Canada

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# Japan's Direct Foreign Investment

## And Its Implications for Canada

## Part I

## Japanese Foreign Investment: Trends and Prospects

Government of Canada
Regional Industrial Expansion

Gouvernement du Canada
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# And Its Implications for Canada
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## EXECUTIVE SUMMARY

The recent increases in Japanese direct investment overseas may just be a taste of what is to come as major Japanese exporters begin to emphasize manufacturing in their major developed trading partners. In Canada, this investment has so far been concentrated in the automotive sector, but this may only be the tip of the iceberg: in the next decade Canada, along with other nations, could well experience more Japanese direct investment than it has seen in the entire period since 1951.

Japan's prominence as a foreign investing nation is not new. The "Japanese economic miracle" that transformed post-war Japan into one of the world's leading economies made it a major exporter of high-technology consumer and industrial goods — and subsequently a prominent capital exporting nation.

Japan's tradition of extremely high personal savings rates has recently reinforced this trend: these savings were able to fuel Japan's aggressive domestic investment program in years of substantial economic growth; but more recently, with domestic investment moderating, they were available to search out foreign investment opportunities.

What is new is the shift in emphasis from indirect foreign investment to direct foreign investment. In overall volume terms, of course, Japan's indirect investment continues to be far more prominent, particularly after having expanded dramatically in the early 1980s as Japanese investors — especially life insurance companies — rushed to buy U.S. and Canadian government bonds. This was motivated by the comparatively high North American interest rates fostered by the U.S. monetary authorities in their effort to finance the huge federal budget deficit.

But recent changes in the international economic climate now call for a new thrust in Japan's direct foreign investment, one that is almost certain to narrow the gap between indirect and direct foreign investment. What is more, the emphasis of Japan's direct foreign investment will shift increasingly to developed countries and, in particular, to their manufacturing sectors.

The change in climate refers primarily to the late 1985 realignment of the U.S. dollar, especially with respect to the Japanese yen. In preceding years the United States had found itself in a dilemma: its high interest rates were attracting foreign capital (especially Japanese) and in so doing were keeping the U.S. dollar very high relative to the currencies of Europe and Japan — with serious adverse consequences for an already problem-ridden U.S. trade deficit.

Japan was a willing participant in the "G-5 Agreement" which saw the United States, Japan, West Germany, France and the United Kingdom agree to effect a new lower exchange rate for the U.S. dollar, particularly relative to the yen. Its action also served to defuse some of the protectionist sentiment or "trade friction" that had been building because of U.S. frustration over its own trade problems and Japan's sharply contrasting trade surpluses.

From a Japanese perspective, these developments provide a compelling reason for Japan to replace some of its exports with direct investment, especially in the manufacturing sectors of North America and Europe. Further support for such a move comes from Japan's inclination in recent years to substitute concern over proximity to major markets and total productivity in place of labour costs in selecting countries in which to undertake direct investment.

Such a move represents yet another shift in Japan's historic pattern of post-war direct foreign investment. Japan has always attached considerable importance to its investment in less developed countries (LDCs): in the early post-war years it was largely concerned with its pressing need for assured supplies of natural resources; and later its attention turned increasingly to setting up manufacturing facilities in Southeast Asia and other LDCs that were using protective tariffs to restrict imports (including Japanese imports) in a bid to foster domestic production.

Despite increased interest in advanced economies from the latter half of the 1970s onward, direct investment in LDCs accounted for over half of Japan's total direct foreign investment in 1981 (whereas direct investment in LDCs accounted for 22 percent of total U.S. direct foreign investment and less than 15 percent of West Germany's total direct foreign investment).

The shift to direct foreign investment in advanced economies, especially North America, gained prominence as investment in support of Japan's booming export activity grew (it focused on providing the facilities needed by Japan's prospering trading companies). It spread to the financial sector in the early 1980s as Japan's presence in these advanced economies assumed a higher profile. More recently it has moved in a major way into such technologically advanced manufacturing industries as automobiles and consumer electronics — areas where future growth potential exists.

The prospect of transferring production from Japan to North America and Europe has been greeted with surprisingly widespread approval in Japanese government and business circles — a reflection of Japanese confidence in its technological edge and ability to come up with new products to take the place of those increasingly being produced abroad.

Concern over the phenomenon known as "caving" (whereby domestic industry is left a "hollow shell" following the transfer abroad of productive capacity) has been limited. However, while only a relatively small number of academics and labour representatives have expressed uneasiness over the possible unemployment implications for Japan, the potential disruptive effect of "caving", should it materialize, remains uncertain.

The prospect of strong growth in Japan's direct foreign investment in North America is reinforced by the recent currency realignment. One ostensibly optimistic study, undertaken a few years ago (and prior to the G-5 Agreement), has already proved to be somewhat conservative: it forecast a major expansion of Japan's direct foreign investment to 1990, but has already seen its 1985 prediction realised a full year ahead of time.

While growth in Japan's indirect foreign investment may ease if, as anticipated, greater U.S. fiscal discipline leads to lower real interest rates, the outlook for direct foreign investment is exceedingly bright -- given the stimulus of currency realignment and the prospect of continuing substantial Japanese current account surpluses. Japan's total direct foreign investment may, under the most favourable circumstances, have the potential to expand to more than $180 billion by the year 2000. Assuming the North American share follows its recent trend, as much as $40 billion of additional Japanese direct foreign investment in North America could be forthcoming up to the year 2000, an amount considerably more than North America experienced in the entire 1951-84 period.

Even though such things as the adverse effects of an appreciating yen are possible inhibitors, it does appear that the amount of additional Japanese direct investment destined for North America will be substantial. On the basis of its historic share of North American direct investment by Japan, Canada may see as much as US$4.0 billion of Japanese direct foreign investment between 1985 and 2000.

The advantages of such investment are obvious: aside from providing substantial capital, Japan's investment in Canada would provide much sought-after managerial skills and a transfer of technology.

The challenge for Canada is to create the best possible environment for the realization of this Japanese direct foreign investment. This involves, first, the establishment of an environment that is conducive to Japanese investment, one that ensures a climate confirming Canada's traditional status as a solid choice for investment. Beyond this, Canada is urged to adopt several recommended measures that promote greater mutual awareness and enhance the mobility of information and people for the ultimate purpose of realising Canada's full investment potential.

# JAPAN'S DIRECT FOREIGN INVESTMENT AND IMPLICATIONS FOR CANADA

## PART ONE: JAPANESE FOREIGN INVESTMENT TRENDS AND PROSPECTS

### 1. INTRODUCTION

Over the past four decades Japan has evolved from an essentially labour-intensive economy into one recognized globally as the leading capital-intensive producer of high technology goods. One consequence of this "Japanese miracle" has been the generation in recent years of huge Japanese trade and current account surpluses. This in turn has enabled Japan to undertake massive foreign investment, both indirect and direct, benefitting both Japan and recipient economies around the world.

#### STUDY OBJECTIVES AND OUTLINE

The purpose of this study is to examine the trends and patterns of Japan's foreign investment since the early 1950s and to determine, from Canada's perspective, the opportunities that may be present for Canada to benefit from prospective Japanese direct foreign investment in this country.

The study is divided into two principal parts. Part One is concerned with outlining the broad evolution of Japan's export of capital and the factors influencing the patterns that have emerged. It includes an overview of the trend of Japan's direct foreign investment since the early 1950s. This is followed by an examination of Japan's recent current account position and the relative prominence of indirect versus direct foreign investment over the years.

The changing nature of Japan's direct foreign investment is the subject of subsequent analysis, including a look at both the geographic swings and the changing emphasis of such investment by industry sector. Part One concludes with a look at the potential volume of Japanese direct foreign investment in Canada and recommended steps that would foster the realization of this potential.

Part Two examines the potential areas for industrial and technological cooperation between Canada and Japan in the electronics industry, and looks briefly at some other areas such as aerospace and biotechnology. Detailed examination of overseas investment and production by Japan's electric and electronic industries includes a brief historical sketch and a look at the changing geographical thrust of such Japanese investment. Individual sectors of the industry group are examined, including household appliances, consumer electronic goods (especially colour television sets and video cassette recorders), semiconductors, and computers and computer accessories.

## 2. JAPAN'S DIRECT FOREIGN INVESTMENT: AN OVERVIEW

Japan's total direct foreign investment, though still small relative to its indirect foreign investment, has nevertheless exhibited interesting growth patterns over the years and taken on greater prominence. In fact, the latest statistics available, which appear in Table 1, indicate that such expenditures exceeded $10 billion[1] in fiscal year 1984,[2] a new high for a post-war period that has seen over three decades of advancing outlays.

The size, nature and destination of Japan's direct foreign investment have all undergone change since 1951, when post-war foreign investment was first approved by the Japanese government. Such investment was quite limited in the 1950s and focused on developing external supplies of natural resources. Modest average annual increases during the 1950s and the first half of the 1960s gave way to more pronounced increases in the closing years of the 1960s, leading to outlays of approximately $600 million in 1968 and 1969. Most continued to be earmarked for resource investment, in particular iron and non-ferrous metal resources (primarily copper).

This period also saw the start of investment in support of the commercial activities of major trading firms in Europe and North America (particularly the United States). Most of the manufacturing investment undertaken at that time, however, was directed primarily at the developing nations of Southeast Asia. As part of their drive

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[1]Dollar amounts referred to throughout this report are U.S. dollars.

[2]In almost all cases throughout this report, years refer to fiscal years ending March 31 of the following calendar year.

TABLE 1

JAPAN'S DIRECT OVERSEAS INVESTMENT (FY 1951 - 1984)

| | No. of Cases | Amount[a] (US$ million) |
|---|---|---|
| 1951 - 1971 | 4,637 | 4,435 |
| 1972 | 1,774 | 2,338 |
| 1973 | 3,093 | 3,494 |
| 1974 | 1,912 | 2,395 |
| 1975 | 1,591 | 3,280 |
| 1976 | 1,652 | 3,462 |
| 1977 | 1,761 | 2,806 |
| 1978 | 2,393 | 4,598 |
| 1979 | 2,694 | 4,995 |
| 1980 | 2,442 | 4,693 |
| 1981 | 2,563 | 8,931 |
| 1982 | 2,548 | 7,703 |
| 1983 | 2,754 | 8,145 |
| 1984 | 2,499 | 10,155 |
| **Total** | **34,313** | **71,431** |

a) Figures are the accumulated value of approvals and notification.

Source: Ministry of Finance, Japan.

towards industrialization, these less developed countries (LDCs) had imposed high protective tariffs and quotas as a means of promoting domestic production, particularly of consumer goods. Japan's strategy was to establish consumer goods manufacturing facilities in these countries and counter the adverse effects of these protective measures by providing import substitutes.

## Direct Foreign Investment Takes Off in the 1970s

The 1970s saw Japanese foreign direct investment rise dramatically. Following 1970 and 1971, when annual investment levels were approximately $900 million, outlays rose to more than $2 billion -- reflecting in large measure the relaxation of the Japanese government's system of strict quotas on foreign exchange. An additional factor was the surge in global economic activity and the thrust in resource development that accompanied post-recession recovery and subsequent expansion. For Japan, a nation in need of natural resources to fuel its own rapid economic expansion, the pressure to ensure adequate resurces was especially acute.

Between 1972 and 1979, Japan's direct foreign investment more than doubled, rising to $5 billion annually by the close of the decade. More of the increase was attributable to resource-related investment than had been the case in the past. Investment in oil and liquified natural gas (LNG) was especially prominent, reflecting Japan's efforts to deal with the two oil crises of 1973 and 1978.

## Manufacturing Investment was Concentrated in LDCs

Manufacturing investment during the 1970s remained largely concentrated in the LDCs and was centred on automobiles, electronics, chemicals and industrial machinery.

Early automotive manufacturing investment concentrated primarily on assembly plants in the LDC market. (One notable venture in a developed economy was Toyota's failed attempt to set up a knockdown assembly plant in Nova Scotia.) Otherwise investment in this industry during the decade was principally for the purpose of establishing marketing networks, mainly dealer chains in the United States and Europe.

Investment associated with electronics was also largely marketing related, and corresponded with the start of colour TV manufacturing (by Sony) in North America in the early 1970s. The push for import replacement in the LDC market accounted for additional investment, though most of it could be characterized as relating to less technologically intensive consumer goods.

Chemicals investment by Japan was essentially small scale, and focussed on such downstream chemicals as plastics, paints and PVCs. Most of this investment related to developing economies, particularly in southeast Asia. One large-scale exception proved to be disastrous: Mitsui's petrochemical venture in Iran in 1973 fell victim to the tumultuous developments that followed in that country, incurring huge losses and ultimately forcing the company to write off its investment there. Later in the decade, however, Japan was more actively involved in large scale petrochemical investment.

Industrial machinery investment grew rapidly during the 1970s, one highlight being the construction of facilities for the manufacture of ball bearings in North America (including Canada). Other smaller ventures included investment in agricultural equipment and construction equipment in southeast Asia.

The trend in manufacturing investment was clearly upward in the decade of the 1970s, setting the stage for the further expansion that was to follow in the 1980s. At the same time, Japanese foreign direct investment in the financial sector gained considerable prominence, with substantial outlays made for bank branches and acquisitions in advanced countries (especially the United States).

**Investment Responds to the Volatile 1980s**

The 1980s have seen further significant developments in Japan's direct foreign investment. As can be seen in accompanying Table 2, the trend in total annual outlays has been erratic -- a reflection of the volatile economic conditions that have characterized the first half of the decade. In 1980, such investment declined by 6 per cent, mainly because of a one-third fall off in mining investment. Recovery the following year was pronounced: spending almost doubled on the strength of virtual across-the-board increases in all major sectors (and an especially large 300 percent increase in mining investment, largely associated with LNG-related investment).

A subsequent 14 percent decline in 1982 might well have been expected, given the worldwide recession conditions and overall investment strength in the previous fiscal year. In fact, however, while manufacturing investment did decline about 10 percent, the decline can essentially be attributed to reductions associated with Indonesian LNG projects. In spite of a further decline in mining in 1983, Japan's total direct foreign investment rose by close to 6 percent, largely on the strength of recovery in manufacturing.

The latest year for which figures are available, 1984, saw investment rise 24 percent -- even though a small decline in manufacturing

TABLE 2

JAPAN'S OVERSEAS DIRECT INVESTMENT TRENDS* BY INDUSTRY
$ million

| | 1973 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|---|---|---|---|---|---|---|---|
| Manufacturing | 1496 | 2038 | 1693 | 1706 | 2305 | 2076 | 2588 | 2505 |
| Resource Development | 609 | 461 | 1011 | 637 | 2645 | 747 | 418 | 534 |
| Commerce and Services | 1173 | 1921 | 2123 | 2139 | 3871 | 4731 | 4940 | 6894 |
| Branches and Real Estate | 216 | 178 | 168 | 211 | 110 | 149 | 199 | 221 |
| TOTAL | 3494 | 4598 | 4995 | 4693 | 8931 | 7703 | 8145 | 10155 |

*by fiscal years

virtually offset a marginal rise in mining. The gain can be credited to the rising prominence of such tertiary industries as commerce, banking and insurance, and other services, which rose almost 40 percent.

Volatility has not been the only distinguishing feature of Japan's direct foreign investment in the 1980s. On the whole, such investment has risen dramatically: in 1984 it was double the $5 billion level of 1979. From a sectoral perspective, one of the most notable developments has been the conspicuous downward trend (except for 1981) in mining investment's share of the annual total -- from 12 percent in 1980 to less than 5 percent in 1984. (Distribution by broad categories is seen in Table 3.) While oil and gas remain relatively important, significant reductions have been evident in iron and non-ferrous metal mining.

Another important development has been the dramatic rise in the share represented by commerce and other services. These tertiary industries accounted for two out of every three dollars of direct foreign investment in 1984. As recently as the early 1980s, this share barely exceeded 40 per cent. Banking and insurance, which had represented 8 percent of the total in 1980, were up to 21 percent in 1984.

## Manufacturing Investment Is Very Promising

While manufacturing's share of total Japanese direct foreign investment has lost some ground over the past decade, this is unlikely to be permanent because of the shifting trend in Japanese foreign investment. Japan's investment in the LDCs (especially in Latin America) has indeed been shifting gradually from manufacturing to natural resources; but Japan's manufacturing investment in advanced economies is a different matter. During the 1980s, funds earmarked for manufacturing in

TABLE 3

JAPAN'S OVERSEAS DIRECT INVESTMENT
DISTRIBUTION OF TOTAL BY INDUSTRY
Per Cent Distribution

| | 1973 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|---|---|---|---|---|---|---|---|
| Manufacturing | 42.8 | 44.3 | 33.9 | 36.3 | 25.8 | 27.0 | 31.8 | 24.7 |
| Resource Development | 17.4 | 10.0 | 20.2 | 13.6 | 29.6 | 9.7 | 5.1 | 5.3 |
| Commerce and Services | 33.6 | 41.8 | 42.5 | 45.6 | 43.4 | 61.4 | 60.7 | 67.9 |
| Branches and Real Estate | 6.2 | 3.9 | 3.4 | 4.5 | 1.2 | 1.9 | 2.4 | 2.2 |
| TOTAL | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

*by fiscal years

developed countries have expanded to the point where they now exceed the manufacturing outlays directed to developing countries.

Japan's success as a major exporter is in large measure responsible for this trend. Continuing large Japanese trade surpluses have in recent years produced "trade friction" and given rise to increasingly protectionist sentiment in the United States and other economies plagued with concern over high unemployment. In part as a strategy to defuse such pressures, Japan has recently embarked on an ambitious direct investment program. Included are a number of small car production plants in North America and Europe, including Honda's plants in Ohio and Ontario and Nissan and Toyota facilities. Similar ventures have been undertaken or proposed in less developed nations such as Mexico and Brazil.

Similar motives are in part responsible for Japan's direct participation in the U.S. electronics field (in particular colour TV production) and in semi-conductor production. Import substitution in part explains similar moves to set up production in Europe. At the same time, large-scale investment is continuing on integrated petrochemical plants in Saudi Arabia and Singapore.

The sizable expansion of investment associated with the financial and commercial sectors actually represents a continuation of a trend that started in the 1970s and more recently has included such acquisitions as the Bank of Tokyo's purchase of California banks. So pronounced has this trend been that, by January 1986, total foreign assets of Japanese banks actually exceeded those of American banks.

## 3. JAPAN'S EMERGENCE AS A MAJOR EXPORTER OF CAPITAL

### Japan's Surpluses Are a Key Factor

The remarkable transformation of Japan from an essentially unsophisticated labour-intensive economy in the early post-war period to a sophisticated high-tech producer today has over the years put it in an enviable trade position. As Table 4 indicates, Japan has in recent years experienced sizable trade surpluses: in 1984 its surplus reached \$44 billion, well in excess of second-ranked West Germany (\$22 billion) and third-ranked Canada (\$16 billion). In striking contrast, of course, is the United States, which saw its trade deficit soar to over \$108 billion in 1984. Statistics available for the first half of 1985 suggest that the gap between Japan and the United States is in fact widening.

A look back to the late 1970s and early 1980s, however, reveals that this sharp contrast is a relatively recent phenomenon. As recently as 1979 and 1980, Japan's trade surplus was only around \$2 billion, reflecting the adverse situation that confronted energy-import-dependent Japan in the period that followed the Iranian oil crisis. This was well below Canada's surpluses of \$4 billion in 1979 and \$8 billion in 1980. During those same years, the United States recorded trade deficits in the \$25 billion range which, while large, did not stand in as stark contrast with Japan as was the case in 1984.

### The Japanese and American Current Accounts Stand in Sharp Contrast

Table 5 shows the current account balances of Japan and its major

TABLE 4

BALANCE OF TRADE FOR SELECTED COUNTRIES (1978 - 1985)*
(US$ million)

| | Japan[a)] | U.S.A.[b)] | Germany, F.R. | France | U.K. | Italy | Canada | Australia | Brazil | Mexico | Korea, Rep. of |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1978 | 24,396 | -33,947 | 24,740 | 101 | -2,965 | 2,912 | 4,184 | 92 | -1,158 | -1,745 | -1,780 |
| 1979 | 1,845 | -27,536 | 16,870 | -3,220 | -7,207 | -990 | 4,179 | 2,511 | -2,717 | -2,830 | -4,395 |
| 1980 | 2,125 | -25,480 | 8,970 | -13,419 | 3,715 | -16,417 | 8,002 | 1,378 | -2,823 | -2,830 | 4,834 |
| 1981 | 19,967 | -27,978 | 16,570 | -9,970 | 7,756 | -10,901 | 6,609 | -2,329 | 1,185 | -4,099 | -3,628 |
| 1982 | 18,079 | -36,444 | 25,280 | -15,785 | 3,423 | -8,050 | 14,959 | -2,612 | 778 | 6,795 | -2,594 |
| 1983 | 31,454 | -62,012 | 22,270 | -8,754 | -1,813 | -3,215 | 14,877 | 30 | 6,469 | 13,763 | -1,763 |
| 1984 | 44,257 | -108,281 | 22,340 | -4,089 | -5,677 | -5,995 | 16,585 | -814 | 13,086 | 12,799 | -1,036 |
| 1984 II | 10,644[c)] | -25,649[c)] | 4,020 | -991 | -2,065 | -1,403 | 4,101 | 10 | 3,600 | 3,429 | -397 |
| III | 9,909[c)] | -32,507[c)] | 4,880 | -343 | -1,930 | -992 | 3,991 | -503 | 3,623 | 2,745 | -427 |
| IV | 13,691[c)] | -24,557[c)] | 7,930 | -476 | -916 | -2,917 | 5,159 | -313 | 3,477 | 2,581 | 431 |
| 1985 I | 11,547[c)] | -29,532[c)] | 5,330 | -2,207 | -2,080 | - | 3,854 | -4 | - | - | - |
| II (P) | 13,058[c)] | -33,001[c)] | - | - | - | - | - | 250 | - | - | - |

* Calendar years.
a) Based on Balance of Payments Monthly.
b) Excludes military grants. Based on Economic Indicators.
c) Seasonally adjusted.

Source: IMF, <u>International Financial Statistics</u>, October 1985.

TABLE 5

CURRENT ACCOUNT BALANCE FOR SELECTED COUNTRIES (1978 - 1985)
(US$ million)

| | | Japan[a)] | U.S.A.[b)] | Germany, F.R. | France | U.K. | Italy | Canada | Australia | Brazil | Mexico | Korea, Rep. of |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1978 | | 16,534 | -15,427 | 9,230 | 7,064 | 2,246 | 6,237 | -4,298 | -4,536 | -7,036 | -3,171 | -1,085 |
| 1979 | | -8,754 | -991 | -6,280 | 5,142 | -954 | 5,414 | -4,120 | -2,646 | -10,478 | -5,459 | -4,151 |
| 1980 | | -10,746 | 1,873 | -16,000 | -4,208 | 8,690 | -9,801 | -953 | -4,136 | -12,806 | -8,162 | -5,321 |
| 1981 | | 4,770 | 6,339 | -5,420 | -4,809 | 15,070 | -8,604 | -5,055 | -8,244 | -11,751 | -13,899 | -4,646 |
| 1982 | | 6,850 | -8,051 | 3,140 | -12,082 | 8,435 | -5,684 | 2,110 | -8,199 | -16,312 | -6,796 | -2,650 |
| 1983 | | 20,799 | -40,790 | 4,170 | -4,904 | 4,862 | 555 | 1,365 | -5,868 | -6,837 | 4,752 | -1,606 |
| 1984 | | 35,003 | -101,532 | 6,070 | 11 | 733 | -2,871 | 1,893 | -8,273 | 42 | - | -1,371 |
| 1984 | I | 7,091[c)] | -19,064[c)] | 1,340 | -1,554 | 772 | -1,138 | -1,207 | -1,735 | -504 | 2,186 | -680 |
| | II | 8,834[c)] | -24,493[c)] | 380 | 342 | -877 | -210 | 310 | -1,801 | 121 | 1,277 | -492 |
| | III | 7,232[c)] | -32,500[c)] | -780 | 545 | -434 | 707 | 1,416 | -2,342 | 588 | 223 | -454 |
| | IV | 11,711[c)] | -25,477[c)] | 5,140 | 678 | 1,273 | -2,231 | 1,373 | -2,395 | -163 | - | 255 |
| 1985 | I | 9,428[c)] | -30,325[c)] | 1,670 | -1,820 | -509 | - | -568 | -1,695 | - | - | - |
| | II (P) | 12,127[c)] | -31,811[c)] | - | - | - | - | - | -1,513 | - | - | - |

a) Based on Balance of Payments Monthly.
b) Based on Economic Indicators.
c) Seasonally adjusted.

Source: IMF, International Financial Statistics, October 1985.

trading partners and provides further evidence of the recent nature of the contrast between Japan and the United States. As recently as 1980, Japan's current account was in deficit by about $11 billion (reflecting the adverse post-Iranian situation), while the United States was experiencing a near $2 billion current account surplus. In 1982, the U.S. moved to a current account deficit of a mere $8 billion; but it jumped to $40 billion in 1983 and to $101 billion in 1984. In contrast, Japan's current account surplus was under $7 billion in 1982, over $20 billion in 1983 and at $35 billion by 1984. Thus the spread had moved from over $12 billion in the United States' favour in 1980 to over $136 billion in Japan's favour by 1984!

The explanation for this dramatic contrast obviously lies in some fairly recent developments. One is Japan's success in becoming much more energy efficient as a means of coping with its energy scarcity problems. The dominant factor by far, however, is the U.S. "strong dollar" policy of the early 1980s. With the U.S. government deficit soaring in the 1980s, the need to attract both domestic and foreign funding of the deficit forced a rise in U.S. domestic interest rates. The resulting influx of foreign capital led to an appreciation of the U.S. dollar and an adverse shift in U.S. terms of trade -- the consequence of which was an aggravated trade imbalance and a serious deterioration in the U.S. current account balance.

## "Trade Friction" Has Arisen in the 1980s

The swing in the balance of United States-Japan trade had consequences of its own. What came to be known as "trade friction" led to increasingly protectionist sentiment in the United States. Even the more restrained called for Japan to help correct the situation by (a) opening its own domestic markets more to imports and (b) adopting more stimulative fiscal policies to encourage domestic demand.

Japan's long-term capital account turned sharply negative in the 1980s (see Table 6). What seemed a remarkable high of almost $15 billion in net long-term capital outflows in 1982 was quickly dwarfed by the sharp rise to almost $50 billion by 1984.

## Japan Has Become A Major Capital Exporter

It was during this period that Japan became a significant capital exporting nation. Expecially important was the increase in Japanese institutional investors' activities, including those of life insurance companies, banks, trusts and the government postal savings fund. Table 7 indicates the changes in the net outflow of capital from Japan by types of investment since 1972, while Table 8 reveals the changing prominence of each type of investment (as a share of the annual total) over that same period.

In contrast with 1974 and 1975, when direct investment represented over half of the total net capital outflow from Japan, in 1984 it accounted for less than 10 per cent of the total. Over the same period, on the other hand, security investments increased dramatically, rising to well over half of the total -- and largely on the strength of purchases of foreign (mainly U.S. and Canadian) government bonds from 1977 onward. This was especially so in 1984, when close to $30 billion went for the purchase of securities, primarily government bonds.

The statistics that follow illustrate the impact that U.S. monetary policy had in attracting Japanese capital investment to the United States.

TABLE 6

JAPAN'S INTERNATIONAL BALANCE OF PAYMENTS - IMF BASIS (1978 - 1985)
(US$ million)

| | Current Balance | | | | | | Long-term Capital | Basic Balance | Short-term Capital | Errors and Ommissions | Overall Balance |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Current Balance | Trade Balance | | | Services | Transfers | | | | | |
| | | Exports | Imports | Balance | | | | | | | |
| 1978 | 16,534 | 95,634 | 71,038 | 24,596 | -7,387 | -675 | -12,389 | 4,145 | 1,538 | 267 | 5,950 |
| 1979 | -8,754 | 101,232 | 99,387 | 1,845 | -9,472 | -1,127 | -12,976 | -21,730 | 2,735 | 2,333 | -16,662 |
| 1980 | -10,746 | 126,736 | 124,611 | 2,125 | -11,343 | -1,528 | 2,324 | -8,422 | 3,141 | -3,115 | -8,396 |
| 1981 | 4,770 | 149,522 | 129,555 | 19,967 | -13,573 | -1,624 | -9,672 | -4,902 | 2,265 | 493 | -2,144 |
| 1982 | 6,850 | 137,663 | 119,584 | 18,079 | -9,848 | -1,381 | -14,969 | -8,119 | -1,579 | 4,727 | -4,971 |
| 1983 | 20,799 | 145,468 | 114,014 | 31,454 | -9,106 | -1,549 | -17,700 | 3,099 | 23 | 2,055 | 5,177 |
| 1984 | 35,003 | 168,290 | 124,033 | 44,257 | -7,747 | -1,507 | -49,651 | -14,648 | -4,295 | 3,743 | -15,200 |
| 1984 II | 9,982 | 43,018 | 31,226 | 11,792 | -1,483 | -327 | -14,314 | -4,332 | -20 | -910 | -5,262 |
| III | 8,679 | 42,286 | 30,930 | 11,356 | -2,420 | -257 | -12,422 | -3,743 | -1,967 | 2,387 | -3,323 |
| IV | 11,536 | 44,390 | 30,874 | 13,516 | -1,596 | -384 | -17,106 | -5,570 | -235 | 2,260 | -3,545 |
| 1985 I | 6,818 | 38,164 | 29,227 | 8,937 | -1,565 | -554 | -10,355 | -3,537 | -577 | 1,700 | -2,414 |
| II | 13,262 | 42,239 | 29,046 | 14,193 | -611 | -320 | -17,166 | -3,904 | 155 | 1,829 | -1,920 |

Source: Bank of Japan, Balance of Payments Monthly, June 1985.

TABLE 7

HISTORICAL CHANGES IN THE NET OUTFLOW OF CAPITAL FROM JAPAN
(US$ million)

| | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Direct Investment | 852 | 2,200 | 1,839 | 1,976 | 1,871 | 1,725 | 2,584 | 2,665 | 2,993 | 4,804 | 4,448 | 4,198 | 4,891 |
| Deferred Payment Credits | 411 | 971 | 511 | 27 | 1,043 | 1,255 | -614 | -885 | 1,210 | 3,315 | 2,843 | 3,068 | 4,119 |
| Government to Government Credits | 2,211 | 2,765 | 1,027 | 1,295 | 1,513 | 1,463 | 7,296 | 7,048 | 2,706 | 4,953 | 9,249 | 8,357 | 9,624 |
| Security Investments | 1,469 | 1,412 | -39 | 131 | 162 | 2,605 | 6,452 | 4,180 | 4,650 | 11,179 | 9,240 | 16,714 | 29,484 |
| Equity | | | | 12 | 7 | 15 | 357 | 213 | -171 | 349 | -008 | 804 | 030 |
| Bonds | | | | 121 | 155 | 2,590 | 5,095 | 3,967 | 4,821 | 10,830 | 9,248 | 15,910 | 29,454 |
| Others | 1,259 | 340 | 117 | 266 | 264 | -184 | 964 | 843 | 1,564 | 1,476 | 2,135 | 1,593 | 2,910 |
| Total | 6,202 | 7,688 | 3,455 | 3,695 | 4,853 | 6,864 | 16,682 | 13,851 | 13,123 | 25,727 | 27,915 | 33,930 | 51,028 |

*Some MOF figures differ slightly from Table (8) for technical reasons.

TABLE 8

CHANGES IN NET CAPITAL OUTFLOW FROM JAPAN BY TYPE OF FOREIGN INVESTMENT (1972 - 1984)

| | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Direct Investment | 13.7 | 28.6 | 53.2 | 53.5 | 38.6 | 25.1 | 15.5 | 19.2 | 22.8 | 18.7 | 15.9 | 12.4 | 9.6 |
| Deferred Payment Credits | 6.6 | 12.6 | 14.8 | 0.7 | 21.5 | 18.3 | -3.7 | -6.4 | 9.2 | 12.9 | 10.2 | 9.0 | 8.1 |
| Government to Government Credits | 35.7 | 36.0 | 29.7 | 35.1 | 31.2 | 21.3 | 43.7 | 50.9 | 20.6 | 19.3 | 33.1 | 24.6 | 18.9 |
| Security Investments | 23.7 | 18.4 | -1.1 | 3.6 | 3.3 | 38.0 | 38.7 | 30.2 | 35.5 | 43.5 | 33.1 | 49.3 | 57.8 |
| Equity | | | | 0.3 | 0.1 | 0.2 | 2.1 | 1.5 | -1.3 | 1.4 | -0.0 | 2.4 | 0.1 |
| Bonds | | | | 3.3 | 3.2 | 37.8 | 36.6 | 28.7 | 36.7 | 42.1 | 33.1 | 46.9 | 57.7 |
| Others | 20.3 | 4.4 | 3.4 | 7.1 | 5.4 | -2.7 | 5.8 | 6.1 | 11.9 | 5.6 | 7.7 | 4.7 | 5.8 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

*Up to January, 1985, others full fiscal year basis.

| Long Term Interest Rates and Spread | U.S. | Japan | Spread |
|---|---|---|---|
| 1984 (Average) | 12.48 | 6.81 | 5.67 |
| 1985 (August) | 10.64 | 6.33 | 4.31 |
| 1985 (December) | 9.50 | 6.30 | 3.20 |

The obvious wide spread is responsible for the flow of Japanese capital to North America for the purchase of government bonds. (An informal "rule of thumb" in Japanese business circles apparently has it that a 3 percent interest rate differential is sufficient to protect investors from substantial capital losses in the event of anything but the most dramatic exchange rate changes.)

The substantial outflow of indirect investment funds so far during the 1980s can also be attributed to changes in Japan's foreign currency regulations, which liberalized the conditions governing foreign investment by domestic institutional investors.

Interestingly, Japan has generated net capital outflows that have in fact exceeded its current account surpluses, indicating it has in the past few years contributed its surplus savings to the rest of the world (see Table 9). In 1984 and 1985 (annual projection based on half-year data), Japan's net capital outflows exceeded the nation's current account surplus by approximately $15 billion and $17 billion respectively (see Table 10). In the process, these capital infusions have helped finance both U.S. and Canadian public sector debt and have helped promote recovery and expansion since the serious recession of 1981-82 in both countries.

TABLE 9

JAPAN'S LONG-TERM CAPITAL ACCOUNT

| (US$ million) | 1983 | 1984 |
|---|---|---|
| Direct Investment[a] | 3,612 | 5,965 |
| Trade Credit[a] | 2,589 | 4,937 |
| Loans[a] | 8,425 | 11,922 |
| Securities[a] | 16,024 | 30,795 |
| Other[a] | 1,809 | 3,156 |
| Assets, total[a] (A) | 32,459 | 56,775 |
| Direct Investment[b] | 416 | -10 |
| Trade Credit[b] | 8 | 3 |
| Loans[b] | -37 | -77 |
| Securities[b] | 14,148 | 7,194 |
| External Bonds[b] | 5,663 | 7,350 |
| Other[b] | 224 | 14 |
| Liabilities, total[b] (B) | 14,759 | 7,124 |
| Balance (B - A) | -17,700 | -49,651 |

a) Plus shows an increase in assets; minus shows a decrease in assets.

b) Plus shows an increase in liabilities; minus shows a decrease in liabilities.

Source: Bank of Japan.

TABLE 10

CHANGES IN JAPAN'S LONG-TERM CAPITAL ACCOUNT, 1984 - 1985

| | 1984 | (of which U.S.) | 1985 January-June |
|---|---|---|---|
| Current Account Balance | 35.0 | (35.0) | 20.1 |
| Long-Term Capital Balance | 49.9 | (14.8) | 28.9 |
| Outflow from Japan | 56.8 | (15.4) | 35.4 |
| - Direct Investment | 6.0 | (15.4) | 3.0 |
| - Deferred Payment Credits | 4.9 | (0.2) | 3.0 |
| - G - G Credits | 11.9 | (0.4) | 4.3 |
| - Security Investment | 30.8 | (11.3) | 24.5 |
| - Others | 32.0 | (6.4) | 0.7 |
| Inflow into Japan | 7.1 | (0.6) | 6.7 |

## Japan's High Savings Rate is Important

Japan's ability to provide such substantial capital exports is in part a result of its extraordinarily high savings rate. Personal savings as a percent of disposable income, presently around 24 percent, represent the highest savings rate of any industrialized country — roughly double the Canadian rate and seven times the corresponding United States rate.

The explanation for such a high rate includes: a tradition of private savings to finance income needs after retirement (in the absence of well-developed public programs); Japanese government tax incentives encouraging savings; a national penchant for substantial insurance coverage; and generally lower domestic consumption rates.

In the 1960s and 1970s, Japan's rapid economic growth was fostered by the existence of substantial savings to fuel domestic investment needs. More recently, with domestic economic growth generally down to a 4 percent upper limit, the absence of strong investment growth in the face of continuing high savings rates has left insurance companies flush with rapidly growing assets and searching for investment opportunities abroad.

This same shift in the Japanese economy to less rapid economic growth has brought with it the prospect of smaller and steadier private sector investment in selected hi-tech industries and considerably reduced investment in primary industries. With land prices so high in Japan, there has been little domestic real estate investment to pick up the slack. The public sector is unlikely to offset this, given the trend toward smaller government and the reduced emphasis on fiscal policy.

U.S. Problems Prompted Action

The foregoing factors help to explain Japan's increased emphasis on foreign capital investment in recent years. From a U.S. perspective, however, the prospect of continuing Japanese capital outflows to the United States in the face of a huge and growing U.S. current account deficit left little choice but to press for changes that would help the United States redress its substantial problems.

Accordingly, U.S. Secretary of State Schultz in April 1985 pressed Japan to deal with the problem created for the U.S. by Japan's trade surpluses and high savings rate. Japan countered with the argument that it was high U.S. interest rates, fostered by the "crowding out" effect of U.S. budgetary financing demands, that was the root of the problem.

According to one Japanese academic, M. Itoh, Japan's current account surpluses ought to have been accompanied by an appreciation of the yen; but the steady outflow of Japanese capital to the United States in response to higher interest rates prevented an appreciation of the yen while holding up the external value of the U.S. dollar.

The substantial volume of Japanese foreign portfolio investment in the United States in 1984 finally prompted recognition on all sides that some measures had to be taken. In the summer of 1985 Prime Minister Nakasone openly acknowledged the need to consider controlling capital outflows. Mr. Gyoten, Director General of the Ministry of Finance's International Currency Bureau, followed up with an "administrative guideline" advising Japanese institutional investors to adopt a more careful approach with respect to their currency risks.

## The G-5 Agreement Has Important Implications for Japan

The September 1985 G-5 Agreement that followed provided an unprecedented move in currency realignment. The five leading industrial economies (United States, Japan, West Germany, France and the United Kingdom) agreed to intervene in international currency markets to correct perceived currency misalignments (rather than to counter excessive currency fluctuations). They agreed to engineer a 20 percent increase in the value of the Japanese yen relative to the U.S. dollar by November, 1985. This was achieved as planned, with the exchange rate rising from 240 yen to the dollar to a recent low of under 180 yen to the dollar. Furthermore, the adjustment was carried out without major short-term currency disturbances.

This realignment did in fact discourage the outflow of portfolio investment from Japan by reducing the value of U.S. dollar holdings relative to the yen. However, it did not in fact reduce foreign holdings: it simply slowed the outflow of indirect investment. (Some increased investment actually occurred for "averaging" purposes, where more was purchased with the higher valued yen in order to offset losses.) Average outflow continued at a $5 billion per month rate during the summer-to-October period, and since last November the level of investment has been sustained at a higherlevel.

## Japan's Life Insurance Companies Have a High Investment Profile

A look back at Tables 7 and 8 reveals the extent of foreign securities investment during the 1980s. Japanese life insurance companies are by far the largest investing group, and their relative prominence has been rising in recent years. Most of the near $15 billion of foreign asset holdings of Japanese life insurance companies in 1984 was denominated in North American currencies: 41 percent in U.S. dollars and 29 percent in Canadian dollars, with Australian dollars accounting for another 19 percent.

Very recent evidence suggests that U.S. dollar investment has begun to weaken, while investment in Deutschmarks and sterling has picked up. Nevertheless, European currency investment remains relatively small, and the United States still appears to account for more than one-third of the nearly $21 billion of indicated investment by life insurance companies early in 1986.

It is interesting to note that almost one third of the foreign securities investment of Japanese life insurance companies has been allocated to Canada. Even more interesting is the stark contrast between such indirect investment in Canada, valued at approximately $4.5 billion, and the comparatively miniscule $184 million total Japanese direct investment in Canada in 1984.

Given that indirect investment is essentially long term in nature, it is indeed probable that it will continue to grow so long as the prevailing U.S.-Japan interest rate spreads are sustained. Even so, however, with the Japanese government currently trying to direct investment funds to domestic applications and with the G-5 Agreement reducing some of the earlier advantages of indirect foreign investment, the strong likelihood is that Japanese direct foreign investment will exhibit a stronger growth trend in the future. This implies that while indirect investment will continue to constitute the lion's share of total Japanese foreign investment, the gap between indirect and direct foreign investment will gradually shrink.

## 4. JAPAN'S DIRECT FOREIGN INVESTMENT: RECENT DEVELOPMENTS AND TRENDS

### Currency Realignment is Encouraging Direct Foreign Investment

While securities investment has played a dominant role in Japan's foreign investment in recent years, conditions now appear to favour a rising prominence for direct foreign investment. This development is attributable in part to the impact of currency realignments on relatively interest-rate-sensitive portfolio investment and in part to the new Japanese strategy of avoiding "trade friction" (and implied protectionist sentiment) through direct investment, especially in the markets of the advanced economies with which Japan trades.

The G-5 Agreement will, of course, change conditions across the broad spectrum of Japanese industry. With the yen recently up by about one third in value (relative to the U.S. dollar) over August 1985, large Japanese utilities are now finding their oil import bills considerably reduced (thanks also in part to the declining world price for oil). The currency alignment in fact is providing huge gains for virtually all Japanese importers.

Japanese exporters face a different situation. Only now is it becoming apparent just how extensive a readjustment will be needed to deal with the sizeable deterioration in their price competitiveness. Increased U.S. price tags for Japanese exports have been in evidence since last September, when Japanese manufacturers first anticipated the problems that currency realignment would bring. But even so, the extent of the price adjustment has not been enough to cope with the swift and extensive change in currency values.

Awareness of the inevitability of currency realignment almost certainly was behind Toyota's decision to build two plants in North America, including one in Cambridge, Ontario. So too was Honda's decision to double its Alliston plant capacity. A Mazda official suggested it was now uneconomical to export from plants in Japan. That company's actions confirmed that sentiment: Mazda is now planning a new plant in Taiwan (in association with Ford) from which to export to Canada. Nissan is expanding its Mexican facilities to serve the U.S. market.

Other illustrations are plentiful. Canon is pushing ahead with an office automation plant in New Jersey, while NEC is expanding its PBX plant in Australia to cope with competition from Canada and the United States. Komatsu, a Japanese producer of civil engineering equipment, is seeking to purchase U.S. facilities for the production of industrial machinery. Japanese electronics producers are now increasing VCR production in Europe and looking to set up production in the United States, where currently there is no VCR production.

As these illustrations suggest, the recent (and ongoing) acceleration in the development of on-site production extends across many industries, including Japan's most technologically-advanced industries (automobiles, electronics, semi-conductors, office automation equipment...). This heightened level of direct foreign investment is expected to continue well into the future.

## Other Factors Are Promoting Direct Foreign Investment

The G-5 realignment, while quite significant, is not the only reason for expecting continued rapid growth in Japan's direct foreign investment. Several other influences can be cited:

(1) Japan's ratio of foreign production to domestic production (especially for manufacturing) has been very low compared with the United States and West Germany. In comparison with the United States (15 per cent) and West Germany (30 per cent), Japan has maintained foreign production at only 3 per cent of domestic production levels in recent years.

It should be noted that some Japanese manufacturing industries have already moved up strongly: for example, Japan's electric/electronics industry now has roughly a 30 per cent ratio. While this is a rare case, other industries will certainly follow this pattern.

A similar comparison of the ratios of overseas production to exports reveals that U.S. overseas production is two to three times as large as its exports, while Japan's overseas production represents less than a third of exports -- about a tenth of the U.S. ratio.

(2) Japan's cumulative direct foreign investment as a share of gross domestic product similarly is small when international comparisons are made. As is evident from the 1983 data presented in Table 11, Japan's share was less than half that of the United States and one seventh that of the United Kingdom. While certainly indicative of much scope for expansion, these statistics may already have become somewhat obsolete, given that Japan's cumulative direct foreign investment more than doubled by 1984.

(3) The Japanese government now strongly supports industrial and technological cooperation with advanced economies as a means of helping to reactivate their domestic industries. This has been

TABLE 11

DIRECT FOREIGN INVESTMENT AND GDP, end of 1983

| | Cumulative Direct Foreign Investment $ billion | DFI as percentage of GDP % | DFI per capita $ |
|---|---|---|---|
| Japan | 32.2 | 2.79 | 270 |
| United States | 226.1 | 6.90 | 964 |
| United Kingdom | 91.2 | 20.04 | 1.618 |
| West Germany | 37.3 | 5.71 | 607 |

Source: JETRO

reflected in the establishment of CITECs[3] in Europe, the United States and, most recently, Canada.

(4) Japan's ability to support foreign investment is likely to be sustained by the probable continuation of current account surpluses (fostered in part by Japan's technological edge in manufacturing). At the same time, the United States and the European Economic Community -- given the prospect of continuing Japanese current account surpluses -- will both likely press for more Japanese investment in their respective economies as a means of helping to reduce unemployment.

## Even Bullish DFI Forecasts Now Seem Conservative

The question of growth prospects for Japan's direct foreign investment was addressed by a 1984 study by the Japan Economic Research Institute (see Table 12). Its forecast of a direct foreign investment balance of just over $70 billion by 1985[4] proved to be somewhat conservative (Japan actually realised the 1985 forecast value in 1984).

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[3]CITECs are Centres for Industrial and Economic Cooperation established by the Japan External Trade Organization (JETRO), a quasi-governmental organization working to promote trade between Japan and other nations. The CITEC recently set up in Canada adds to the Centres established since 1984 in the United Kingdom, Franch, West Germany, Italy, Belgium and the United States. The purpose of such CITECs is to promote mutually beneficial exchange of investment and technology between Japan and the nations in which they are located.

[4]References are actually to positions at the end of fiscal years (1985 therefore refers to March 31, 1986).

TABLE 12

JAPAN'S FOREIGN DIRECT INVESTMENT: PROJECTIONS TO 1990 (I)

Projections in U.S.$ millions

| | 1965 | 1970 | 1975 | 1980 | 1985 | 1990 |
|---|---|---|---|---|---|---|
| North America | 211 | 918 | 3,917 | 9,798 | 20,235 | 42,742 |
| Latin America | 281 | 566 | 2,881 | 6,168 | 11,643 | 22,503 |
| Asia | 188 | 751 | 4,219 | 9,830 | 21,432 | 42,367 |
| Middle East | 185 | 334 | 976 | 2,259 | 1,150 | 8,607 |
| Europe | 26 | 610 | 2,517 | 4,471 | 8,837 | 20,165 |
| Africa | 11 | 92 | 501 | 1,445 | 3,102 | 7,784 |
| Oceania | 7 | 281 | 930 | 2,525 | 5,072 | 13,207 |
| Developed Countries | 271 | 1,831 | 7,361 | 16,494 | 31,441 | 76,110 |
| Undeveloped Countries | 675 | 1,713 | 8,579 | 19,702 | 10,627 | 81,261 |
| Total | 919 | 3,577 | 15,943 | 36,497 | 71,771 | 157,371 |

TABLE 13

JAPAN'S FOREIGN DIRECT INVESTMENT: PROJECTION TO 1990 (II)

| | Projections: Distribution in Percentage Terms | | | | | |
|---|---|---|---|---|---|---|
| | 1965 | 1970 | 1975 | 1980 | 1985 | 1990 |
| North America | 25.4 | 25.5 | 21.6 | 26.8 | 27.1 | 27.2 |
| Latin America | 29.6 | 15.8 | 18.1 | 16.9 | 15.6 | 14.3 |
| Asia | 19.8 | 21.0 | 26.5 | 26.9 | 28.7 | 26.9 |
| Middle East | 20.6 | 9.3 | 6.1 | 6.2 | 5.5 | 5.5 |
| Europe | 2.7 | 17.9 | 15.8 | 12.3 | 11.8 | 12.8 |
| Africa | 1.2 | 2.6 | 8.1 | 4.0 | 4.5 | 4.9 |
| Oceania | 0.7 | 7.9 | 5.8 | 6.9 | 6.8 | 8.4 |
| Developed Countries | 28.9 | 51.3 | 46.2 | 46.0 | 45.7 | 48.4 |
| Developing Countries | 71.1 | 48.7 | 53.8 | 54.0 | 54.3 | 51.6 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

That same study forecast a cumulative investment of $157 billion by 1990, with $42.7 billion allocated to North America. (As Table 13 indicates, this represented for North America a relatively stable 27.2 percent share of Japan's global direct foreign investment.)[5]

It is noteworthy that, as of March 31, 1985, Japan's actual direct overseas investment in North America was valued at $21.47 billion, of which Canada accounted for $1.58 billion (see Table 14).

As later discussion will indicate, even this bullish forecast to 1990 is likely to prove far too low. It underestimated 1984 by a considerable amount and predates the G-5 Agreement, with its important consequences for future foreign investment.

As further testimony to the promise of expanding Japanese direct foreign investment, another study projected that total annual foreign production by Japanese manufacturers would by 1997 be equivalent to approximately 10 percent of total projected manufacturing production in Japan that year.

**Some Risks Must Be Considered**

The prospect of large-scale production shifts abroad raises the spectre of increased risk of "caving", a phenomenon whereby a formerly active domestic industry is to a degree abandoned, leaving it a 'hollow shell'. Such a prospect had indeed been feared in the case of the United States in the late 1950s and 1960s, when U.S. multinationals

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[5]The projections will be looked at more closely later in this study.

Table 14

JAPAN'S DIRECT OVERSEAS INVESTMENT BY COUNTRY

| (As of March 31, 1985) | No. of Cases | Amount[a] (US$ million) |
|---|---|---|
| U.S.A. | 11,603 | 19,894 |
| Indonesia | 1,319 | 8,015 |
| Panama | 1,979 | 4,916 |
| Brazil | 1,274 | 4,274 |
| Australia | 1,129 | 3,153 |
| Hong Kong | 2,299 | 2,799 |
| U.K. | 963 | 2,766 |
| Liberia | 588 | 2,296 |
| Singapore | 1,665 | 1,930 |
| Canada | 673 | 1,575 |
| Korea, Rep. of | 1,207 | 1,548 |
| Saudi Arabia/Kuwait | 4 | 1,234 |
| Mexico | 232 | 1,220 |
| Netherlands | 256 | 1,074 |
| Total | 34,313 | 71,431 |

a) Figures are the accumulated value of approvals and notification.

Source: Ministry of Finance, Japan.

expanded their foreign-based production. Evidence of a caving effect did appear in certain U.S. domestic industrial centres. The present heavy reliance of the U.S. auto industry on foreign-supplied parts and overseas assembly provides a possible illustration of caving in the United States.

What is strange is the absence of much concern over caving in Japanese business and government circles, given the general recognition that Japanese direct foreign investment appears to be on the threshhold of a major expansion. While there is some opposition from Japanese labour unions and academics (not unlike the situation in the United States), it appears to represent the views of a surprisingly small minority.

Even the leaders of Japan's major unions appear to favour expanded foreign direct investment: they have realized the risks to Japanese employment inherent in full reliance on export-based industries at a time when protectionist sentiment and "trade friction" have emerged in Japanese export markets. From labour's perspective, it is preferable to expand foreign production, thereby protecting company profitability in the long run, than to resist on the grounds that some jobs will be lost. In essence, fear of protectionism is stronger than concern over the loss of some export potential.

As for Japanese business, it generally appears to believe that caving will be averted. This view, however, is not unanimous: the degree of optimism appears to vary from industry to industry, with greater optimism apparent in Japan's more sophisticated high technology industries. Some comfort appears to have been provided by the successful transition from conventional production technology to higher-level technology.

One example is the shift from domestic production of colour TVs to foreign production in North America and Southeast Asia. Although the shift was dramatic in scope, domestic Japanese manufacturers averted the caving effect by shifting attention to VCRs, which represented a major initiative associated with an even higher level of technology. Another illustration is the Japanese textile industry's shift from conventional textile production, which was allocated to plants in LDCs, to more technologically sophisticated production at home. Such was the case where Toray, a large Japanese textile producer, used its sophisticated productive abilities to produce carbon fibre.

Not surprisingly, the generally confident mood prevailing in Japan reflects the distinct technological edge exhibited by Japanese industry in recent years -- an edge that promises to sustain the pattern of current account surpluses well into the future. A MITI study in the summer of 1985 reflected this attitude when it cautiously concluded that a continuation of Japan's trend of new product and new technology development would help minimize the negative effects of increased foreign direct investment on domestic production. Buoyed by such confidence, the Japanese government has actively pursued a policy of substituting direct foreign investment for exports in order to eliminate potential trade conflicts with other developed economies.

## 5. JAPAN'S DIRECT FOREIGN INVESTMENT: GEOGRAPHICAL ANALYSIS

### LDCs Were Early Beneficiaries

During the 1950s and 1960s, Japan's direct foreign investment was heavily concentrated in LDCs: in 1966, almost 75 per cent of Japan's total outlays were directed to these less developed economies. Though this trend began to ease during the late 1960s and beyond (see Table 15 for Japan's investment trends by region from the late 1970s onward), the table that follows indicates that, even as recently as 1981, Japan's concentration on LDC investment considerably exceeded that of the United States and West Germany.

Direct Foreign Investment in LDCs, 1981

| | % of total DFI |
|---|---|
| United States | 21.9 |
| West Germany | 14.7 |
| Japan | 54.8 |

Several factors account for Japan's emphasis on LDC direct foreign investment. During the period from the 1950s to the 1970s, Japan's wage level was considerably lower than in North America and Europe. This fact deterred Japan from undertaking direct investment in these advanced economies, particularly in manufacturing, because of the adverse effect it would have had on its labour cost competitiveness. Indeed, this advantage gave Japan a strong competitive edge in expanding its manufacturing base in Asian nations. Such investment proved mutually agreeable to both Japan and the LDCs whose industrialization efforts tended to centre around a wall of high tariffs promoting domestic production.

In addition, Japan in the early post-war years concentrated

TABLE 15

JAPANESE DIRECT FOREIGN INVESTMENT
BY REGION
(Millions of Dollars)

| | Fiscal Year 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | Cumulative |
|---|---|---|---|---|---|---|---|---|---|
| North America | 735 | 1364 | 1438 | 1596 | 2522 | 2905 | 2701 | 3544 | 21,469 |
| Latin America | 456 | 616 | 1207 | 588 | 1181 | 1503 | 1878 | 2290 | 13,020 |
| Asia | 864 | 1340 | 976 | 1186 | 3338 | 1384 | 1847 | 1628 | 18,027 |
| Middle East | 225 | 492 | 130 | 158 | 96 | 124 | 175 | 273 | 2,927 |
| Europe | 220 | 323 | 495 | 578 | 798 | 876 | 990 | 1937 | 9,072 |
| Africa | 140 | 225 | 168 | 139 | 573 | 489 | 364 | 326 | 3,198 |
| Oceania | 165 | 239 | 582 | 448 | 424 | 421 | 191 | 157 | 3,718 |
| TOTAL | 2806 | 4598 | 4995 | 4693 | 8931 | 7703 | 8145 | 10155 | 71,431 |

Notes: 1. Figures based on investments notified to Japanese government.
2. Figures rounded off to the nearest whole number.
3. Cumulative: fiscal 1951 to fiscal 1984.

on resource-related investments. With the exception of some investment in developed nations such as Canada and Australia, Japan's resource investment initiatives leaned heavily toward such LDCs as Indonesia and Middle East countries.

The gradual shift away from LDC investment started in the late 1960s, as Japan gradually evolved as an advanced and increasingly capital-intensive economy. In subsequent years the level of commercial and financial investment in advanced countries increased markedly, as a supplement to Japan's growing commodity exporting activities. Through the 1970s and into the 1980s, direct investment was undertaken to establish branch offices of large trading companies; and it was followed by finance-related investment to lay the ground for future Japanese involvement in international financial activities. By the end of 1981, Japan's cumulative direct investment in the United States reflected a growing services orientation: while manufacturing was 29 percent of the total, services were at a high of just under 34 percent.

During recent years, Japanese managers began to realise that labour costs were not as all-important a consideration as they had thought. Rather than make all direct foreign investment decisions on the basis of labour cost advantage or access to material resources, they became more aware of the importance of accessibility to large markets and of the need for more concentration on overall productivity. On both counts, investment in advanced economies such as North America was an attractive proposition. (Besides the appeal of North America's high productivity economy, it was becominging increasingly obvious that wage differentials with Japan were fast shrinking.

A more comprehensive picture of the pattern of recent Japanese direct foreign investment is available in Tables 16 and 17, which give detailed information by country, region and industrial sector.

TABLE 16

JAPAN'S OVERSEAS DIRECT INVESTMENT BY COUNTRY AND REGION

| | 1983 | | | 1984 | | | Aggregate for FY 1951-84 | | |
|---|---|---|---|---|---|---|---|---|---|
| | No. of Invest-ments | Value | Percen-tage | No. of Invest-ments | Value | Percen-tage | No. of Invest-ments | Value | Percen-tage |
| U.S.A. | 855 | 2,565 | 31.5 | 757 | 3,359 | 33.1 | 11,603 | 19,894 | 27.9 |
| Canada | 33 | 136 | 1.7 | 41 | 184 | 1.8 | 673 | 1,575 | 2.2 |
| North America Total | 888 | 2,701 | 33.2 | 798 | 3,544 | 34.9 | 12,276 | 21,469 | 30.1 |
| Panama | 413 | 1,223 | 15.0 | 502 | 1,671 | 16.5 | 1,979 | 4,916 | 6.9 |
| Brazil | 29 | 410 | 5.0 | 30 | 318 | 3.1 | 1,274 | 4,274 | 6.0 |
| Mexico | 13 | 121 | 1.5 | 12 | 56 | 0.6 | 232 | 1,220 | 1.7 |
| Peru | 1 | 0 | 0.0 | - | 6 | 0.1 | 92 | 685 | 1.0 |
| Bermuda | 3 | 14 | 0.2 | 5 | 29 | 0.3 | 73 | 453 | 0.6 |
| Antilles | 2 | 69 | 0.8 | 3 | 66 | 0.6 | 33 | 248 | 0.3 |
| Cayman Isl. | 1 | 1 | 0.0 | 3 | 1 | 0.0 | 52 | 217 | 0.3 |
| Chile | 2 | 3 | 0.0 | 5 | 37 | 0.4 | 57 | 179 | 0.3 |
| Bahamas | 3 | 1 | 0.0 | 7 | 97 | 1.0 | 42 | 156 | 0.2 |
| Argentina | 2 | 5 | 0.1 | 1 | 1 | 0.0 | 109 | 151 | 0.2 |
| Puerto Rico | - | - | - | 1 | 1 | 0.0 | 38 | 141 | 0.2 |
| Venezuela | 3 | 1 | 0.0 | 2 | 0 | 0.0 | 81 | 130 | 0.2 |
| Others | 25 | 30 | 0.4 | 19 | 7 | 0.1 | 452 | 249 | 0.3 |
| Latin America Total | 497 | 1,878 | 23.1 | 590 | 2,290 | 22.6 | 4,514 | 13,020 | 18.2 |
| Indonesia | 89 | 374 | 4.6 | 82 | 374 | 3.7 | 1,319 | 8,015 | 11.2 |
| Hong Kong | 178 | 563 | 6.9 | 119 | 412 | 4.1 | 2,299 | 2,799 | 3.9 |
| Singapore | 184 | 322 | 4.0 | 108 | 225 | 2.2 | 1,665 | 1,930 | 2.7 |
| Republic of Korea | 45 | 129 | 1.6 | 57 | 107 | 1.1 | 1,207 | 1,548 | 2.2 |
| Malaysia | 95 | 140 | 1.7 | 63 | 142 | 1.4 | 879 | 1,046 | 1.5 |
| Philippines | 20 | 65 | 0.8 | 12 | 46 | 0.5 | 615 | 832 | 1.2 |
| Thailand | 73 | 72 | 0.9 | 76 | 119 | 1.2 | 1,002 | 711 | 1.0 |
| Taiwan | 92 | 103 | 1.3 | 68 | 65 | 0.6 | 1,385 | 647 | 0.9 |
| China | 5 | 3 | 0.0 | 66 | 114 | 1.1 | 93 | 187 | 0.3 |
| Brunei | 7 | 2 | 0.0 | 3 | 5 | 0.0 | 29 | 107 | 0.1 |
| Others | 37 | 76 | 0.9 | 20 | 21 | 0.2 | 351 | 206 | 0.3 |
| Asia Total | 825 | 1,847 | 22.7 | 674 | 1,628 | 16.0 | 10,844 | 18,027 | 25.2 |
| Saudi Arabia-Kuwait | - | 66 | 0.8 | - | 55 | 0.5 | 4 | 1,234 | 1.7 |
| Iran | - | 1 | 0.0 | - | - | - | 108 | 1,003 | 1.4 |
| Saudi Arabia | 10 | 90 | 1.1 | 7 | 43 | 0.4 | 90 | 357 | 0.5 |
| U.A.R. | 3 | 1 | 0.0 | 2 | 148 | 1.5 | 40 | 229 | 0.3 |
| Others | 8 | 18 | 0.2 | 3 | 27 | 0.3 | 65 | 105 | 0.1 |
| Middle East Total | 21 | 175 | 2.1 | 12 | 273 | 2.7 | 307 | 2,927 | 4.1 |
| Great Britain | 66 | 153 | 1.9 | 68 | 318 | 3.1 | 963 | 2,766 | 3.9 |
| West Germany | 58 | 117 | 1.4 | 48 | 245 | 2.4 | 710 | 1,170 | 1.6 |
| Netherlands | 25 | 113 | 1.4 | 30 | 452 | 4.5 | 256 | 1,074 | 1.5 |
| Luxembourg | 8 | 265 | 3.3 | 7 | 315 | 3.1 | 71 | 916 | 1.3 |
| France | 50 | 93 | 1.1 | 50 | 117 | 1.2 | 629 | 751 | 1.1 |
| Belgium | 20 | 126 | 1.5 | 11 | 71 | 0.7 | 233 | 659 | 0.9 |
| Switzerland | 31 | 37 | 0.5 | 22 | 229 | 2.3 | 198 | 602 | 0.8 |
| Spain | 19 | 52 | 0.6 | 11 | 140 | 1.4 | 140 | 423 | 0.6 |
| Soviet Union | - | - | - | - | - | - | 6 | 193 | 0.3 |
| Ireland | 2 | 3 | 0.0 | 1 | 1 | 0.0 | 53 | 179 | 0.3 |
| Italy | 12 | 13 | 0.2 | 6 | 22 | 0.2 | 127 | 149 | 0.2 |
| Others | 25 | 17 | 0.2 | 15 | 27 | 0.3 | 221 | 189 | 0.3 |
| Europe Total | 316 | 990 | 12.2 | 269 | 1,937 | 19.1 | 3,607 | 9,072 | 12.7 |
| Liberia | 54 | 323 | 4.0 | 51 | 281 | 2.8 | 588 | 2,296 | 3.2 |
| Zaire | - | 15 | 0.2 | - | - | - | 56 | 282 | 0.4 |
| Nigeria | 3 | 1 | 0.0 | 2 | 0 | 0.0 | 88 | 157 | 0.2 |
| Zambia | - | - | - | 2 | 22 | 0.2 | 17 | 142 | 0.2 |
| Others | 8 | 24 | 0.3 | 11 | 23 | 0.2 | 306 | 321 | 0.4 |
| Africa Total | 65 | 364 | 4.5 | 66 | 326 | 3.2 | 1,055 | 3,198 | 4.5 |
| Australia | 95 | 166 | 2.0 | 62 | 105 | 1.0 | 1,129 | 3,153 | 4.4 |
| New Zealand | 22 | 11 | 0.1 | 4 | 15 | 0.1 | 204 | 238 | 0.3 |
| Papua, New Guinea | 9 | 3 | 0.0 | 11 | 17 | 0.2 | 179 | 197 | 0.3 |
| Others | 16 | 10 | 0.1 | 13 | 20 | 0.2 | 198 | 129 | 0.2 |
| Total Oceania | 142 | 191 | 2.3 | 90 | 157 | 1.5 | 1,710 | 3,718 | 5.2 |
| TOTAL | 2,754 | 8,145 | 100.0 | 2,499 | 10,155 | 100.0 | 34,313 | 71,431 | 100.0 |

## TABLE 17

### OVERSEAS DIRECT INVESTMENT BY INDUSTRY AND REGION AS OF MARCH 31, 1985

| | North America | | Latin America | | Asia | | Middle East | | Europe | | Africa | | Oceania | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | A | B | A | B | A | B | A | B | A | B | A | B | A | B | A | B |
| Foodstuffs | 378 | 465 | 111 | 187 | 401 | 222 | 1 | 0 | 37 | 61 | 29 | 8 | 44 | 59 | 1,001 | 1,002 |
| Textiles | 130 | 243 | 150 | 406 | 683 | 1,173 | 3 | 4 | 110 | 185 | 51 | 39 | 8 | 6 | 1,135 | 2,055 |
| Lumber and pulp | 82 | 598 | 41 | 197 | 281 | 186 | - | - | 2 | 0 | 1 | 0 | 84 | 125 | 491 | 1,106 |
| Chemicals | 193 | 591 | 121 | 557 | 738 | 1,253 | 21 | 1,124 | 84 | 202 | 10 | 19 | 19 | 103 | 1,186 | 3,849 |
| Iron and steel/ nonferrous metals | 132 | 913 | 87 | 1,469 | 559 | 1,661 | 10 | 59 | 302 | 224 | 27 | 117 | 105 | 361 | 1,222 | 4,805 |
| Machinery | 350 | 533 | 118 | 347 | 614 | 504 | 6 | 11 | 138 | 189 | 2 | 0 | 21 | 35 | 1,249 | 1,619 |
| Electric/Electronic | 403 | 1,752 | 116 | 300 | 977 | 781 | 5 | 12 | 118 | 352 | 8 | 7 | 12 | 31 | 1,639 | 3,234 |
| Transport machinery | 81 | 975 | 49 | 667 | 233 | 541 | 6 | 4 | 26 | 299 | 5 | 14 | 13 | 246 | 413 | 2,746 |
| Other | 407 | 415 | 103 | 106 | 1,115 | 736 | 19 | 43 | 131 | 252 | 8 | 6 | 29 | 75 | 1,812 | 1,633 |
| Manufacturing Total | 2,156 | 6,483 | 896 | 4,236 | 5,601 | 7,057 | 71 | 1,257 | 948 | 1,765 | 141 | 211 | 335 | 1,040 | 10,148 | 22,048 |
| Agriculture & Forestry | 156 | 243 | 198 | 171 | 344 | 242 | 4 | 2 | 3 | 1 | 13 | 7 | 180 | 102 | 898 | 768 |
| Fishery | 70 | 97 | 96 | 86 | 169 | 94 | 5 | 1 | 5 | 2 | 79 | 71 | 105 | 49 | 529 | 399 |
| Mining | 228 | 896 | 136 | 1,421 | 178 | 5,883 | 11 | 187 | 11 | 862 | 127 | 579 | 206 | 1,329 | 897 | 11,158 |
| Construction | 179 | 216 | 65 | 165 | 364 | 194 | 51 | 39 | 16 | 42 | 16 | 20 | 19 | 28 | 710 | 703 |
| Commerce | 4,969 | 6,645 | 524 | 957 | 1,988 | 922 | 57 | 15 | 1,652 | 2,076 | 25 | 7 | 437 | 506 | 9,652 | 11,128 |
| Finance & Insurance | 165 | 2,729 | 106 | 781 | 204 | 613 | 18 | 91 | 238 | 2,742 | 13 | 3 | 33 | 96 | 777 | 7,054 |
| Service Industries | 797 | 958 | 180 | 461 | 677 | 1,707 | 15 | 4 | 121 | 141 | 63 | 619 | 112 | 130 | 1,965 | 4,021 |
| Transportation | 100 | 44 | 1,286 | 3,530 | 99 | 168 | 6 | 2 | 17 | 6 | 192 | 901 | 12 | 9 | 1,712 | 4,660 |
| Real estate | 270 | 955 | 18 | 13 | 39 | 293 | - | - | 11 | 46 | - | - | 29 | 20 | 367 | 1,326 |
| Other | 900 | 1,587 | 860 | 1,135 | 513 | 613 | 32 | 87 | 230 | 992 | 353 | 778 | 161 | 392 | 3,049 | 5,583 |
| Non-Manufacturing Total | 7,834 | 14,368 | 3,469 | 8,720 | 4,575 | 10,729 | 199 | 430 | 2,304 | 6,910 | 881 | 2,983 | 1,294 | 2,661 | 20,556 | 46,800 |
| Branches | 281 | 134 | 50 | 41 | 506 | 205 | 36 | 1,238 | 175 | 359 | 12 | 1 | 11 | 10 | 1,071 | 1,989 |
| Real Estate | 2,005 | 485 | 99 | 23 | 162 | 37 | 1 | 2 | 180 | 38 | 21 | 2 | 70 | 7 | 2,538 | 595 |
| TOTAL | 12,276 | 21,469 | 4,514 | 13,020 | 10,844 | 18,027 | 307 | 2,927 | 3,607 | 9,072 | 1,055 | ,198 | 1,710 | 3,718 | 34,313 | 71,431 |

A: Cases; B: $million

## JAPAN'S DIRECT INVESTMENT IN THE UNITED STATES

Japan today is clearly indicating a preference for investment in advanced economies such as the United States and Canada. According to Table 18, which indicates annual changes over the past few decades in Japan's direct investment in the United States and Canada, investment in the United States varied in its relative prominence through the 1960s and 1970s, but has become more important in recent years.

For example, while Japanese direct investment in the U.S. generally accounted for less than 25 percent of Japan's total direct overseas investment, in the 1980s it represents about a third of the total. By 1984, the annual increase amounted to $3.4 billion, bringing the aggregate investment since 1951 to just under $20 billion -- almost two thirds of this having come since 1980.

### Access to Markets Is Now a Priority

There are several reasons for Japan's increased interest in North American investment. Aside from reducing its traditional emphasis on developing foreign natural resource supplies (which, with few exceptions, relate to LDCs), Japan has put a greater premium on gaining closer access to its markets. It has found other costs, such as land, cheap in North America compared to the corresponding costs in Japan. The willingness of state and provincial governments to provide major tax and other concessions as a lure to Japanese direct investment is certainly another attraction.

Recent international oil price developments provide further testimony to the fact that resource-related investment has progressively lost ground. By the end of 1981, Japan's balance of direct foreign

TABLE 18

HISTORICAL CHANGES IN JAPAN'S FOREIGN DIRECT INVESTMENT IN THE U.S. AND CANADA

| | (a) Total Overseas Direct Invest. | (c) Direct Investment in Canada | (b) Direct Investment in the U.S. | (c) as a percentage of (a) | (b) as a percentage of (a) | (c) as a percentage of (b) |
|---|---|---|---|---|---|---|
| 1951-1964 | 790 | 10 | 187 | 1.3 | 23.7 | 5.3 |
| 1965 | 159 | 11 | 33 | 6.9 | 20.8 | 33.3 |
| 1966 | 227 | 38 | 71 | 16.7 | 31.3 | 53.5 |
| 1967 | 275 | 4 | 53 | 1.5 | 19.3 | 7.5 |
| 1968 | 557 | 40 | 145 | 7.2 | 26.0 | 27.6 |
| 1969 | 665 | 10 | 119 | 1.5 | 17.9 | 8.4 |
| 1970 | 904 | 98 | 94 | 10.8 | 10.4 | 104.3 |
| 1971 | 858 | 14 | 216 | 1.6 | 25.2 | 6.5 |
| 1972 | 2,338 | 51 | 356 | 2.2 | 15.2 | 14.3 |
| 1973 | 3,494 | 113 | 801 | 3.2 | 22.9 | 14.1 |
| 1974 | 2,395 | 52 | 498 | 2.2 | 20.8 | 10.4 |
| 1975 | 3,280 | 59 | 846 | 1.8 | 25.8 | 7.0 |
| 1976 | 3,462 | 86 | 663 | 2.5 | 19.2 | 13.0 |
| 1977 | 2,806 | 48 | 686 | 1.7 | 24.4 | 7.0 |
| 1978 | 4,598 | 82 | 1,283 | 1.8 | 27.9 | 6.4 |
| 1979 | 4,995 | 93 | 1,345 | 1.9 | 26.9 | 6.9 |
| 1980 | 4,693 | 112 | 1,484 | 2.4 | 31.6 | 7.5 |
| 1981 | 8,931 | 167 | 2,354 | 1.9 | 26.4 | 7.1 |
| 1982 | 7,703 | 167 | 2,738 | 2.2 | 35.5 | 6.1 |
| 1983 | 8,145 | 136 | 2,738 | 1.7 | 33.6 | 5.0 |
| 1984 | 10,115 | 184 | 3,359 | 1.8 | 33.2 | 5.5 |
| 1951-1984 Total | 71,390 | 1,575 | 19,894 | 2.2 | 27.9 | 7.8 |

All figures in $million and percentages.

investment in the United States was heavily weighted toward services (or commerce). As Table 19 reveals, a full 79 percent of Japan's balance of direct investment with the U.S. by that time represented services. In contrast, services accounted for a smaller 35.4 percent of Europe's total balance of direct investment with the United States, while for Canada the corresponding share of its direct investment balance with the U.S. accounted for by services was again half that, or only 17.1 percent.

The same table records Japan's direct investment balance with the United States at the end of 1981 as $6.9 billion, placing it fourth among the leading nations investing in the United States (the Netherlands was first at $20 billion; the United Kingdom second at $15.5 billion and Canada third at $12.2 billion). By 1984, however, the fast-paced developments of the 1980s had catapulted Japan's direct investment balance with the United States to $19.8 billion (as seen in Tables 16 and 18).

Japan's reduced emphasis on direct investment in resources in the United States is also apparent. Whereas 52.5 percent of Dutch total direct investment in the U.S. was resource-based, and Canada's corresponding share was 28.1 percent, Japan's resource investment represented a miniscule 3 percent of its total direct investment balance with the United States.

Japan similarly ranked low in terms of the share its direct manufacturing investment in the U.S. accounted for relative to its balance of total direct investment in the United States. Table 19 compares such shares for major direct investors in the United States and places Japan, at 16.1 percent, well down the list, behind Canada (47.4 percent), West Germany (41.3 percent), United Kingdom (38.1 percent), France (31.1 percent) and the Netherlands (22.8 percent).

TABLE 19

BALANCE OF DIRECT INVESTMENT IN THE UNITED STATES, BY COUNTRY AND SECTOR

| | Manufacturing | | Resources | | Commerce or Services | | Real Estate | | TOTAL | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Canada | 4,787 | 47.4 | 3,427 | 28.1 | 2,085 | 17.1 | 912 | 7.5 | 12,212 | 100 |
| Europe | 19,016 | 33.0 | 16,303 | 28.3 | 20,421 | 35.4 | 1,966 | 3.4 | 57,705 | 100 |
| France | 1,815 | 31.1 | 2,786 | 47.7 | 1,240 | 21.2 | 3 | 0.1 | 5,844 | 100 |
| West Germany | 2,917 | 41.3 | 630 | 8.9 | 3,336 | 47.2 | 183 | 2.6 | 7,067 | 100 |
| Holland | 4,604 | 22.8 | 10,602 | 52.5 | 3,681 | 18.2 | 1,289 | 6.4 | 20,177 | 100 |
| United Kingdom | 5,910 | 38.1 | 208 | 1.3 | 8,972 | 57.8 | 436 | 2.8 | 15,527 | 100 |
| Japan | 1,111 | 16.1 | 208 | 3.0 | 5,438 | 79.0 | 131 | 1.9 | 6,887 | 100 |
| Latin America | 3,314 | 39.7 | 1,928 | 23.1 | 2,283 | 27.3 | 827 | 9.9 | 8,352 | 100 |
| Middle East | 52 | 1.4 | 2,552 | 69.2 | 448 | 12.2 | 635 | 17.2 | 3,686 | 100 |
| TOTAL | 29,533 | 32.9 | 24,583 | 27.4 | 31,078 | 34.6 | 4,564 | 5.1 | 89,759 | 100 |

Source: Survey of Current Business, 1982

Japan's FDI in U.S. Manufacturing Is On the Rise

While such statistics reflect Japan's heavy bias toward direct foreign investment in services in the U.S. as of a few years ago, it is essential to keep in mind that Japanese investment in the United States aimed at the manufacturing sector has risen dramatically over the past few years. The purpose of such investment has been principally to substitute for -- and not simply to supplement -- Japanese exports to the United States, reflecting Japan's strategy of reducing "trade friction" problems.

Recent manufacturing investment has focused on several prominent manufacturing industries. Major auto investment has seen Honda develop facilities in Ohio, Toyota in California and Nissan in Tennessee. In iron and steel, NKK (Nippon Kokan) acquired National Steel and Kawasaki Steel acquired Kaiser Steel. As for the currently prominent electric/electronics area, considerable investment has been undertaken in consumer electronics and hi-tech electronics, including compact discs, drum heads, large-scale integrated circuits (LSI), digital PBX, ICs, lead frames, etc.

Especially important is the extensive Japanese direct investment in research and development in the United States. Included are Sony's SOCEL (Sony Consumer Electronics Laboratory); Toray's new U.S. research lab (a joint Japan-Holland venture); Aisin's research institute concerning advanced auto parts; Toyo-Jyozo's high-tech research lab investigating interferon with Johns Hopkins University; and Sumitomo Electric's fibre optics research centre in North Carolina.

Such examples of Japans's R and D investment in the United States clearly attest to the benefits certain to accrue to the host country. What is particularly illuminating is that Japanese business is prepared to invest in sophisticated high technology research of a basic nature — the kind that will almost inevitably yield vast benefits for the nation as a whole.

## JAPAN'S DIRECT INVESTMENT IN CANADA

Japan's direct foreign investment in Canada, which amounted to \$184 million in 1984, is obviously quite small when compared with Japan's direct foreign investment of \$3.4 billion in the United States (see Table 18). Furthermore, it represented only 1.8 percent of Japan's total of \$10.1 billion for 1984 (while the U.S. represented 33.2 percent). Viewed from a slightly different perspective, Japan's direct investment in Canada was only 5.5 percent of its investment in the United States.

On a cumulative basis, total Japanese direct investment in Canada since 1951 has amounted to \$1.58 billion,[6] or 2.2 percent of Japan's total direct foreign investment (and 7.8 percent of its aggregate direct investment in the United States).

As Table 14 has already shown, Canada ranks well down in the list of countries receiving Japanese direct investment. In terms of accumulated Japanese direct investment as at March 31, 1985, Canada ranked a lowly tenth, immediately behind Singapore and ahead of South Korea. Heading the list, quite understandably, is the United States, followed

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[6]It is interesting to compare this figure with the recently sharply higher \$8 billion of indirect investment in Canada undertaken by Japanese life insurance companies alone. A Statistics Canada report recently referred to rapidly increasing Japanese participation in the secondary market for new Government of Canada bond issues.

by a number of LDCs (such as Indonesia, Panama, Brazil and Liberia) and interspersed with a few advanced economies such as Australia and the United Kingdom.

Closer examination of Japanese direct foreign investment over time suggests that Canada probably did not always rank as far down the list as it has recently. Table 19 shows that the pattern of Japanese direct investment in Canada has been varied, generally representing larger shares of total Japanese direct foreign investment in the latter half of the 1960s than in subsequent years. Especially noteworthy is the dramatic jump in share in 1966 and 1970. As in the other instances of elevated Japanese investment in Canada, these represented heavy outlays in the resource sector -- underscoring Canada's special status in the 1960s and early 1970s as one of the few advanced nations that were major suppliers of natural resources.

This yielded an unusual development: whereas recently Japanese direct investment in Canada was only 5.5 percent of Japan's corresponding investment in the United States, in 1970 it was actually 104.3 percent, as the dollar amount of investment in Canada actually exceeded that in the United States. Though total dollar volumes were not as impressive as they are today, through most of the first half of the 1970s, Canada accounted for over 10 percent of Japanese direct foreign investment in the U.S. Unlike recent years, when Canada has accounted for less than 2 percent of Japan's total overseas direct investment, in 1966 and 1970 the respective shares were 16.7 percent and 10.8 percent. The pattern began to change noticeably in the latter half of the 1970s, when Japan's direct investment in the U.S. picked up substantially.

## Manufacturing Has Done Well - But Not in High Tech As Yet

A sectoral disaggregation of Japan's direct foreign investment in Canada is displayed in Table 20. It indicates that, as of the end of 1983, investment was concentrated in both manufacturing and resource development -- with each accounting for virtually one third of the overall total of $1.4 billion. The prominence of manufacturing might be somewhat surprising, given Canada's obviously strong resource background; but this becomes more readily understood by examining Table 21.

It reveals quite clearly that Japanese investment in Canada's manufacturing sector concentrates heavily in three groups: lumber and pulp; iron, steel and non-ferrous metals; and textiles. At 49 percent, 22 percent and 12 percent respectively, these three represent over 80 percent of Japan's manufacturing investment in Canada. All three are illustrations of predominantly primary manufacturing and basic processing. This contrasts with the very small shares accounted for by such advanced (and high value-added) industries as electric/ electronics (4.8 percent) and transportation equipment (1.1 percent).

A brief scrutiny of Table 22 shows that the relative industrial distribution of Japan's total overseas manufacturing investment differs somewhat from its Canadian manufacturing investment. Cumulative manufacturing investment to the end of 1984 is led by iron, steel and non-ferrous metals (at 22 percent of total manufacturing investment), with chemicals second at 17.5 percent. Close behind are electric/ electronic and transportation equipment, at 14.7 percent and 12.5 percent respectively, indicating that the high technology industries now account for over one quarter of Japan's cumulative manufacturing investment abroad.

TABLE 20

JAPANESE INVESTMENT IN CANADA
BY MAJOR CATEGORIES
Cumulative to end of 1983

| | Cases | Amount ($ Million) | Percentage |
|---|---|---|---|
| Manufacturing | 142 | 459 | 33.0 |
| Resource Development | 148 | 452 | 32.5 |
| Commerce | 214 | 227 | 16.3 |
| Finance & Insurance | 17 | 126 | 9.1 |
| Others | 111 | 126 | 9.1 |
| TOTAL | 632 | 1,390 | 100.0 |

TABLE 21

SECTOR-BY-SECTOR BREAKDOWN OF JAPANESE MANUFACTURING INVESTMENT IN CANADA

Cumulative to the end of FY 1983

| | Cases | Amount ($ million) | Percentage |
|---|---|---|---|
| Foodstuffs | 36 | 30 | 6.5 |
| Textiles | 26 | 57 | 12.4 |
| Lumber & Pulp | 24 | 225 | 49.0 |
| Chemicals | 5 | 2 | 0.4 |
| Iron & Steel/ Nonferrous metals | 20 | 102 | 22.2 |
| Machinery | 9 | 13 | 2.8 |
| Electric/Electronic | 12 | 22 | 4.8 |
| Transport Machinery | 5 | 5 | 1.1 |
| Other | 5 | 3 | 0.8 |
| TOTAL | 142 | 459 | 100.0 |

TABLE 22

JAPAN'S OVERSEAS DIRECT INVESTMENT BY INDUSTRY (1983 - 1984)

| | 1983 Cases | 1983 US$ million | 1983 Percentages | | 1984 Cases | 1984 US$ million | 1984 Percentages | | 1951 - 1984 Cumulative Cases | 1951 - 1984 Cumulative US$ million | 1951 - 1984 Cumulative Percentages | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Foodstuffs | 85 | 77 | 0.9 | 3.0 | 70 | 118 | 1.2 | 4.7 | 1,001 | 1,002 | 1.4 | 4.5 |
| Textiles | 54 | 174 | 2.1 | 6.7 | 47 | 85 | 0.8 | 3.4 | 1,135 | 2,055 | 2.9 | 9.3 |
| Lumber and pulp | 25 | 91 | 1.1 | 3.5 | 26 | 115 | 1.1 | 4.6 | 491 | 1,106 | 1.5 | 5.0 |
| Chemicals | 96 | 450 | 5.5 | 17.4 | 75 | 223 | 2.2 | 8.9 | 1,186 | 3,849 | 5.4 | 17.5 |
| Iron and steel/ nonferrous metals | 63 | 479 | 5.9 | 18.5 | 52 | 718 | 7.1 | 28.7 | 1,222 | 4,805 | 6.7 | 21.8 |
| Machinery | 93 | 169 | 2.1 | 6.5 | 80 | 185 | 1.8 | 7.4 | 1,249 | 1,619 | 2.3 | 7.3 |
| Electric/Electronic | 118 | 502 | 6.2 | 19.4 | 146 | 409 | 4.0 | 16.3 | 1,639 | 3,234 | 4.5 | 14.7 |
| Transportion Equipment | 41 | 486 | 6.0 | 18.8 | 53 | 437 | 4.3 | 17.4 | 413 | 2,746 | 3.8 | 12.5 |
| Other | 131 | 160 | 2.0 | 6.2 | 128 | 215 | 2.1 | 8.6 | 1,812 | 1,633 | 2.3 | 7.4 |
| **Manufacturing Total** | 706 | 2,588 | 31.8 | 100.0 | 677 | 2,505 | 24.7 | 100.0 | 10,148 | 22,048 | 30.9 | 100.0 |
| Agriculture & Forestry | 46 | 18 | 0.2 | | 41 | 26 | 0.3 | | 898 | 768 | 1.1 | |
| Fishery | 35 | 17 | 0.2 | | 30 | 24 | 0.2 | | 529 | 399 | 0.6 | |
| Mining | 42 | 382 | 4.7 | | 20 | 484 | 4.8 | | 897 | 58 | 15.6 | |
| Construction | 80 | 55 | 0.7 | | 70 | 112 | 1.1 | | 710 | 703 | 1.0 | |
| Commerce | 892 | 1,164 | 14.3 | | 644 | 1,482 | 14.6 | | 9,652 | 11,128 | 15.6 | |
| Finance & Insurance | 68 | 1,167 | 14.3 | | 79 | 2,085 | 20.5 | | 777 | 7,054 | 9.9 | |
| Service Industries | 218 | 622 | 7.6 | | 2,116 | 681 | 6.7 | | 1,965 | 4,021 | 5.6 | |
| Transportation | 498 | 1,363 | 16.7 | | 558 | 1,651 | 16.3 | | 1,712 | 4,660 | 6.5 | |
| Real estate | 95 | 375 | 4.6 | | 85 | 430 | 4.2 | | 367 | 1,326 | 1.9 | |
| Other | 36 | 193 | 2.4 | | 44 | 454 | 4.5 | | 3,049 | 5,583 | 7.8 | |
| **Non-Manufacturing Total** | 2,010 | 5,357 | 65.8 | | 1,787 | 7,429 | 73.2 | | 20,556 | 46,800 | 65.5 | |
| Branches | 38 | 200 | 2.5 | | 35 | 221 | 2.2 | | 1,071 | 1,989 | 2.8 | |
| Real Estate | - | - | - | | - | - | - | | 2,538 | 595 | 0.8 | |
| **TOTAL** | 2,754 | 8,145 | 100.0 | | 2,499 | 10,155 | 100.0 | | 34,313 | 71,431 | 100.0 | |

It is especially interesting that recent annual increases to Japan's total overseas manufacturing investment indicate an even greater emphasis on the latter two high-tech industries (in 1983 and 1984 they represented over a third of new manufacturing investment). From a Canadian perspective, of course, more recent developments suggest that Canada too will be enjoying growth in these high-tech areas, given the current and planned production of more Japanese car manufacturing facilities in Canada.

As already suggested, much of Japan's investment in Canada was resource related in the 1960s and 1970s. In the 1960s, the emphasis was on non-ferrous metal mines, especially copper; in the 1970s attention was directed toward coal production. Aside from some investment in textile manufacturing in Ontario and Quebec, there was no substantial manufacturing investment by Japan in the 1970s.

One reason for the reduced prominence of Japan's investment in Canada is its decreased emphasis on resources. Japan, a resource-poor nation, will always have to concern itself with ensuring adequate resource supplies. But a number of developments have reduced these pressures: these include the vast progress made in energy conservation, lower levels of economic growth that correspondingly reduce pressures on resources; and new technological advances that allow the substitution of new materials (for example, plastics and fibre optics) for traditional industrial materials (such as steel and copper).

Since the mid 1970s, Japanese direct foreign investment has been concentrated in the United States, especially in commerce, finance and manufacturing. At first the emphasis was in commerce, as trading companies undertook investment activity to provide themselves with needed office space. More recently, attention has turned to finance and manufacturing in keeping with Japan's shift toward import substitution -- a move somewhat reminiscent of its much earlier move to investment in LDCs to circumvent protectionist trade policies in those countries.

The shift in Japanese investment to the United States, particularly in manufacturing, is in part attributable to the size and affluence of the $^{\text{II}}$.S. market, thdeveloped countries and, in particular, to their manufacturing sectors.

The change in climate refers primarily to the late '˜°5 realignment of the U.S. dollar, especially with respect to the Japanese yen. In preceding years the United States h appear to have a decisive edge by being able to offer greater incentives than their Canadian counterparts. What is more, Japanese awareness of individual regions of the United States is vastly greater than their awareness of different areas of Canada. The need for Canada to promote its image as an industrial nation to the Japanese public is compelling.

## It's Not All One Sided

Direct foreign investment between Canada and Japan is not all in one direction. Table 23 indicates there have been years of fairly substantial Canadian direct foreign investment in 'apan since the early 1970s.

According to Japan Ministry of Finance data, Canada had aggregate direct foreign investment in Japan valued at $111 million, as of March 31, 1985. (One of the largest ventures is Alcan's 50 percent participation in a large aluminum company project.) As Table 24 shows, Canada ranked seventh among the leading direct investors in Japan, behind the United States, the United Kingdom, Switzerland, West Germany, the Netherlands and France. Its 1.8-percent share of the $6.1 billion

TABLE 23

CANADIAN INVESTMENT IN JAPAN 1950 - 1983

| | Cases | Amount: $million |
|---|---|---|
| 1950 - 1970 | 45 | 13 |
| 1971 | 5 | 0 |
| 1972 | 7 | 4 |
| 1973 | 15 | 15 |
| 1974 | 13 | 2 |
| 1975 | 5 | 3 |
| 1976 | 12 | 1 |
| 1977 | 5 | 7 |
| 1978 | 6 | 18 |
| 1979 | 5 | 0 |
| 1980 | 12 | 13 |
| 1981 | 4 | 2 |
| 1982 | 3 | 0 |
| 1983 | 13 | 31 |
| TOTAL | 150 | 109 |

of direct foreign investment in Japan also happens to be relatively close to the 2.2 percent share that Japan's Canadian direct investment represents of Japan's total direct foreign investment.

TABLE 24

FOREIGN DIRECT INVESTMENT IN JAPAN BY COUNTRY
(as of March 31, 1985)

| | No. of Firms[a] | Amount (US$ million) |
|---|---|---|
| U.S.A. | 2,144 | 3,195 |
| U.K. | 364 | 318 |
| Switzerland | 246 | 309 |
| Germany, F.R. | 286 | 228 |
| Netherlands | 102 | 119 |
| France | 213 | 117 |
| Canada | 73 | 111 |
| Panama | - | 32 |
| Belgium | - | 5 |
| Other | - | 1,631 |
| Total | 5,661 | 6,065 |

a) As of end 1984.

Source: Ministry of Finance, Japan.

## 6. JAPAN'S DIRECT FOREIGN INVESTMENT: INDUSTRY SECTOR REVIEW

### Iron and Steel/Non-Ferrous Metals

As Table 22[7] has already shown, this category of manufacturing investment has been a dominant component of total Japanese direct foreign manufacturing investment: on a cumulative basis (1951-84), it accounted for $4.8 billion of investment, or 21.8 percent (and the largest share) of the manufacturing total. From a geographical perspective, virtually 65 percent of Japan's direct foreign investment in this sector has been in Asia (34.6 percent) and Latin America (30.6 percent), with North America accounting for only 19 percent (see Table 17 for comparative statistics by region and by industry).

Most of the recent investment activity in this sector has been related to secondary steel manufacturing and aluminum refining. Recent ventures include NKK's takeover of National Steel in the United States and a case of active involvement in the manufacture of steel cord for radial tires. Such "downstream" investment is typical of the shift that has seen Japan's investment change from primary production (as represented by earlier concentration on helping LDCs build iron and steel making capacity) to more sophisticated and higher value-added specialty steel products.

Investment in primary production, however, has not been abandoned. The Ashahan aluminum refining project in Indonesia is still ongoing; so too is the case of additional aluminum refinery investment under-

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[7]This Table, along with Table 17 (indicating Japan's direct foreign investment by region and by industry group), will be used throughout this section of the study.

taken in Brazil.

Japan's Canadian investment has followed the trend to increased concentration on secondary manufacturing. Japan has participated in financing and providing technological assistance for Stelco's and Dofasco's cold steel plate plant for automotive production.

The prominence of Japan's foreign investment in iron and steel, especially in 1984, conceals the very strong likelihood that this sector of manufacturing investment will gradually lose its dominant position. (The sharp rise in 1984 was due to short-term concentration of investment, particularly with NKK's takeover of National Steel in the United States.) Japan's iron and steel industry, currently at its mature stage, is now the world's largest. While it was once a key factor in Japan's ascent to industrial superiority, it has in more recent years been displaced -- first by the auto industry and lately by the booming electric/electronics group.

**Textiles**

Japan's foreign investment in textiles long ago passed its peak, that industry having been the first that Japan concentrated on in its direct foreign investment and in its climb to industrial maturity. World supply and demand conditions are now well balanced and no substantial change is expected. The ebbing role of investment in textiles is apparent: while cumulative investment in textiles since 1951 accounts for 9.3 percent of Japan's foreign direct investment in manufacturing, on an incremental basis it represented only 3.4 percent of manufacturing investment in 1984. Asia accounts for the largest portion (57.1 percent) of Japan's direct investment in this sector, followed by Latin America at just under 20 percent.

Japan's textile industry has now shifted the weight of its activities toward higher value added products and diversified to other related industry areas, such as chemicals and cosmetics. Kanebo has become closely identified with cosmetics, while Toray has diversified into carbon fibre production.

As the heavy concentration of Japanese investment in Asian textile manufacturing might suggest, the transplantation of textile production to southeast Asia is now at the saturation point. Japanese companies currently account for 100 percent of textile-related production in Malasia and Indonesia, 80 percent in the Philippines, and 60 percent in Korea and Taiwan.

## Industrial Machinery

Japan's foreign investment associated with industrial machinery accounts for only 7.3 percent of the total accumulated foreign investment in manufacturing. Geographically, North America now accounts for the largest share (32.9 percent), closely followed by Asia (31.1 percent).

In earlier years, investment in construction machinery typically would have been concentrated in LDCs or NICs (newly industrialized countries). This Japanese investment in countries such as South Korea, Brazil and Indonesia represented a move toward import substitution. In more advanced economies, such investment by Japan was directed toward marketing investment, involving such activities as building franchises.

It is anticipated that some major firms (such as Komatsu) may increase investment in advanced economies in today's post G-5 environment. One illustration is the extension of U.K. production facilities for oil pressure machinery to the U.S. However, not all situations are alike. In the field of agriculture-related machinery, little movement to the North American arena is anticipated, given that existing producers are involved with small-scale machinery intended for intensive farming, and not the large-scale implements used for North America's extensive farming practices.

Investment in machine tool industries has been concentrated primarily in LDCs and NICs (such as Singapore, Brazil and Taiwan), but some movement to North America is anticipated. Makita, an increasingly prominent tool manufacturer, has already made remarkable inroads into the North American market over the past five years.

Expanded activity in the production and export of bearings has been under way in North America since the 1960s. One illustration is NTN's establishment of a Canadian bearing plant in the 1970s, which primarily acts as a supplier to the automotive industry. Expansion in Europe currently is at an early stage, but as in the case of North America, considerable scope for expansion exists.

## Electric/Electronics

This sector of manufacturing has, along with automobiles, become the main pillar of Japan's export performance since the 1970s. The mere mention of such products as colour TVs, VCRs, computers, ICs and advanced communications equipment conjures up images of Japanese technology at its best and of virtually complete Japanese market domination. Recently accounting for over 16 percent of Japan's direct foreign manufacturing investment, this sector has been following a generally strong rising trend in the 1980s.

Its relatively recent emergence explains the heavy concentration of Japan's investment in the United States market (54.2 percent), with Asia a distant second at 24.1 percent. Japan's investment in the U.S. electric/electonics group, at $1.75 billion, already represents 27 per cent of Japan's total investment for all U.S. manufacturing, and is about double that for the next-largest manufacturing group (transportation equipment).

While Table 25 indicates that, as of 1980, over 60 percent of all Japanese overseas electric/electronics plants were located in Asia, they were clearly of a smaller scale than U.S. and Canadian plants -- given that by the end of 1980 aggregate investment in North America (at $662 million) was greater than Asia's $544 million (see Table 26). As indicated, the heavy concentration of Japanese investment in North America has since then swung the balance even further in North America's favour.

Though currently associated with the high-tech products that have emerged over the past few years, this particular manufacturing group in the 1950s and 1960s primarily served LDC markets, providing import substitutes for such tariff-protected products as TVs. A major turning point came in the late 1960s and early 1970s, when substantial Japanese exports of colour TVs to the United States resulted in "trade friction". Whereas Japan's direct foreign investment in this sector had been essentially in LDCs and NICs, the post 1973 oil-crisis period, with its currency adjustments, induced a rapid move to North America and Europe.

Sony was the first to move, setting up colour TV facilities in 1972. This was soon followed by investment by Matsushita, Sanyo, and

TABLE 25

JAPANESE ELECTRICS & ELECTRONICS PLANTS OVERSEAS AS OF 1980

| | Number of Cases | | | |
|---|---|---|---|---|
| | Consumer Electronics | Electronic Components | Industrial Electronics | Total |
| Europe | 15 | 4 | 2 | 21 |
| North America | 15 | 7 | 9 | 33 |
| Latin America | 14 | 14 | 6 | 27 |
| Asia | 61 | 138 | 13 | 207 |
| Others | 23 | 9 | 4 | 37 |
| Total | 128 | 172 | 34 | 325 |

TABLE 26

CHANGES IN INVESTMENT BY JAPANESE ELECTRONICS & ELECTRICS FIRMS BY REGION

| Fiscal Year | North America $ million | North America Percentage of Total | Asia $ million | Asia Percentage of Total | Europe $ million | Europe Percentage of Total | Others $ million | Others Percentage of Total | Total $ million | Total Percentage of Total |
|---|---|---|---|---|---|---|---|---|---|---|
| 1979 | 495 | 39.0 | 473 | 37.2 | 72 | 5.2 | 230 | 18.6 | 1,270 | 100 |
| 1980 | 662 | 41.9 | 544 | 34.5 | 127 | 8.0 | 246 | 15.6 | 1,579 | 100 |
| 1981 | 991 | 48.2 | 601 | 29.2 | 173 | 8.4 | 290 | 14.2 | 2,055 | 100 |
| 1982 | 1,141 | 49.1 | 643 | 27.7 | 226 | 10.0 | 312 | 13.2 | 2,322 | 100 |
| 1983 | 1,509 | 53.4 | 688 | 24.4 | 294 | 10.4 | 333 | 11.8 | 2,824 | 100 |
| 1984 | 1,752 | 54.2 | 781 | 24.1 | 352 | 10.9 | 349 | 10.8 | 3,234 | 100 |

Sharp and others,[8] in recognition of the fact that the advanced economies were now their principal markets. Today Japanese producers supply 40 percent of the colour TV market and 90 percent of the VCR market. Because of high European tariffs, Japanese investment relating to European VCR production is already well established. A corresponding strong presence in North America is expected before long.

Investment relating to ICs has already been established in Europe, where Japan has had to deal with high tariffs and strong political pressures exerted by the European Economic Community. More European investment is expected, as is a move to North America to take advantage of the expanding market. Investment in LDCs, where production is directed more toward transistors and diodes than to ICs, is not expected to expand substantially.

In the computer area, Japanese producers already have a dominant position in hardware; and they are now embarking on a drive to increase their position in computer software. The computer sector represents one of the most important prospective sources of major gains.

A movement to set up facilities in North America is anticipated for manufacturers of photocopiers. Canon, now a major force in the industry, has recently responded to the G-5 Agreement by accelerating plans for its New Jersey plant.

The burgeoning market for industrial robots has led to very rapid growth in related investment. With a $2 billion market in the United

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[8]A comparison of the overseas production of these and other major Japanese firms in 1983 is provided in Table 27.

TABLE 27

OVERSEAS PRODUCTION OF MAJOR JAPANESE COMPANIES (1983)

| | Amount (US$ million)[a] |
|---|---|
| Sanyo Electric | 1,762 |
| Matsushita Electric | 1,730 |
| Sony | 809 |
| Hitachi | 766 |
| Suzuki Motor | 601 |
| Toray Industries | 572 |
| Mitsubishi Electric | 526 |
| Fuji Kosan | 511 |
| Yoshida Kogyo | 469 |
| Sharp | 461 |
| Asahi Glass | 439 |
| Yazaki | 320 |
| Hitachi Cable | 264 |
| Shin-Etsu Chemical | 250 |
| Sumitomo Metal Industries | 235 |
| Asahi Chemical Industry | 227 |

a) U.S. $1.00 = Y224.70 (as of March 31, 1984).

Source: Shukan Toyo Keizai.

States expected by 1990, FANUC, the dominant Japanese producer, has been asked to invest in the United States. Similar requests have also been made for the company to establish facilities in the United Kingdom and Europe.

## Chemicals

Japan's direct foreign investment in chemicals in the 1951-84 period ranks second only to iron, steel and non-ferrous metals in terms of its share of total manufacturing investment (17.5 percent versus 21.8 percent). Consisting largely of "lumpy" investment, spending in this sector has tended to fluctuate significantly according to where and when the large projects have been undertaken.

On a geographical basis, the most active region has been Asia (32.6 percent of all areas), followed closely by the Middle East (29.2 percent). Large petrochemical plant investments in Singapore and Saudi Arabia in 1983 contributed to the prominent position held by these two regions: but the subsequent impact as activity varies has already pulled down the annual increment in foreign investment in this category. For 1984, Japan's direct foreign investment in chemicals was down to less than 9 percent of its total manufacturing investment (see Tables [illegible] and 28). While this share may have risen in 1985, the expected completion in 1986 of some large projects will almost certainly pull down the chemical sector's share of total manufacturing investment noticeably.

While these major primary investments exert a strong influence on statistical aggregates, investment in other "downstream" areas is expanding. In particular, increases are taking place in investment in pharmaceuticals, soaps, printing liquids, biotechnology and specialty

TABLE 28

HISTORICAL CHANGES IN OVERSEAS INVESTMENT BY THE JAPANESE CHEMICAL INDUSTRY
(Unit: $100 million U.S.)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | Cumulative to end of 1984 | # of Cases until end of 1984 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| North America | 3 | 1 | 2 | 15 | 1 | 18 | 24 | 48 | 58 | 60 | 13 | 40 | 101 | 89 | 118 | 591 | 193 |
| Europe | 16 | 2 | - | 18 | 13 | 4 | 6 | 6 | 16 | 15 | 9 | 15 | 39 | 40 | 3 | 202 | 84 |
| Latin America | 8 | 0 | 49 | 286 | 20 | 14 | 26 | 28 | 36 | 14 | 19 | 7 | 14 | 26 | 10 | 557 | 121 |
| Asia | 19 | 13 | 9 | 32 | 34 | 49 | 44 | 75 | 189 | 63 | 193 | 136 | 132 | 207 | 56 | 1,253 | 738 |
| Middle East | - | - | - | 39 | 15 | 4 | 161 | 159 | 402 | 86 | 80 | 30 | 37 | 87 | 28 | 1,124 | 21 |
| WORLD TOTAL | 50 | 17 | 66 | 394 | 61 | 151 | 270 | 325 | 705 | 238 | 314 | 228 | 322 | 450 | 223 | 3,849 | 1,186 |

chemicals -- much of it in the U.S.

## Transportation Equipment

As suggested earlier, Japan's auto industry in the 1970s became a major engine of growth for the Japanese economy as Japanese auto exports assumed a prominent position worldwide. Its continuing importance is reflected in the strength of recent direct foreign investment in that sector: outlays on transportation equipment for the 1951-84 period were 12.5 percent of Japan's foreign investment in all manufacturing (see Table 22), but annual increments in this sector in 1983 and 1984 have represented roughly 18 percent of the annual increment for all manufacturing investment.

On a regional basis, aggregate Japanese direct foreign investment in transportation equipment in the post-war period has been mainly in North America (35.5 percent), followed by Latin America (24.3 percent) and Asia (19.7 percent).

Up until the late 1970s, Japanese direct foreign investment in transportation had distinct regional characteristics. In LDCs and NICs, investment generally was for smaller-scale direct manufacturing, assembly (knockdown) plants, and production of auto parts and motorcycles. In the U.S. and European markets, Japanese investment was essentially for marketing development purposes and concentrated on franchises and dealerships. A look at Table 29, which indicates the type, year and country of investment by different auto manufacturers, confirms this pattern.

In the aftermath of the second oil crisis in the late 1970s, Japan adopted a new policy of expanding its North American and European

## TABLE 29

### OVERSEAS DIRECT INVESTMENT IN PLANTS BY JAPANESE AUTOMOBILE COMPANIES 1958 - 1985

| Region | Country | Toyota | Nissan | Honda | Mitsubishi | Mazda | Isuzu | Suzuki | Hino | Daihatsu | Nissan Diesel |
|---|---|---|---|---|---|---|---|---|---|---|---|
| North America | - U.S.A. | A84, B71 | A80 | A80, D78 | | A85 | | | | | |
| | - Canada | B83 | | A86 | | | | | | | |
| Europe | - Spain | | A80 | | | | | A84, D84 | | | |
| | - Italy | | A80 | D77 | | | | | | | |
| | - U.K. | E83 | A84 | | | | | | | | |
| | - Portugal | A72 | | | A82 | | | | | | |
| | - Belgium | | | D62 | | | | | | | |
| Asia | - Korea | | | | E82 | A82 | | | | | |
| | - Taiwan | | | D82 | | | | D83 | C84 | | |
| | - China | | | | | | | C85 | | | |
| | - Thailand | C62, B78 | C65 | D65, D76 | C64 | C74 | C66, B77,78 | D67 | C65, B78 | | |
| | - Philippines | | C82 | D73 | C72, B74 | | C79, B80 | D75 | C75 | | C83 |
| | - Indonesia | B84, B77 | | D73, B77 | B73, B82 | | B83 | D73 | | B78, B83 | |
| | - Malaysia | | | D75,C83,B83,B78 | A83 | C68 | | | | | |
| | - India | C84 | C83 | D84 | C85 | C84 | | C83, D83 | | | |
| | - Pakistan | | | | | | | C83 | | | C84 |
| Latin America | - Brazil | C58 | | | | | | | | | |
| | - Costa Rica | C73 | | | | | | | | | |
| | - Mexico | | B82 | | | | | | | | |
| | - Colombia | | | | | C84 | | D82 | | | |
| | - Peru | C65 | C66 | D74 | | | | | | | |
| Oceania | - New Zealand | | C75 | | | | | D84 | | | |
| | - Australia | C68, B77 | C76 | | C79 | | | | | | C73 |
| Middle East | - Saudi Arabia | | | | | | | | C80 | | |
| | - Turkey | | E73 | | | | | | | | |
| | - Iran | | | D74 | | | | | | | |
| Africa | - Egypt | | | | | | C83 | | | | |
| | - Tunisia | | | | | | C82 | | | | |
| | - Nigeria | | | D79 | | | | | | | |

A: Assembly Plant; B: Parts Production; C: Knockdown; D: Motorcycle; E: Others; Number = Year productive facilities. One reason for this surge in the 1980s was the fear of increasing protectionist sentiment in the face of Japan's near domination of the new car market. In an attempt to counter growing "trade friction", the major Japanese producers set out on a course of import replacement, resulting in major assembly plant undertakings in 1980 by Honda (in Ohio) and Nissan (in Tennessee) and later, in '984, by Toyota (in California).

The recent G-5 Agreement and subsequent currency realignments now provide additional motives for increased Japanese automotive investment abroad. Japanese auto manufacturers now see a comparative advantage in foreign production because of the swing to a reduce labour cost differential between North America and Japan and the reduction of profits attributable to exchange rate developments (as well as proximity to the largest car market in the world). In contrast with the situation only a few years ago, when producing in North America was almost automatically dismissed, the current move to North American production represents a sensible way for Japanese auto producers to maintain their market shares without incurring severe criticism.

As for LDCs and NICs, countries such as Korea and Taiwan are already entering into triangular arrangements, whereby their auto industries are collaborating with Japanese and American auto producers in the production of cars for the world market. Talks are also under way between the major producers and China, now commonly considered the "last great frontier".

Canada, of course, has seen Japanese automobile investment soar in the form of major projects by Honda (in Alliston, Ontario) and Toyota (in Cambridge, Ontario), with obvious beneficial effects for Canada. At the same time, however, auto producers are aware of the danger of possible saturation and accordingly will not necessarily rush to expand facilities without very serious consideration of the consequences. A more appropriate course of action, then, might be a shift in the direction of major parts production, including perhaps engines or transmissions.

## 7. CONCLUSIONS AND RECOMMENDATIONS

### Outlook for Japan's Foreign Investment

As mentioned earlier, a 1984 study by the Japan Economic Research Institute predicted that total cumulative direct investment would reach $71.77 billion by FY 1985. In fact, this figure was nearly achieved earlier, at the end of FY 1984, when cumulative direct investment reached $71.43 billion. These predictions were based on an annual average growth rate of 14.5 percent in direct investment abroad by Japanese firms. It seems now as though the figures for FY 1985 (ending March 1986) will turn out to be substantially higher than those of the previous year, due to the recent major investments which have been made by Japanese firms abroad.

The reseach institute's predictions, it will be recalled, also forecast that, by 1990, total cumulative investment would have reached $157 billion, with an average annual growth rate of 17 percent. However, it should be noted that the econometric hypothesis upon which the institute based its findings is not known, and may be arguable.

A report of the planning committee of the Industry Structure Council, released February 6, 1986, provides other predictions which may be examined. The review focused on Japan's industrial society moving into the 21st century, and released its own forecast on the same subject of direct investment abroad, based on the responses of major Japanese corporations to a Ministry of International Trade and Industry (MITI) questionnaire. These indicated that cumulative overseas direct investment might total $179.5 billion by 2000 (Y32.3 trillion, based on $1 = Y180) with an annual average growth rate of 12 percent, lower than the economic research institute's 14 percent figure for 1980-1985. In fact, this 12 percent figure may be regarded as an extremely conservative prediction, as it is less than the actual rate of increase (per annum) over the 1980-1985 period.

It should be noted that the above predictions by the Japan Economic Research Institute preceded the G-5 meeting and the subsequent currency realignment and increasing value of the yen. These events, which have served as a substantial incentive for Japanese manufacturers to invest overseas, will undoubtedly affect the actual investment figures. Even the most recent estimates published by the Industrial Structure Council may not fully reflect the impact of last autumn's events, as part of its research was conducted before the September meeting. Given these changes, it seems as if direct investment abroad by Japanese firms will only overtake these projections.

The post-G-5 developments must be interpreted as on balance a stimulus to increased Japanese direct foreign investment because of the disadvantages posed to Japanese exporters by the new foreign exchange rate which provide compelling reasons to follow the growing trend of offshore production. Furthermore, it is widely recognized by Japanese exporters that direct investment abroad is one of the best ways of averting the potentially harmful consequences of "trade friction".

Given these factors and the already strong push for increased direct foreign investment, Japanese investment is bound to increase and probably at much higher rates than predicted by various research bodies. In this light, the 12 percent annual growth rate in investment forecast by the Industrial Structure Council appears even more conservative, and it seems likely that a higher percentage increase will be seen throughout the rest of the decade and into the 1990s. It would be no surprise if the figure of $179.5 billion were achieved prior to 2000, taking into consideration the recent rapid increases in direct investment. Even if this figure is not surpassed, however, but met, an additional $108 billion of Japanese direct foreign investment will be made in the next 15 years.

## Implications for North America and Canada

The questions remains as to how this figure will be distributed worldwide, and particularly between the United States and Canada. Predictions by the Japan Economic Research Institute (Tables 12 and 13) suggest that North America's share of Japan's total direct foreign investment will remain almost stable throughout the decade, around the 27 percent level. Actual statistics, however, confirm that, by the end of 1984, this figure was 30.1 percent. Considering the recent interest in import substitution and Japan's strong move to invest more in the advanced economies, a much higher share for North America may in fact be seen.

According to the Industry Structure Council Report, the United States may expect to see total cumulative investment by Japanese firms reach $58 billion by 2000, with an annual rate of increase of 14.2 percent in direct investment in the intervening years. This would result in the U.S. having a 32.4 percent share of total Japanese overseas direct investment. As of March 1985 (the end of FY 1984) total cumulative Japanese direct investment in the U.S. amounted to $19.9 billion: this means that over a fifteen year period an additional $38.1 billion of Japanese direct investment is likely to be made.

With regard to Canada, the picture is similarly optimistic, if not as grandiose. If the $179.5 billion figure is reached and Canada maintains its 7 percent share of Japanese investment in North America, it seems likely that total cumulative direct investment in Japan in Canada would reach $4.06 billion by 2000. Currently, this figure is $1.66

billion, meaning that an additional $2.4 billion might be expected within the next fifteen years. It seems most likely that more than half of this will be made within the next few years, between the late 1980s and 1990s.

There are, of course, several factors that could prevent the full extent of this increase from being realized. One concerns a negative aspect of the G-5 Agreement's impact. The appreciation of the yen will have some negative implications for the domestic operations of Japanese manufacturers. Reduced profits from domestic operations as well as from export sales could weaken these firms financially for a while, undermining their ability to undertake foreign investment.

The process of domestic adjustment should take major firms, at best, some six months to overcome. Large firms who are already well established internationally will likely have a sufficiently broad financial base from which to launch their profit-generating foreign investment plans -- regardless of the short-term difficulties. As for small and medium-sized firms, their ability to prevail may depend upon either their financial strength or, if applicable, their unique technological assets. Accordingly, it is not expected that this factor will seriously undermine the forecast.

A second potentially disruptive factor concerns the risk that expected U.S. success in implementing new economic policies will not materialize. This could undermine the entire international economic climate.

The need in the United States to cope with continuing huge budgetary deficits in the first half of the 1980s produced an odd mixture of restrictive high interest rate monetary policy and investment incentives, such as accelerated depreciation and other tax measures, aimed at softening the adverse effect of high nominal interest rates on domestic investment activity.

These steps did enable the financing of the U.S. federal deficit while keeping domestic investment at adquate levels. But at the same time it resulted in the pronounced flow of savings from Japan to the United States, at the same time sustaining the U.S. dollar at undesirably high levels and thus undermining the U.S. trade performance.

The current hope and expectation is that real progress will be made in reducing the federal deficit and achieving greater fiscal responsibility (with the aid of the Gramm-Rudman amendment mandating government expenditure cuts). If realised, this would permit the lowering of real interest rates -- a step widely being encouraged to sustain adequate economic growth.

While this could obviously be less attractive for Japanese indirect investment, which is quite sensitive to interest rate levels, such a scenario is compatible with continuing strength in Japanese direct foreign investment.

Another consideration is the pressure that is being directed at advanced economies to undertake more direct investment in LDCs. Under the leadership of the World Bank and Treasury Department, steps are being taken to direct capital from the advanced economies to the LDCs as a means of helping such debt-ridden economies as Mexico, Brazil and other developing countries. To date, however, this goal has not been translated into real action.

## Benefits for Canada

In contrast with indirect foreign investment, which results in the simple (though desirable) international transfer of capital, direct foreign investment has several appealing features.

It does, of course, provide the needed financial resources that help promote increased economic activity and a rising standard of living. In addition, however, direct foreign investment often permits the international transfer of managerial skills, through the movement of key personnel and the transfer of technology.

Japan's highly respected reputation in business organization and its position as a world leader in sophisticated technology and advanced researech makes it a highly prized partner in business activity — as is evident from the eagerness which has greeted its direct overseas investment plans virtually around the globe. Once transplanted, new technology may more readily be incorporated throughout the Canadian economy and serve as a springboard for more widespread development of technologically advanced industries in Canada.

## Future Directions

The advantage of foreign investment to the host country are many, and eagerly sought after by most countries. The challenge that confronts these hosts is to create an environment that will attract this foreign investment.

Canada has a good base on which to build. Vast resources, skilled labour, political stability and a high quality of life, combined with an overall history of steady economic growth have all contributed to this in the past. But Canada cannot rest on its past laurels, and must take a more active role in identifying and seizing opportunities to attract new investment in an increasingly competitive global environment.

To that end, the basic advantages that potential investors see Canada as possessing must continue to be promoted. Fiscal responsibility, policies promoting low interest rates and a stable currency and a sound regulatory environment encouraging rather than stifling healthy economic activity are key elements in this. Despite some past difficulties in this direction, which eroded its status as a solid growth prospect, Canada's economy is seen to be the target of a number of policies promoting a more favourable investment environment.

The following more specific ideas are offered as ways of enhancing Canada's ability to attract more Japanese direct investment, capitalizing on opportunities that undoubtedly exist.

## 1. Identify the Opportunities

Canadians, particularly those involved in selling Canadian potential as a site for future investment, must become aware of the magnitude of the potential, and realize that at least an additional $3.4 billion could be attracted to this country from Japan over the next fifteen years, the majority of which will be within the next decade. This $2.4 billion figure represents the potential that exists if Canada continues to maintain its 7 percent of Japanese direct foreign investment relative to the United States. Complacency, however, must be avoided: this depends entirely on the efforts of Canadians. The figure will undoubtedly rise or fall relative to these efforts.

At this point in time, the Japanese government is actively promoting increased direct investment by firms abroad, despite a negative impact on employment. Not only is it calculated that the 12 percent growth in overseas direct investment predicted by the Industry Structure Council will result in decreasing opportunities to the tune of 560,000 jobs, the more realistic figure of a 15 percent growth (per annum average) will mean the loss of an additional 410,000 jobs. In addition, the trade surplus would decrease by some $52 billion. Yet still the Japanese government is promoting investment abroad.

Canadians must capitalize on this opportunity before it disappears, and before domestic political pressure begins to build within Japan.

## 2. Why Canada?

One frequently asked question by Japanese businessmen is why they should invest in Canada. It has a good investment environment, political stability, a well educated and relatively inexpensive labour force.... But many of these advantages are also possessed by the United States, which has the even more influential edge of having a market ten times the size of that of Canada. The query by Japanese businessmen is logical: why should they invest in Canada to take advantage of the combined market when they can do so in the U.S.? Why locate manufacturing facilities in Canada to export to the U.S. when they could locate in the U.S. and export to the smaller Canadian market? These are the questions which Canadians must be prepared to answer.

In the meantime, a brief look at some statistics may offer a new perspective on Japanese investment in the U.S. vis-a-vis that in

Canada, and the opportunities available in North America. During the April to September period of 1985, a total of 94 cases of investment in the U.S. were noted. In contrast only 7 Japanese investments in Canada were announced in the same period. In the U.S. investment was made in a wide variety of areas, high technology, electronics, automotive industry, real estate, etc. In Canada, the scope and variety of these investments were much smaller. Canadians should monitor the nature of the Japanese investments in the U.S. in order to identify new opportunities and maximize their competitive advantage vis-a-vis the U.S.

### 3. Public Relations

Canada should not underestimate the importance of public relations and generally promoting Canada and its distinctive economic features and advantages within Japan. While the Japanese are becoming more aware of Canada's diversity and nature thanks to the efforts of the federal and provincial governments and those of the private sector, the perception still largely remains that Canada is more of a 'dreamland' than a place to do business.

This is in strong contrast to the efforts of other nations, particularly the U.S., in promoting their countries and regions. Research-oriented Japanese businessmen are frustrated by the difficulty of obtaining information about Canada (the only source being the Canadian embassy library), especially when compared with the proliferation of information centres and libraries that other national and regional authorities maintain in Tokyo.

This issue is more important than it may first appear. A few opportunities that might have come to Canada have been lost to the United States not because of the superior investment environment south of the border but simply because of a greater familiarity with the area.

## 4. Small and Medium Sized Business

Canadians should keep an eye on the developments within small and medium sized businesses. Although the majority of previous investment in Canada has been made by the larger Japan-based multinational corporations, this situation is likely to change in the near future. In 1974, small businesses accounted for only 5.4 percent of total Japanese direct investment overseas, but by 1984 this had more than trebled, totalling 16 percent of total value. But in terms of cases, investment by smaller companies constituted nearly half of all foreign direct investment. Growth in this sector is likely to increase even more steeply. Larger companies will both reach a limit to their expansion, and will invite smaller companies to accompany them. This latter case is already being demonstrated in connection with the automotive industry, as parts suppliers move to establish joint ventures with local producers following the move by Japanese auto manufacturers to locate production facilities in North America. This trend can only continue, and is being extensively promoted by the Japanese government.

## 5. Government Policy Initiatives

Although there is as yet little awareness of this in Canada, the Japanese government is taking a wide variety of steps to promote foreign direct investment. Especially notable are changes in the financing policies of crown financing corporations, especially the Export-Import Bank of Japan (Eximbank). In the past few months, a new financing rate for projects promoting industrial cooperation between advanced industrial economies has been introduced, together with policies allowing direct financing of foreign joint ventures and financing manufactured imports and market development projects. These are the sorts of opportunities which must be identified and pursued by interested Canadians.

## 6. R & D Joint Ventures

A new interest of the Japanese public and private sector is the promotion of international R & D ventures, partly to counter Western criticism that while Japan has proved adept at adapting new technologies for production purposes it has not taken any steps to innovate. To that end, Japanese firms and the government seem to be determined to take advantage of their large capital surplus by establishing themselves as investors in international R & D. Here also exist many opportunities for Canadians for linkages with Japanese researchers, whether in the public or private sector.

## 7. The Reasons for Investment

Canadians must make clear to the Japanese the reasons they are encouraging new foreign investment, so that both will have a clear idea of the type of investment that is appropriate given the objective. If Canadians wish to offset a capital account deficit, indirect investment, including more investment in real estate by Japanese institutional investors, should be promoted. If Canadians seek export income and transfers of technology, they should concentrate on coming up with a persuasive answer to the question of why invest in Canada rather than the United States. Or if investment is sought to create new employment opportunities, a focus on sectors such as auto manufacturing would be most appropriate. A focus on regional development might translate into emphasis on resources.

## 8. The Intangible Considerations

There exist a number of smaller considerations affecting Canada's ability to attract new investment, including such things as the inconvenience of renewing a visa annually with which the Japanese businessman, particularly manufacturers and engineering representatives, must deal. As the number of Japanese doing business in Canada is small and the amount of red tape is relatively large in comparison with other nations, this inconvenience may loom large in the minds of Japanese when they think of Canada. This is one example of ways in which Canada, without realizing it, can adversely affect its own image in the eyes of potential investors. Conversely, by taking steps to improve this situation, it could appear as a country receptive to foreign business and foreign businessmen within the Japanese business community.

Awareness of the opportunities, the active promotion of Canada as an attractive investment environment, and more subtle efforts to ensure that Canada is in the forefront of investors' minds combine with these smaller details to strengthen Canada's competitive edge in taking advantage of future increases in Japanese overseas investment.

TABLE 30

DIRECT OVERSEAS INVESTMENT OUTSTANDING
(as of end of 1983)

| | Amount (US$ million) | Share (%) |
|---|---|---|
| U.S.A. | 226.1 | 43.9 |
| U.K. | 91.2 | 17.7 |
| Germany, F.R. | 37.3 | 7.2 |
| Netherlands | 33.3 | 6.5 |
| Japan[a)] | 32.2 | 6.2 |
| Canada | 22.0 | 4.3 |
| France | 21.6 | 4.2 |
| Other | 51.5 | 10.0 |
| World, total | 515.2 | 100.0 |

a) Figure is for external assets and liabilities of Japan.

Source: JETRO, White Paper on Overseas Investment, 1985.