Japanese Direct Investment Abroad

By Seiichi Tsukazaki

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Japanese direct investment abroad (DIA) began expanding rapidly in the mid-1970s. In fiscal 1986 it reached a record $22,320 million, exceeding the $20 billion mark for the first time on an approval/notification basis. The increase pushed cumulative DIA approved and notified since fiscal 1951 to $106 billion (Table 1).

The annual value of Japan's DIA had remained below $1 billion up through fiscal 1971. In the following years, however, it suddenly took off, averaging between $2.3-$5.0 billion in 1972-80, and $7.7-$12.2 billion in 1981-85. In fiscal 1984 DIA reached $10,155 million, passing the $10 billion level for the first time. It increased to $12,217 million in 1985 and in 1986 it posted a record gain of $10 billion, up 82.7% from the preceding year.

Where it went

A sectoral breakdown of 1986 DIA reveals that $3,806 million was invested in manufacturing, $737 million in resources development and $17,212 million in commerce and services. Manufacturing investment rose slowly up until fiscal 1980, but leveled off in the $2-$2.5 billion range in fiscal 1981-85. Last year, however, it jumped 61.8% over fiscal 1985, reflecting rapid overseas expansion in electric machinery and electronics, general machinery and motor vehicles. Investment in commerce and services increased even more rapidly, rising 93.8% year-on-year.

DIA in commerce and services, as with manufacturing, expanded most sharply in the United States. Japanese banks and insurance companies bought out large local financial institutions to diversify their operations or broaden their customer base in line with financial deregulation. Another factor was a massive flow of capital into real estate and other fields as Japanese investors sought better investment opportunities abroad than they could hope for given the diminishing returns on investment at home. In the services sector, there was a marked increase in investment in tourism and resort development projects in Australia and New Zealand.

Japan's annual DIA has doubled over the few years since fiscal 1972, the year before the first oil crisis, and the pace is quickening. It took six years, from 1972 to 1978, to double from $2.3 billion to $4.6 billion. It doubled again from $5.0 billion to $10 billion in the five years from 1979 to 1984. The third leap from $10 billion to $20 billion took only two years.

As Japan's DIA has grown, it has also undergone a significant qualitative change. In the manufacturing sector, DIA up until the late 1970s was aimed primarily at maintaining overseas market share in response to policy changes in importing countries, or avoiding siting difficulties and higher wage costs at home. In nonmanufacturing, a main objective was to secure stable supplies of key resources, and investment was concentrated in the developing world, particularly in East and Southeast Asia.

Table 1 Trends in Japan's Direct Overseas Investment

Fiscal year	Number of investments	Value ($ million)	Increase over the previous year (%)
1951–73	9,504	10,267	–
1974	1,912	2,396	–31.4
1975	1,591	3,280	37.0
1976	1,652	3,462	5.5
1977	1,761	2,806	–18.9
1978	2,393	4,598	63.9
1979	2,694	4,995	8.6
1980	2,442	4,693	–6.0
1981	2,563	8,932	90.3
1982	2,549	7,703	–13.7
1983	2,754	8,145	5.7
1984	2,499	10,155	24.7
1985	2,613	12,217	20.3
1986	3,196	22,320	82.7
Total	40,123	105,969	–

Note: Numbers of investments indicate new investments only.
Source: Statistics on overseas direct investments (on an approval/notification basis) issued by the Ministry of Finance

Table 2 Capital Flow in Japanese Investment in the U.S. ($ million)

	Capital inflows			Valuation adjustments	Total
	Equity and intercompany account inflows	Reinvested earnings	Total		
1977	424	163	587	–10	577
1978	770	217	987	7	994
1979	282	462	744	0	744
1980	92	639	732	0	732
1981	2,330	640	2,970	502	3,472
1982	1,850	126	1,977	3	1,980
1983	1,068	585	1,653	6	1,659
1984	3,073	1,301	4,374	334	4,708
1985	2,042	1,039	3,081	–8	3,073

Source: U.S. Dept. of Commerce, *Survey of Current Business*, various issues

Since the start of the 1980s, however, manufacturing investment in Asia has slowed while that in North America and Western Europe has gained momentum. Investment in industrial nations has been prompted in part by the need to cope with trade friction.

It is also worth noting that direct investment in the commerce and services sector, particularly in finance and insurance, has expanded markedly. A major reason is the rapid expansion of overseas financial and capital markets accompanying the liberalization of related regulations in Japan. Investment has also been prompted by the growing trend toward international "financial engineering" as one way to cope with differentials between domestic and foreign interest rates and exchange rate fluctuations. These large international movements of capital reflect the growing strength of Japanese corporations as they accumulate management resources—people, goods, capital, technology, production control techniques and management know-how. The rapid appreciation of the yen since the Plaza Accord of September 1985 has given Japanese corporations further impetus to moves to shift production offshore. This appeared in the sharp growth of manufacturing investment in fiscal 1986.

High-yen impact

The yen has appreciated against the U.S. dollar by more than 40% since the Plaza Accord. Manufacturing costs have risen, export earnings have deteriorated, and the export volume has shrunk. Under the circumstances, Japanese corporations are stepping up efforts to set up offices and plants abroad. It is not easy to quantify the extent to which the yen's rise has accelerated direct overseas investment by Japanese corporations. However, according to "Overseas Business Activities of Japanese Enterprises," a Ministry of International Trade and Industry report published in February 1987, 55% of the manufacturers questioned said their direct investment had been hastened by the strong yen.

The impact of the strong yen was most apparent in real estate investment. DIA in real estate, excluding direct purchases of foreign real estate by Japanese individuals and corporations for asset management, increased sharply to $3,997 million in fiscal 1986, more than three times the $1,207 million in 1985, the previous record. Relative real estate prices in the United States have dropped markedly as the yen has risen against the dollar. Soaring real estate prices in Japan have also made it difficult to expect high returns on domestic investments.

The profits reinvested by the overseas sales companies of Japanese firms have increased rapidly of late. U.S. Commerce Department statistics show that Japanese sales subsidiaries in the U.S. reinvested $1,301 million and $1,039 million in profits in 1984 and 1985, respectively. These reinvested earnings are added into Japan's total capital inflows. The recent increases are all the more conspicuous given the fact that such reinvestment totaled at most $500–$600 million in previous years (Table 2). Japanese car makers, for instance, gained substantial profits in the U.S. market after the imposition of voluntary restraints on U.S.-bound exports in fiscal 1981. The earnings retained by their U.S. sales companies were reinvested mainly in local production projects as well as in forming wholesale networks.

Regional trends

On a region-by-region basis, Japan's fiscal 1986 DIA remained stagnant from the year before only in the Middle East. In all other regions it grew rapidly in both number of cases and value (Table 3). In value terms, the growth rate exceeded 50% in most regions. It reached as high as 90% in North America and 80% in Europe, sending investment in these two regions surging to $10,441 million and $3,469 million, respectively, both record figures. Total investment in the two regions accounted for 62.3% of Japan's global total. The share of investment in North America has expanded rapidly to 46.8%.

Japan's DIA was traditionally destined for Asia, but from 1978 onward, North America took first place. For the first time Europe superseded Asia in 1984 and the two subsequent years. This is because Japanese investments have been oriented mainly toward finance and insurance, and also toward manufacturing industries in the industrialized countries since that time.

In other regions, the year-to-year increase in fiscal 1986 was $2,121 million in Latin America, up 81%; $892 million in Asia, up 62%; and $467 million in Oceania, up 89%. As a result, investment in Latin America reached a record $4,737 million (86% of which was put into Central American tax havens mainly by banking, insurance and transport companies). Investment in Oceania also reached an all-time high—$992 million.

Table 3 Direct Overseas Investment by Industry and Region in Fiscal 1986 (on a notification basis)

(Units: cases, $ million, %)

Region	Industry	Foodstuffs	Textiles	Lumber/Pulp	Chemicals	Iron and steel/ Nonferrous metals	Machinery	Electric/Electronic	Transport equipment	Others	Manufacturing total (FY 1985 total)	Agriculture and forestry	Fisheries	Mining	Resources development total (FY 1985 total)	Construction	Commerce	Finance and insurance	Services	Transportation	Real estate	Others	Commerce and services total (FY 1985 total)	Branches	Total (FY 1985 total)
North America	No. of investments	33	5	5	31	39	70	76	41	72	372 (267)	3	11	10	24 (28)	21	331	60	134	32	273	16	867 (651)	21	1,284 (962)
	Value	66	22	45	294	223	460	577	290	221	2,199 (1,223)	2	16	118	136 (272)	203	1,047	2,057	505	27	3,680	298	7,817 (3,784)	289	10,441 (5,495)
	Percentage	52.0	34.9	78.9	82.8	68.0	73.5	58.5	35.0	50.8	57.8 (52.0)	13.3	30.8	17.6	18.5 (41.8)	81.2	56.3	28.4	32.4	1.4	92.1	78.6	45.4 (42.6)	51.1	46.8 (45.0)
Latin America	No. of investments	7	4		1		2	3	9	3	29 (19)	9	10	4	23 (21)	1	11	65	14	337	2	6	436 (435)	2	490 (476)
	Value	10	2		2	34	2	17	202	3	273 (324)	5	16	93	114 (14)	13	131	2,519	97	1,547	4	37	4,348 (2,227)	1	4,737 (2,616)
	Percentage	7.9	3.2		0.6	10.4	0.3	1.7	24.4	0.7	7.2 (13.8)	33.3	30.8	13.9	15.5 (2.2)	5.2	7.0	34.8	6.2	80.4	0.1	9.8	25.3 (25.6)	0.2	21.2 (21.4)
Asia	No. of investments	50	18	13	43	32	52	111	36	107	462 (322)	6	17	15	38 (35)	18	131	33	77	12	25	2	298 (312)	21	819 (685)
	Value	28	21	9	47	61	95	262	130	150	804 (460)	4	5	238	246 (328)	14	211	288	588	5	96	9	1,211 (629)	66	2,327 (1,435)
	Percentage	22.0	33.3	15.8	13.2	18.6	15.2	26.5	15.7	34.5	21.1 (19.6)	26.7	9.6	35.6	33.4 (50.3)	5.6	11.3	4.0	37.7	0.3	2.4	2.4	7.0 (7.1)	11.7	10.4 (11.7)
Middle East	No. of investments						1				1 (2)				(1)		1	1					2 (7)	1	4 (10)
	Value						0				0 (2)				(4)		0	2					2 (4)	42	44 (45)
	Percentage						0.0				0.0 (0.1)				(0.6)		0.0	0.0					0.0 (0.0)	7.4	0.2 (0.4)
Europe	No. of investments	4	17	1	8		17	21	6	20	94 (92)	1		2	3 (0)	2	136	109	34	16	5	1	303 (216)	4	404 (313)
	Value	20	17	1	11	1	64	125	78	52	370 (323)	0		27	27 (1)	12	388	2,281	96	10	87	29	2,905 (1,544)	167	3,469 (1,930)
	Percentage	15.9	27.0	1.8	3.1	0.3	10.2	12.7	9.4	12.0	9.7 (13.7)	0.0		4.0	3.7 (0.2)	4.8	20.8	31.5	6.2	0.5	2.2	7.7	16.9 (17.4)	29.5	15.5 (15.8)
Africa	No. of investments										0 (0)		5	1	6 (4)	1		1	4	38			44 (51)		50 (55)
	Value	0	0			7	0				8 (4)	0	12	0	12 (7)	0		1	3	285		0	289 (160)		309 (172)
	Percentage	0.0	0.0			2.1	0.0				0.2 (0.2)	0.0	23.1	0.0	1.6 (1.1)	0.0		0.0	0.2	14.8		0.0	1.7 (1.8)		1.4 (1.4)
Oceania	No. of investments	3	1	4			2	1	5	7	23 (16)	8	3	4	15 (9)	2	39	5	27	5	27	2	107 (87)		145 (112)
	Value	1	0	2	1	1	4	5	127	10	151 (15)	5	4	193	202 (25)	8	83	92	271	52	130	5	639 (485)	0	992 (525)
	Percentage	0.8	0.0	3.5	0.3	0.3	0.6	0.5	15.3	2.3	4.0 (0.6)	33.3	7.7	28.8	27.4 (3.8)	3.2	4.5	1.3	17.4	2.7	3.3	1.3	3.7 (5.5)	0.0	4.4 (4.3)
World	No. of investments	97	45	23	83	71	144	212	97	209	981 (718)	27	46	36	109 (98)	45	649	274	290	440	332	27	2,057 (1,759)	49	3,196 (2,613)
	Value	127	63	57	355	328	626	987	828	435	3,806 (2,352)	15	52	669	737 (652)	250	1,861	7,240	1,560	1,925	3,997	379	17,212 (8,883)	566	22,320 (12,217)
	Percentage	0.6	0.3	0.3	1.6	1.5	2.8	4.4	3.7	1.9	17.1 (19.3)	0.1	0.2	3.0	3.3 (5.3)	1.1	8.3	32.4	7.0	8.6	17.9	1.7	77.1 (72.7)	2.5	100.0 (100.0)

Note: Percentages for the regions indicate the share of each region in the total for each industry, and those for the world indicate the share of each industry in the grand total.

Some $2,327 million was invested in Asia, compared with $3,338 million in fiscal 1981, which included $1.8 billion for LNG development projects in Indonesia. If the 1981 LNG project investments were excluded, the figure for fiscal 1986 would again be a record.

DIA in Africa increased slightly over the year before to $309 million, just short of fiscal 1984's $326 million. However, the 1986 figure was far short of the $573 million invested in 1981, as investment in Liberia related to flag-of-convenience shipping declined. Investment in the Middle East remained sluggish, with no significant investment other than in an oil development project in the Divided Zone between Saudi Arabia and Kuwait.

On a country-by-country basis, investment in the United States totaled $10,165 million, accounting for 45.5% of the global total. The U.S. was followed by Panama ($2,401 million), Luxembourg ($1,092 million), the United Kingdom ($984 million), the Cayman Islands ($930 million) and Australia ($881 million).

North America

Of the $10,441 million invested in North America, $2,199 million was in manufacturing, up 79% over the preceding year. It was the first time for North American investment in this sector to exceed $2 billion. The rapid growth clearly reflected the impact of the strong yen.

The Japan-U.S. trade friction that arose in the 1980s also contributed significantly to spurring such investment. Investment in sectors vulnerable to trade friction, such as electric machinery and electronics, automobiles, steel and general machinery, totaled $1,550 million, representing 70% of total manufacturing investment in this region.

In the nonmanufacturing sector, finance and insurance accounted for a large portion of the investment in the commerce and services sector, with $2,057 million, or 26.3% of the sectoral total. Real estate investment also claimed a large share—$3,680 million, or 47.1% of the total. Large-scale acquisitions and capital participation, up markedly in recent years, continued in fiscal 1986 in such sectors as chemicals (Sun Chemical Corp.), finance and insurance (Goldman Sachs & Co.) and real estate (The Exxon Building and ARCO Plaza).

Latin America

Manufacturing investment in Latin America dropped by $51 million from the preceding year to $273 million out of a regional total of $4,737 million, despite additional large-scale investments in such existing undertakings as passenger car production in Mexico. On the other hand, nonmanufacturing investment increased substantially, especially in the financial and insurance industries. The all-time record of $2,519 million last year owed much to moves by Japanese life and nonlife insurance companies to establish overseas finance corporations in tax havens such as the Bahamas and the Cayman Islands. Investment in the transportation sector in Panama, mainly flag-of-convenience ships, totaled $1,547 million, or 32.6% of the regional total. Total investment in Panama, including tax haven investments, reached $2,401 million, up 56.6% over a year earlier. It was the fifth straight year that Panama ranked second only to the United States on a country-by-country basis. Investment in the Cayman Islands amounted to $930 million and that in the Bahamas to $792 million. Combined investment in these three countries claimed 87% of total Japanese direct investment in the region.

Asia

Investment in Asia declined in fiscal 1984 and 1985 for all industries. In fiscal 1986, however, the trend was reversed, with total investment increasing by $892 million over the year before to $2,327 million and manufacturing investment expanding by $344 million to $804 million. The relatively high rate of growth in manufacturing investment was a result of shifts in production to the newly industrializing countries of Asia as the price competitiveness of various Japanese domestic industries declined under the impact of the strong yen. Audio equipment producers, home appliance and electronics makers and auto-related companies are all setting up shop in the NICs, where wages are still lower than in Japan but where infrastructure and components industries are already relatively well developed. The products involved last year included stereos, radio-cassette tape recorders, calculators and auto parts.

In fiscal 1986, investment from Japan reached $502 million in Hong Kong, $436 million in South Korea, $302 million in Singapore, $291 million in Taiwan, $250 million in Indonesia and $226 million in China. Investment in Thailand stood at only $124 million, but that could change in the near future as the country's investment climate improves relative to the NICs. Not only does Thailand enjoy political and economic stability, but the NICs are being forced to revalue their currencies against the U.S. dollar. The attractions of Thailand as a production base for Japanese corporations are growing.

Europe

Manufacturing accounted for $370 million of the $3,469 million invested in Europe in fiscal 1986, just clearing the previous record of $337 million set in fiscal 1984. Total investment increased by 80% over a year before, mainly because investment in the finance and insurance business rose $1,328 million (139%) to $2,281 million. This was in part due to the establishment of financial subsidiaries by major Japanese trading houses, life and nonlife insurance firms and manufacturers to ensure more efficient fund raising and management by their corporate groups. Also noteworthy were the large investments by Japanese banks and brokerage houses in fields related to the banking and securities business.

On a country-by-country basis, Luxembourg ranked first in Europe with $1,092 million in Japanese direct investment followed by the United Kingdom with $984 million and the Netherlands with $651 million. Luxembourg offers various tax incentives to foreign investors, while the United Kingdom has been encouraging Japanese corporations to invest in its industries.

Oceania

Direct investment in Oceania totaled $992 million in fiscal 1986, nearly double the $525 million invested in fiscal 1985. Manufacturing sector investment increased sharply to $151 million, 10 times the figure for the preceding year. Most of the increase was explained by moves by Japanese auto companies to produce auto parts in Australia and cars in New Zealand. Investment in resources development showed eight-fold growth from a year earlier to $202 million ($25 million in fiscal 1985) as a major LNG development project on the northwest continental shelf of Australia got into full swing.

Investment in services amounted to $271 million, a gain of $178 million (191%) over a year before. The increase reflected active resort development in Australia, New Zealand, the Northern Marianas and other Oceanian countries. Most of this investment took the form of capital participation in existing hotels and in new hotel construction.

On a country-by-country basis, Australia accounted for $881 million, or 89%, of total DIA in the region.

Sectoral trends

Manufacturing

Manufacturing investment increased rapidly in fiscal 1986, climbing 61.8% to

Table 4 Direct Overseas Investment by Industry

(Units: cases, $ million, %)

Industry \ Fiscal year	1981			1982			1983			1984			1985			1986			
	No. of investments	Value	Percentage	No. of investments	Value	Percentage	No. of investments	Value	Percentage	No. of investments	Value	Percentage	No. of investments	Value	Percentage	No. of investments	Value	Percentage	Increase over the previous year
Foodstuffs	100	142	1.6	57	78	1.0	85	77	0.9	70	118	1.2	87	90	0.7	97	127	0.6	41.1
Textiles	71	91	1.0	62	67	0.9	54	174	2.1	47	85	0.8	40	28	0.2	45	63	0.3	125.0
Lumber/Pulp	40	65	0.7	47	76	1.0	25	91	1.1	26	115	1.1	18	15	1.1	23	57	0.3	280.0
Chemicals	105	228	2.6	114	322	4.2	96	450	5.5	75	223	2.2	87	133	1.1	83	355	1.6	166.9
Iron and steel/ Nonferrous metals	78	521	5.8	98	468	6.1	63	479	5.9	52	718	7.1	57	385	3.2	71	328	1.5	–14.8
Machinery	124	207	2.3	98	164	2.1	93	169	2.1	80	185	1.8	107	352	2.9	144	626	2.8	77.8
Electric/Electronic	113	475	5.3	103	267	3.5	118	502	6.2	146	409	4.0	133	513	4.2	212	987	4.4	92.4
Transport equipment	40	406	4.5	45	439	5.7	41	486	6.0	53	437	4.3	49	627	5.1	97	828	3.7	32.1
Others	132	169	1.9	124	195	2.5	131	160	2.0	128	215	2.1	140	208	1.7	209	435	1.9	109.1
Manufacturing total	803	2,305	25.8	748	2,076	27.0	706	2,588	31.8	677	2,505	24.7	718	2,352	19.3	981	3,806	17.1	61.8
Agriculture and forestry	79	75	0.8	61	40	0.5	46	18	0.2	41	26	0.3	24	12	0.1	27	15	0.1	25.0
Fisheries	26	36	0.4	21	22	0.3	35	17	0.2	30	24	0.2	42	42	0.3	46	52	0.2	23.8
Mining	125	2,534	28.4	65	685	8.9	42	382	4.7	20	484	4.8	32	598	4.9	36	669	3.0	11.9
Resources development total	231	2,645	29.6	147	747	9.7	123	418	5.1	91	534	5.3	98	652	5.3	109	737	3.3	12.9
Construction	512	96	1.1	52	44	0.6	80	55	0.7	70	112	1.1	59	94	0.8	45	250	1.1	166.6
Commerce	742	1,174	13.1	806	1,899	24.7	892	1,164	14.3	644	1,482	14.6	644	1,550	12.7	649	1,861	8.3	20.1
Finance and insurance	53	843	9.4	67	533	6.9	68	1,167	14.3	79	2,085	20.5	164	3,805	31.1	274	7,240	32.4	90.3
Services	184	623	7.0	193	702	9.1	218	622	7.6	216	681	6.7	255	655	5.4	290	1,560	7.0	134.6
Transportation	299	722	8.1	357	924	12.0	498	1,363	16.7	558	1,651	16.3	474	1,240	10.1	440	1,925	8.6	55.2
Real estate	101	167	1.9	86	354	4.6	95	375	4.6	85	430	4.2	149	1,207	9.9	332	3,997	17.9	231.2
Others	57	246	2.8	50	278	3.6	36	193	2.4	44	454	4.5	44	322	2.6	27	379	1.7	17.7
Commerce and services total	1,487	3,871	43.3	1,611	4,731	61.4	1,887	4,940	60.6	1,696	6,895	67.8	1,759	8,883	72.7	2,057	17,212	77.1	93.8
Branches	42	110	1.2	42	149	1.9	38	200	2.5	35	221	2.2	38	329	2.7	49	566	2.5	72.0
Total	2,563	8,931	100.0	2,548	7,703	100.0	2,754	8,145	100.0	2,499	10,155	100.0	2,613	12,217	100.0	3,196	22,320	100.0	82.7

Notes: 1. Numbers of investments indicate new investments only.
2. Percentages indicate the share of each industry in the total value.

$3,806 million from $2,352 million in the previous year (Table 4). Companies sought to increase production abroad in order to secure overseas markets without provoking trade friction. Others sought to counter the appreciation of the yen, or to produce merchandise abroad to avoid rising production costs at home. Yet despite the growth, the share of manufacturing investment in total investment continued to decline from its peak of 31.8% reached in fiscal 1983. The figure for fiscal 1986 stood at only 17.1% as growth in financial investments continued to outpace manufacturing.

On a regional basis, manufacturing investment in North America increased by 79% over a year earlier to $2,199 million, accounting for 57.8% of the world total. Next came Asia with $804 million, up 75% year-on-year to take 21.1% of the world total. In Oceania, manufacturing investment expanded by $136 million (900%), mostly thanks to automotive parts investment in Australia. In Europe and Latin America, however, investment levels remained about the same as in the preceding year. The $370 million in Europe was up 15% from fiscal 1985, and the $273 million in Latin America down 16%.

Resources development

Resources development investment rose by $85 million from a year earlier to $737 million in fiscal 1986, passing the $700 million mark for the first time in four years. Mining accounted for most of the investment at $669 million. Investment in agriculture, forestry and fisheries remained extremely low as in the year before (Table 4).

Mining investment has been sluggish for many years as the prolonged stagnation in the world economy following the second oil crisis combined with the global trend toward energy conservation to depress demand. The increase for fiscal 1986 reflected the full-fledged start of LNG development in Australia, as well as oil development and other projects in Indonesia. The weight of resources development in total investment shrank to 3.3% in fiscal 1986 from a little over 5% for the previous four years.

Commerce and services

Investment in commerce and services jumped by 93.8% last fiscal year, leaping from $8,883 million in fiscal 1985 to $17,212 million (Table 4).

Finance and insurance

Investment in the financial and insurance industries increased by 90.3% to $7,240 million from $3,805 million the year before. Japanese corporations, and particularly life and nonlife insurance companies, established finance corporations in tax havens to buy bonds in the New York market and manage funds more efficiently. Behind these moves were unprecedentedly low interest rates in Japan accompanying the internationalization and liberalization of financial services. Another factor was a rash of capital tie-ups between leading Japanese commercial banks, trust banks and securities companies and foreign financial institutions as seen in the much-talked-about tie-up between Sumitomo Bank and Goldman Sachs. These linkages are aimed at diversifying operations through the acquisition of know-how on the international finance business in the U.S. and Europe, and by moving into trust banking to manage corporate pension funds and provide investment consultancy services. In the United States, Japanese banking and securities companies were especially keen to acquire U.S. interests to qualify as primary dealers.

Real estate

Investment in real estate continued to accelerate in fiscal 1985 and 1986. In 1985 it increased three-fold over a year earlier, and in 1986 it expanded 3.1-fold to $3,997 million. Japanese real estate companies invested heavily in the United States, prompted by diminishing returns on domestic investments as Japanese land prices soared. The continuing appreciation of the yen also sharply reduced the relative cost of acquiring land and buildings in the U.S.

Encouraged by these developments, Japanese real estate agents rushed into the U.S. real estate industry by themselves, or financed purchases of U.S. real estate by local subsidiaries. Examples include the acquisition of the famous Exxon Building in central New York and the ARCO Plaza in Los Angeles. These moves may have been prompted by 1986 revisions in the U.S. tax code. U.S. real estate companies were eager to sell before the depreciation terms for buildings were extended early in 1987.

Services

Investment in services increased by $895 million (135%) in fiscal 1986 over the year before to $1,560 million. The main source of the increase was efforts to develop tourist resorts in Australia, New Zealand, Hawaii and the Northern Marianas by building new hotels or by buying up existing ones.

Transportation

Investments in transportation rose by $685 million (55%) over fiscal 1985 to $1,925 million. As usual, most went into flag-of-convenience shipping in Panama, Liberia and other countries.

Commerce

Investment in commerce stood at $1,861 million last year, an increase of $311 million (20.1%). Japanese trading companies and automakers provided most of the funds as they set up sales companies in the U.S. and Europe to promote sales and improve their customer service capabilities.

Prospects: no slowdown likely

Japan's DIA is expected to rise in the years to come, in part because of a continued strong yen and intensified trade frictions, and in part because Japanese corporations are gaining in the managerial and technical know-how needed to invest wisely abroad.

Manufacturing

DIA in manufacturing is expected to increase, particularly in such assembly and processing industries as automobiles and home appliances, as companies shift production overseas to defuse trade friction. These moves are likely to spread as well to machine tools, office equipment and other machinery.

Overseas production by so-called set makers could lead to similar moves by small and medium-sized enterprises such as auto parts producers. Yet there are problems as well. A flood of auto parts makers into the United States could cause a new round of "investment friction." Nor would such companies be able to turn a profit overseas so long as they cling to their traditional business ties with Japanese automakers.

In developing countries such as those found in Southeast Asia, however, Japanese investment is being welcomed as a way to develop local export industries. These nations are even offering a variety of investment incentives. Eventually such investment will be widespread throughout Asia, although the scale will of course vary from country to country. This in turn will accelerate the horizontal division of labor between Japan and its neighbors. Future investment in Asia is likely to be targeted on producing products for export to Japan and the U.S. as well as to other countries in the region.

Resources development

Slack demand for resources assures Japan of stable supplies over at least the medium term, while oil prices seem to be headed upward again, at least during the 1990s. Absolutely essential investment in this field by Japanese companies is expected to continue, but a full-scale recovery looks unlikely for the time being.

Commerce and services

This sector accounts for the bulk of Japan's DIA. In particular, investment in finance and insurance and in real estate has been taking a growing share of the total. Now, however, finance and insurance investment in the U.S. and Europe by Japanese financial institutions seems to have run its course. This, plus the sensitivity of such investment to local market trends and government policies, makes it hard to predict whether growth will continue as it has in the past. Real estate investment, meanwhile, depends largely on the yen-dollar exchange rate. It seems doubtful that it can maintain the same level as posted in fiscal 1986, when investment was concentrated in a small number of key U.S. cities.

Smoothing the transition

Japan urgently needs to correct its external imbalance, the source of continuing economic friction with other countries. The nation is being urged to restructure its economy to reduce its dependence on exports and develop a pattern of growth led by domestic demand. The yen's rapid appreciation is already forcing some Japanese corporations to shift part of their production abroad to counter the declining cost competitiveness of certain products. These moves are expected to hasten structural adjustments within corporations and industries, and give further impetus to the international division of labor. At the same time, increased imports of finished and semifinished products and growth in transactions through third countries in which Japan has direct investments are expected to alter global physical distribution systems.

Japan is committed to promoting structural reforms in its economy, and especially expansion of domestic demand, to help achieve the harmonious development of the world economy. This goal is spelled out in the so-called new Maekawa Report, published in April this year. To achieve this target, it is essential that Japan work even harder to promote direct overseas investment, particularly in the manufacturing sector.

If such investment is to go well, investing corporations must seek coexistence with their host countries and contribute positively to their societies. This is a major challenge for Japanese executives as they transplant Japanese-style management and production quality-control techniques in foreign soil. In Japan as well the process of structural adjustment will bring various problems, especially in the labor market. It will be necessary to continue efforts on both the public and private levels in the years ahead to work out the best possible solutions to these problems. ●