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Ryutaro Komiya
The University of Tokyo

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JAPAN'S FOREIGN DIRECT INVESTMENT: FACTS AND THEORETICAL CONSIDERATIONS*

Ryutaro Komiya

The University of Tokyo

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The main purpose of this paper is to examine the phenomenon generally called foreign direct investment in a concrete case of present Japan, and reconsiders the theory of direct investment in the light of findings therefrom. The paper begins with examining the concept of foreign direct investment used and statistics thereof compiled by national governments, in particular the Japanese government. It is shown that the distinction between direct and indirect investment cannot be clear-cut and that there exists wide grey areas of different shades in-between (Section I). Then the paper sketches out the history of Japan's foreign direct investment in postwar years (Section II), and surveys different types of investment included in the direct investment statistics (Section III).

In the next section a number of distinctive features of Japan's foreign direct investment as compared with other countries' direct investment are discussed

(Section IV). Then theories of direct investment are reviewed and reconsidered in the light of Japan's experience, and the author's view on direct investment is developed (Section V). The last section summarizes main conclusions of the paper.

The paper does not go into the policy issues such as whether and in what ways a developing host country should restrict foreign direct investment, or a developed home country promote or restrict it. Such subjects require separate articles. This paper is intended to facilitate better factual and theoretical understanding of foreign direct investment which must underlie any discussion of policy issues related to it.

I. THE CONCEPT OF DIRECT INVESTMENT AND STATISTICS

The term "multinational enterprise" or "transnational corporation" is a vague one, sometimes accompanied by emotional and/or propaganda connotations. While the concept of direct investment is perhaps a more neutral one, it is not free from ambiguity. Foreign direct investment (FDI) is generally defined as a form of long-term international capital movement, made for the purpose of productive activity and accompanied by intention of managerial control or paticipation in the management of a foreign firm. It is distinguished from indirect (portfolio, or securities) long-term investment where the investor is concerned only with the yields on securities or other claims acquired.

Yet it is not always easy to ascertain whether or not such a productive or managerial intention accompanies the long-term capital movement. In fact, whether an investment is direct or indirect is not a black-and-white affair: there are wide "grey zones", as examples in the below show.

Japan's Official Definition of Direct Investment Within Japan's present

legal framework the term "outward (overseas) direct investment" is defined to include (1) acquisition by residents of securities issued by nonresident corporations and (2) lending to foreign corporations, both for the purpose of establishing some long-term relationship with them, and (3) establishment of branch offices and factories. It includes shareholding with an equity share exceeding 10 per cent in a foreign corporation, and long-term lending to such a corporation . It also includes equity ownership below 10 per cent, if the resident corporation has some "close relationship" with the foreign corporation of which the equity share is acquired, such as the former's representative serving as directors of the latter, or a long-term purchase, licensing or agency contract between them.

Moreover, long-term credit not accompanied by equity ownership is included in outward direct investment, if a certain close relationship exists between the lender and the borrower. An example is the "yūshi baikō" arrangement referred to in Section III.

The definition of inward direct investment by the Japanese government is not symmetric with that of outward direct investment. For example, "inward direct and other investment" includes, acquisition by nonresidents of any equity share of a corporation which is not listed in the stock exchange. Inward direct investment also includes acquisition, exceeding a certain amount, by nonresidents of corporate bonds privately issued by a resident corporation.

Direct Investment vs. Market Mechanism The fact that such legal definitions and treatments are quite complicated is revealing, since it substantiates the point that direct investment is various forms of behavior through which a firm tries to organize productive activities in different locations, transfers resources and collects and transmits information more efficiently— from the firm's point of view in the first place, but often also from a social point of view—than through market mechanism. A branch office, a directly owned factory or mine and a wholly owned subsidiary are most rigid or most "direct"

forms of direct investment, whereas a minority-owned subsidiary with or without a management contract and a comprehensive long-term contract without involving equity ownership but covering wide areas of management and technology (e.g. the so-called "voluntary chain" stores in retail trade) or the "shitauke" (subcontracting) system in Japan are less direct, looser forms of the firm's organizational behavior bypassing the use of open markets.

Thus it is intrinsically difficult to define clearly what is direct investment and what is not, whether from a purely academic point of view or from an economic policy point of view. There are wide grey zones between "pure" direct investment and what is not direct investment.

Partly for this reason, statistics on direct investment published by the governments of various countries are poor in quality as well as quantity, much poorer than, for example, international trade statistics.

Statistics on Japan's Outward Direct Investment In Japan there are three major official statistical sources on outward direct investment. I believe that the situation is more or less similar in many other countries. First, there is statistics published by the Ministry of Finance (MOF) on the amount of direct investment with industry- and country-breakdowns, approved by (until 1980) or notified to (after 1981) MOF (Figure 1). This statistics, most commonly used in the literature on Japan's direct investment, has three major defects: (1) firms sometimes do not actually undertake investment approved or notified, or make only a smaller amount than approved or notified, (2) the time of actual investment is generally later than the time of the approval or notificaiton, and (3) the annual amount of investment includes certain types of loans and acquisition of bonds—which constitute a very large proportion of the total investment (Figure 2)—, whereas repayments of these loans or bonds are not covered by the statistics, nor withdrawals of (or capital losses on) equity investment. Both (1) and (3) result in a substantial overstatement of the actual value of direct investment.

Second, direct investment flows are reported in the balance of payments statistics published by the Bank of Japan (BOJ). No country- or industry-breakdowns are given. Unlike the United States statistical practice the retained earnings of Japanese-owned (totally or partially) corporations abroad are neither included in the annual flows of investment nor in the investment incomes in the current account. Hence the exact stock value of investment cannot be reached by cumulatively adding up of annual flow amounts. This is the same with the MOF's approval/notification statistics. Many authors do so, however, to derive the approximate stock value, since there is no other way.[1)]

There are several other conceptual discrepancies between MOF and BOJ series, and the discrepancy between the two series is substantial (Figure 1). For example, BOJ's series includes loans for mineral resource development ("yūshi baikō" loans) not in direct investment but in long-term loans. The timing of inclusion in the statistics is naturally different: at the time of the approval or notification in MOF's series and at the time of the foreign exchange transactions or remittance in BOJ's (See Figure 1 for comparison of the two series).

Third, the Ministry of International Trade and Industry (MITI) conducts surveys of Japanese enterprises' activities abroad: a detailed survey once in every three years since 1981, and less detailed one annually except in the year in which a detailed survey is conducted. MITI sends questionnaires to the head offices of Japanese parent corporations whose overseas direct investment has been approved or notified in the past. The main defect of this statistics is that only about a half of the questionnaires are recovered. The recovery ratio is sometime considerably lower, especially at the time of the detailed survey, of which the questionnaire is more cumbersome to fill out.

There are many other sources of statistical and factual information on direct investment, such as "Yūkashōken Hōkokusho" (report on securities) filed to MOF by each "listed" corporation, publications of JETRO (Japan External Trade

Organization), Research Institute on Overseas Investment of the Japan Export-Import Bank, various industry associations, and so forth.

Pitfalls in Direct Investment Statistics Yet it is not possible to obtain more or less accurate information even on a few certain key statistics. It is not an exaggeration to say that statistics on direct investment are full of errors and pitfalls and that they generally lack international comparability.

Some of such pitfalls of direct investment statistics have already been mentioned. A few additional examples are now given.

(i) When a corporation (A) in country I invests in a "child" subsidiary (B) in country II—often a mere paper company in a tax-haven country—, and then the latter in a "grandchild" subsidiary (C) in country III, the fact that A has a direct investment interest in C is rarely reflected in the statistics.

(ii) A Japanese company participated in a British oil exploration project offshore of Abu Dhabi. In Japan's statistics, this was classified as investment in British mining.

(iii) In the international comparison of the "ratio of overseas production" of manufacturing firms whose headquarters are located in major industrialized countries, the figure for Japan has the following problem: the numerator is the total sales of all the manufacturing corporations (hence excludes sales of independent proprietors) in Japan, the denominator is the total sales of Japanese-owned overseas subsidiaries engaged in manufacturing, taken from the MITI survey. As mentioned above, the recovery ratio of the questionnaires is only about a half or less. The sales of all subsidiaries are included, whether wholly or partially owned, and even those of less-than-10-per-cent owned ones, when there is a certain "close relationship" with the parent.

(iv) If a Japanese construction company undertakes a construction project in a foreign country directly, without establishing a subsidiary, or as a joint

venture on a contract basis, its work is not counted as associated with overseas direct investment. But if the company decides to undertake the work by establishing a subsidiary in that country, wholly or partially owned, then the funds remitted to the construction work is counted as direct investment.

(v) The statistics on foreign direct investment generally records the amount of certain funds sent across the national border. A subsidiary in a foreign country often borrows funds—or issue bonds or even new stocks—there or in a third country to expand its operation. But such transactions are usually not recorded in direct investment statistics. Hence the statistics does not reflect exactly the changes in the scale of operation of overseas subsidiaries, even they are substantial.

These examples amply demonstrate that there are many pitfalls and errors in statistics on foreign direct investment, and that the degree of their international comparability is rather low. Apparently different countries uses different criteria, concepts and procedures in compiling statistics on direct investment. Even just for the direct investment flows in the balance of payments statistics published in International Monetary Fund (IMF), International Financial Statistics, different countries seem to use different conceptual criteria.[2)]

Thus quite contrary to the export and import trade statistics of which the degree of international comparability is fairly high relative to other economic statistics, generally the direct investment statistics are deficient in international comparability, and their quality and quantity seem much poorer.[3)] This is partly due to the fact, already mentioned, that direct investment is not a black-and-white affair, as in the case of export and import trade, but is a phenomenon taking place in wide grey zones.

In the following, however, I shall largely ignore these conceptual problems as well as defects and pitfalls in direct investment statistics. The figures and

statistics used in the below should be taken as indicating long-run general trends and rough comparisons between countries.

II. A BRIEF HISTORY [4)]

1. A Minuscule Beginning

By the defeat in World War II Japan lost all the overseas territories, investments and assets, so that when Japan resumed foreign investment in postwar years around 1950, accumulated overseas assets were nil. Japan had been a nearly closed country for almost twenty years, and a meagre amount of expertise the Japanese business community accumulated in earlier years—during World War I and the 1920s—to run business abroad had been largely lost by then. This situation is in a sharp contrast to those of Britain and the United States, which had large amounts of foreign direct investment assets and managerial expertise carried over from the prewar years at the beginning of the high growth period for the world economy in the 1960s and 70s, and are now still the two leading direct investor countries in the world economy. Several smaller European countries such as Netherland, Sweden and Switzerland also have long experience as direct investors, and have large foreign direct investment assets relative to the size of their home economies.

Although Japan's foreign outward direct investment was resumed in 1951, the amount invested and the scale of operation abroad remained minuscule in the 1950s and early 60s (Figure 1). This is partly due to the Japanese government policy strictly restricting outward investment, whether direct or indirect. The government's restrictive policy on foreign investment was primarily for the balance of payments reasons. Outward investment involves an immediate loss of foreign exchange similar to import. It appears that the government tried to restrict both foreign investment and import to the low level compatible with the

balance of payments constraints. This policy of severely restricting overseas investment had a counterpart on the side of capital import: namely, "the yen-basis investment" provision, put into effect between 1956 to 63, to promote inward direct investment. Foreign investment into any industry in Japan was allowed, provided that earnings from investment and liquidation proceeds would not be converted into foreign exchange for repatriation. Restrictive policy pursued by MITI on inward direct investment was started only after 1963, when this yen-basis investment provision was abolished.[5)] Also, a wholesale capital flight appears to have been a nightmare—perhaps usually a remote, but sometimes a more imminent one—for the Japanese foreign exchange authorities since the time of Japan's brief return to the gold standard from November 1930 to December 1931 when a heavy capital outflow took place within a short time. Foreign investment whether outward or inward, and whether short-term, portfolio or direct, was regulated, in principle, under the application-and-approval system until 1980, although as a matter of fact it was gradually liberalized throughout the 1970's.

In the early years after the resumption, Japan's foreign direct investment was concentrated mainly in two areas. First, Japanese trading companies, banks and later manufacturers established branch offices or subsidiaries in Japan's trade-partner countries, to assist and promote Japan's overseas trade. Second, from the last years of the 1950s a number of fairly large-scale investment projects were undertaken in natural-resource related industries in foreign countries. In the 1950s and early 1960s three or four such "national"—in the sense that the government along with a number of large firms and banks were deeply involved in their planning and implementation—projects, namely Alaskan pulp (started in 1953), Usiminus (Brasil) steel (1957), Arabian oil (1958), and North Sumatran (Indonesia) oil (1960)—were dominant ones in the amount invested. In the 1960s and early 70s development projects abroad for the supply of copper,

lead, zinc, chromium, bauxite, iron ores, petroleum, coal, paper and pulp, mostly jointly with foreign governments and/or firms, were among Japan's most important overseas direct investment projects (Figure 4).

In the 1950s and 1960s the Japanese government and business community were much concerned about the availability of these mineral and forestry resources. As the Japanese economy grew at an unusually high rate, it needed to expand rapidly import of these natural resource products. It was thought that the supply of many of these natunal resources were under the restrictive control of the exporting countries, international monopolies or cartels. It was thought advantageous for Japan to develop the new supply sources by itself through direct investment, although it required then precious foreign exchange funds.

Until 1969 the firm undertaking a foreign direct investment project had to apply for the use of foreign exchange, and the project went through a strict screening process. Most projects approved, on the other hand, were given preferential treatments by the government such as overseas investment insurance, low interest-rate financing by Japan Export and Import Bank and certain tax privileges. Also, two government enterprises were established specifically to undertake and promote overseas investment to develop new supply sources, one for oil and the other for other mineral resources.

Outward direct investment was liberalized by several steps between 1969 and 72, much faster than inward investment which was also largely liberalized by several steps between 1967 and 76. Both outward and inward direct investment were then almost completely liberalized, and at present only a few restrictions of minor importance remain.

2. The Foreign Investment "Gannen"

The year 1972 was called the "gannen" of Japan's foreign (direct) investment. The "gannen" means the first year of the reign of an emperor in

China or Japan. Japan's direct investment increased sharply in 1972 and 73 (Figure 1). In these two years many Japanese firms for the first time considered, planned and undertook foreign direct investment as an important and integral part of their business strategies. While the Japan's outward foreign investment for the 21 years 1951 through 71 adds up only to 3.6 billion U.S. dollars, the total for just two years 1972 and 73 amounts to 5.8 billion.

Major factors behind this sharp increase may be summarized as follows. First, abrupt and sharp appreciations of the Japanese yen from 360 yen to one U.S. dollar under the Bretton Woods regime to 308 yen in 1972 and then to 265 yen to a dollar in 1973 raised all costs of production in Japan relative to those prevailing in other countries, especially nearby Far Eastern countries. Also, the large appreciations of the yen enabled Japanese firms to build factories and acquire equity shares in other countries much more cheaply than before.

Second, in addition to the currency appreciation, real wages were rising sharply in Japan, inducing Japanese firms to look around outside of Japan, seeking the sites of production in nearby Asian countries where the labour costs were lower. Thus Japan's comparative advantage pattern was changing, and labour-intensive industries within Japan were losing competitiveness in international markets.

Third, Japan's balance of payments on current account recorded sizable surpluses for the first time after World War II, or, to go back to the past further, for the first time since a few years during and after World War I. In view of the complaints from deficit countries, that is primarily the United States, the Japanese government encouraged and promoted the use of foreign exchange, including outward direct investment abroad. The monetary authorities pursued extremely easy money policy in 1971 and 72, and Japanese firms could easily and cheaply finance foreign investment until the middle of 1973. The unusually easy money—called "excessive liquidity"—resulted in a high rate of inflation from the

middle of 1973 through 75 and many of the borrower-investors benefited much as a result.

In this period a large number of manufacturing firms including many smaller ones—called "small- and medium-size businesses" in the Japanese law—rushed to South Korea, Taiwan, Hongkong and ASEAN countries for manufacturing activities there. One of the notable feature of Japan's overseas direct investment is that smaller businesses are quite active as direct investors (Section IV), and it was first exhibited in this period, when the government policy changed almost 180 degree from restriction to encouragement.

3. Stagnation after the First Oil Crisis

After the first oil crisis the level of annual direct investment ouflows from Japan declined and remained largely stagnant until the beginning of the 1980s. Taking into account the high rate of inflation after 1973-74, one may say that the 1972-73 "gannen", peak level was not surpassed until 1981 (Figure 1).

After the first oil crisis the Japanese economy—and the world economy at large—ran into the severest depression or stagflation after World War II, and a large number of Japanese firms recorded losses: in the worst year, 1975, nearly one third of the corporations listed in the stock exchanges recorded deficits on their operating accounts. This is the worst corporate performance among major industrialized countries in recent years. Many industries continued to have excess capacity and redundant personnel well into the last years of the 1970s. It is no wonder that outward direct investment remained stagnant under such conditions.[6)]

The yen exchange rate which had gone up sharply in 1972 and 73 depreciated in 1974 and 75 as a result of the first oil crisis and the ensuing large balance of payments deficits on current account, making foreign direct investment less attractive than in the "gannen" years of 1972 and 73.

A large number of Japanese firms withdrew their investments from East and Southeast Asian countries in this period, especially in 1976 through 79, by selling out subsidiaries or equity shares, or simply abandoning unprofitable factories.[7)]

During this period, however, major changes in the conditions underlying direct investment were taking places. At the beginning of this period Japan was still a medium-rank industrial power in the world economy. Its balance of payments position was jeopardized by the two oil crises, especially the first one. At the time of a sort of "seizing up" or a "clog" situation in the summer of 1974, Japan was considered—along with Italy—as a country with the highest country-risk among industrialized countries. Japanese banks then experienced considerable difficulties in rolling over the short-term borrowing in the Eurodollar market, and the phenomenon of the so-called "Japan rate"—Japanese banks having to pay several points higher rates than LIBOR—persisted for a number of weeks. When the wave of the second oil crisis subsided in the latter part of 1980, however, Japan emerged as one of the most active countries in world financial markets. By 1982 its country-risk rating was among the lowest three or four countries of the world.

In industrial technology, in the first half of the 1970's Japan was generally still behind the United States and Western Europe, and was exporting mainly manufacturing products using more or less labour-intensive, medium-level technologies such as textiles, iron and steel, ships and tankers, although higher value-added machinery and equipment were gradually replacing textiles and other labour-intensive products, steel, ships and tankers, as Japan's major exports. The value of motor vehicles in export exceeded that of ships and tankers for the first time in 1975. By the first half of the 1980's Japan's chief exports were automobiles, electronics products, communication equipment, semiconductors, electronically controlled machine tools and so on. Other industrialized countries including the United States were having difficulties to compete with Japan in

many of these products even in their home markets, and the cases of what is called "trade friction" between Japan on the one hand and the United States and West European countries on the other (bōeki masatsu, that is, cases of import restrictions, dumping charges, bilateral negotiations to restrict import or export of particular commodities, moves toward protective trade legislation, etc.) increased sharply. Cases of trade friction on Japan's export side---there have been cases of "trade friction" on Japan's import side as well---arose first in textiles and other labour-intensive products in the 1950's and early 60's, then moved to medium-level technology products such as shipbuilding, iron and steel and colour TV sets in the late 1960's and 70's, and by the middle of the 1980's are occurring most frequently in the medium-to-high-level technology products such as automobiles, motorcycles, quartz watches, construction machinery, semi-conductors, video tape recorders (VTR), copying machines, computors, electronically controlled machine tools, telecommunication equipment, etc.[8)]

4. The Second Upsurge of Outward Direct Investment since 1981

Japan's overseas direct investment flows which remained in the range between 2 and 4 billion U.S. dollars for the six years 1972 through 77 and in the range between 4 and 5 billion for the three years 1978 through 80 sharply increased to nearly 9 billion in 1981, and surpassed the 10 billion line in 1985. It then jumped up to over 22 billion in 1986 (MOF series). Thus the years since 1981 may be said the second period of an upsurge, after the "gannen" years 1972 and 73 (Figure 1). The year 1986 and afterwards may prove to be another new era of activation of outward direct investment, although it is still unknown what developments will take place in the coming years. Japan's outward direct investment in just two years 1985 and 86 amounts to 34.5 billion U.S. dollars, which is nearly equal to the total investment of 36.5 billion over 30 years from 1952 to 81.

Sharp Increase in Tertiary Sector Investment Besides the sharp increase in the total, two prominent tendencies in Japan's outward direct investment are observed since 1981, especially towards the latest years. First, in the industry breakdown---according to the main line of business in the host country---there has been a shift away from mining and natural-resource related investment, and also to some extent also away from manufacturing, towards the tertiary industries (Figure 4). The tertiary sectors such as finance, insurance, wholesale and retail trade, services and real estate became more and more dominant in Japan's direct investment. In the direct investment outflow in 1986, finance and insurance (32.3%) and real estate (17.9%) were the two leading industries in Japan's direct investment accounting for more than a half of the total between them. The shares of transportation (8.6%), commerce (8.3%) and services (7.0%, especially leasing business and hotels) were also quite large. The shares of manufacturing and mining in the 1986 outflow were only 17.1% and 3.0% respectively: this is a substantial decline from their shares of 34.5% and 19.4% respectively in the total outflows between 1951 and 80 (figures are those from the MOF series).

In mining and other resources related projects there were a few large-scale, government-supported projects in the early part of this period (or the last years of the previous period), such as the Asahan Aluminum project in Indonesia, LNG (liquefied natural gas) in Brunei and Indonesia and copper in Zambia. However, a generally declining tendency in the prices (or terms of trade) of minerals and natural-resource commodities and the excess supply conditions thereof resulting from the world-wide depression after the second oil crisis seems to have diminished Japanese firms'---and government's---interest in direct investment in natural-resource development. Although included in manufacturing (chemicals), large-scale petrochemical projects in Iran, Singapore and Saudi Arabia, undertaken mostly in the early part of this period are also in a sense resources-related direct investment. But the enthusiasm in petrochemical investment

projects rapidly subsided partly by the Iranian revolution and the Iranian-Iraqi war and partly by the decline of oil prices and the world-wide glut of petrochemicals.

Direct investment in manufacturing has been generally increasing after 1980, but its growth has been far outpaced by the growth of direct investment in the several tertiary industries mentioned above.

Shift Away from LDC toward Developed Countries Second, in the area and country breakdown, there has been a remarkable shift away from the developing countries in Asia, Middle East and Latin America toward North America, especially the United States, and Western Eupore, that is, toward the developed countries (Figure 3). The rise of the United States as the host country of foreign direct investment appears to be true not only of Japan's but also of other countries' outward investment (Figure 7).

In the area breakdown North America accounted for only about a quarter (26.8%) in Japan's total direct investment outflow between 1951 and 80, but nearly half in 1985 and 86 (45.0 and 46.8% respectively). The rise of the North America in the share of manufacturing investment is more dramatic: it accounted only for 19.3% for years 1951 through 80, but more than half in 1985 and 86 (52.0 and 57.8% respectively). The rise in the European share is less pronounced: from 12.3% for 1951 through 1980 to 15.8 and 15.5% respectively for 1985 and 86, but taking only manufacturing investment it rose from 6.7% for 1951 through 1980 to 13.7 and 9.7% respectively for 1985 and 86.

In contrast the share of Asia in Japan's outward direct investment declined sharply: from 16.9% for 1951 through 80 to 11.7 and 10.4% in 1985 and 86. In manufacturing investment the Asian share declined from more than one third (36.4%) for 1951 through 80 to only about one fifth (19.6 and 21.1% respectively) for 1985 and 86.

Factors behind Recent Changes Several factors may be pointed out as among those giving rise to the major changes in the pattern of Japan's outward

direct investment in the period after 1981 just described.

(1) Financial Deregulation and Integration First, the development of the Euromarket (Eurocurrency and Eurobond markets) and financial deregulation first in the United States and then in the United Kingdom, Japan and other developed countries led to an acceleration of integration of the financial markets on a global scale, centred around in developed countries but not confined to them. The Japanese government and financial circles took part in this process of world-wide financial liberalization and integration. Since the basic change of Japan's law on foreign exchange controls in December 1980 toward deregulation Japanese banks, securities companies and institutional investors especially life insurance companies were gradually freed from rigid regulations on their overseas activities, and their management horizons and business activities were expanded on a world-wide scale. Hence their direct investment was steadily stepped up.

(2) Current Account Imbalance Second, Japan began to run a large surplus in the balance of payments on current account after 1983. Japan's net foreign asset and liability position had rarely been much in excess of one or two per cent of GNP on either side until 1981, but began to turn into a large net asset position after 1983. Japan has now become a large net creditor country, and its foreign assets have been accumulating rapidly. In contrast the United States turned into a net debtor country after 1985, and its international asset and liability position has been deteriorating steadily.

A large capital outflow or capital export from Japan and a large capital inflow or capital import into the United States are mirror images of the large scale current account imbalances of the two countries. They reflect the excess of saving over investment in Japan resulting from, among other factors, a substantial decline in the growth rate of the Japanese economy and scarcity of investment opportunities at home, and the excess of investment over saving in the United States. Portfolio investment constituted a predominant part of Japan's capital

export since the early 1980's, but it is no wonder that Japan's direct investment outflows also increased sharply under such conditions even in the absence of the heightening of tariff- and nontariff-barriers to import on the part of the United States and other trade partners of Japan.

A large part of direct investment is composed of loans, including—but not necessarily exclusively of—loans from the parents to subsidiaries (Figure 2). Since in the first half of the 1980's the monetary conditions were predominantly easy in Japan where saving was in excess of domestic investment, while they were generally tight in the United States, subsidiaries of Japanese based companies in the United States and elsewhere increased the proportion of loans from the parents in financing their operations, thus increasing direct investment outflows from Japan.

(3) Trade Barriers in U.S. and Europe Third, various types of tariff- and nontariff-barriers to trade were newly set up or substantially heightened by the United States, Canada and West European countries during this period, as Japanese export of certain types of manufactures to these countries increased sharply, and also as the bilateral trade imbalances between Japan and these countries grew rapidly. Not only actual raises of the trade barriers to restrict import from Japan such as "voluntary" export restraints (VER), orderly marketing arrangements (OMA), the raises of tariff rates and dumping charges—the fact that prices set by Japanese manufacturers were lower than the prices of a similar products made in the importing country was often complained of as dumping—, but also the possibility that some such import trade barriers might be set up or heightened in the near future promoted direct investment by Japanese manufacturers in the United States and Western Europe. In 1986 somewhere between 30 and 40 per cent of Japan's export to the United States was said to be covered by some formal or informal quantitative restrictions.

The raising of such trade barriers without any other measures to promote

direct investment would have an effect of increasing direct investment to get over the trade barriers, but as a matther of fact while raising the trade barriers on the one hand, the U.S. and some West European governments and local governments took various measures to encourage Japanese direct investment within their jurisdiction in the hope of increasing employment. In the 1980's "to cope with trade friction" has become by far the leading reason for Japanese direct investment going to developed countries (Figure 11).

One of the earliest cases of direct investment by Japanese manufacturers to get over trade barriers newly set up by the United States was investment by manufacturers of colour TV sets. An intergovernmental OMA agreement was concluded between the Japanese and U.S. governments covering three years beginning from July 1977. Prior to this agreement Japanese export of colour TV sets to the United States increased sharply and the Japanese manufacturers' share in the U.S. domestic market rose from 12.5% in 1974 to 30% in 1976. Most Japanese manufacturers of TV sets set up new factories or acquired existing ones in the United States, and local production in the United States partially but increasingly replaced export from Japan. Some manufacturers set up factories in East or South East Asian countries which were not covered by the OMA agreement and exported to the United States. Export from such countries even enjoyed a lower tariff rate under GSP (the Generalized Scheme of Preference) for developing countries. Japanese manufacturers was not necessarily forced to cut their domestic employment much, since major parts and assemblies were often continued to be manufactured in Japan and exported to their subsidiaries in the United States or elsewhere, and since Japanese manufacturers were able to expand their sales in the United States (Figure 12 A).

Since then more or less similar types of direct investment in the United States and Western Europe were made by Japanese manufacturers of automobiles, motorcycles, TV sets, VTR (Figure 12 B), other electronics products, semi-

conductors, copying machines, machine tools and some other products. In later years, some of the channels of exporting through subsidiaries in East and South East Asian countries as in the case of colour TV sets were closed or narrowed, as the United States or European countries took measures to restrict import of certain manufactures from such countries, or at least decided not to apply the GSP tariff rates on them.

(4) Large Appreciation of the Yen Fourth, the Japanese yen exchange rate began to appreciate sharply beginning from the G-5 meeting at the end of September 1985, and went up from the range of 240-250 yen to a U.S. dollar in the spring and summer of 1985 to around the range of 140-150 yen in the middle of 1987. This is indeed a nearly 70% rise. The appreciation of the yen on an effective exchange basis has been somewhat smaller, but still amounts to nearly 50 per cent. East and South East Asian currencies are more or less tied to the U.S. dollar, so that the Japanese yen rose sharply vis-a-vis the currencies of Japan's neighbouring countries.

The large yen appreciation must have contributed substantially to a sharp increase in Japan's direct investment outflows in 1986 and 87.[9)] It meant that the costs of foreign direct investment whether in the form of mergers and acquisitions, establishing new subsidiaries, expanding existing factories and other productive capacity or purchasing real estates declined greatly. Also, wages and other costs of production in Japan rose 50 per cent or more in terms of a common currency whether the U.S. dollar or yen, relatively to the wages and other local costs in other countries, especially the United States and neighbouring Asian countries, in a very short period.

The full effect of the recent yen appreciation on Japan's direct investment is still unknown. It is bound to be accompanied by prolonged lags. Obviously it takes much time for a firm to plan and execute a change in the location of productive activities, or to decide the direction or a major expansion of its

operations. At present many Japanese firms are considering to shift some parts of their operations to the United States, Western Europe and/or East and South East Asian countries. It is likely that there will be a continued upsurge of Japan's oversea direct investment.[10)] On the other hand, it should be also noted that the large yen appreciation has been bringing great hardship to many Japanese-owned subsidiaries abroad, as they depend on raw or intermediate materials, parts and assemblies imported from their parents in Japan.

(5) Worsening of Investment Environment in LDC An important factor which has contributed to a decline in the share of developing countries including those in East and South East Asia in the country-breakdown of Japan's outward direct investment is a general tendency of the worsening of investment environment in these countries. In addition to the problem of accumulated debt, wars, civil wars and political instability repelling foreign investment from a number of developing countries, economic conditions in most developing countries generally deteriorated in the first half of the 1980s as a result of world-wide depression and stagnation in world trade, especially in primary commodities.

Moreover, the government policy and public attitude in some developing countries toward incoming foreign direct investment vacillated within a short period. The list of measures adopted by developing countries toward foreign direct investment is a really long one including all sorts of prohibitions and restrictions on the one hand, and a number of measures intended to promote investment. By and large changes in governmental policies of those developing countries in recent years which had been the major host countries to Japan's direct investment were making them less attractive as places in which foreigners invest.

III. VARIED TYPES OF DIRECT INVESTMENT

When economists speak of foreign direct investment they tend to think of a large "multinational" corporation engaged in large-scale mining, plantation agriculture or manufacturing at estalishments located in many countries, all of which are controlled and directed by a headquarter in the investor's home country. But such an image is obviously little more than a stereotyped picture of foreign direct investment, applicable to only a small part of it, at least in the case of Japan's overseas investment. As a matter of fact there are a wide variety of types of direct investment. This may be true of foreign direct investment of other countries as well, but I have been struck by the wide variety of different types of investment, as I have gone through the literature in this area.[11] Some of them are now enumerated.

(1) Mining and other natural-resource development projects As already mentioned its relative importance in the Japan's total foreign investment was quite large in earlier years. In recent years, as a result of the strengthening of the assertion of "permanent sovereignty over natural resources" by developing countries direct investment of this type often takes the form of "the long-term credit with a product sharing" arrangement ("yūshi baikō") without equity participation, in which the repayment is made through export of minerals or other products over an extended period after the development project succeeds. Such an investment project involves no equity ownership legally, but is obviously quite risky and treated as direct investment by the Japanese government.

(2) Manufacturing over the fence of protective tariff- and nontariff-barriers This is one of the traditional types of direct investment, quite common in other countries' outward investment as well. A large number of developing countries and Australia—and Japan sometime ago—have been pursuing a policy of raising the tariff rates or setting up formal or informal quantitative import restrictions on the one hand, and inviting foreign direct investment in manufacturing within

their countries often providing some preferential treatments such as tax holidays, low cost financing or offers of land for factories at favourable terms, on the other hand. It is needless to say that the proclaimed aims of such a policy are generally, first, to gain in employment, and, second, to obtain technological and managerial expertise. But the users of the products have to pay higher prices at least in the short run, and the cases of successful development of viable—in the sense of becoming competitive without protection—industries in the long-run are not many. A large part of Japanese investment in manufacturing industries in these countries have been of this type.

Recently, the United States and a number of West European countries joined in the group of countries pursuing this type of policies. A large part of the recent rush of direct investment by Japanese manufacturing firms there can be classified in this category, namely investment over the fence of protective trade barriers (Figures 11 and 12), although the changes in the cost conditions resulting from the rise in real wages in Japan and the yen appreciation are also important factors behind it.

The scale of operation under this type of manufacturing investment is generally small, and the cost of production tends to be much higher than the cost at the "base factories" in the home country, where the scale of operation is by far greater.

This type of investment is not altogether import-substituting or trade-replacing, since the subsidiaries behind the protective barriers usually import parts and assemblies from the parent firms in the home country or affiliates in third countries, and trade in them often expands over time. The host country is often keen, however, to raise what is called "the local contents", that is the proportion of the value-added accruing to local residents and to reduce the import of parts and assemblies from the parent firms or affiliates as much as possible. Both the United States and the European Community (EC) countries seem to have

joined developing countries recently in pursuing such a policy.

It is ironical to see that in the United States, which was the country most strongly opposed to the local-contents requirements for direct investment set up by development countries in the past, not only many "local-contents bills" have been introduced in its Congress, but also in the actual planning of investment projects its local governments and communities often request higher local contents than the investors have planned. The EC commission recently decided that only those manufactured products in certain categories which have local (EC) contents higher than 50 per cent are considered as made in EC and will not be subject to EC's common external tariff rates. This amounts to a policy of requesting those non-EC, especially Japanese, manufacturers who are trying to get over EC's tariff and nontariff import barriers through direct investment to raise the local contents above 50 per cent.

(3) Manufacturing investment in low-wage countries serving as the bases for export Some of the Japanese-owned manufacturing subsidiaries in Asian "NICS", that is South Korea, Taiwan, Hongkong and Singapore, and other ASEAN countries are established to take advantage of lower labour cost in these countries,[12)] and to export their products back to Japan and/or to third countries, especially the United States and Western Europe.

The mainland Chinese government generally requests the direct investor to achieve at least a balance between its foreign exchange payments and receipts and preferably an excess of the receipts over payments, so that the investor must export a substantial part of products.

Such investment is sometimes induced by the fact that export from these countries to the United States or Western Europe is not subject to VER, OMA or other quantitative restrictions which cover export of certain products from Japan, and sometimes even enjoy the GSP tariff rates.

Certain types of Japanese direct investment in the food processing industry

in Asian countries are made to take advantage of the facts that not only wages but also raw materials—agricultural products—are cheaper in the host country, and that certain processes in food processing is highly labour-intensive. For example, a number of Japanese trading and food processing companies have been involved in Thailand, mostly with minority equity shares, in businesses producing corn (maize) and other feedstuff for chicken, raising chicken and then preparing chicken meat for "yakitori" and other chicken dishes. These processes, especially the meat preparation are quite labour-intensive. The products are frozen and shipped to Japanese restaurant chains and food processing firms.[13)]

Recently, however, real wages are rising rapidly in Hongkong, Singapore, Taiwan and South Korea. Some of these countries now do not welcome foreign direct investments made mainly for the purpose of taking advantage of lower wages, but are trying to attract foreign investments in high-technology industries bringing in advanced technologies.

(4) Wholesale and Retail Trade In terms of the sales of subsidiaries in host countries classified by industry, wholesale and retail trade is by far the leading sector in which Japanese firms invest, with a share of 83.0 per cent in 1983, followed by manufacturing in the second place with a meagre share of only 14.5 per cent, according to a survey by MITI.[14)]

From the 1950's when Japan's foreign direct investment was resumed, Japan's large trading companies (sōgō shōsha) have always been leading figures in foreign direct investment. When we list Japanese corporations in the order of the amount of their overseas direct investments, all the leading trading companies are among the top ten or fifteen. Trading companies have invested heavily not only in their overseas networks for exporting and importing business, but also in mining and other resource development projects as well as in manufacturing industries. In the mining, forestry, fishery and manufacturing investment projects they participate mostly with minority shares, jointly with local and/or Japanese

mining, manufacturing or other investors or with the governments of the host countries. Besides assuming investment risks trading companies engage themselves in the trading aspects of the projects (marketing of outputs, procurement of machinery, etc.).

On the other hand, not only trading companies but also Japanese manufacturers invest heavily in wholesale and retail trade abroad. Japan has strong comparative advantage in fabricating and assembling type manufacturing industries using mass-production technologies. Typical examples of such industries are automobiles, semiconductors, electronics products, cameras, watches, electronically controlled machine tools, and stereo equipment. For all of these products "product differentiation" is quite important and they are sold to a large number of customers—since they are mass-produced. It is essential for the success of the manufacturer in these fields to establish and maintain an efficient marketing and servicing network on a global basis.

Such a network can be set up by the manufacturing firm itself, by a cooperating Japanese trading company or by a local importer acting as a general agent. But the manufacturing firm often finds it advantageous to set up the network by itself. It requires a substantial amount of investment in wholesale and retail trade.

(5) Finance and Insurance As mentioned earlier one of new developments in Japan's direct investment since the beginning of the 1980's and especially since 1985 is a sharp increase in investment in the finance and insurance sector. Japanese banks, securities companies, and insurance companies are establishing subsidiaries abroad and acquiring or merging foreign firms. Also, Japanese non-bank (insurance, trading and manufacturing) firms are establishing wholly owned "finance companies" in the United States, Britain, and such tax-haven countries as Bahama, Cayman Islands, Luxemburg and Panama.

A remarkable phenomenon in recent years is that many Japanese firms have

come up on the list of the world's 10, 20 or 100 leading banks or securities underwriters, and are very active in the world's financial centres. They are expanding their business even in purely domestic markets in foreign countries such as retail banking in California or Britain.

I do not understand at all what comparative advantage Japan has in banking or securities business, and what special managerial expertise Japanese banking and securities firms have, to record such remarkable successes in international financial business within a short period.

(6) Investment in Real Estate Business One of new developments in Japan's foreign direct investment in the last few years is a sharp increase in investment in real estate business abroad, especially in the United States.[15)] There are various types within this category of investment, such as investment by real estate firms engaged in the planning and development of community and shopping centres, or investment to acquire buildings for renting offices and apartments. The amount of real estate properties acquired by borrowed funds is not included in Japan's direct investment statistics figures, which include only the amounts remitted from parents to subsidiaries.

A not insignificant part of Japanese direct investment in real estate in the United States since 1984 seems to have been made by life insurance companies, as a way of diversifying their "portfolio" of investments. They are accumulating an enormous amount of funds annually, and have been investing a part of them in bonds denominated in foreign currencies, especially the U.S. treasury bonds, and equity stocks of foreign corporations. Since around 1984 they are increasingly investing also in real estate properties in the United States.

(7) Flag-of-Convenience Ships Many Japanese owned ocean-going ships are today operated under a flag of convenience, namely as ships registered in countries with low taxes on ships such as Panama, Liberia or Hongkong. In the country-breakdown list of Japan's outward direct investment, Panama is the

second place—in terms of the amount invested, accumulated over 1951-86—next to the United States at the top, and Liberia the eighth. The amount of Japanese investment in even the latter country is more than the amount invested in any of Korea, Taiwan or Singapore, or in any European or African country except Britain. A predominant part of Japanese direct investment in Panama and Liberia is in subsidiaries for the purpose of owning, operating and/or leasing flag-of-convenience ships, although Panama is recently hosting financial subsidiaries also.

(8) Research Laboratories Recently a number of Japanese manufacturing firms in such industries as electronics, chemicals, pharmaceuticals and rubber have acquired, newly established or expanded research laboratories—primarily for basic research but sometimes also for development research—in the United States, Britain and West Germany, and employed scientists and engineers in these countries.[16)] Similar moves by some U.S. and European firms to establish research laboratories in Japan and hire Japanese scientists have been taking place from much earlier times. Some of these Japanese and foreign firms made direct investment only in research laboratories in the country in question, having no production facility at all there.

IV. CHARACTERISTICS OF JAPAN'S DIRECT INVESTMENT

In this section a few characteristics of Japan's foreign (outward) direct investment will be discussed, in comparison with foreign direct investment by other major investor countries, such as the United States, Britain and West Germany. To discuss such characteristics fully and precisely it is necessary to have comparable statistics for countries concerned. As noted in Section I, however, statistics on direct investment are not readily available, and the degree of their international comparability seems rather low. Hence the following discussion is mostly based upon generally available information. I hope to be

helped by conference participants from other countries regarding information or foreign direct investment of their countries.

1. Still in the Early Stage of Development

In terms of the overall size of the amount of foreign (outward) direct investment outstanding Japan occupies either the third or fourth place among the major direct investor countries, after the United States, Britain and possibly West Germany (Figure 6). Next to these three countries and Japan perhaps come Canada and France. Thus Japan is among the world's largest investor countries, but it is not an investor country as "mature" as other leading investor countries. Japan is the latest-comer in this field, and is still in its early stage of development as a direct investor country.

The fact that Japan is far from a state of full growth or maturity as a direct investor country is reflected in many facts. In an international comparison of the ratio of the outstanding value (stock) of outward—and also inward—direct investment to GNP, the ratio of the annual flow of direct investment to gross national saving, or the ratio of Japanese manufacturing enterprises' overseas production to their total (domestic plus overseas) production, Japan's ratios are the lowest among the major investor countries (Figures 7, 8 and 10). Thus the relative weight of foreign direct investment—both outward and inward—in the national economy is still small in Japan.

Also, the share of direct investment in the total capital outflow is small in Japan. Especially in recent years indirect (portfolio) investment is dominant in the total capital outflow. Some of the other major direct investor countries, such as the United States, West Germany and Sweden, have been even net capital importer on indirect investment account.

From the international comparison Britain comes out as the most advanced and mature in foreign direct investment among the major industrialized countries.

If comparable statistics are available, however, perhaps three "great" direct-investor countries among smaller European countries, namely Netherland, Sweden and Switzerland, would be seen to be more advanced than Britain as a direct investor country.

Major direct-investor countries other than Japan namely the United States, Britain, West Germany, other EC countries, and Canada are also important as host countries to foreign direct investment, but Japan's share in the world as the recipient of foreign direct investment is still small.[17)]

2. A Small Share of Manufacturing and Large Shares of Investment in Developing Countries

The share of manufacturing industries in overseas direct investment is relatively small in the case of Japan, probably substantially smaller than in the case of the United States, Britain or West Germany, especially when petroleum refining is included in manufacturing.[18)] The share of manufacturing would be perhaps higher in the case of Sweden, Switzerland and Netherland. In Japan's direct investment the shares of (i) sectors supporting export and import trade such as retail and wholesale trade and finance, (ii) a sort of substitutes for indirect (portfolio) investment such as acquisition of real estate, and (iii) investment for the purpose of maintaining flag-of-convenience ships are quite large, relative to the share of manufacturing.

In the regional breakdown of Japan's foreign direct investment, the shares of developing countries used to be relatively large, as compared with foreign direct investment by the United States, and West Germany. Much larger shares of foreign direct investment of the latter and other major investor countries seem to have gone to the United States, EC, Canada and other developed countries.

Such a tendency for Japan's direct investment to concentrate in developing countries seems to have been more pronounced in the case of direct investment in

the manufacturing sector (Figure 5). This tendency is recently being corrected, however. As mentioned in Sections II and III, Japan's direct investment in United States and Western Europe is now sharply increasing, both overall and in the manufacturing sector.

These characteristics in the industry-wise and regional break-downs of Japan's direct investment may be viewed as reflecting the fact that Japan is a late-comer in this area, and is still in the early stage of growth as a direct-investor country. In other words the share of investment in manufacturing as well as the share of investment going to developed country will rise, as Japan will become a more mauture direct-investor country.

3. Low Profitability

Although available data on the rate of profit earned by Japan's overseas direct investment are scarce, they seem to indicate that the profitability of Japan's direct investment is variable, and often lower than the rate of profit at home, that is, in Japan.

When the ratio of net profit (to be precise, "kēijo-rieki") to the sales is compared between overseas subsiaries of Japanese corporations (those covered by MITI's survey, see Section I) on the one hand and their parent corporations and all the domestic corporations in Japan on the other, in recent years the average profit rate tends to be lower for the former. This is true especially for subsidiaries engaged in manufacturing set up recently in North America and Europe. On the other hand, for subsidiaries engaged in mining in Middle East and Oceania, those engaged in manufacturing in Asia and in wholesale and retail trade in North America the profit rate seems to be relatively high.

Also, according to U.S. Department of Commerce data on foreign-owned subsidiaries in the United States the rate of profit earned by Japanese-owned subsidiaries in the U.S. manufacturing sector is much lower than the average rate

earned by all foreign-owned subsidiaries in the same sector (Table 1). Especially in 1982 and 83 the profit rate turned into negative for Japanese-owned subsidiaries.

One of the reasons for low profitability of Japanese overseas direct investment may be that the length of the period in operation of Japanese overseas subfidiaries is still generally short, especially in the case of manufacturing investments in the United States and Western Europe.[19] Several other reasons for low profitability in the case of the manufacturing sector will be considered below.

On the other hand, the rate of profit earned by Japanese direct investment in retail and wholesale trade is relatively high, perhaps because many of Japanese-owned subsidiaries in this area have long been in existence. Also, when the import of certain products dealt with by an overseas subsidiary engaged in retail and wholesale trade comes to be subject to some not-too-restrictive quantitative restrictions such as an import quota system, VER or OMA, a part of the premium between the supply cost and demand price often accures to the subsidiary.

4. Active Participation by Smaller Businesses

Smaller businesses—in Japanese terminologies "small- or medium-size businesses"—are legally defined in Japan as a firm employing 300 (100 in wholesale and 50 in retail trade) employees, or a corporation with paid-in capital of 100 (30 in wholesale and 10 in retail trade) million yen or less. If either of these two criteria is met, the firm is classified as a small- or medium-size business and eligible for various privileges including certain special tax treatments and low-interest financing from special government financial institutions. In terms of the number of employees smaller businesses cover between 70 and 75 per cent of the manufacturing sector and between 80 and 85

per cent of all the sectors excluding agriculture and finance (but including manufacturing).

The coexistence of a large number of smaller businesses along with large, modernized enterprises was once called as the "dual structure" of the Japanese economy, and considered as a reflection of its backwardness and one of its weaknesses in the 1950's and 60's. But the relative weight of smaller businesses in terms of employment has not diminished in recent years. As a matter of fact it is rising slightly since the early 1970's. Nowadays a majority view on this point is that the existence of thick layers of a wide variety of smaller businesses and their flexibility and innovativeness are one of the sources of strength of the Japanese economy.

Smaller businesses play important roles in the Japanese economy and their roles both in export and in foreign direct investment are no exception.[20)] Smaller businesses have a considerable share in Japan's foreign direct investment (Figure 13). This situation is in sharp contrast to the situation of some other countries where large firms are dominant both in export and in foreign direct investment.[21)] Their share is especially high in direct investment by manufacturing firms going to Asian countries.

Some of the cases of foreign direct investment by Japanese smaller businesses in the manufacturing sector are those in which smaller-business subcontractors are following the parents going to the United States, Asian NICS countries and elsewhere (See 5. below). But a majority of the cases seems to be direct investment by "independent" (as opposed to subcontracting) small-business manufacturers. There are a number of cases in which Korean small businessmen resident in Japan invest in South Korea. In such cases linguistic and cultural barriers to "foreign" direct investment should be very low.

5. Certain Characteristics of Japanese-Owned Subsidiaries Engaged in Manufacturing Abroad

As stated above Japan's overseas direct investment is still in the early stage of development especially in the manufacturing industry. Not only the ratio of overseas production by Japanese manufacturing firms to their domestic production is low relatively to their U.S. or German counterparts (Figure 10), but also there are few example of their well-established, large subsidiaries in foreign countries comparable to subsidiaries of General Motors and Ford in West Germany, IBM in Japan and many other countries, GE and Ericsson in Latin America, or Unilíver, Nestle, Ciba-Geigy, Phillips and major petroleum companies all over the world.

These U.S.- and European-based manufacturing firms and many others have large, well-established subsidiaries abroad, which have long history, are among the leading firms in the respective industries in the host countries, and engage themselves in full operation including production, marketing, exporting and, not infrequently, research and development. They are appropriately called multinational corporations, in the sense that they engage themselves in full operation on a substantial scale in a number of countries.

It is no exaggeration, however, to say that there are no overseas subsidiaries of Japanese manufacturing firms which have its roots as deep down in the soil of the host countries as such subsidiaries of U.S. and European multinationals.[22] Although many Japanese manufacturing firms have come up in the list of world's largest firms, their main overseas operation has so far been export sales and related activities.

The overseas direct investment for the purpose of "production" activities, as distinguished from their marketing and assembling ones, by Japanese manufacturing firms at present consists mainly of either of the following two types. The first type is direct investment over the fence of protective tariff and

nontariff barriers. The factories built for this propose are generally small and their "local contents" are low. Leading Japanese automobile manufacturers have five to ten overseas plants each, but almost all of them are very small compared with their home factories in Japan. Most of them are of the order of one twentieth or even less in terms of the number of cars or trucks produced, and depend heavily on parts and assemblies imported from Japan. The situation is more or less similar in electronics products, electrical appliances and machine tools.

The second type is direct investment in "NICS" and other neighbouring Asian countries to take advantage of low labour cost. In this type of investment those processes of production which are labour-intensive and technologically less sophisticated are shifted abroad. The scale of operation is not necessarily smaller than at home, but normally technologically sophisticated processes as well as product planning and designing, research and development, and other head-office functions all remain in Japan. Moreover, since in these Asian countries adopt more or less restrictive policies, such as phased localization or not allowing majority ownership, and their policies and political atmospheres toward foreign investment tend to vacillate, most Japanese firms feel that they cannot depend entirely on just single overseas plants for any process, nor invest heavily in these countries for the essential processes of their production activities.

Thus both types of overseas factories of Japanese manufacturing firms tends to take the form of small—sometimes miniature—branches or offshoots of the plants at home. Generally speaking they are relatively new, immature, small in scale and often technologically inefficient. This may well be the basic reason for the low profitability mentioned above.

Would some of these overseas subsidiaries of Japanese manufacturing firms grow up in the future to become full-fledged, deep-rooted and more autonomous ones as their U.S.- or European-owned counterparts?

As far as subsidiaries in developing countries are concerned a majority view may be that the future outlook does not seem too bright. Even setting aside the international debt problems and political difficulties some of developing countries have run into, policies of most developing countries toward foreign investment do not seem to be liberal and stable enough to allow one to be optimistic.

Then what is the perspective for Japanese-owned manufacturing subsidiaries in developed countries, especially in United States and Western Europe? It is definitely brighter there than in developing countries. Yet there are a number of difficulties for Japanese firms in expanding their overseas "production"—apart from marketing—activities.

Even if the language barriers, which are still severe at present,[23] are somehow overcome, some of the Japanese management, production and employment practices which form the basis of the strength of Japanese manufacturing industries, especially in the fabricating and assembling type of manufacturing using mass-production technologies, do not seem to be easily transplanted in North America or Europe. It would be difficult to transfer the Japanese type labour-management and subcontractor-parent relationships in a foreign land with basically European cultural traditions. There are a number of studies on how Japanese type management practices have been introduced,[24] and some of them report that Japanese practices are bringing some successes. But so far only a small part or limited aspects of Japanese practices have been transplanted or experimented in subsidiaries abroad.

Some of the difficulties encountered in bringing Japanese ways of management and industrial relations in countries with European cultural traditions are as follows.

(i) At Japanese firms, the labour union is organized on a company-by-company basis, and the management and the labour union of a company, composed of all the "regular" employees of the company including both blue-

collar and white-collar workers, cooperate closely, share the benefits from its successful operation and have a feeling of solidarity. Such a union structure cannot be brought into subsidiaries in North America and Europe. There the labour unions or some other bodies representing employees, especially blue collar employees, tend to be antagonistic to the management, can be at best neutral and are rarely be cooperative with the management. Japanese managers are often dismayed at dealing with union representatives in foreign countries.

(ii) One of the major sources of the strength of Japanese firms is that an employee serves in the same firm for a long time—the so-called "life-time employment" practice—, is promoted regularly in terms of salary and post, and experiences a number of different kinds of posts in different divisions—that is, he (or she) is promoted in a "spiral", not "lineal", way—during the career. In this way the employees get extensive training on the job and becomes to know well about the firm and colleagues working together with in the firm.[25)] But this gives rise to a difficulty, called "tanshin-funin", when the firm runs subsidiaries abroad. That is, a large number of Japanese businessmen are serving in foreign countries away from their families, leaving their wives and children in Japan, especially when they have old parents to take care of and/or children going to middle (junior high) or high schools.

(iii) The Japanese practices of long-term (or life-time) employment, extensive on-the-job training, and regular promotion in a "spriral" way give rise to certain difficulties in absorbing and assimilating foreign white-collar workers, engineers and managers, very few if any of whom speak the Japanese language, into the body of the Japanese firm's permanent employees.

(iv) Japanese firms are more egalitarian than U.S. or European firms, with

respect to various matters, including income distribution between blue-collar and white-collar employees and between highest paid (that is, the president and other top managers) and the rank and file, and the use of common canteens and entrances by blue-collar and white-collar employees. This is welcome by blue-collar workers, but not by foreign white-collaremployees, enginners and managers. Together with the difficulties explained in (iii), generally speaking Japanese-owned subsidiaries in the North America and Western Europe are not popular as employers of white-collar workers, and have difficulties in attracting and keep employing capable non-Japanese managers and engineers.

(v) Japanese large firms especially in industries such as automobiles, electronics, electrical appliances, machinery in general, and iron and steel depend heavily on the system of subcontracting. The relationship between a parent firm and its subcontractors is a long-term one based upon mutual trust, in which the parent firm often provides financial and technological assistance and subcontractors seriously endeavour to meet the needs of the parent. That such a relationship is difficult to be reproduced outside of Japan is one of the causes of technological inefficiency and high costs at overseas subsidiaries as compared with production at home.[26)] To overcome this difficulty, when a Japanese automobile manufacturer builds a plant in the Untied States or Europe, a number of its major subcontractor firms follow it and build plants near the parent's plant. But such a move tends to give rise to a new case of "economic friction" accompanying direct investment, since the producers of automobile parts in the host country protest that they will lose their market shares.

In spite of these difficulties, however, since Japanese firms are steadily accumulating "managerial resources" including expertise to run subsidiaries in foreign countries, and since Japan's balance of payments on current account is

expected to run large surpluses for some time, outward direct investment flows by Japanese manufacturing firms are likely to increase steadily and perhaps fairly rapidly.

V. THEORY OF FOREIGN DIRECT INVESTMENT

I first became interested in the economics of foreign direct investment (FDI) from around 1966 by the public discussion in Japan on the government policy to liberalize inward direct investment into Japan. My view on FDI then (Komiya 1967, 1969, Sumita, Komiya and Watanabe 1972) was based upon—and enlarged upon—Edith Penrose's (1956, 1959) view of the growth of the firm and foreign investment. Its main points are as follows.

(1) FDI takes place when the firm grows and accumulates "managerial resources" within it, and tries to make use of them in most profitable—and efficient—ways. It often finds it more profitable (over the long run) to use them abroad rather than within the country where its head office is located.

(2) The existing economic theories of FDI tend to treat FDI as international movement of "capital" in the sense of funds or general purchasing power. This misses the essence of FDI which is not so much of international movement of "capital", as that of "managerial resources", that is, managerial, technological, marketing and organizational knowhow and expertise, necessary to run a firm efficiectly.[27] Some of managerial resources have a public-goods character, or a partially public-goods character, within the firm.

(3) FDI takes place from those countries and industries which have accumulated or are accumulating "managerial resources", to countries where their marginal returns are high. The firm undertaking FDI is often a Schumpeterian innovator, and is making a new entry in an industry in the

host country.

(4) Conditions determining the flows of FDI are not too different from those determining the flows of "internal" direct investment, that is direct investment between regions within a country. But political and cultural barriers for direct investment are generally much higher between countries than between regions within a country.

(5) On the other hand, tariff and nontariff barriers to import often induce FDI, and are intentionally employed by national governments to promote FDI. This is an aspect absent in the case of "internal" direct investment.

The dominant theory of FDI in the late 1960's and early 70's was the oligopoly theory or the monopolistic MNE (multinational enterprise) theory of FDI advocated by the late Steven Hymer (1960), Charles Kindleberger (1968, 1969 and elsewhere), Richard Caves (1971 and Caves and Jones, 1981) and others. The Hymer-Kindleberger theory asserts that monopolistic or oligopolistic elements are essential for FDI, and that the success of FDI is based upon some monopolistic advantages.

I remember a conference in Canberra, Australia, on FDI in Asia and Pacific in 1970, which was attended by Hymer and Kindleberger---and also by Hugh Patrick---among others. I tried there to refute the Hymer-Kindleberger ologopoly theory of FDI, and argued that such a theory is not correct, and that direct investment is undertaken mostly by Schumpeterian firms which have succeeded in certain innovations and have special advantages based upon such innovations and special managerial resources accumulated within themselves. At that time, however, the Hymer-Kindleberger theory was dominant, and my view appeared to be a minority one.

There were a few other theories in the late 1960's and early 70s such as the product life cycle theory (Vernon, 1966) or an argument emphasizing the investor's risk diversification to cope with exchange rate fluctuations (Aliber, 1970). From

the early 1970's Kiyoshi Kojima argued in a number of his writings (for example, Kojima, 1977, 1985) that while the U.S. or "multinationals" type FDI is generally trade-reducing, the Japanese type FDI is, in contrast, generally trade-increasing (or should be (?) trade-increasing). But I found none of these theories or arguments convincing.

After participating in a United Nations study group on multinational corporations in 1973 and 74 (United Nations, 1974), my interest shifted away from FDI and multinational enterprises until asked to write this paper. Hence I have come back to study this field after a thirteen-year absence.

Looking through statistical and other data on Japan's FDI and recent literature on FDI cursorily, I felt that what I wrote on FDI in the 1960s and early 70's, and in particular the growth-of-the-firm theory or the managerial-resources theory of FDI were basically correct. In particular I have been much surprised to find that in the literature on FDI written in Japanese recently the concept of "managerial recources" which I first proposed in 1967 is now widely and frequently used.

The oligopoly or monopolistic advantage theory of FDI seems to be on the decline. On the other hand, the views which emphasize the economies associated with internalization within the firm organization (Williamson, 1975, Imai, Itami and Koike, 1982) seem to be on the rise.[28)]

I now feel that earlier I emphasized the "supply side" of managerial resources a little too much, and not enough the "demand side". I now think the following two points are also important, in addition to (1)-(5), in understanding FDI.

(6) When transferring goods, services and other resources and exchanging information and knowledge between different locations it is often more efficient to use some intrafirm or semi-intrafirm organization than to use the market. The market here means selling and buying between independent

firms, especially in the form of an arm's length spot transaction each time. FDI is such intrafirm, organizational forms of transferring resources and information between different locations and organizing productive activities at different locations.

Thus when some organizational way of transferring resources and information is more efficient than the transfer through the market mechanism, a firm undertakes direct investment whether international or within a country. It must be emphasized, however, to be able to use an intrafirm, non-market way of transferring resources and information, the firm must have accumulated within it "managerial resources" to be applied to FDI. If such managerial resources can readily be procured through the market other firms rather the particular firm in question will be able to undertake the transfer or the productive activities at different locations. Hence the growth of the firm and accumulation or availability of "managerial resources" within it are essential in explaining the supply side of resources for direct investment.

When direct investment is viewed in this way as a non-market way of transferring resources and information, it is perhaps easy to understand the following point.

(7) There are many forms of FDI of different shades, from the use of straightforward intrafirm organization such as a branch office or a wholly owned subsidiary to weaker and shorter-lived forms having an element of the market, such as combination of a loan and a long-term purchase contract, the so-called "fade-away" or "turn-key" arrangement, technology licensing combined with minority shareholding, and so on.

Thus whether or not a certain behavior or activity of a firm is direct investment is not a black-and-white affair: there are wide grey areas of all shades between the purely organizational forms and the pure market mechanisms (Sections I and IV).

Now I will make some comments on points (1) through (7) which summarize my theory of direct investment, and give a few examples to illustrate them.

(i) Points (1) and (2) mean that FDI is generally beneficial to both the host and home countries. In the host country the productivities of other factors of production are raised by incoming managerial resources, and outputs increase more than the profits earned by the foreign direct investor. The home country also gains since managerial resources earn higher returns abroad than they can earn at home.

(ii) The oligopoly theory of FDI, the product-life-cycle theory of FDI and Kojima's argument contrasting U.S. or multinationals' "anti-trade" FDI with Japanese "pro-trade" FDI all seem to emphasize respectively particular aspects of particular countries' FDI in particular periods, neglecting other aspects, and situations in other countries and other periods. Since counter-examples to their assertions abound, they cannot be claimed to be the—general—theory of direct investment, or a statement of general validity.

(iii) Investment including FDI in the flow sense takes place only in a changing world, not in a stationary one. There must be some new factors or changing conditions shifting the status quo for investment in the flow sense to take place. Such industrial organization concepts as oligopoly, imperfect competition, product differentiation, and economies of scale or scope are all concepts of basically static economic theory. It is intrisically contradictory to explain FDI in the flow sense, which is taking place in a changing, dynamic world, by the use of basically static concepts formed to describe a stationary state.

FDI in the flow sense often constitutes a new entry into the host country's industry or is associated with a major expansion of an existing foreign firm in the host country. It is often undertaken by a Schumpeterian, innovative firm which has some special managerial resources lacking in the firms of the host countries. I belong to the school which considers, for example, the A and P company in the

1930s which was accused---erroneously---of predatory dumping and other monopolistic practice not as a monopolist or oligopolist but as a Schumpeterian innovator in a rapidly changing and increasingly competitive market.[29)]

(iv) The fact that in Japan small- and medium-size businesses are quite active as direct investors (Section IV) itself almost demonstrates the invalidity of the oligopoly theory of FDI. I will give an example of a small business which is a really innovative direct investor.

A manufacturer of "jika-tabi", a traditional style footware made of rubber and cloth used by Japanese farmers and consturction workers, established in 1948, now employs only 27 25 employees in Japan, and its paid-in capital is merely 96 million yen. It is so small that most Japanese have never heard of its name. The production process is highly labour-intensive, so that the costs went up sharply in the 1960's with the rise in the general wage level. When the firm decided to build a factory in Taiwan in 1968, its share in the "jika-tabi" market was about 20%. The factory was successfully operated for some time, but wages in Taiwan rose rapidly, and it was shut down in 1982. In the mean time the firm opened a factory in Korea in 1973 and ran it until 1984. Here again the wages rose rapidly, and investment there proved to be unprofitable. Now the firm's factories are one in the Phillipines operated since 1979 and one in China (mainland) operated since 1983. In all of these cases all the outputs are exported to Japan since there is no demand for this kind of footware outside of Japan. It has no factory in Japan now. The firm's market share has gone up to 65% in 1986. Looking at the figure of the market share one might call this firm oligopolist or monopolist, but the amount of funds used by this firm is very small and technologies used are labour-intensive light-industry ones with no "high technologies" involved. The firm is a Schumpeterian innovator, which others have found it difficult to imitate. There must be some special managerial, technological and organizational expertise to run the "jika-tabi" business efficiently and successfully. Otherwise other

businessmen would have been able to run the business similarly. Or businessmen in Taiwan, the Phillipines or China would be able to manufacture the footware and export to Japan. By now the firm has accumulated a substantial amount of expertise to run factories in nearby Asian countries, and that is the source of the firm's strength which has raised its market share.

(v) Japanese manufacturing firms have made a great success in the fabricating and assembling type of manufacturing using mass-production technologies, but have so far undertaken FDI only to a limited extent. As already mentioned the ratio of the value of production in foreign countries to that of domestic production is much lower for representative Japanese manufacturing firms than for similar firms in Western Europe or the United States. Moreover a large part of FDI they have so far undertaken appears to be induced by tariff and nontariff barriers to import or threats or possibilities of establishing such. In the absence of such barriers or possibilities they would have preferred producing in Japan in many cases, and exporting therefrom.

Japanese firms in such industries as automobiles, machinery, electrical machinery, and electronics have developed highly efficient production technologies, and accumulated "managerial resources" to run factories and firms. Many of them can now produce better quality products at lower costs than their foreign competitors. But it is not easy to transfer their technologies to foreign countries because of the differences in employment practices, the labour union structure and parent-subcontractor relationships. They have not yet accumulated enough "managerial resources" necessary for running factories abroad as efficiently as those at home.

(vi) Most large firms in the industries mentioned in (v) might be described as oligopolists in markets characterized by product differentiation, but they are severe competitors with each other, especially in developing new products, improving the quality and lowering the costs of existing ones. They spend a large

amount of expenditure on research and development, product planning, market research and investment not only in plant and equipment but also in laboratories and marketing networks. They are better viewed as competing Schumpeterian innovators and followers in rapidly changing, dynamic environments, rather than as oligopolists or monopolists in a stationary market.

(vii) There are no theoretical reason to associate oligopoly with FDI. Suppose that an industry is dominated by a few oligopoly firms on a world-wide scale, say two or three firms each in country A and country B. There appears to exist no incentives for these oligopolists to make FDI in their rivals' country or in a third country, simply because they are oligopolists. If economies of scale are substantial, it would be better for each of them to produce at only one factory in their respective home countries, and export from there to all over the world. There is no reason for FDI for the purpose of marketing either, unless there are some advantages in intrafirm organization of having subsidiaries for marketing over a market-oriented approach such as securing a general agent in each importing country.

Another alternative to FDI available to "oligopolists" in the market characterized by product differentiation is what is called the OEM (original equipment manufacturing or manufacturers) arrangement. This is an alternative to FDI for the purpose of manufacturing in a low cost country. Under this strangely named arrangement a firm, A, in country I asks another firm, B, in country II (I and II can of course be the same) to manufacture and supply a product to be sold by A with A's brand name in country I or elsewhere. Not infrequently A and B are by and large competitors in the same industry. The OEM contract is nowadays a quite common practice in automobiles, construction machinery, electronics products, electrical appliances, computor terminals, office machines, machine tools and so on. Thus an "oligopolist" firm has a choice whether to make FDI for the purpose of production by itself in a low cost country, or make an OEM

arrangement with a manufacturer in a low cost country.

The OEM arrangement is sometimes accompanied by minority shareholding and may be considered as belonging to a grey zone between a pure market relationship and a pure intrafirm organization, and illustrates point (7) above.[30]

VI. SUMMARY

This paper examines Japan's foreign direct investment (FDI) in recent years and reconsiders the theory of FDI in the light of Japan's experience. Direct investment whether international or within a country takes place when a firm considers that some intrafirm or partially intrafirm way of transferring resources and information between different locations is more advantageous—and more efficient—than transfer through market mechanism. There are many such intrafirm or partially intrafirm ways of transfer, so that direct investment is not a black-and-white affair, but a phenomenon taking place in a wide range of grey zones of all shades.

A necessary condition for direct investment to take place is that the firm has specific managerial resources accumulated within it or is accumulating them. Direct investment in the flow sense is taking place in a changing, dynamic situation, and is undertaken by a Schumpeterian, innovative firm attempting a new entry into an industry in the host country. National borders are naturally a high barrier to FDI just as they are to foreign trade, but at the same time FDI is promoted by tariff and nontariff barriers to import trade.

Japan's outward FDI includes a wide variety of different types such as ownership of flag-of-convenience ships, investment in real estate by institutional investors and acquisition of laboratories for research and development. In terms of the total value of overseas direct investment Japan ranks among the three or four largest investor countries of the world, and the annual FDI flows has recently

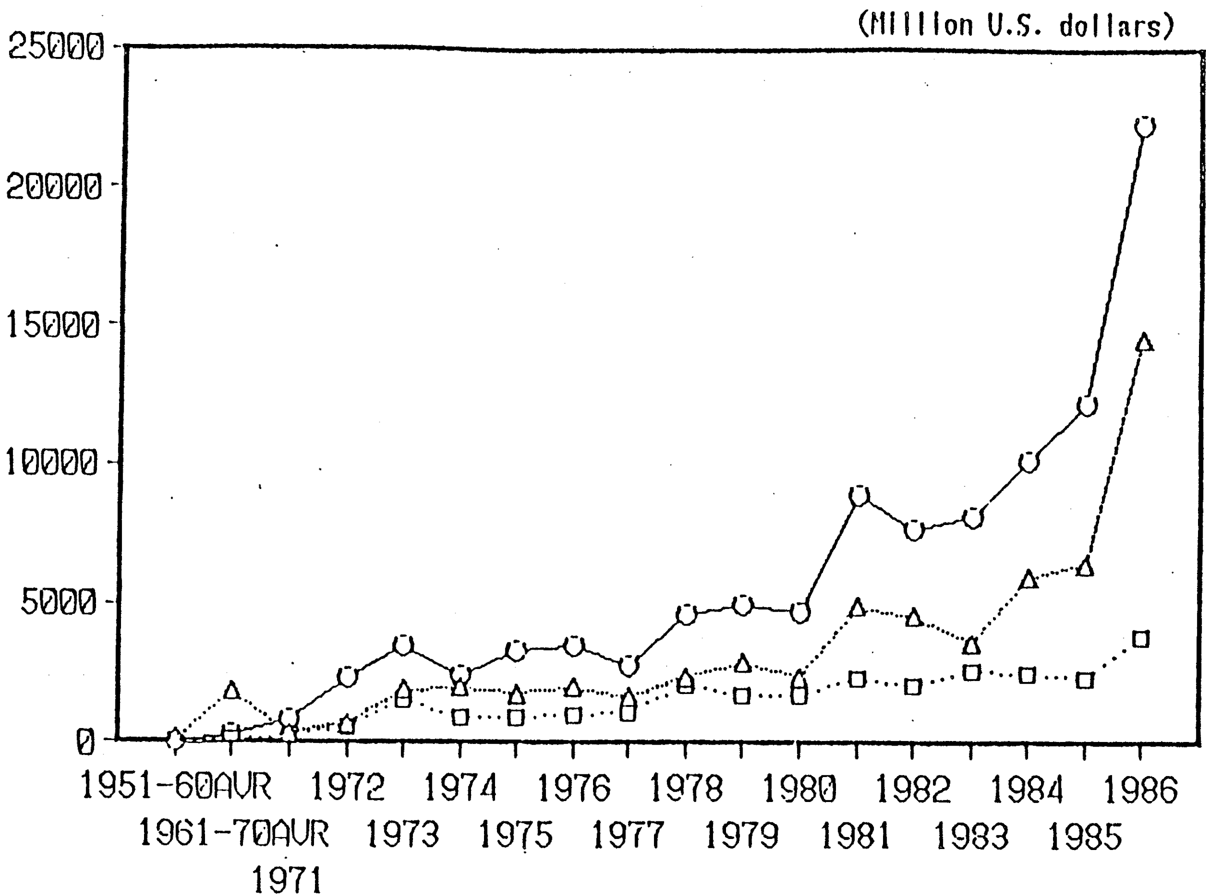
been increasing by leaps and bounds, especially when the yen exchange rate appreciated sharply. Yet as a whole Japan is still in an early stage of development as a direct investor country.

The relative importance of FDI in the Japanese economy is still small. While the share of trade-related investment in FDI is high, the share of manufacturing in FDI is still small. In the destination of FDI the share of developing countries has been relatively high. The profitability of Japan's FDI seems relatively low, reflecting its immature state. There are few large, really multinational enterprises based in Japan, comparable to U.S.- or European-based ones.

Recently a big shift in Japan's FDI flows is taking place away from developing countries including those in East and Southeast Asia to developed countries in North America and Western Europe, especially the United States. The shift has been caused by several factors including the worsening of investment environments in most developing countries on the one hand, and the heightening of barriers to import from Japan in the United States and some European countries on the other. Thus the patterns of Japan's FDI has been much affected by the trade and investment policies of the host countries as well as by changes in the yen exchange rate.

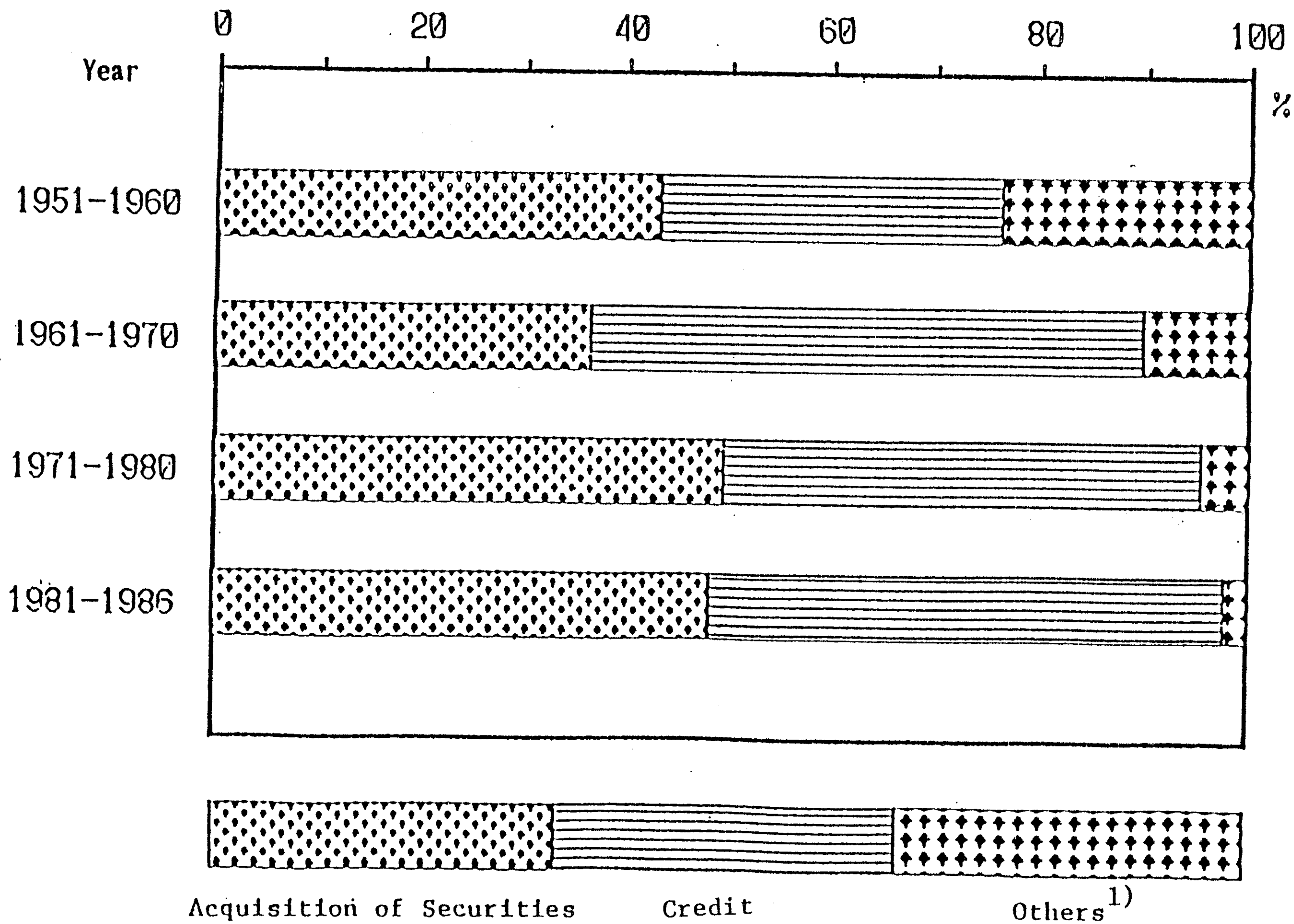
There are several difficulties in transplanting to overseas subsidiaries Japanese managerial, personnel and subcontracting practices, which constitute the basis of the strength of Japanese firms, especially those in fabricating and assembling type manufacturing using mass-production technologies. However, since Japanese firms are rapidly accumulating "managerial resources" including expertise to run subsidiaries in foreign countries, and since Japan's balance of payments on current account is expected to run large surpluses for some time, annual FDI flows of Japanese manufacturing firms are likely to continue to increase in the coming years.

Figure 1 Annual Flows of Japan's Outward Direct Investment



Source: Ministry of Finance and Bank of Japan (see text).

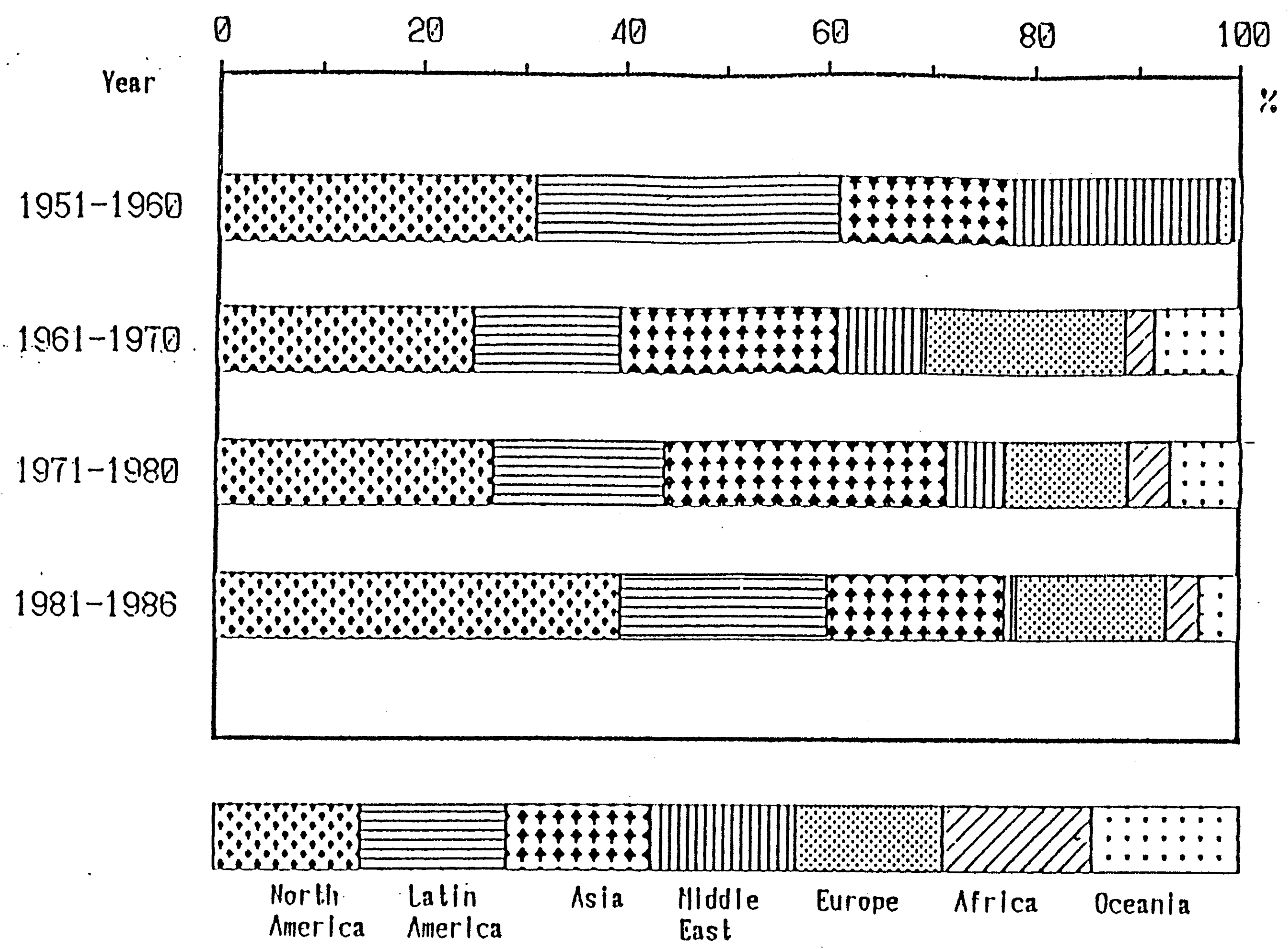
Figure 2 Composition of Outward Direct Investment by Types of Investment



1) Branch offices and, until 1980, acquisition of real estate.

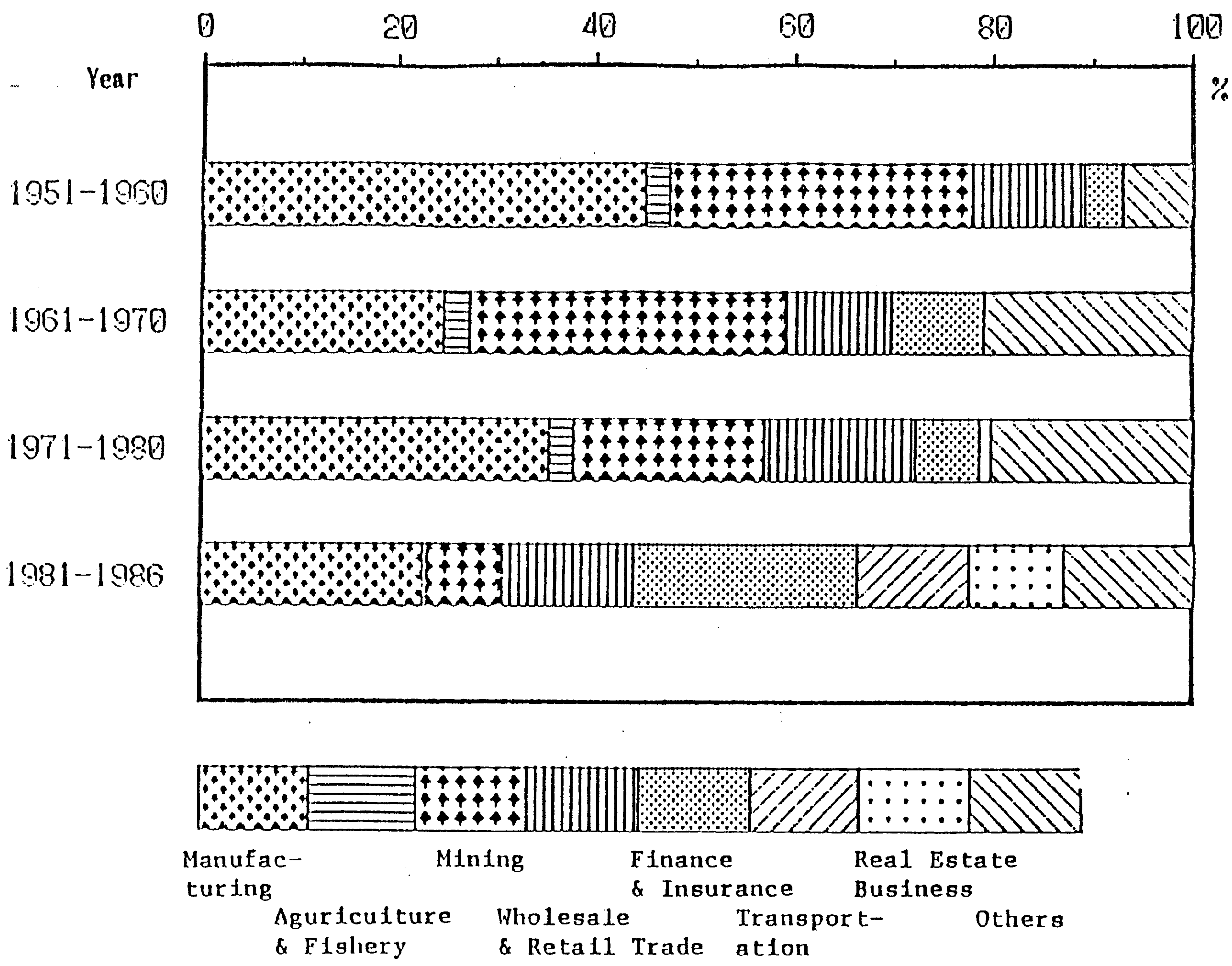
Source: MOF.

Figure 3 Composition of Japan's Direct Investment by Area of Destination



Source : MOF.

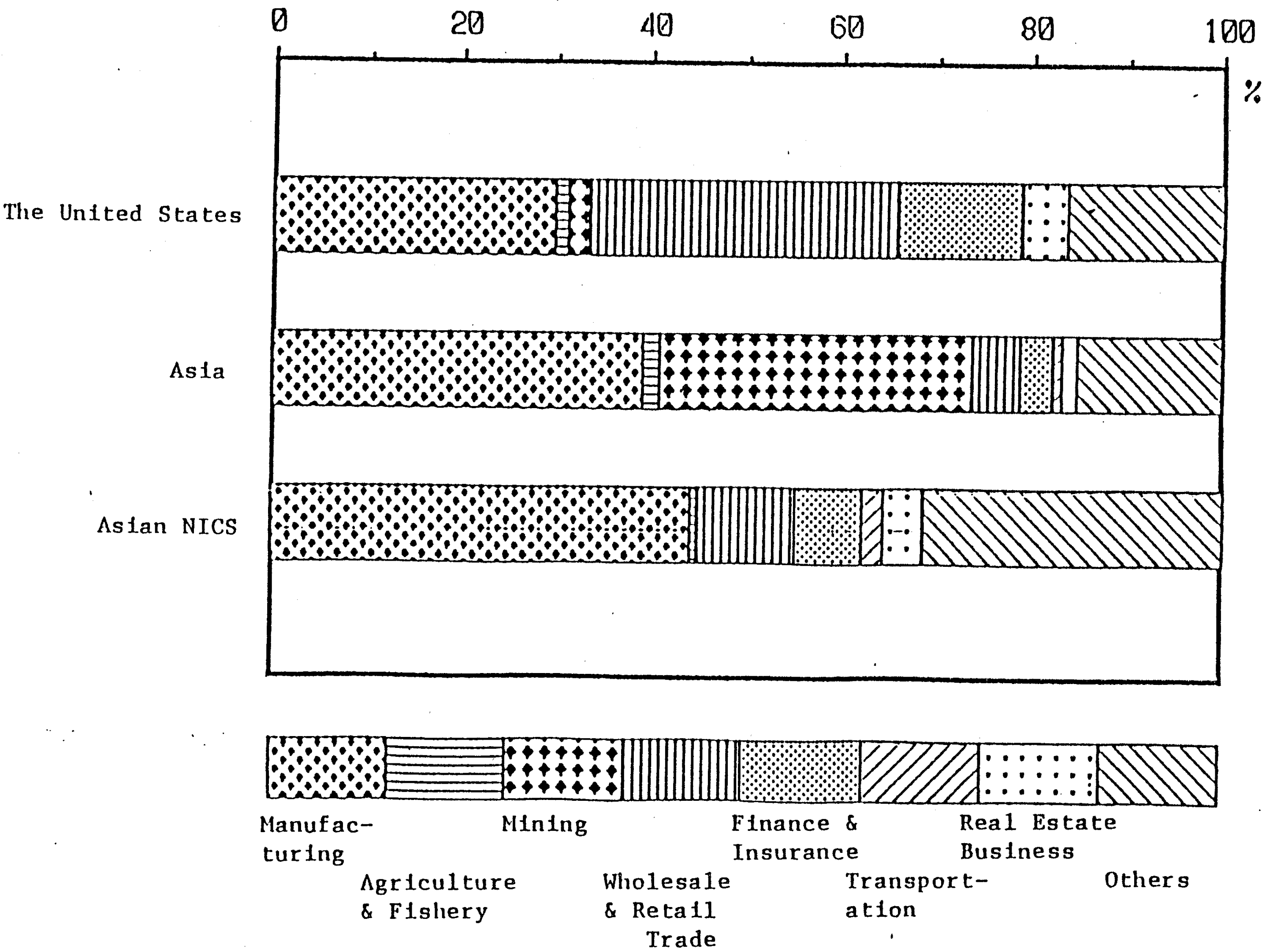
Figure 4 Composition of Japan's Direct Investment by Industry[1)]



1) By industry in the host country in which investment is made.

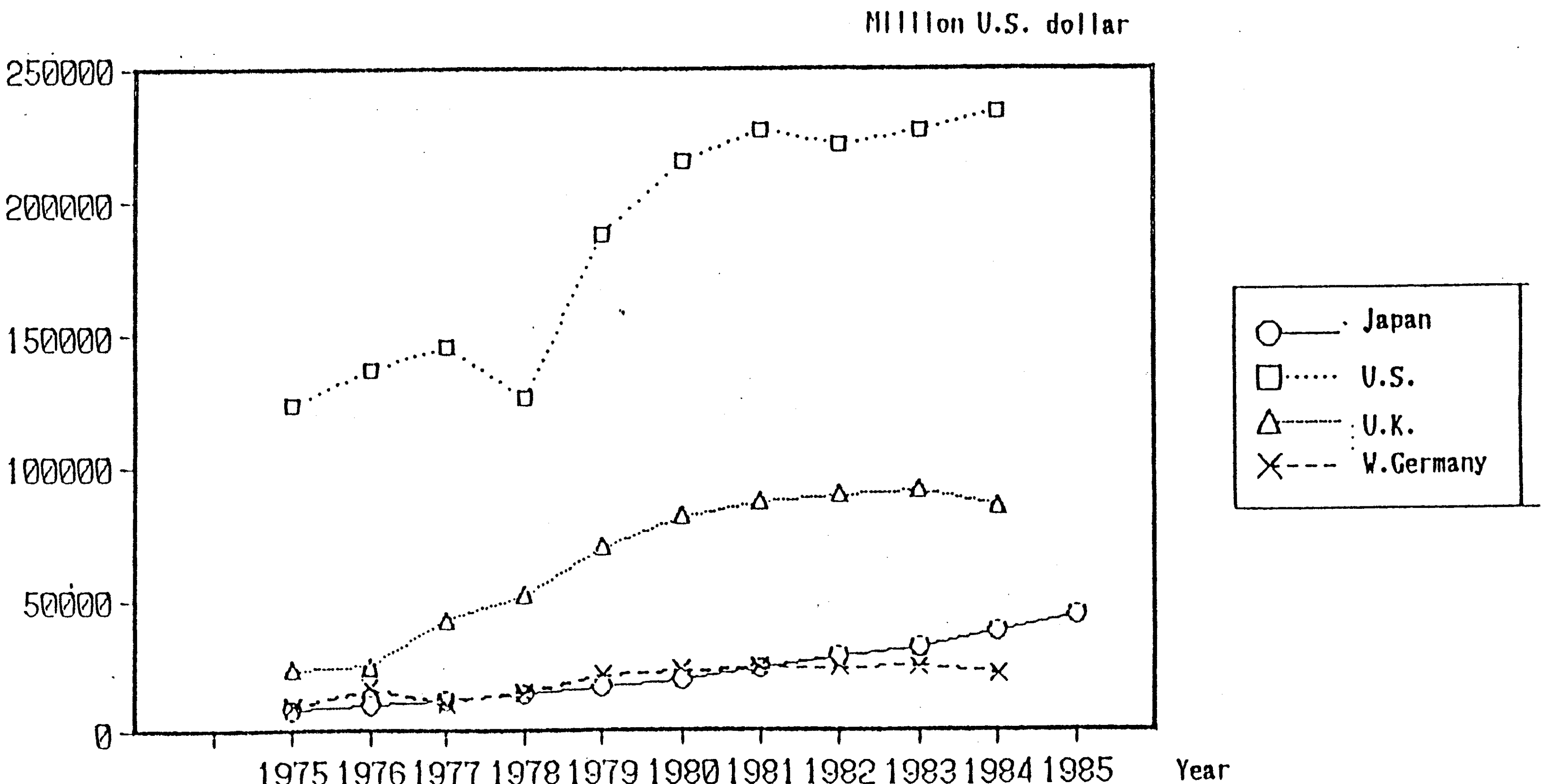
Source: MOF.

Figure 5 Industry Breakdown of Japan's Direct Investment in the United States and Asia : 1985 [1]



1) Accumulated total of the amount of investment approved or notified, at the end of March 1985.

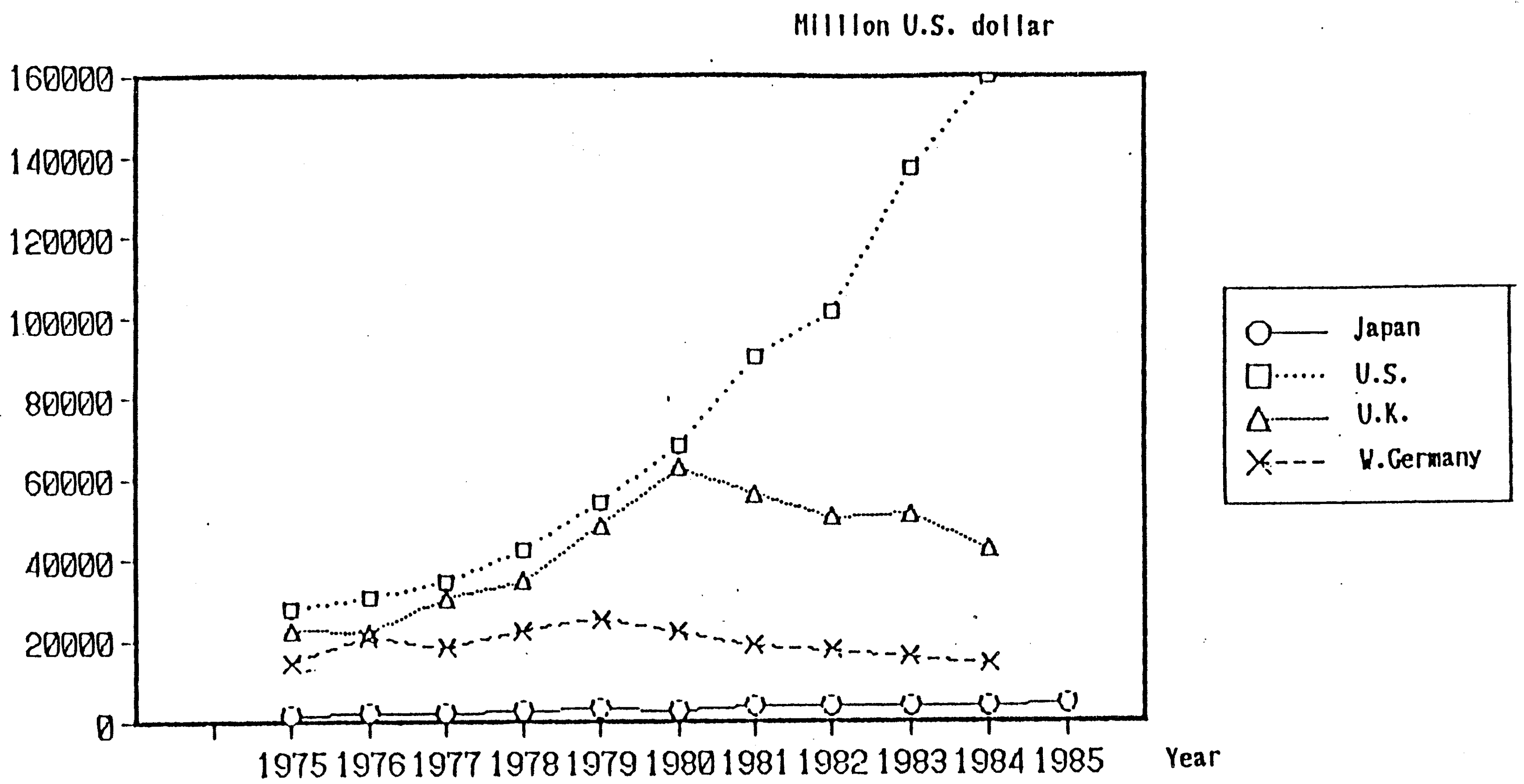
Figure 6 The Value of Outward Direct Investment ; Selected Countries[1)]



1) The total value of outward direct investment outstanding at the end of the year.
For U.K. and West Germany the exchange rate at the end the year was used for conversion into the value in U.S. dollar.

Source: Bank of Japan, Gaikoku Keizai Tōkei Nenpō (Yearbook of Foreign Economic Statistics), various issues.

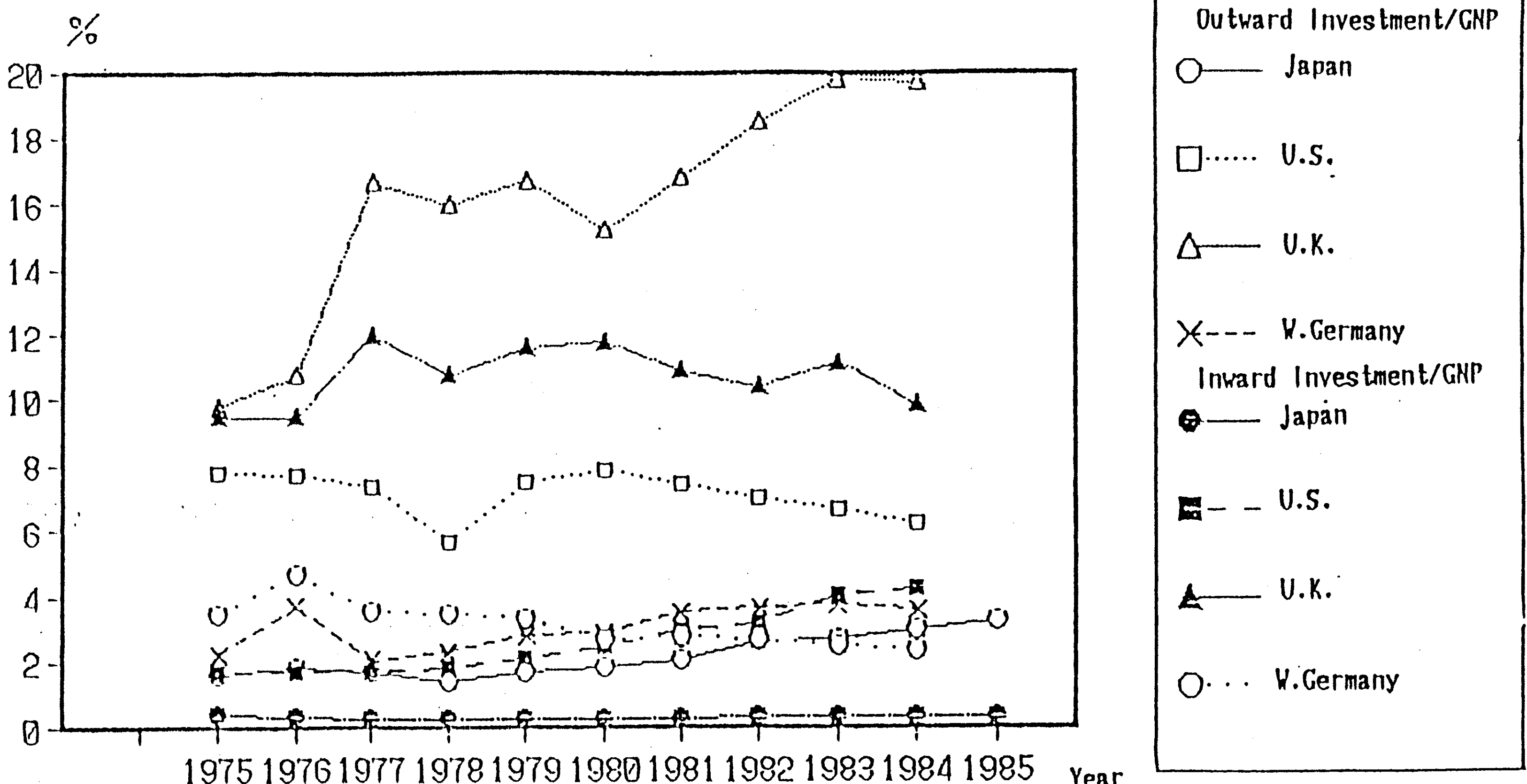
Figure 7 The Value of Inward Direct Investment ; Selected Countries [1)]



1) The same as in Figure 6.

Source : The same as Figure 6.

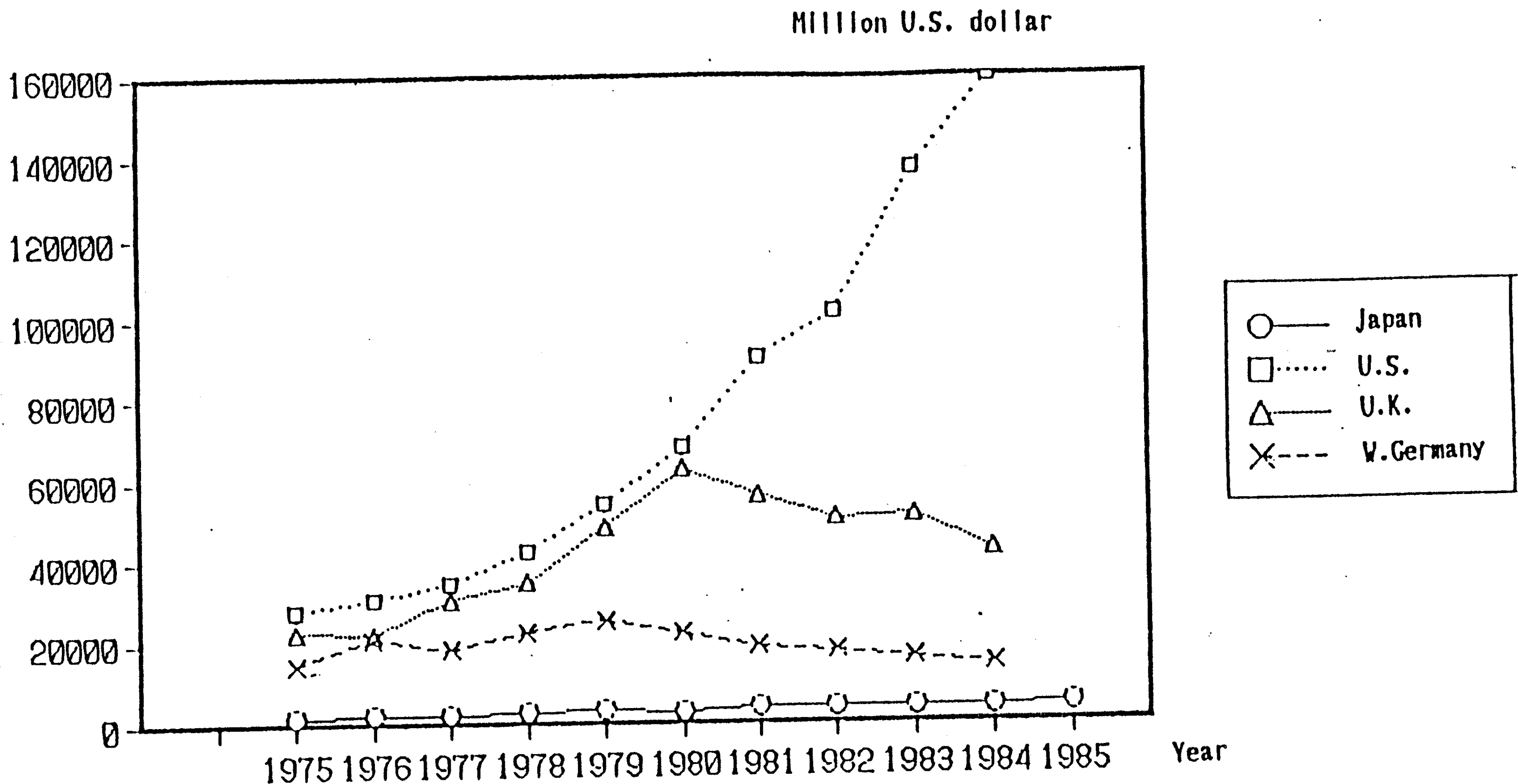
Figure 8 The Ratios of the Values of Outward and Inward Direct Investment to GNP : Selected Countries[1)]



1) The ratios for Japan were derived by using the exchange rate at the end of the year for conversion.

Source : The same as Figure 6.

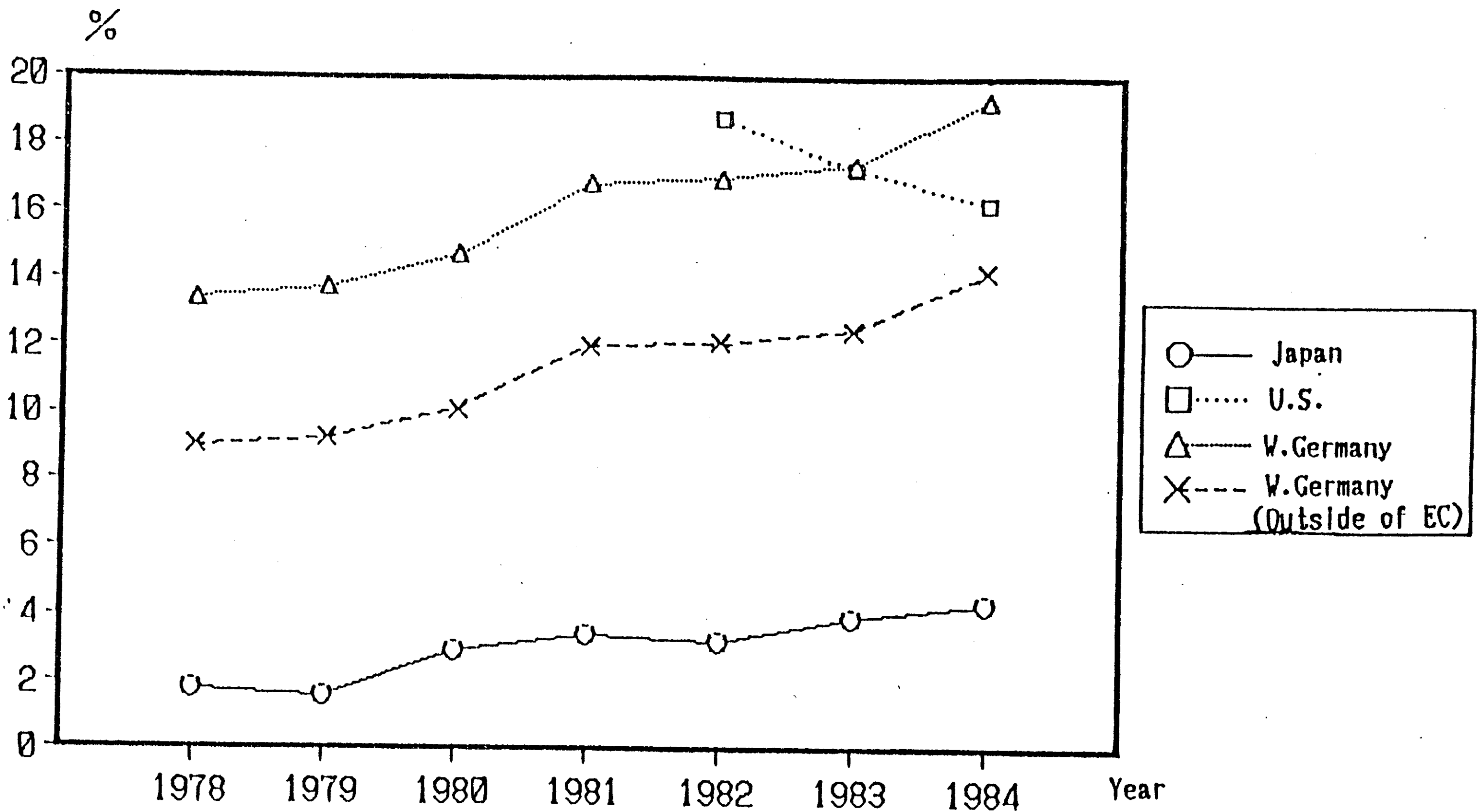
Figure 7 The Value of Inward Direct Investment ; Selected Countries [1)]



1) The same as in Figure 6.

Source : The same as Figure 6.

Figure 10 The Proportion of Overseas Production of Manufacturing Firms : Selected Countries [1]

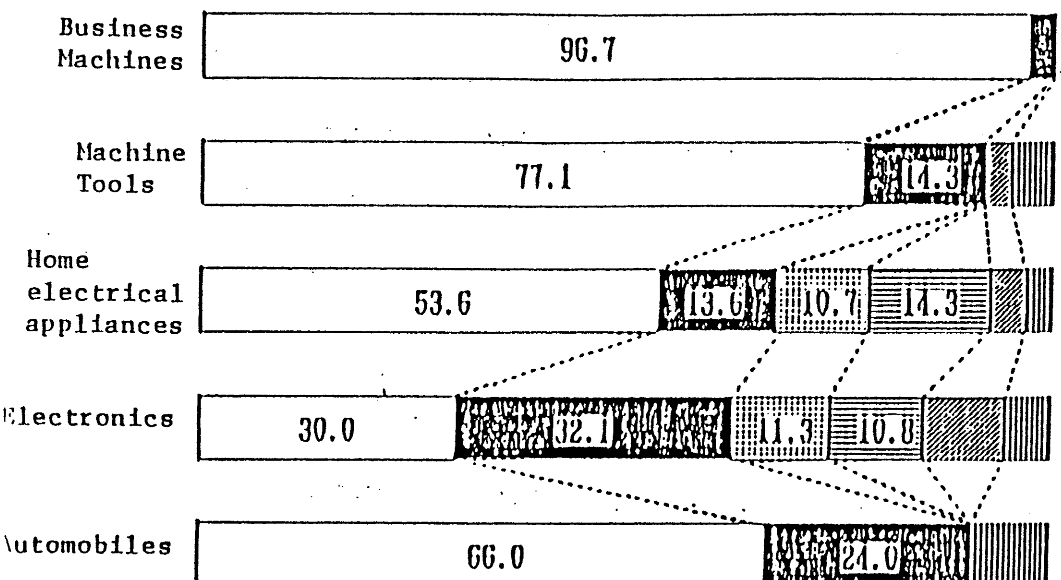


1) The value of production by overseas subsidiaries of manufacturing firms divided by the value of total manufacturing production of each country.

Source : MITI's survey. The figures for U.S. and W.Germany are based upon respective countries' official statistics.

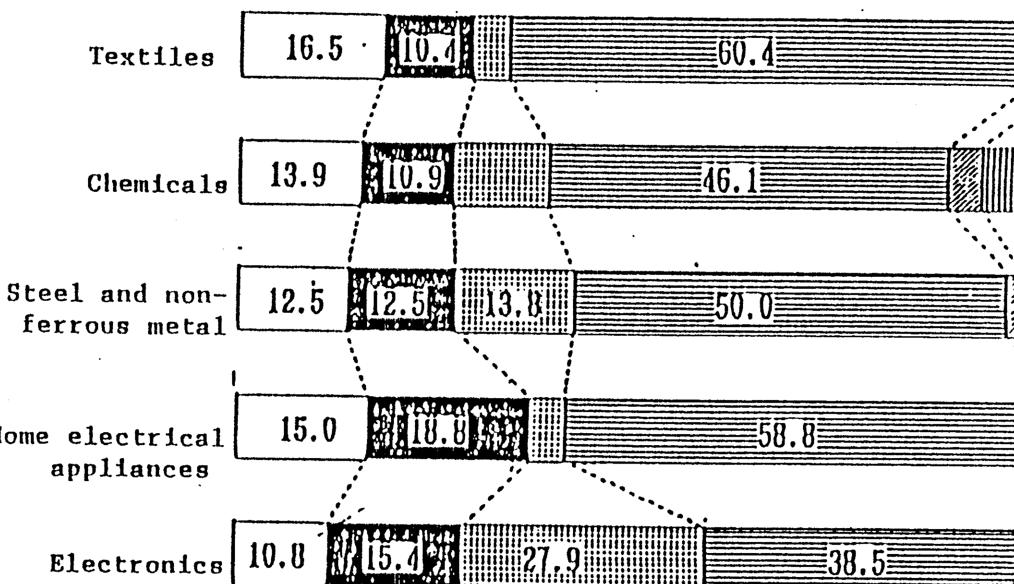
Figure 11 Comparison of the Motives of Overseas Direct Investment

A. Subsidiaries in Developed Countries
(established after 1980)



To cope with "trade friction"
To maintain and expand market shares in the host countries
Following the customers investing abroad

B. Subidiaries in Developing Countries
(established before 1979) (Unit:%)

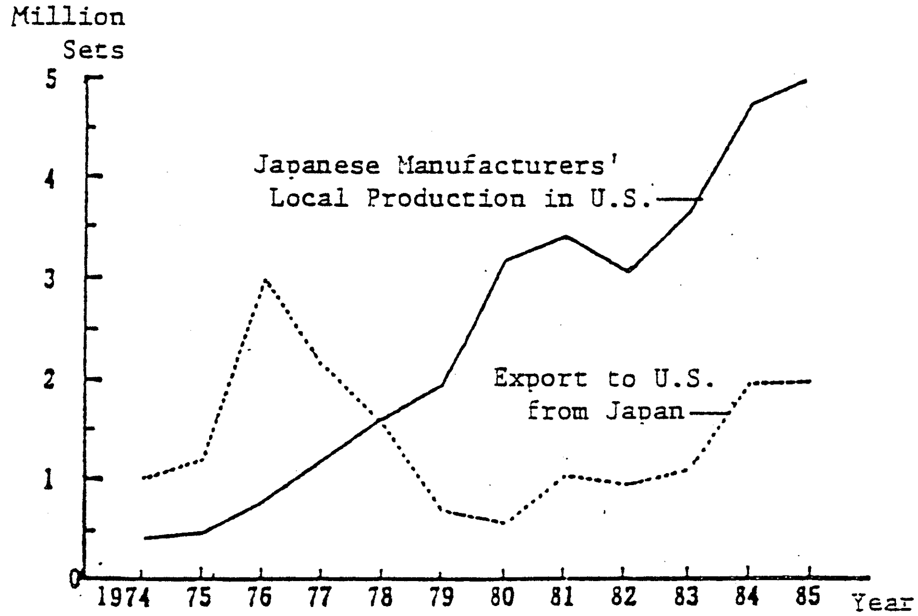


Cost advatages
To hedge exchange risks
Others

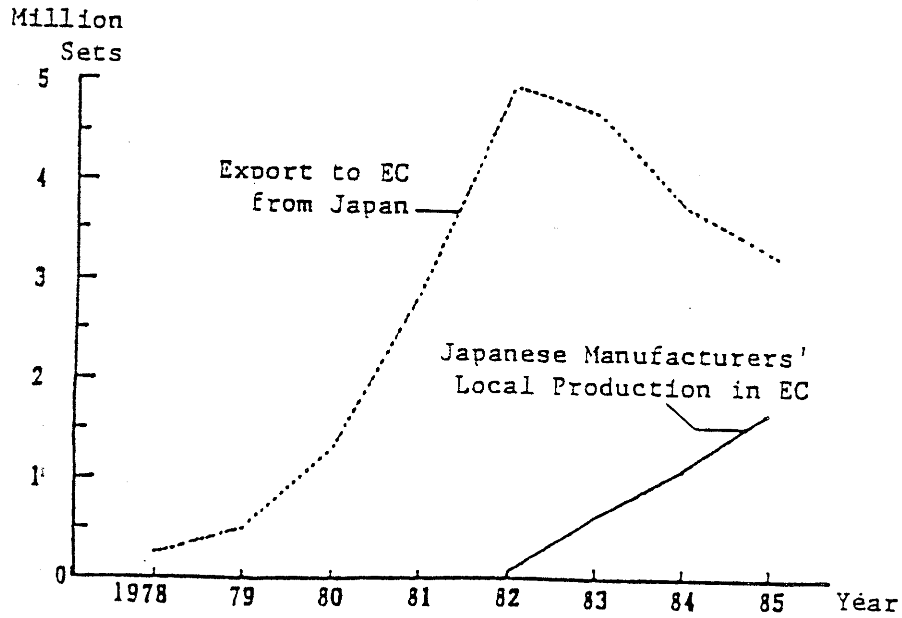
Source: MITI, Tsūshō Hakusho (International Trade White Paper), 1986: based upon a special questionnaire survey.

Figure 12 Replacement of Export by Local Production

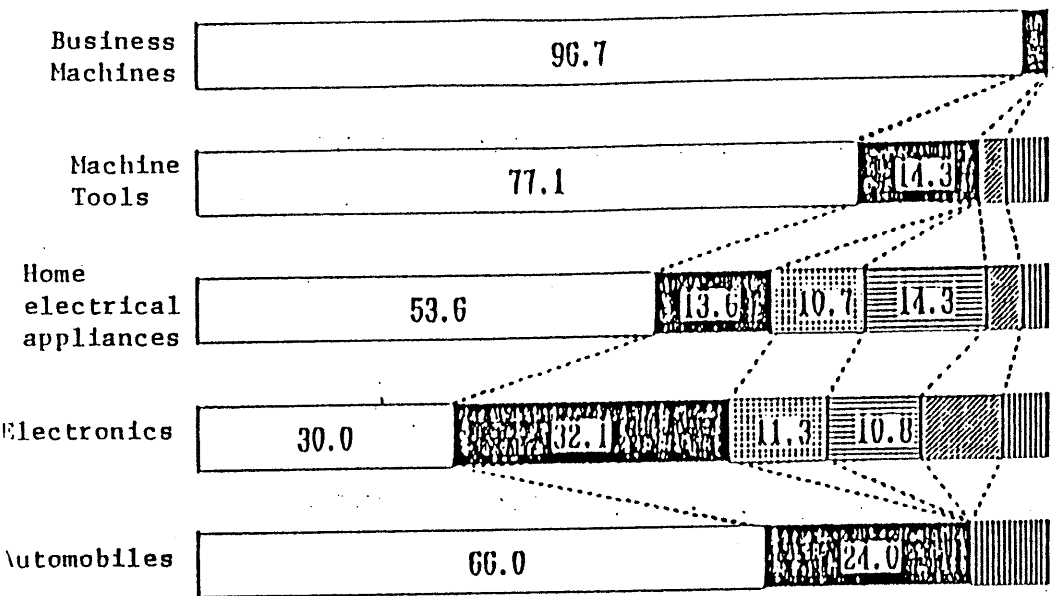
A. Colour TV Sets in U.S.

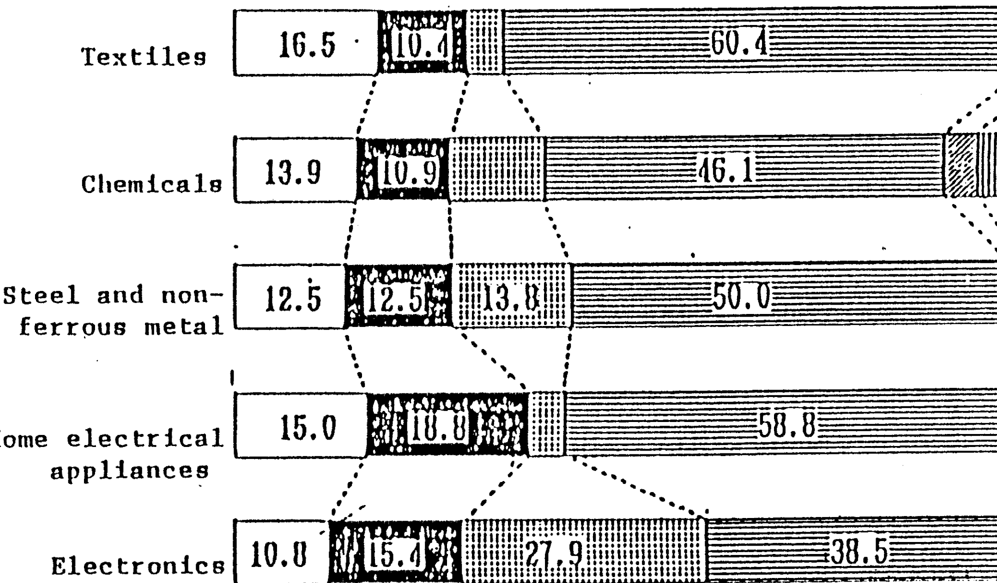


B. Video Tape Recorders in EC



Source: MITI, Tsūshō Hakusho (International Trade White Paper), 1986, p.193.





Source: MITI, Tsūshō Hakusho (International Trade White Paper), 1986: based upon a special questionnaire survey.

1) The number of cases of direct investment undertaken by small- and medium-size businesses divided by the total number of cases.

Source: MITI's survey.

Table 1 The Rate of Profit[1)] of Foreign Direct Investors in U.S. Manufacturing Industries.

(unit:%)

	1980	1981	1982	1983	1984
Japanese	5.2	3.3	-4.6	-4.3	0.2
All Countries	10.3	3.4	0.0	1.8	5.4

1) Profits divided by the average of the amounts of investment at the beginning and end of each year.

Source: From a table in: Japan Export-Import Bank, Kaigai Tōshi Kenkyusho-Ho (Bulletin of the Research Institute on Overseas Investment), Vol. 12, No.10 (October 1986). Based upon U.S. Department of Commerce, Survey of Current Business, various issues.

NOTES

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1) Such a procedure involves another serious valuation problem, since it amounts to adding up values at different time points without adjusting for changes in prices or exchange rates over time. But that is a problem common to many stock value—as compared with flow value—statistics, for example, corporate financial data.

2) In particular, the threshold line of the effective management control given in IMF's The Balance of Payments Manual is 50 per cent by an individual resident and 25 per cent by a single or organized group, but actually different countries seem to use different percentages. Accumulation of retained earnings is to be included in both the annual flow of direct investment (in capital accout) and that of investment incomes (in invisible trade), but few countries other than the United States seem to observe this accounting principle.

3) For a comparison of the concepts of direct investment used and statistics published thereof by various countries (including both developed and developing countries) see Kayoko Kitamura (1984).

4) For more of the history of Japan's foreign direct investment in postwar years, see, for example, Hamada (1972), Kojima (1977, 1985), Sekiguchi (1979a, b), and Sekiguchi and Japan Economic Research Centre (1982),

Sekiguchi and Matsuba (1974).

5) See Ryutaro Komiya (1972).

6) On the other hand, the Japanese government supported, as a national policy, several large scale foreign investment projects to secure and diversify the energy supply sources during this period.

7) See Zaigai Kigyō Kyōkai (1986) and Horaguchi (1986).

8) For a historical review of the cases of "trade friction" Japan has been confronted with—or Japan has given rise to—see Ryutaro Komiya and Motoshige Itoh (1986).

9) It may be noted that somewhat paradoxically, the large yen appreciation has caused an increase in certain types of foreign direct investment inflows into Japan also. As a result of the yen appreciation the import into Japan of finished products increased by about 35% in 1986 over the previous year, and will be likely to increase much again in 1987. The foreign—especially West European—companies are increasing their investments in Japan for assembling, manufacturing, marketing and servicing their products for Japan's domestic markets.

10) The fact that Japan is running large current account surpluses since 1983 implies that there is abundant funds available for capital export. The J-curve effect appears to have peaked out in May or June 1987, so that the total size of Japan's capital export will gradually diminish from then on. But this is no reason to suppose that the total size of Japan's outward direct investment will be declining.

11) JETRO (1987) and other publications of JETRO (Nihon Bōeki Shinkō kai, Japan External Trade Organization), MITI's annually published Tsushō Hakusho (International Trade White Papers), articles published in Japan Export-Import Bank's Kaigai Tōshi Kenkyūsho-Hō (Bulletin of the Research Institute on Overseas Investment), publications of other Japanese banks'

research departments, and reports and articles in daily newspapers (especially Nihon Keizai Shinbun) and other periodicals.

12) It is perhaps needless to say that for such a type of direct investment to take place, the mere fact that the wage rate in the host country is lower than in the home country is not enough: the labour cost taking into account of productivity, fringe benefits, social security taxes and so on must be lower.

It is also needless to say that a typical Marxian indictment that the monopoly-capitalists as direct investors "exploit" workers in lower-wage countries through such direct investment is basically mistaken. First, the workers in the host countries usually benefit from greater employment opportunities and higher wages. Second, the use of lower-cost labour usually results not in higher profits but in lower prices of products when the markets of products are competitive—which is true over the long run, in almost all cases—and benefits accrue mostly to the users of the products.

13) Some Japanese investors have been induced to engage in food processing abroad at least partly because Japan's effective rate of tariff protection for some food processing industries is negative. The import of rice, wheat, barley, sugar (molasses) and a number of other agricultural products is either totally prohibited or under highly restrictive quotas, or the tariff rates on them are very high. As a result Japan's domestic prices of such products are very high relative to prices in exporting counties. On the other hand, import of certain processed products of such agricultural products such as "sake" (rice wine), "senbei" (rice cake), or glutamic soda are not subject to quantitative import restrictions, and the tariff rate is moderate to high, but not prohibitive. Thus the effective rates of protection for a number of food manufacturing processes seem to be negative, and there is a good reason for Japanese firms to engage in overseas production of such processed foods. Resently many Japanese foods such as "yakitori" (frozen), "sake", "miso"

(bean paste), "umeboshi", never produced in countries other than Japan before, or those never imported into Japan earlier (e.g. eels), are now produced in Asian countries—and even in the United States—often with participation of Japanese investors, and imported into Japan.

On the other hand some food processing firms, often rather small ones, have gone to invest in the United States and Britain to produce traditional Japanese foods such as "tōfu", "yakitori" and "kamaboko" for local consumption, as such foods become increasing popular in the host countries.

14) MITI, Kaigai Tōshi Tōkei Sōran (Yearbook of Overseas Investment Statistics), 1983 edition.

15) When a Japanese resident whether an individual or a corporation purchases a real estate in a foreign country directly, it was included in Japan's outward direct investment until December 1980, when such a purchase was completely liberalized. But since then it is not included in the amount of direct investment. Hence the figures for Japan's outward direct investment before and after 1980 are not comparable in this regard. When a Japanese resident establishes a subsidiary abroad engaged in real estate business, however, the investment in the subsidiary is included in the amount of direct investment. Japanese life insurance companies almost always own real estate properties in the United States in the latter way.

16) According to a report in Nihon Keizai Shinbun (Japan Economic Daily), May 24, 1987.

17) The fact that the level of inward foreign direct investment into Japan is still low should not be construed as reflecting the "closedness" of the Japanese economy. According to a well known index of business environment for foreign investors prepared by an American business research firm, Japan is now rated at the top, second only to Switzerland and higher than the United States and any EC countries. The index is prepared taking into

account numerous factors including attitude to foreign investors, local management and partners, nationalism, bureaucratic delays and enforceability of contract.

18) Nihon Keizai Kyōiku Centre (1987) estimates the share of developed countries in the regional breakdown of overseas direct investment (the value outstanding) made by Japan, the United States and West germany at the end of 1980 (1979 for West Germany) as follows.

The Investor Country	Total	Investment in Manufacturing Sector
	%	%
Japan	44.8	31.9
The United States	73.5	80.2
West Germany	78.6	77.2

19) One might ask a question whether the difference in the profit rate results from Japanese direct investors' practice of transfer-pricing, whereby they try to transfer overseas profits to Japan. My impression is that perhaps they do not do so much. The tax rate on corporate profits is now higher in Japan than in the United States and most other countries, and nowadays the tax authorities in most countries are intensely watchful of wholly owned (or even majority-owned) subsidiaries of foreign corporations with respect to the possibility of transfer-pricing. Transfer-pricing may be practiced between direct investors and their subsidiaries in countries where remittance of profits and repayment of loans are subject to restrictions under exchange controls or where there is a possibility of such restrictions.

20) It is perhaps well known that Japanese smaller businesses are quite active in export trade. It is less well known that they account for a fairly high proportion in the export and import of technologies. See T. Koshiba (1987).

21) I was once told that almost 90 per cent of Italy's foreign direct investment

was accounted for by 10 large firms. I was also told that while Japanese smaller businesses are quite active in export trade in the United States export trade tends to be dominated by large "multinationals".

22) It is not easy to think of which Japanese companies will become multinationals in the sense explained in the text. Perhaps Honda, Sony and Matsushita may be among the leading candidate.

23) For example, which language is to be used in conducting the top management meeting of foreign subsidiaries or in correspondence between subsidiaries and the head office is a difficult problem for Japanese emerging "multinationals".

24) Recently a large number of case studies and surveys of management practices and/or industrial relations at Japanese-owned subsidiaries in foreign countries have been published. Two examples available in English are Susumu Takamiya and Keith Thurley (1985) and John Dunning (1986).

25) On these and other structural and behavioral characteristics of the Japanese firm, see Ryutaro Komiya (1986).

26) See, however, Dunning (1986), for the impact of Japanese-owned subsidiaries on the subcontractors in Britain.

27) Foreign-owned firms often raise funds from the financial markets in the host countries and sometimes borrow heavily there, especially in developed countries.

28) See, for example, Teece (1985).

29) See Adelman (1959) and also Komiya (1972, p. 162)

30) I will not deal with two theoretical problems related to FDI: (1) the effect of FDI on the balance of payments of the host and home countries, and (2) the effect of FDI on the employment of the home country and the possiblity of deindustrialization of the home country as a result of large direct investment outflows. These are difficult problems and cannot be dealt with within

limited space. I wish to note, however, that most discussions on these two problems are unsatisfactory to me because they try to deal with these essentially macroeconomic problems by a partial equilibrium approach. To answer the first problem adequately the impact of FDI on the total savings and domestic investment and the likely change in the income levels of countries concerned must be analyzed. Also, it is necessary to have a satisfactory macroeconomic theory on the mechanism and factors determining the level of unemployment in a national economy, in order to discuss the effect of FDI on unemployment. By and large I believe both effects (1) and (2) would not constitute a serious economic problem for the national economy, whether of a home or host country, so long as (i) it is basically healthy and possesses a proper degree of flexibility, and (ii) the government pursues appropriate macroeconomic policies and policies to assist adjustment for resource reallocation.

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