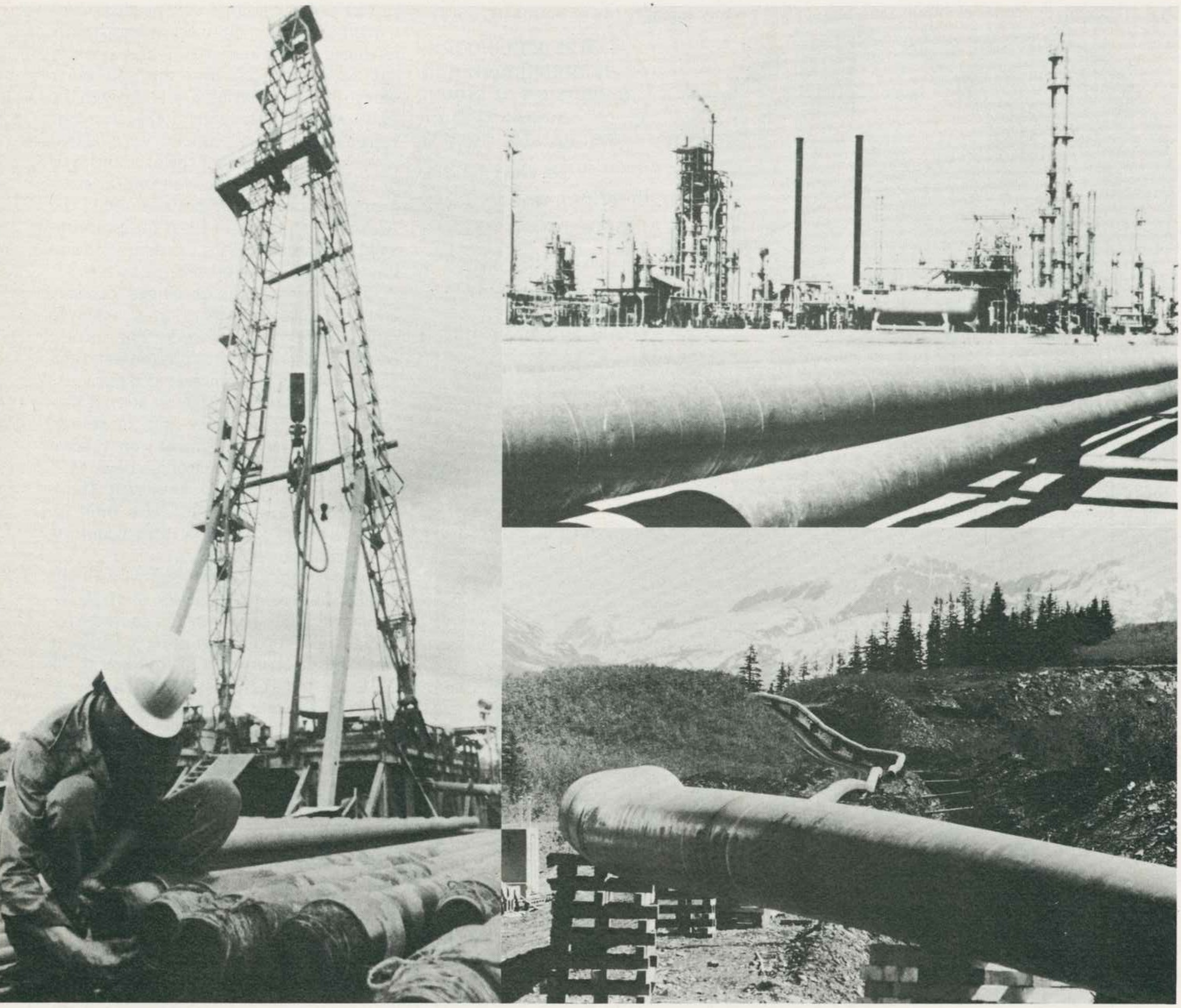
In the 1960s, Japan developed its heavy and chemical industries and achieved rapid industrial growth. The world economy itself expanded vigorously and Japan profited from increased exports. As a result, the country's international balance went into the black and the restrictions on overseas investment were relaxed step by step beginning around 1969. Corporations accumulated abundant funds for use in investment and also built up their technical knowhow, thus acquiring investment capability.

Japan's rapid economic growth in the 1960s resulted in a domestic shortage of labor and industrial sites and caused environmental problems, putting a stricture on domestic investment. The Nixon shock of 1971, and the subsequent floating of the exchange rate as a consequence of the dollar crisis, made the price competitiveness of Japanese products questionable. This led labor-intensive industries like textiles and electric appliances to invest in the developing countries where labor was cheap. On their part, the developing countries instituted measures to welcome direct foreign investment in line with their industrialization aims. In addition, Japanese investment in resources development increased. With all these factors combined, Japanese direct investment overseas increased to boom proportions in fiscal 1972 and 1973, particularly in Thailand, Indonesia and Brazil (see Fig. 2).

The oil crisis and the rise of nationalism in the developing countries threw cold water on Japanese overseas investment. Investment decreased steeply in fiscal 1974, and the years 1975-77 became a period of stagnation.

Although Japanese overseas investment expanded greatly in fiscal 1978-80 (see Fig. 2), the investment pattern also underwent a significant change.

As Japan overcame the negative effects of the sudden rise in crude oil prices and succeeded in rationalizing and modernizing its industry, its exports expanded sharply. As a result, the yen appreciated greatly in value and the trade friction with the United States became serious. The appreciation of the yen made production overseas advantageous from the point of view of cost, while trade friction led to the expansion of investment in overseas production as a substitute for export by



industries which had strong international competitiveness.

As a result, there was an increase in investment in technology-intensive fields such as electrical equipment and electronics and in the fabrication and assembly type of industry such as machinery. The forerunners of this kind of investment were the advances made by Sony Corp., Matsushita Electric Industrial Co., Ltd. and Hitachi Ltd. to produce their color TV sets in the United States.

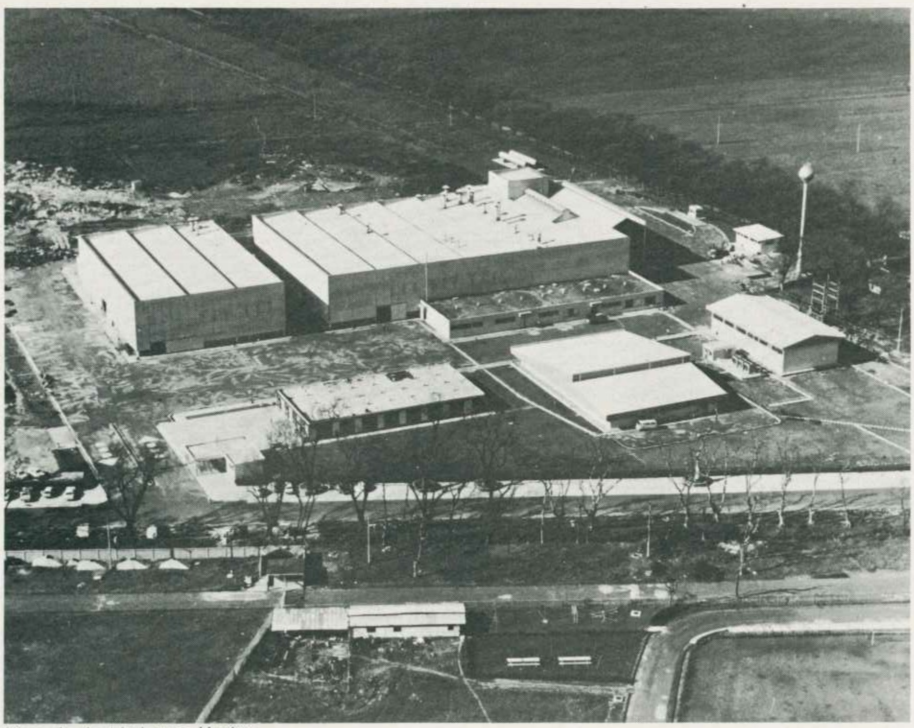
The second oil crisis of 1979-80 spurred this change in the pattern of Japanese overseas investment. Because of the aggravation of trade friction with the United States, the Japanese automotive industry was driven to a point where it had to make a decision on manufacturing in America. Semi-conductor manufacturers, too, had to start production in the United States in order to circumvent friction. As a consequence, Japanese production in America now includes VTRs by Sony Corp., Matsushita Electrical Industrial Co., Ltd. and Victor Co. of Japan Ltd., semi-conductors by Hitachi, Toshiba, Nippon Electric Co., Ltd. and Fujitsu, Ltd., and motor vehicles by Honda Motor Co., Ltd. and Nissan Motor Co., Ltd.

Materials industries, such as aluminum refineries and petrochemical companies, whose international competitiveness declined because of the rocketing energy prices following the first oil crisis, also began to move overseas, particularly to developing countries (the Asahan aluminum project, Amazon aluminum project, Saudi petrochemical project, etc.).

Japanese overseas investment in fiscal 1981 jumped by $8.9 billion, or 90%, over the year before. There were various factors behind this sudden spurt in Japanese investment overseas. Because of the high interest rates in other countries, it became a widespread practice among Japanese corporations to raise funds in low-interest Japan and lend them to their overseas subsidiaries. In this year, moreover, a huge investment was made in LNG development in Indonesia.

Impact

A survey conducted by the Ministry of International Trade and Industry revealed that as of the end of fiscal 1978 the number of persons employed by Japanese overseas subsidiaries totaled 770,000. Of these, 660,000, or 86%, were in the manufacturing industries. Further, 58% of those in the manufacturing industries were in Asia, mostly working in textile and electrical equipment plants. In recent years, the number of employees in Japanese subsidiaries in the United States has been increasing conspicuously. In the case of European corporations, many of their investments in the United States are in the


Nissan's plant in Lerma, Mexico

form of acquisition of American companies or in the purchase of land, having very little effect in creating new employment. In contrast, Japanese investment in the U.S. is mostly in the form of the establishment of new plants whose effect in providing local employment and increasing income is very great.

A feature of Japanese manufacturing investment in Asia is that with the passing of the years, Japanese equity is decreasing in proportion to local equity, the percentage of local procurement is rising, and the ratio of Japanese directors and managers is decreasing. Localization is progressing in the fields of capital, supplies and personnel. In the United States, too, the percentage of local procurement is rising.

Direct overseas investment represents not only a movement of capital but also a transfer of technology. In addition, it leads to the transfer of culture. Soft technology, such as manufacturing technology and QC (quality control), developed in Japan is being exported to both the developing and the advanced countries where it is contributing to productivity and improvement of product quality. In recent years, there have been attempts to export the Japanese style of management which places importance on job security and training of employees. It goes without saying that this form of cultural export inevitably causes friction in the host country. Even so, there is much interest in the fact that the Japanese style of management is more effective than the Western style of management in boosting worker morale and raising productivity. In the long run, the Japanese style of management might gradually be adopted by other countries.

It is possible that direct investment may have demerits for the host country as well as benefits. In the mid-1970s, as resources nationalism mounted, we witnessed protest movements in Southeast Asia against the "overpresence" of Japanese business. With progress made in mutual understanding, backlashes of this type have all but evaporated. At present, the United States welcomes Japanese investment and is enthusiastically wooing Japanese enterprises. On the other hand, it appears that European companies generally do not welcome Japanese investment.

Outlook

On the basis of current trends, it is expected that direct Japanese investment overseas will increase greatly in the future. Because it is inconceivable the international competitiveness of Japanese manufacturers will weaken in the foreseeable future, expansion of exports and resultant trade friction will probably continue. In order to avoid this, it is expected that cases of local production in the advanced countries by Japanese companies will increase as a substitute for exports. The products for overseas manufacture will probably spread from color TV and motor cars to advanced products such as sophisticated electronic goods and computers.

Direct investment in developing countries will probably increase in the materials industries, such as steel, aluminum and petrochemicals. Manufacturing companies already operating in a host country will probably make additional investments in order to raise their ratio of overseas production. There will also be an increase in investment in the development of energy and other resources overseas.

The speed at which such investment will proceed depends on the numerous factors which influence the investment environment, such as the state of world business, interest rates, the price of energy, country risk, trade friction, the results of the industrial revitalization policies of the advanced countries and so forth. The pace of investment will also be influenced by the management strategy of Japanese corporations, particularly their strategies regarding internationalization and multinationalization. Direct Japanese overseas investment will continue to expand in the 1980s and Japan will rise in the world ranking of foreign investment.

The expansion of direct overseas investment and the accompanying increase in overseas production by Japanese companies will pose new problems for Japanese industry.

Firstly, Japanese direct investment will take on a decidedly strong tone of industrial cooperation in the developing countries' industrialization and modernization programs and in the industrial revitalization of the advanced countries. It will be different in nature from the profit-maximization investment made by Western corporations when they became multinationalized in the 1960s. Investment, however, is investment and not aid. Therefore great effort and wisdom will be needed to attain compatibility between profitability or efficiency of direct investment and the other benefits demanded of industrial cooperation (expansion of employment, localization of personnel and supplies, etc.).

Secondly, the direct overseas investment of the past did not greatly affect Japan's domestic production, employment and international payments balance. Thus, there were no cases in which Japanese labor unions opposed overseas investment as a form of job export as did American labor unions. However, in the future it will be necessary to give careful consideration to labor unions, related manufacturers and the regional community which will be affected by a company's move overseas.

Thirdly, expansion of production overseas by Japanese companies will reduce Japan's export of finished goods and have the boomerang effect of causing changes in Japan's industrial structure (production structure). Therefore, it will be necessary for Japanese industry to prevent the evisceration of the domestic industry. This will have to be done by vigorously promoting R&D and investing in plant and equipment for furthering technology-intensive production and achieving greater value added. It is also desirable to increase foreign investment in Japan to balance the effects of Japanese investment overseas. ●