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THE HANDMAIDEN'S TALE: JAPAN'S FOREIGN INVESTMENT AS A REFLECTION OF ITS DOMESTIC ECONOMY

No. 26, October 2008

Abstract

One aspect of globalisation has been the changing pattern of foreign investment in East Asia. The evolving pattern reflects both the objectives of potential investors and the constraints imposed by the host governments. Future trends should be heavily influenced by Japanese decisions since Japan will continue to maintain one of the largest economies in the region. Japanese Direct Foreign Investment appears to have greatly redefined itself over the post-war era. However, our analysis demonstrates that the pattern of Japanese overseas investment has been a dependable reflection of its domestic economy as constrained by the political imperatives of the day. The fundamental changes now occurring within the Japanese economy will most likely herald a corresponding departure in the nature of its investment policy. The unsettled question is to what degree such strategy will continue to play handmaiden to more provincial concerns or whether this essential influence will to some degree be reversed.

Keywords: Japan; Direct Foreign Investment; China
JEL#: F21;F23; O24;O53

The Handmaiden's Tale: Japan's Foreign Investment as a Reflection of its Domestic Economy

> Harry had heard that the moon was different in Japan, the cherry trees were different, the seasons were different, the mountains were different, the rice was different. Add them all up and he supposed that reality itself was different (Smith 2005: 227)

A debate has lingered on for nearly a half century as to the exact nature of Japanese overseas investment. The question remains as to whether there is anything unique about the way in which the Japanese have strategically approached and even managed these decisions. However, much of the mystery dissipates if we only seek and identify the ruling imperatives that have defined such investment as Japan has progressed from a developing to a dominant economy[i]. What might seem odd at times about the Japanese approach can upon reflection be reduced to more ordinary dimensions if we succeed in identifying Japanese objectives and constraints within any given period. Once understood, Japan's off shoring and other overseas ventures become as understandable as that of other industrial countries.

In any investigation of this sort, what is perhaps crucial is trying to discern whether differences dominate similarities. A mistake in either direction can prove analytically fatal. This becomes glaring in the work of those theorists who start with a priori conceptions. Thus the very success of post-war Japan created a cottage industry devoted to explaining Japan as a special case. In the 1980s, bookshops proliferated with works by Ronald Dore or Ezra Vogel explaining the culturally determined uniqueness of the Japanese brand of managed capitalism[ii]. As with any strong thrust, a matching counter-thrust, conspicuous in the voluminous work of such stalwarts as Gary Saxonhouse or J. Mark Ramseyer, insisted on placing standard market explanations at centre stage. Often these authors resembled the fable of the blind men confronted with an elephant. Each grabs a portion of the whole and insists that his generalisations based on partial knowledge encompass the entirety. But this only muddles understanding and relegates analysis to a contest between two contending camps. More preferable would be an honest attempt to look at what facts there are as well as any and all contending explanations. When we look at foreign direct investment, certainly

there should be some differences in the way Japanese firms approached this issue in the post war period when compared to other corporate entities. Japanese firms faced constraints that were to some degree unique to their own domestic base. But that doesn't preclude that these firms were motivated by similar incentives as their western counterparts. Again, the problem is making sure we compare like with like instead of looking for similarities in firms facing quite different situations. There is also a danger of overlooking the obvious fact that patterns of foreign direct investment change over time as the incentives of the operative firms evolve, as do the key characteristics of each and every potential host country.

What we propose to examine is the way Japanese foreign investment has changed in the post-war years and the underlying determinants of that change. Not surprisingly, these changes closely reflect the evolving Japanese domestic economy. In this, Japanese firms are little different than their Western counterparts. By taking such an approach we will be able to discern something of a trend that might give us an insight into the future direction of this investment.

I. The Story of Japanese Foreign Investment as an Odyssean Saga[iii]

> Outward investment is a way of maximizing the rents on the accumulated knowledge and skill of a country's firms, or preserving them as long as possible when the country itself has lost its comparative advantage in their industries, and the industries, or parts of them must relocate (Blomström, Konan and Lipsey 2000: 2).

The great epic poem, the Odyssey, is divided into two parts indicated by Odysseus' own name. It can be translated as 'hated by the Gods' or as 'man of wrath'. What this counterpoises is the dual nature of the hero as determined by his own abilities and the constraints he faces. Without sufficient knowledge and development, Odysseus is a play thing of the Gods who must simply respond to the forces and situations he faces. This could be construed as the passive, or reactive, stage of the poem. With greater self-knowledge and on the familiar ground of his home island, he becomes an active force to be reckoned with.

Consequently, for the first few post war decades, Japanese firms also needed to learn and develop. The limited foreign investment undertaken was a direct extension of domestic imperatives and to

some extent characterised by the type of administrative guidance provided by the Japanese bureaucracy. Only with the coming of age of the Japanese economy in the 1980s did Japanese firms begin to break free and invest independently and actively instead of simply as a response to an economic environment others created.

Although economists are wont to use short hand designations like 'Japanese Foreign Direct Investment', decisions to invest overseas must by definition be made by individual firms. This is reflected in most of the more recent economic research done in this area.

> The theoretical refinements have focused on the individual firm, studying its choices in response to its own characteristics, the nature of the industry in which it operates, and the opportunities afforded by foreign trade and investment (Helpman 2006: 589).

These individual decisions are in turn constrained not only by a firm's own internal limitation (efficiency and size) but by obstacles placed by both home and foreign governments[iv]. To then understand the changing nature of Japanese Foreign Direct Investment (FDI) we must analyse the changing objectives of these individual firms as well as the domestic market in which they operated. We would then expect that the more Japanese firms reflected the same concerns as firms in other developed economies and were faced with many of the same binding constraints, the more Japanese FDI would be roughly similar to the FDI undertaken by western economies.[v] This is the direction in which the existing statistics, economic history and current anecdotal evidence seems to point quite strongly. Trends are always difficult to clearly discern, however in the case of FDI it seems far more useful to focus on common incentives motivating such decisions than to fix upon any unique characteristics which can be easily explained and which over time has played a reduced role in such decisions.

II. Post War Japan – Establishing a Low Risk, Middle Class Society

> Many argue that the above features are reflections of the unique aspects of Japan's cultural and social norms whose origins can be traced back to the history of Japan. I will argue that these are not necessarily "intrinsic Japanese" and that most of them were introduced as the wartime system during the years around 1940, and hence can be called the "1940 system" (Noguchi 1998: 404).

To understand the economic system in which Japanese firms made their initial post war FDI decisions requires an understanding of the economic approach that system ostensibly replaced. As can be argued, the Japanese during the occupation period preferred the appearance of acquiescence rather than the reality.[vi] Necessity and the objectives of the traditional ruling classes led them to opt for the simpler choice of adopting those institutions that had already served them sufficiently well. In essence, the post war Japanese government substituted 'strong economy' for 'strong army' in the traditional recipe of building a strong country. The key to building that strong economy however was achieving a secure level of political stability. This accomplishment required an implicit working promise to build a middle class, low risk society; an inclusive economy where everyone who worked hard and obeyed the rules (both explicit and implicit) could be assured of a secure job and an ever rising living standard.[vii]

By the sixties, this underlying objective became more exigent in Prime Minister's Ikeda's income doubling promise (a response to the rising unrest at that time). To achieve this, post war Japan borrowed heavily from the structures that had guided Japan through the war. While the war itself was certainly misguided, the system had performed remarkably well, mobilising severely limited resources available. These military era strategies provided a familiar institutional framework for the millions of veterans returning from military service. More specifically, prior to actual hostilities, FDI had largely been focused on expediting exports and securing raw materials.[viii] Japan's colonial empire imitated the western model in which colonial investment yielded key commodities. Moreover, economic growth depended in part on competitive exports. Such trade needed financing and distribution channels.

> Mitusi Bussan (in English, Mitsui Trading) had by 1876 established an overseas marketing organization for selling Japanese coal in China, Hong Kong, and Singapore. In time, this distribution network had grown and new products were included reflecting the expansion of the business activity. The distribution web extended to London, Paris, Bombay, Sydney, as well as New York and San Francisco … Mitsui & Co. also served as a transmitter of American technology to Japan (Wilkens 1982: 506; 508).

It should come as no surprise that of the 41 million dollars of Japanese Direct Investment in the U.S. in 1937, 16.5 million was in terms of distribution while 21.8 million reflected financial services (Wilkens 1982: 507).

It might be argued somewhat convincingly that this type of simple vertical integration characterised such overseas investment both prior and subsequent to the war. In adopting this tack in the post war recovery, Japanese firms reflected the reality of the constraints under which they operated[ix]. Direct constraints in the form of government directives limited the foreign exchange available for overseas adventures. The immediate challenge was to rebuild domestic capacity and create employment for returning war veterans. Japanese manufacturing firms at this stage lacked the efficiency required to compete overseas, making the question of direct investment a moot one.[x] It might be safe to say that in those early post war years the constraint imposed by government authority was not a particularly binding one. Few firms were in any condition to attempt extensive overseas investment with most lacking the size or efficiency required.

> A small fraction of firms engage in FDI, and these firms are larger and more productive than exporting firms. A lot of within-industry heterogeneity exists, and the distribution of firms by size or productivity varies substantially across industries (Helpman 2006: 590).

Clearly imposed constraints did start to be felt starting with the sixties and every following year until all such restrictions were removed by 1982[xi]. In general these changes reflected rising pressure exerted by those firms most constrained by government impositions. At such moments, barriers interfered too crucially with these firms' ability to exploit potential opportunities. What is noticeable is that although in popular myth Japan Inc. was characterised as a reflection of the power held by government bureaucrats, their role should be more accurately seen as that of adjudicators and coordinators that attempted to slow down and channel the standard adjustments made by competitive markets[xii]. Such implicit administrative guidance through vehicles like indicative planning sought to stabilise markets and reduce a significant degree of their underlying variability. A lower risk environment would after all encourage more investment. Greater investment in these early decades translated into greater growth and a quicker movement toward achieving the desired middle-class, low risk society.

Given its status as a capacity constrained, developing economy until sometime in the seventies, FDI could be expected to play only a relatively small role in Japan's rapidly growing post war period.

> The total book value of manufacturing investment abroad in 1972 was no more than $1.74 billion about 5 per cent of the comparable figure for the United States, but almost half the total investment has taken place during the most recent three years, and it is growing … Almost one-half of the total investment is found in three industries – textiles, timber and pulp, and steel. Among firms surveyed, the foreign manufacturing operations, on the average accounted for only 1.3 per cent of the total output, 1.6 per cent of the total assets, and less than 5 per cent of the employees of the parent companies. The total sales of the manufacturing subsidiaries are only 6 per cent of the export sales of all the companies surveyed (Yoshino 1974: 357-358)[xiii].

A useful way to grasp the purpose and reactive nature of FDI during this period is to focus on the textile industry. Patterns would be formed here that would foreshadow future overseas investment strategies. As in many other developing countries, textiles established itself as a key domestic and export industry for the Japanese. Its labour intensive quality created jobs and the low wage structure of Japanese industry immediately following the war made this industry export competitive. Textiles also represented familiar corporate ground. This had been one of Japan's flagship export sectors prior to the war with the Japanese acknowledged as a technological leader. Access to cheap cotton imports and a pool of low wage labour made the Japanese a formidable competitor. However, the industry would have to react to two potentially damaging constraints. Exports could be shut out by developed countries trying to protect their own domestic industry or by other developing economies trying to build a strong market sector given the import substitution strategy popular in those years.

Then as the sixties progressed, Japanese textile firms were forced to respond to rising wages as the supply of farm labor (especially of the female variety) started to dry up. With other employment opportunities arising, wage costs steadily increased, making output less competitive.

> Access to cheap and productive labor was increasingly difficult after 1960 as well. Many young women either continued their education or went into new and more attractive sectors. Higher wages and longer-term employment (longer than three years) had to be offered to attract enough staff. While textile wages in Japan increased much faster than elsewhere, the growth in labor productivity was comparable to that of other countries (Delanghe 2005: 81).

The solution was two-fold. Initially, investment in third world markets was intended to overcome cases where Japanese exports faced limited if any entry. This would provide them needed access not only to the domestic market, but also in many cases to raw cotton and low wages. Exemplifying a classic case of horizontal integration, little if any output was shipped back to Japan. Such goods would only spoil the domestic sector and disrupt the status quo of Japanese labour markets.

> Most of these manufacturing facilities were established to serve the foreign market. Approximately 75 per cent of the total output of the manufacturing affiliates surveyed is marketed locally; 20 per cent is exported to a third country, and only 5 per cent is shipped back to Japan (Yoshino 1974: 359).

The focus of such investment changed in the late sixties when Japanese textile industries ceased to be internationally competitive. FDI (especially in Brazil) allowed a paced withdrawal from this sector in terms of the domestic economy. Lower valued production was shipped abroad while Japanese manufacturers of power looms (such as Toyoda) maintained the higher value added end of operations by exporting technologically advanced machinery to Brazilian mills. Thus as efficiency in a sector slid, MITI would act as an industrial midwife, allowing domestic production to shrink without disrupting the Japanese economy or relevant labour markets. This is where producer cartels and administrative guidance came to the fore. In fact it can be safely claimed that such strategies more closely characterised sunset rather than sunrise industries[xiv].

The pattern set by the post war textile industry foreshadowed future Japanese FDI both in its purpose and the category of investing firms. In this case, some of Japan's largest corporations were behind this move.

> Eight Japanese companies undertook cotton textile FDI in Brazil in the postwar period. Four companies entered in the first wave. These were Kanebo, Toyobo, Tsuzuki, and Unitika. … Kanebo ranked 171st out of the 200 largest non-U.S. companies in 1962, and Toyobo ranked 163rd. Both companies continued to move up the ranks of the largest non-U.S. companies until 1973 (Delanghe 2005: 87).

The Brazilian example also makes clear that Japanese firms, when choosing overseas ventures, preferred low risk options. One of the attractions of the Brazilian market lay in the Japanese

immigrants making their home there who were willing to raise and provide the raw cotton. The link was further secured by establishing and operating cotton gins in concert with the mills.

> The cleaning and classification problems that plagued the processing of Brazilian raw cotton were solved by firms that linked up with raw cotton producing Japanese immigrants and that integrated backward into cotton ginning. … Operating one's own cotton gin had additional advantages. It provided information on the quality of the season's crop and, by cutting out intermediaries, further reduced the price of an already cheap raw material (Delanghe 2005:88-89).

Vertical integration, or strong vertical relationships, traditionally reflects a need to reduce risk in uncertain markets by improving informational flows. In such markets, the reliability of suppliers, as well as the quality of their output, is often an unknown. It is then unsurprising that in later decades, Japanese suppliers often followed the lead of their key corporations in making parallel overseas investments. As Japanese car makers shifted production out of Japan, suppliers to these firms followed. Statistics showing the relatively low use made of local producers by Japanese firms reflect this ingrained risk avoidance based on a lack of information and experience in operating overseas. As expected, overtime, use of such local suppliers became more common.

> The relative value of local materials and components in products assembled in Taiwan, for example, ranges from almost 100 per cent for standard lines of transistor radios, to 50 per cent for bland-and-white television sets, to 15 per cent for color sets. The significant increase in local content is due largely to similar expansions abroad by specialized parts and components manufacturers. There are now half a dozen medium-size Japanese components manufacturers which produce as much as one-third of their total output overseas [as of 1973] (Yoshino 1974: 359).

In these early days, foreign investment often depended on a collective effort involving trading companies, local firms and financial institutions as well as a pivotal Japanese manufacturer. Given the capital constraints, lack of experience and often dire lack of local information, it is unsurprising that a number of early examples of overseas investments reflect joint efforts with government input constraining corporate decisions. This was not so much a typical example of culturally determined preference for a cooperative strategy but rather a reasonable economic response to restrictive necessity.

> ‘Group’ investment (i.e. where a number of Japanese firms, usually involving trading companies, participate in a given overseas venture as co-investors) is a popular form of overseas investment among Japanese firms. The Overseas Economic co-operation fund, a government agency also participates, as a shareholder, directly in overseas ventures that have an overtone of economic assistance. … Japanese firms are highly dependent on external source of funds to finance their direct foreign investments. As of the end of march 1975, for example, 34.2 per cent of their overseas investment capital came from government-affiliated financial institutions … 32.8 per cent from private financial institutions (mostly city banks whose liquidity was, in turn, created by the Bank of Japan), and the remainder from the investing firms’ own internal funds (Ozawa 1979: 75).

In some cases, joint ventures with local firms reflected a binding constraint imposed by the host government. However, the role played by Japanese trading companies was especially significant during this period. These firms were unsurprisingly central in the first few decades of Japan’s export drive when most products could be fairly described as unbranded commodities. (Not until the advent of such consumer electronics as transistor radios did Japanese firms start building brand name reputations abroad. This necessitated overseas investment in the form of marketing and specialised distribution centres.) Given their superior knowledge of foreign markets and larger capitalisation, trading firms could sell a portfolio of Japanese goods and reduce the risk of those Japanese producers wanting to sell abroad or even produce overseas.[xv] In these early days, provided with sufficient assistance, even small companies were as likely to venture abroad as larger, more efficient ones. Twenty-five percent of parent companies were capitalised at less than ¥50 million ($167,000 in 1973) (Yoshino 1974:358).

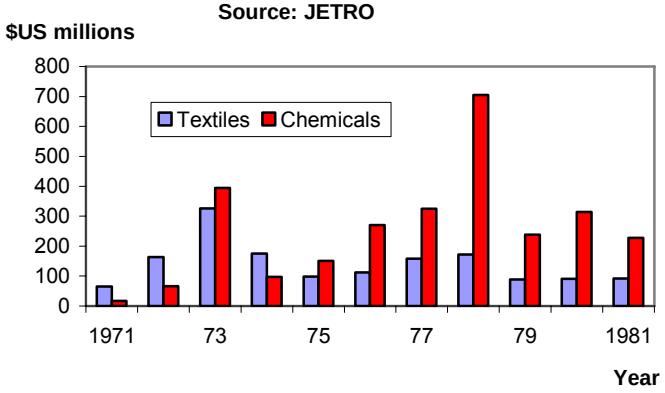
> Trading companies, traditionally an essential element in the distribution of textile products, were also mobilized. They performed useful integrative functions linking the large fiber manufacturers with a myriad of downstream operators and distributors. A particular value of the trading companies was their financial strength and their close contact with many small enterprises (Yoshino 1974: 363).

Clearly during this period, domestic imperatives largely dictated these foreign investment reactions. Higher value added production where Japan remained competitive and which provided rising wages for Japanese workers, largely remained bound within the domestic market. However, more

undesirable production, especially in a rapidly developing country with aspirations toward middle class comfort, was carefully shifted overseas.[xvi] This led to a deliberate shift of the petro-chemical industry.[xvii] The seventies saw an increasing concern with excess capacity coupled with a public unwillingness to tolerate any more plant sites. As incomes rose domestically, so did demand for less pollution, meaning fewer 'dirty' industries. Shifting out of these undesirable sectors became even more compelling than leaving behind such labour intensive industries as textiles which dominated overseas investment in the sixties (see figure 1 below).

> Meantime, finding plant sites has become increasingly difficult; virtually all attractive locations have been occupied and even more basic is a change in the social climate. Concern for environmental protection has heightened, and any efforts to expand existing capacity or to create a new complex would almost inevitably meet serious opposition from local citizens (Yoshino 1974: 378).

Figure 1: FDI in the 1970s Selected Industries
Source: JETRO



The defining characteristic towards the end of this reactive period is a rather distinct shift away from investment in developing countries (initially Latin America and then Asia) to more developed countries in North America or Europe.

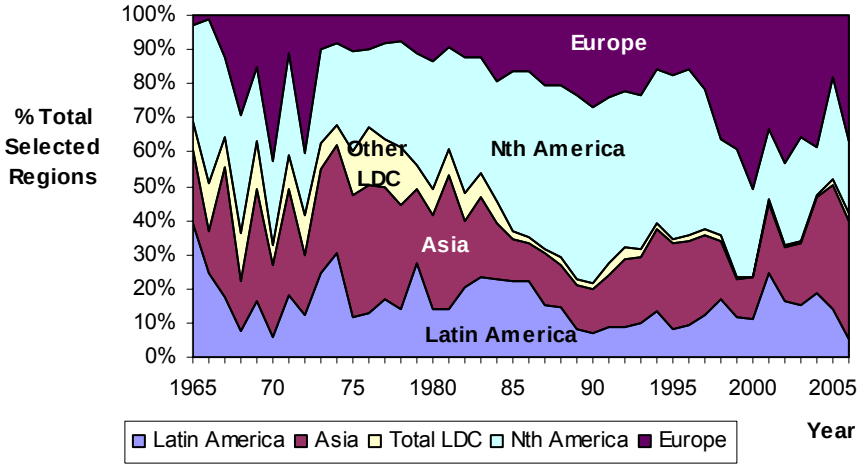
> Most striking is that the relative importance of flows to North America (Canada and the U.S.) has doubled since the mid 1970s, accounting for about $24 billion in 1988 (more than half of the total outflow). Similarly, the European share of FDI has risen from about 12 to 20 percent of the $47 billion outflow in 1988. These increases in the share of FDI to developed countries have come at the expense of developing-country shares (Froot 1991: 8).

This unmistakeable change of course which refocused FDI toward developed economies can again be understood as largely reactive in nature (see figure 2 below). Its clear objectives were to insure export markets and to overcome export restrictions. Notice once again the conservative, risk reduction aspect of this strategy. It is hardly a coincidence that this shift coincides with the distinct creation of international Japanese brand names which came of age in the seventies. Such a changed focus complemented the continuing move into more value added areas, leaving more competitive markets, characterised by generic type products, behind. Continuing to produce consumer electronics that were simply re-branded by established U.S. companies held too much risk and provided unattractively low margins. As Japanese wages rose, demand for such no-name products could shift easily to lower cost producers. An oligopolistic brand advantage would eliminate such dead end options. This impetus, moving FDI away from its more traditional destinations, was augmented by two other unavoidable factors that gained prominence after 1972. First, Japanese firms feared the likelihood that rising concern in countries like the U.S. would soon see attempts to block the flood of Japanese imports. Second, the expanded opportunities created by the continued liberalisation of constraints on foreign investment, driven by the Japanese bureaucracy's attempt to retard any further appreciation of the yen.

> The suddenly swollen coffers of international reserves and the steep appreciation of yen triggered by the successive devaluations of the dollar in the early 1970s compelled the Japanese government to go through three stages of the so-called 'yen defence programme' to reduce an embarrassingly large stock of reserves and to 'defend' the yen from further appreciation. … Various measures were taken to encourage imports and capital outflows, each time more progressively than before, and to discourage exports and capital inflows on a temporary basis. All overseas investments were in principle completely liberalized in June 1972 (Ozawa 1979: 87).

Figure 2: Japanese FDI by Region

Source: JETRO (2005-06 data on BoP net basis)



Efficient and innovative Japanese firms made the unsurprising choice to promote their brands abroad, first through distributional and marketing investment but then eluding potential barriers to trade by producing locally. As previously pointed out, the textile industry provided something of a template for this strategy. Sony was a clear pioneer in this movement which would build and peak in the late eighties and early nineties. Again, this reactive strategy provided a relatively low risk alternative considering the rapidly changing economic circumstances.

> In the late 1960s, the company became increasingly concerned with its ability to continue serving the American market from Japan in the face of mounting pressures for import restrictions. Having established a strong market position, and given the overriding importance of the U.S. market to the company (roughly a third of its total sales), Sony began to contemplate the establishment of a plant in the United States. Because it was a rapidly growing company, Sony was faced with the need to expand its capacity at regular intervals; it made good sense to build an incremental capacity in the United States. No doubt, some production costs would be higher in the U.S., but the wage gap between the two countries was narrowing, and there would be some savings in tariffs and transportation costs. Most importantly, Sony had the distinct oligopolistic advantage of a well-accepted brand, which made it easier to pass any increased costs on to consumers (Yoshino 1979: 375).

This set the pace for the onslaught of manufacturing investment which would be the hallmark of the eighties.

> Significant investment in manufacturing sectors of the industrial countries, especially the United States, began only in the 1970s, as two necessary conditions came to be satisfied. One was the considerable successes scored by many Japanese industries during the 1960s in exporting sophisticated goods that won substantial goodwill in the U.S. market. The second was changes in conditions that began to make the United States an attractive base for Japanese firms to supply the U.S. market – depreciation of the dollar following the collapse of the Bretton Woods system and the rise of pressure to protect U.S. industries against Japanese exports (Drake and Caves 1992:230-231).

With Honda making the initial move in 1982, other Japanese car makers followed suit. Capacity expansion meant shifting plants to the U.S[xviii]. The Japanese manufacturers had responded rapidly to an opportunity provided by an unanticipated shift in demand. The first oil shock in 1973 created a new opportunity for small car sales in the U.S. Japan, given the nature of their domestic market, had managed to produce quality small cars efficiently. The 'Big Three' U.S. manufacturers, eschewing low profit margins provided by small car sales, largely chose to ignore this sector believing demand for larger sized vehicles would rebound. They were correct initially, but the industry was soon overwhelmed by a second oil crisis later in the same decade. Rapidly falling sales led to intense pressure by domestic car makers on the U.S. government to provide them with what they claimed was a much needed period to recover.

Breathing space came mostly from government to government negotiations. In 1980 the Big Three car manufacturers had lost a total of $4 billion. Domestic sales dropped 1.5 million and factories were running at only 60 per cent capacity. Faced with the possible collapse of two major car companies (Ford and Chrysler), the U.S. government successfully pressured the Japanese into limiting their annual exports to 1.68 million cars compared with the 1980 sales level of 1.9 million cars. Rapid recovery of the U.S. industry would see import restraints raised to 1.85 million.[xix]

Japanese car-makers in the early eighties were stuck in the small economy end of the market where margins were thin and competition, if only among themselves, was fierce. To gain any lasting success, that is to hold on to and increase their current customer base, the Japanese would need to

expand their model lines: translated this meant more expensive cars loaded with more options in order to widen profit margins. Further, if they were to become immune to political pressures and foreign exchange fluctuations, (achieve a lower risk profile) production would need to be shifted to the U.S. Sticking mainly to the lower end of the market would make such a transition more perilous.

The quotas allowed Japan to limit its imports, to more profitable models and to charge prices some 15-25% higher than otherwise by artificially limiting supply. This brought Japanese car-makers an additional $3.25 - $5 billion in 1985 alone[xx]. In a sense, these import restrictions financed the Japanese invasion into domestic production and their move into the more upscale market. Without such an assist these companies would have had to borrow heavily, taking on additional commitments and additional risk. These imposed constraints allowed the Japanese to raise prices by only 25% despite the yen's doubling in appreciation between 1985 and 1988.

Notice that the Japanese carmakers were largely reactive in this situation. To prosper they had no other viable option. But such an opportunity had scarcely been foreseen. This was essentially horizontal integration driven by the host country's imposed limitations. Given export constraints, Japanese car makers could only continue to exploit the existing opportunity and build their sales base by shifting part of the production process overseas. A similar strategy operated in Europe with a number of Japanese firms choosing to expand into the U.K. to avoid similar restrictions.[xxi]

Not only did Japanese FDI grow rapidly[xxii] as firms expanded horizontally to overcome imposed restrictions and maintain viable export markets, but the nature of this overseas investment was also evolving as well. Ozawa (1979) focusing on the developmental stage of Japan's post-war economy could easily contrast the sharp differences with the U.S. during the same period.

> Other than her commerce-oriented investments, Japan's overseas investments are aimed mostly at exploiting natural resources in resource-rich countries or manufacturing labour-intensive products in labour-abundant developing countries … Most outputs from the first type of investment are shipped back to Japan, while the manufactures from the second type are increasingly exported back to Japan or to third-country markets. In contrast, American overseas manufacturing investments are designed mostly to produce highly sophisticated, technology-based products for local markets, as envisaged in the oligopoly theory of direct

> investment. Kojima[xxiii] characterized the Japanese type as 'trade oriented', the American type as 'anti-trade oriented' (Ozawa 1979:79).

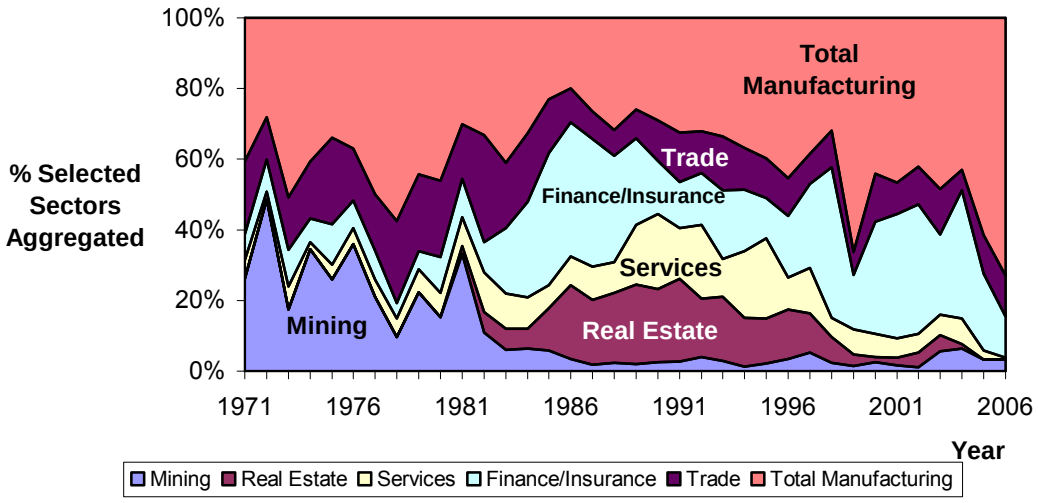
Ozawa was contrasting this approach with the then prevailing theory emphasising the monopolistic nature of international investment. What is important here is that as he was writing these conclusions, the nature of Japan's investment was changing to reflect its evolving domestic economy. By the late seventies, the prominent features of foreign direct investment were no long those of the sixties. And indeed even American investments so concisely characterised by Ozawa would also shift away from any simple manifestation of horizontal integration.

> Thus, the profile of Japanese manufacturing investments five years from now is likely to be quite different from the present picture. The motives of investment have become more diverse; the commitments will become larger. Not only is a pull generated by Japanese industrialists' desire to defend export markets, but internal forces are now pushing a number of them abroad. The character of the investment has shifted from small, labor-intensive, fragmented operations to more capital-intensive and technologically oriented ones. The behavior of large, oligopolistic Japanese firms has begun to manifest characteristics commonly associated with their U.S. counterparts, but the Japanese enterprises are forging distinctive patterns of cooperation which may have important ramifications for the future (Yoshino 1974: 381).

The new wave, peaking in the early to mid-eighties featured what would become a roster of dominant Japanese multinational firms. Along with these manufacturers came associated suppliers and firms that largely serviced these corporations. These included financial firms, realtors and others who initially came to facilitate the needs of this growing contingent of Japanese firms (see figure 3 below). Characteristically, and as expected by theory, the firms that dominated this activity were large and apparently efficient. With the players in place and the nature of overseas investment evolving noticeably from the earlier developmental stage, the transition toward a more individualistic and independent FDI profile was in the making.

Figure 3: Japanese FDI by Selected Sectors

Source: JETRO (data post-2004 is on BoP net basis)



III. The Bubble Transition – A Drunken Sailor Paradigm of Overseas Investment

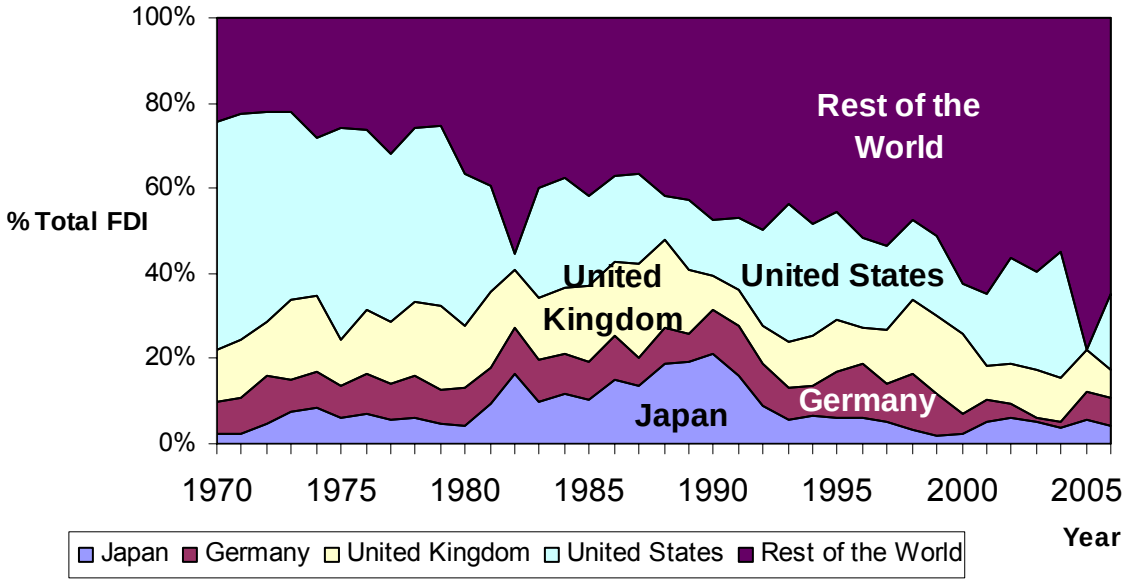
> Ishizaki, ever the fixer, would arrange the art deals with the help of a female French friend who was a retired prostitute. "She had grown too old to be a hooker," Ishizaki said, "she had a few too many wrinkles, so she decided to become a freelance art dealer." Though she had switched careers, the Frenchwoman had not lost her accommodating ways. 'I'd ask her to draw up a valuation certificate for, say, ten million dollars," Ishizaki later explained, "and then the bankers would come and look at this painting. The bankers didn't know a Cezanne from a Monet, but they'd nod and say, 'Yes, this is worth ten million, so we'll lend you eight million against it.' Then my French friend would sell us the painting, probably under a different name, and take a commission on the deal." (Tett 2003: 55).

Back in 1988, there was a widespread joke in Australia which played on a ubiquitous ad for Queensland tourism. The original had as its hard to forget tagline 'Beautiful one day, perfect the next.' The joke quickly transformed into 'Beautiful one day, Japanese the next' which perfectly summed up the anxiety, xenophobia and downright paranoia surrounding Japanese overseas investment of the time. The Japanese were seemingly buying up any asset they could get their hands on with swaths of real estate falling into their clutches. There was talk of Japanese retirement village and a Japanese Multi Function Polis to be located somewhere north of Adelaide in South

Australia.[xxiv] The reality was that in the late eighties Japanese FDI seemingly exploded, peaking at 20 per cent of total world FDI for 1988 (see figure 4 below). To outside eyes, Japanese firms were acting like convent educated young ladies left unchaperoned in the big city for the first time. In contrast to the previous conservative, risk averse nature of its FDI ventures, this new era seemingly disregarded the issue of risk altogether. This 'bubble period' provided a necessary shock that would largely change the nature of Japanese overseas investment. But it would be a transition that would come at an enormous cost and which would provide lessons that have been fully absorbed only in the last few years (2007-8).

Figure 4: Japan FDI as Proportion of World FDI

Source: UNCTAD



Flooded with cash, Japanese firms moved away from boring investment in manufacturing to the more enticing option of speculative assets. The Japanese bought other firms, real estate and just about any asset that an abundance of funds could purchase. The rule of thumb seemed to be to buy anything as long as it was selling for top dollar. In some distorted way, Japanese ventures overseas during this period seemed to operate on the basis of 'buy high, sell low'.[xxv]

Meanwhile, outside Japan, some American brokers estimated that Japanese companies had acquired about two-thirds of the value of real estate in Manhattan. Mitsui Real Estate had spent $610 million to buy the Exxon building in New York, even though the building was

> initially valued at just $375 million. Mitsubishi Real Estate bought Rockefeller Center in New York for $850 million, at its time a record deal in New York. Japanese companies were also spending lavishly on other trophies: Sony acquired Columbia Pictures for $3.4 billion. Matsushita paid $6.6 billion for MCA. Yasuda Fire and Marine paid $39 million for a single Van Gogh painting (Tett 2003; 49-50).

This extended buying spree simply imaged the parallel domestic economic changes at that time in the same way as Japanese FDI had during previous periods. The difference was that firms were now awash in cash and free from all constraints. They could pursue their objectives and search for easy profits unimpeded by Japanese or even foreign host governments.

The domestic economy was at this time encapsulated in the self-delusion of a 'bubble economy' whose hallmark was, of course, extreme asset inflation. In reaction to the Plaza Accord which led to a doubling in value of the yen against the dollar within a three year period[xxvi], the Bank of Japan sought to insure continuing economic growth by floating the economy on a sea of liquidity. Not only was the key discount rate sliced in half (from 5 percent to 2.5 percent) but funds were for all intents and purposes shovelled at the banks through the traditional mechanism of 'window guidance'.[xxvii] Other than losing funds, the next worse thing a bank can do with its financial resources is to let them lie idle. Given that Japanese banks at that time earned most of their income from lending, finding borrowers became exigent. But suitable borrowers were not so readily available. Highly successful firms like Toyota could easily fund their expansion through retained earnings. Reliable corporate borrowers, even when pressed could not absorb the quantity of loans banks were eager to make. Therefore, less suitable and more risky targets soon caught their attention.

The key area here was the real estate market where loans seemed based on future asset inflation rather than the feasibility of any given project. Golf courses[xxviii], theme parks and resorts sprang up as commercial and residential real estate prices predictably climbed. The more outrageous the project, the more banks seemed able to earn. A herd like mentality ensured that no financial institution would hold back given what appeared to be easy profits available to all who were willing to lend to each and every applicant. Given their domestic success, as asset prices did consistently climb, the natural next step was to extend this fool-proof formula overseas. Japanese

banks had already branched out, operating in the financial capitals of the world. Overseas investment in the late eighties became dominated by the financial and real estate sectors. Many in the financial world thought that given such easy access to what seemed to be bottomless funds, Japanese banks would roll over western competition much as their car manufacturers had done beginning with the seventies.[xxix] The banks themselves seemed to buy this dubious analysis, seeing themselves as 'Masters of the Universe' despite a clear lack of experience in the market into which they were now venturing. They acted in the certainty that what had bought success domestically would also triumph in overseas ventures. Thus the domestic collapse of asset prices would have a parallel in the international market where Japanese investors had purchased commercial properties at inflated values.

> In most countries today, when banks lend money for corporate investment they pay close attention to the likely *cash flow* of a project. What banks want to know is whether a company will be able to pay the loan back out of a future stream of earnings. In Japan during the 1980s, however, the banks only ever cared about one thing: collateral, or the asset that a company could sell to repay a loan, if it ever faced a crunch. And the only collateral that mattered – at least in the eyes of bankers – was land. For by 1985, banks like LTCB [Long Term Credit Bank] had come to the conclusion that land was an almost fail-safe store of wealth; its value could only ever *increase*. (Tett 2003: 40).

With greater individual decision making at the firm level free of any clear constraints, overall Japanese FDI boomed[xxx]. Moreover, the initial trend toward overseas investment switching from developing to developed countries accelerated in this period between 1985 and 1993. Not only did the regional nature of the investment change, but so too did the type[xxxi]. Starting with the mid-eighties such investment was largely generated by the tertiary sector.

> Indeed, during the 1980s, the share of FDI outflows received by industrial countries rose to absorb over three fourths of the total, with the United States alone receiving close to one half, whereas the share received by developing countries (including Asia) declined from one half to around one quarter. Coincident with such a development was the spectacular growth in overseas investment in the tertiary sectors, including finance, insurance, transport and real estate, while the share of FDI in manufacturing and mining declined sharply (Bayoumi and Lipworth 1997: 7).

To some degree, this transition period was something of an aberration since with the collapse of asset inflation domestically, FDI would also rapidly deflate. Moreover it would shift back to more traditional regions, namely developing countries and in particular Asia, as well as toward more manufacturing opportunities. But this simply mirrored the constraints of a now floundering economy where firms looked toward a booming Asian region to pull them out of the mire left over from their 'bubble' experience. What had shifted distinctly however, was that Japanese firms in the overseas arena were capable of acting much like firms from other developed countries. After slowly recovering and recouping from this era, FDI in the next century would be characterised by similar individual decision-making that defined this boom period. However with the lessons absorbed from previous mistakes, FDI would be determined much more carefully and conservatively. Issues of risk were once again part of the analysis.

> The post-bubble period has witnessed a partial reversal of the trends exhibited in the 1980s in both the regional and sectoral composition of Japanese FDI outflows. Regionally, the share of FDI to developing countries has risen to the early 1980s level, and the share received by Asia within this total has increased substantially, while FDI flows to industrial countries have declined, particularly that to the United States (Bayoumi and Lipworth 1997: 7).

IV. Not So Different After All – Recent Trends in Overseas Investment

> ... among U.S. multinationals with affiliates in Canada, only 12 percent are of the purely horizontal type (i.e., they have negligible intrafirm flows of intermediate inputs) and only 19 percent are of the purely vertical type (i.e., they have negligible intrafirm flows of intermediate inputs in one direction only). The remaining 69 percent of the firms pursue more complex integration strategies (Helpman 2006: 599).

The changes wrought in the domestic economy by the rather abrupt end to the good times fostered by asset inflation were certain to be reflected in overseas strategies by Japanese corporations. At home the touchstone was consolidation as firms sought to resolve the excess capacity and debt ridden balance sheets that were the natural hangover of the previous period. In matters of FDI it was largely back to the future for the remainder of the nineties. Investment in developed countries slowed or even stagnated with the focus of what were now a smaller pool of funds turned toward the lesser developed countries of Asia and particular toward China. These opportunities turned

mostly on characteristically lower wages and the opportunity to sell in overseas markets. There was a clear shift away from the service sector and back toward manufacturing. These were of course some of the drivers of Japan's initial forays abroad. However this time, more emphasis was placed on selling back into the Japanese market. The impetus for this shift lay with individual Japanese firms rather than a collaborative effort between an assortment of firms and government agencies. This shift had much less to do with ensuring anything like a domestic low risk middle class economy and much more with the individual survival and advancement of the Japanese firms involved.[xxxii] As expected, individual firms varied noticeably in the strategies adopted.[xxxiii] However the overwhelming causes of this shift was an increasing need to cut costs in a sluggish economy and the booming growth of Asia, especially China, compared to the developed world. Like other firms, Japanese corporations shifted their attention to where opportunities lay.

> After 1995, the growth in the number of subsidiaries in DCs became nearly flat, and more investments were then directed towards LDCs is due in part to the growth of interest in China. In our sample, there were 2443 subsidiaries in China as of the end of 1999, accounting for 21.7% of FDI in LDCs and 12.6% of the whole. This changing pattern in the choice of JFDI location corresponds closely with the changes in both the relative GDP growth in LDCs and DCs and the economic climate in Japan in this period (Makino, Beamish and Zhao 2004: 379).

One way to get some feel for the direction in which Japanese FDI is heading in this more independent era is to contrast the Japanese experience in China with that of the U.S. Since both have viewed this booming economy as a potential opportunity not to be ignored, it may prove instructive to note how the approaches have differed and whether such differences are fundamental or simply a product of specific constraints. It is quite easy to become mislead by the apparent dissimilarities between the two. In broad terms the approaches of each country's multinational corporations seemed driven by different necessities.

> In the 1970s, the FDI by Japanese MNEs focused predominatly on adjacent countries within their economic and strategic sphere of influence. Such FDI was mainly of a "natural resource seeking" and "vertically oriented efficiency seeking" kind. By contrast, most of the US FDI was concentrated in Canada and Europe, and was characterized as "market seeking" or "horizontally oriented efficiency seeking". These difference can be accounted for by the comparative economic institutional advantages and market opportunities of both investing

> and host countries. However, over the last 20 years, the Japanese MNE activity has changed its industrial and geographical profiles to place more emphasis on the European and North American markets as destinations for FDIs in the context of 'market' and 'horizontal efficiency'. By contrast, the US FDI has placed more emphasis on Asian markets as a "vertical efficiency" seeking. As a result, the regional distribution of both countries' FDI flows has been reversed in recent decades (Dunning, Kim and Lee 2007: 29).

It is much simpler to say that in the seventies the two countries and the firms based within them were operating at different developmental stages. The U.S. had not been faced with the competitive onslaught from abroad they were about to face. American multinationals sought instead to achieve economies of scale and scope by snatching opportunities in foreign markets. Resource poor Japan was more concerned with insuring the flow of natural resources and shifting out of lower to higher value added manufacturing as their domestic standard of living persistently rose. As Japanese multinationals became more competitive, they sought to spread subsidiary operations to developed countries while in reaction American multinationals resorted to lower wage investment opportunities in Asia to meet this competitive threat. However the story described by Dunning, Kim and Lee extends only until 1996. Thus it largely limits the aftermath of two major events for both countries; the end of the 'bubble economy' for Japan and the importance of the North American Free Trade Agreement for the U.S. When we in fact turn to the Chinese case we would expect to see more complex arrangements and motivations than those given previously. We would also expect that all multinationals in China share a common behaviour of rooting out independently and aggressively any opportunity for reasonable gain.

Chinese exports have to a large extent been driven by overseas investment with such FDI defining the shift into goods that are at the value added, high-tech end of the spectrum. This is the type of technology transfer that often characterises multinational investment. Without such FDI it could be expected that developing countries might under a given set of circumstances be condemned to pursue a comparative advantage limited to labor intensive goods.

> In 2004, they exported $339 billion, about 60% of China's exports. … In the high-tech products category, foreign invested firms performed an even more important role. They produced about 88% of China's high-tech exports. … Therefore, FDI not only boosted

China's export growth, but also accelerated the transition of its exports from low value-added to high value-added products (Xing 2007: 686).

At first glance there would seem to be significant differences between the U.S. and the Japanese approach to investing in Japan. Accumulated stocks of such investment by the U.S. was only approximately half that of the Japanese. As the tables below illustrate the difference in such sectors as transportation equipment and electrical goods is particularly striking (See Tables 1 and 2 below).

Table 1: Cumulative Japanese FDI in China

Sectors	1984	1992	2004
Food	20.9	139.6	1,167.2
Textile	2.6	283.5	2,049.2
Chemical	14.0	108.4	1,731.6
Metal	3.0	103.2	1,900.2
Machinery	2.1	229.9	2,713.7
Electrical	2.7	657.4	5,316.9
Transport	1.2	55.6	4,137.3

Table 2: Cumulative US FDI in China

Sectors	1989	1992	2004
Food	10	69	593
Chemical	27	93	1,643
Metal	2	−3	149
Machinery	21	14	455
Electrical	10	13	493
Transport	Na	Na	1,832

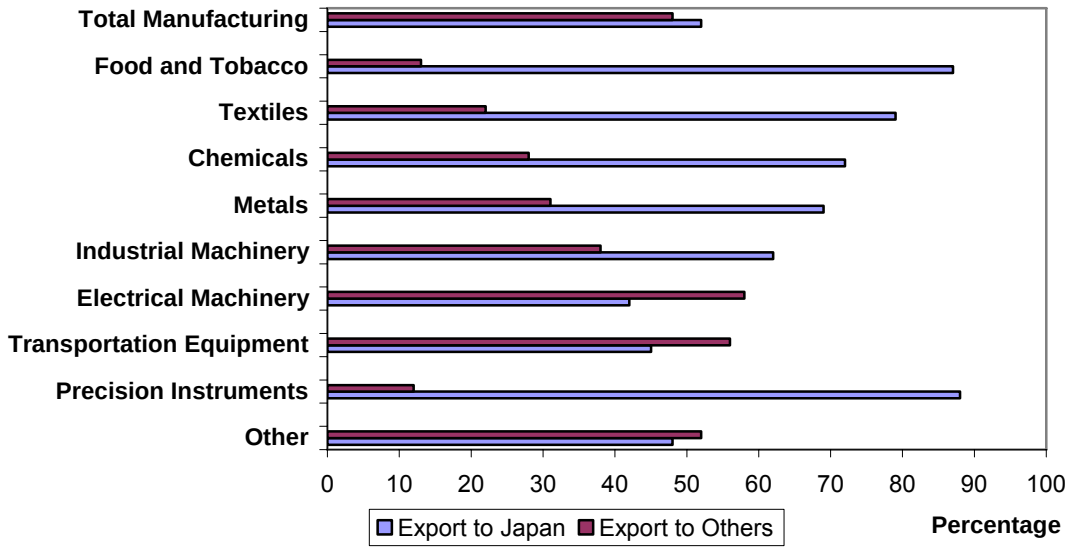
All figures $US million Xing 2007: 688, 690

But it is not simply a matter of size. Japanese investors used China basically as an export base as opposed to the U.S. strategy of focusing on the Chinese domestic market. In some sectors of the market, Japanese multinationals shipped almost all of their output back to their home base (see

figure 5 below). The impetus for this approach was the need to remain competitive in a domestic market that had seen practically no wage growth over a long decade of sluggish economic activity and continued to face weak consumer demand. This pattern remained even after the resurgence in the Japanese economy which may now (2008) be coming to an end.

> Using China as an export platform is one of the major motivations that Japanese multinational enterprises have to invest in China. By investing in China, Japanese MNEs are able to strengthen their global competitiveness by combining China's low production costs together with their superior technology, brand recognition, and global distribution networks. According to a JETRO study (2003), 61.6% of Japanese firms operating in China exported at least 70% of their products. In 2001, Japanese affiliated manufacturers in China as a whole sold 65% of their products in overseas markets … Another unique practice of Japanese affiliated manufactuers is their extensive involvement in "reverse imports," exporting their products back to Japan. … on average, more than 50% of exports headed for Japan (Xing 2007: 688).

Figure 5: Export destinations of Japanese Affiliates in China 2003
Source - Xing 2007: 689

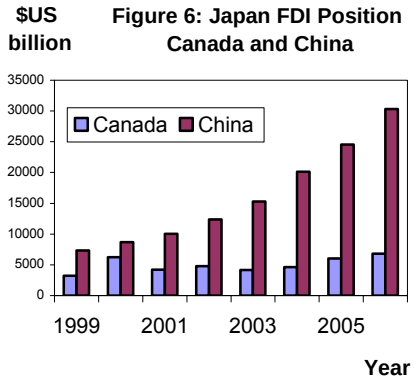


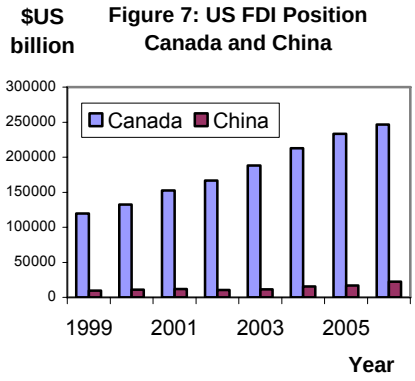
Since the days of the 19th century, China has held a distinct fascination for American traders. Population numbers grabbed their imagination. Selling just one bar of soap to each individual in China would make some wily entrepreneur's fortune. Much the same mindset seems to have propelled more recent U.S. direct investment there.

Moreover, unlike Japanese FDI, the US FDI is primarily domestic market oriented, and simply functions as a means of accessing the Chinese market rather than using it as an export platform. According to the Government Accountability Office, in 2003 the US affiliates in China sold about 75% of their products in China, and 25% in overseas markets. Of the total exports, only 7% were exported back to the US (Xing 2007: 690).

What appears to be a defining difference between the two countries tends to dissipate when looked at from a wider lens. As previously explained, the shift by Japanese multinationals into the U.S. in the 70s and 80s was largely an attempt to sustain and enlarge a key export market. The US did not serve as an export platform to any significant extent but instead investment was aimed at serving the North American market. Similarly, if U.S. overseas investment were to be restricted to the Western Hemisphere it would tend to resemble that between Japan and China (see figures 6 and 7 below). The determining factor is geographic rather than any characteristic inherent in the nature of the individual corporate decision makers. Investment in one's back yard looks different than that done on the other side of the world. This pattern should become even more reinforced as transport costs tend to rise.

The study, published in may [2008] by the Canadian investment bank CIBC World markets, calculates that the recent surge in shipping costs is on average the equivalent of a 9 percent tariff on trade. "The cost of moving goods, not the cost of tariffs, is the largest barrier to global trade today," the report concluded, and as a result "has effectively offset all the trade liberalization efforts of the last three decades." (Rohter 2008: 2).





V. Convergence: Looking Exactly Unlike Each Other

Outward FDI is still not very large relative to the Japanese economy despite the rapid growth since the mid-1980s, so there is still scope for significant increases before it reaches the levels of other OECD countries. The outsourcing and relocation of production will particularly affect labor intensive manufacturing operations, not least because of demographic factors. On the domestic scene, this will facilitate the necessary restructuring of the Japanese economy towards more advanced activities with higher value added (Blomström, Konan and Lipsey 2000: 23) (see figures 8 and 9 below).

Figure 8: FDI as % GDP Selected Countries

Source: OECD

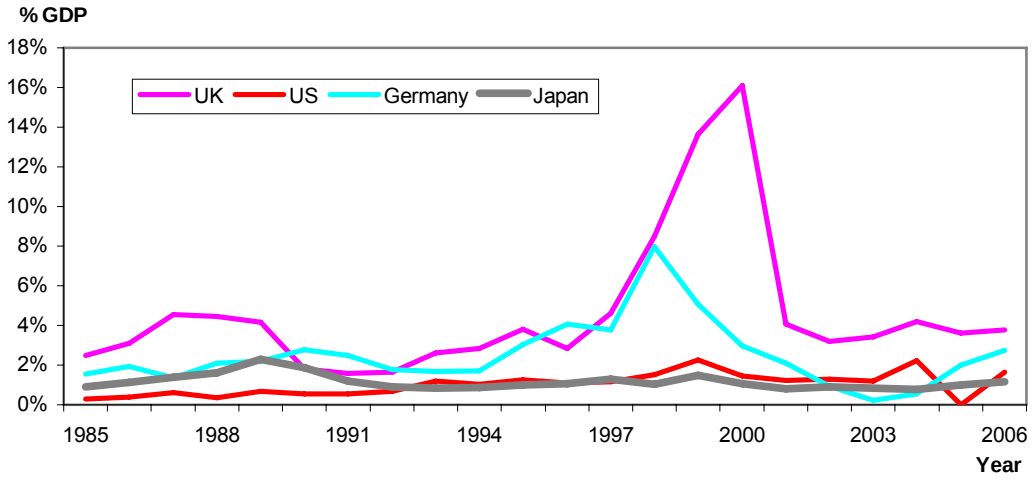
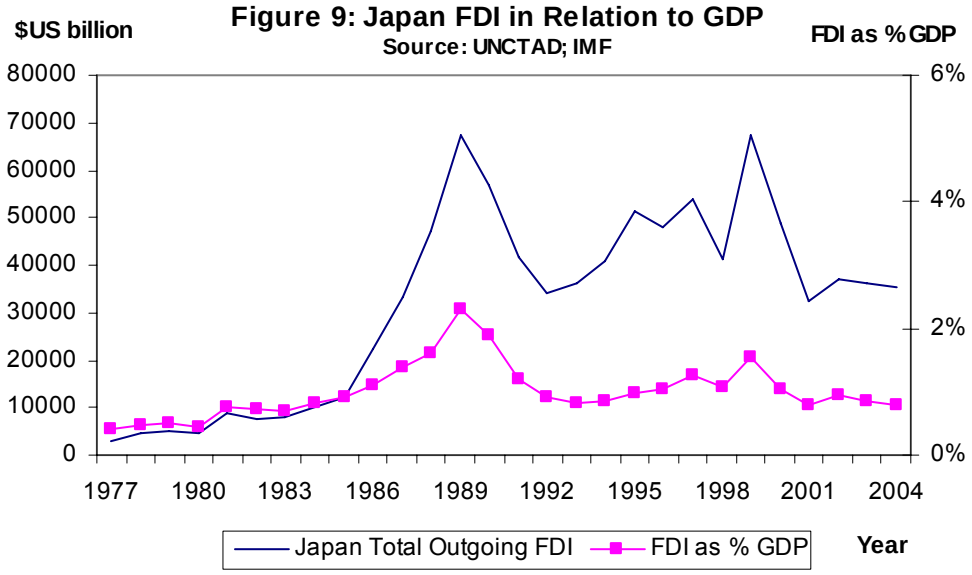


Figure 9: Japan FDI in Relation to GDP

Source: UNCTAD; IMF



To estimate the future direction of Japanese FDI we clearly need to have some idea of future changes in the multinationals that make such decisions and the objectives they will pursue. What seems clear is that each firm will consult their own particular interests and act ever more aggressively in what is an increasingly competitive global market. To what degree Japanese firms have actually changed in the last decade is still a matter of debate.

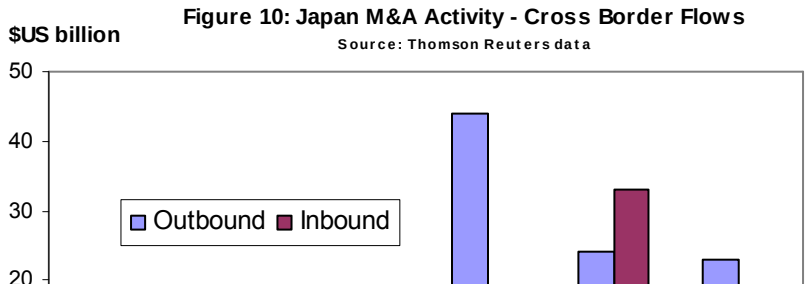
However, it is clear that these firms have more foreign ownership than ever before and fewer corporate cross-holdings[xxxiv]. Together this is reflected in what seems to be a shift towards seeking higher profits domestically as well as in foreign subsidiaries.[xxxv] Japanese firms have also shifted away from an inclination to place the domestic market first. Figure: Data for 2008 is year to July 2008 Instead they are moving toward a strategy of seizing opportunities wherever and wherever they might occur. Many corporate managers now realise that given the constraints of the domestic market, growth needs to be led externally, specifically through mergers and acquisitions overseas (see figure 10 below).

> Japanese companies are turning increasingly to overseas acquisitions to drive growth, buy technology and build market share, spurred by a stagnant domestic economy, shrinking population and largely unburdened by subprime credit damage. … Already this year, outbound acquisitions from Japan total $24 billion according to Thompson Reuters data, nearly matching the haul for all of 2007 (Munroe and Emoto 2008: 1).

One clear direction is in seeking out more mergers and acquisitions abroad. Poor judgement followed by a collapsing economy made Japanese corporations and financial institutions[xxxvi] extremely shy of repeating the mistakes made during their 'cowboy' era. The moves now are more conservative and measured but this seems clearly the direction an increasing number of Japanese multinationals is taking. These include moves by pharmaceutical companies such as Takeda, Eisai and Daiichi Sankyo; Kirin Beer (acquiring the Australian industry leader in dairy (Dairy Farmers and National Foods) and beverages (Lion Nathan)); and precision instrument maker Olympus (buying a British medical equipment business) (Iinuma 2008: 8).

Figure 10: Japan M&A Activity - Cross Border Flows

Source: Thomson Reuters data



> Having come back from the brink so recently themselves, the Japanese bankers may well believe that they know how to spot a bargain. SMFG is attracted to Barclays, believing that it has reliable revenue from its British retail operations (and the Japanese bank hopes the two can co-operate in new areas, such as wealth-management in Asia). MUFJ has yet to make a big move, though it is thought to be considering an acquisition. Of course the deals themselves, at around $1 billion apiece, are hardly more than a toe in the water. But it is just that conservatism that has recently worked to Japan's banks' advantage (*Economist* 2008;1).

There will always be minor differences between Japanese firms and Anglo-American ones, but there also will be striking difference between the firms operating within the same market sector. Japanese firms may simply be more conservative and slower to move due in part to corporate structure and practices. American firms for instance seem more willing to divest themselves of divisions and businesses than their Japanese counterparts. The cause is often attributed to a greater reluctance to focus more exclusively on a limited number of promising sectors. Yet there may be some sense to this alternative strategy. Japanese firms are more concerned with continuing to earn quasi-rents from an established roster of brand name products by maintaining their existing good reputations amongst Japanese consumers. These corporations are more eager to offshore the lower

tech aspects of production in order to remain price competitive while retaining the higher end of technological processes.

> And yet, despite all this, in April-June, Toshiba suffered a net loss of ¥11.6 billion ($107 million), its first quarterly loss in three years, largely because of failing semiconductor operations. Although 75% of the loss came from falling markets for chips for video games, the company says it will not cut back on its investment plans for those kinds of chips. It says it doesn't want to repeat its "error" of letting the Koreans out-invest it in DRAM chips. It remains to be seen whether this will prove to be wisely farsighted or foolishly stubborn (Iinuma 2008: 8).

Japanese firms have changed not from any specific desire to imitate western strategies, but rather the constraints and incentives under which they operate have evolved over time. Their more active role in seeking out and creating individual opportunities is nothing remarkable. Rather, the environment in which they now operate has greatly changed making such action more imperative. Though Japanese firms will continue to be somewhat distinct in their overseas investment strategies and different from each other as well, in the realm of foreign direct investment it is the similarities rather than the differences that should most inform our analysis.

Appendix: Data Summary

Figure 1: GDP is calculated by expenditure approach, measured in national currency (millions). Foreign direct investment figures are aggregated figures by industry, in submitted currency. Source: OECD.

Figure 2: Regional shares of Japanese foreign direct investment calculated as percentages of total sampled. Data based on Reports and Notifications, Gross. Disinvestment not included. Series discontinued 2004, data for 2005 and 2006 are based on international investment position, net. 'Other LDC' is aggregate of Africa, Middle East and non-Australasian Oceania. 'Asia' includes ASEAN, East Asia, and Indian Sub-Continent. 'Europe' is aggregate of data for Western and Eastern Europe. Source: JETRO for all data.

Figure 3: Industry shares of Japanese foreign direct investment calculated as percentages of total sampled. Services, trade and other categories are as defined by source. Data based on Reports and Notifications, Gross. Disinvestment not included. Series discontinued 2004, data for 2005 and 2006 are based on international investment position, net. Source: JETRO for all data.

Figure 4: Foreign direct investment data are for all outward flows, in $US at current prices (millions). Source: UNCTAD.

Figure 6: Foreign direct investment data are for position in host economy in $US current prices and market values. Source: OECD.

Figure 7: Foreign direct investment data are for position in host economy in $US current prices and market values. Source: OECD.

Figure 8: Foreign direct investment data are in submitted currency. Data for GDP by expenditure approach, in national currency at current prices (millions). Source: OECD.

Figure 9: Foreign direct investment data for outward flows are in $US current prices in millions. Source UNCTAD. Data for GDP by expenditure approach are in $US current prices in millions. Source: International Financial Statistics (International Monetary Fund).

Figure 10: Figures for Merger and Acquisition activity are in $US billion at current prices. Figures for calendar year 2008 are partial to July 2008 only. Source: Thomson Reuters.

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Endnotes

[i] Some of the confusion was undoubtedly created by much of the early literature on direct foreign investment which took as its model highly developed western economies like the U.S. In such modelling, earlier developmental stages were ignored as were earlier historical periods. The Japanese propensity to seek comfort in its own uniqueness also tended to mislead many researchers. A constant background hum proclaiming uniqueness is enough to bias anyone's judgement. This created a tendency to generalise into universals rather historically specific investment strategies.

[ii] In the eighties, there were related uniqueness arguments among Japanese opponents in the U.S. (the Japan bashers) as well as in Japan itself. The American contingent might have caricatured the idea of unique practises as a polite subterfuge that cloaked what was in their view manipulative cheating. That the new found position enjoyed by Japanese firms could not be legitimate was true by definition. The Japanese unaided by such wiles could in no sense out-compete Americans. The mirror image of uniqueness in Japan (associated with *Nihonjinron* studies) saw this triumph as demonstrating that the Japanese could do what others were incapable of achieving. Such a stance has roots in the sort of universalised samurai ethic popularised in the thirties and forties. For a good introduction to *Nihonjinron* see Befu (2001).

[iii] In what follows there may be at time some difficulties with the FDI data presented. It is a truth universally acknowledged that different agencies use different measurements for what is ostensibly the same output. In Japan, the Ministry of Finance provides FDI data based on prior notifications by the relevant Japanese firms. There also exists another series based on balance of payments statistics. The later has more appeal since it represents actual movements of capital overseas. However the series published by the Ministry of Finance has the advantage of being disaggregated by country of destination and industrial sector. The two series track closely. Bayoumi and Lipworth (1997: 29) estimate that their contemporaneous correlation coefficient is 0.92. Which series is chosen for relative movements over time is not that significant. However, absolute numbers will vary noticeably. See the Appendix on Data provided by Bayoumi and Lipworth (1997: 29).

[iv] It is also incorrect to assume that firms within the same industry will make similar FDI decisions. Each firm represents a set of different capabilities, the result of unique histories, and is guided by distinct management teams. Therefore each firm will see distinct opportunities in the same set of circumstances as well as separate ways of exploiting them. Of Japanese car makers, Honda was the first to move manufacturing operations to the U.S. Honda being the newest of Japanese car firms found opportunities within the domestic market to be limited. Given the 70s, with the U.S. market unexpectedly opening to smaller, fuel efficient cars, Honda took the riskier path of U.S. production instead of simply exporting as its competitors were satisfied to do until faced with government brokered restrictions. In contrast, Toyota took the least risk path, attempting a joint venture with General Motors in California (NUMMI) to gain first hand knowledge of the U.S. market before committing to a more risk prone 'go it alone' option.

[v] Given that the bulk of economists tend to be U.S. centric in their research, U.S. or Anglo-American companies are often implicitly assumed to be something of a benchmark. This can be deceptive given that Japanese firms and the Japanese economy tend to resemble more closely those of Continental Europe with the U.S. standing as an outlier. Nonetheless, in the case of FDI, Japanese multinationals (firms that decide to invest overseas) will be seen as becoming less distinguishable from their US counterparts over time. We need to remember here that multinationals of all types and countries inevitably evolve, aligning with their environment.

[vi] Those interested in this Japanese strategy of appearing to acquiesce would benefit by looking at Dower (1999).

[vii] Early work on the underlying promise of a middle class Japanese society is best typified by Murakami (1982).

[viii] The U.S. embargo of oil and iron ore was a key rationale for the Japanese attack on Pearl Harbor. American actions were portrayed as leaving the Japanese with no other option if they were to survive and not to capitulate to self-dealing U.S. demands.

[ix] James Fallows in what might be described as a classic period piece of Japan bashing, tried to depict the Japanese drive to secure basic commodities as unusual if not unique.

> Last year Japan agreed to reduce its barriers against beef imports, in stages over the next few years. One immediate effect was to increase the sales not of U.S. beef in Japan but of U.S. beef *ranches.* … "The whole point in opening up the Japanese market was for American producers to be able to sell here," Bill Cody, of Oregon's Japan Representative Office, told Fred Hiatt, of *The Washington Post.* "So what is the mentality that refuses to buy our products? What is the necessity to come and buy our producers?" (Fallows 1989: 8).

However, western colonial empires were premised on this basis. One possible underlying reason for George Bush's 2003 Iraqi invasion is thought to have been the likelihood that the Saddam Hussein regime was about to strike oil development deals with French, Russian and even Chinese multinationals instead of Anglo-American ones. Moreover, the rationale behind China's persistent support of such questionable regimes as those in the Sudan or Myanmar reflects an almost unquenchable desire to secure key resources.

[x] The now rightly admired Japanese car industry was in 1964 largely incapable of producing a car that would be competitive in the U.S. market. It is sometimes claimed that Nissan marketed its first exports under the Datsun logo so as to not damage its brand name. These early cars proved incapable of the demands of freeway driving in California. As expected, FDI by the Japanese car industry at this time would have been minimal since relatively few units were even exported to the States.

[xi] Controls over Foreign Direct Investment were implemented with the Foreign Exchange and Foreign Trade Management Law (promulgated December 1949) and the Investment Law (May 1950), allowing MITI to veto all FDI proposals, particularly in the case of outward flows to prevent 'reverse exports' (Cowling and Tomlinson, 2001: 3). In June 1960 he Cabinet announced easing of regulations including "gradual easement" of capital account transactions, mindful of the possible negative effects on the domestic economy. Easement was further foreshadowed by Japan's move to IMF Article 8 status in April 1964.

Liberalisation of outward FDI flows lagged easing of restrictions on inward flows, the latter being encouraged and the former discouraged especially in times of Balance of Payments constraint. The volatility of short term capital flows in particular meant that partial liberalisation was often followed by subsequent re-regulation, depending on the conflicting needs such as of preventing too rapid yen appreciation or of controlling payments deficits.

The liberalisation of outward FDI flows commenced in October 1969, with a series of five foreign capital liberalisation packages. The last occurred in June 1972, with broad "in principle" (Aramaki, 2006: 188) liberalisation of FDI, though subsequently there was a general reversal of policy back to facilitating inflows and restricting outflows given the Balance of Payments problems surrounding the first Oil Shock.

The Foreign Exchange and Foreign Trade Management Law was revised, with promulgation in December 1979 and implementation in December 1980. Under these regulatory changes there was a shift to a general and permanent liberalisation of the capital account. Remaining impediments included prior notification requirements for transactions such as external borrowing and portfolio securities investment flows, with Ministry approval required for transactions likely to disturb financial markets or exchange rates (Aramaki, 2006, 189). Sources cite these regulatory changes of 1979-1980 as eliminating "most controls on outward FDI" (Bailey, 2003: 10).

[xii] The idea that corporate leaders simply took their marching orders from MITI bureaucrats was no more than a gross exaggeration. In some industries, like steel, firms saw a certain mutual advantage to adopting a co-operative approach with government officials mediating conflicts and suggesting probable paths and strategies. But even in the steel industry, often seen as the prime example of this approach, disputes would rage amongst firms and with the relevant bureaucrats.

> The *Jishu Chosie* [self-regulation] system institutionalised MITI's earlier capacity co-ordination. With MITI's help, the leading steel company managers assumed the task of co-ordinating capacity increases to protect firms from overcapacity, low operating rates, and rising unit costs. …Of course, while the firms agreed that a common solution was desirable, negotiating an agreement was far from orderly or harmonious. *Jishu Chosei* meetings were intensely heated, described by some participants as 'boxing matches' among the companies (O'Brien 1992:146-147).

[xiii] To provide some perspective on the limited size of Japanese FDI in 1972, the accumulated stock of such investment was only 5 percent of the U.S. total. However the Japanese economy of that time was one-third the size of its American counterpart. Overseas investment was still only a minor economic appendage for the Japanese of that era.

[xiv] To a degree, this does contrast with the Anglo-American approach. (Note that there is no compelling reason to see the U.S. as any sort of desired or even dominant standard. Continental European countries often deviate in their own various ways.) However in the case of textiles, it is useful to remember that for many years the domestic U.S. sector was heavily protected. There was also initially no need for investment overseas as the U.S. South served the same purpose, providing lower wage, non-union labor in contrast to the original New England area of textile mills. However, the key difference is that the disruption caused by abandoned mills and lost jobs was not at the time greatly alleviated.

[xv] Paul Sheard (1989) develops the numerous ways in which trading companies were able to shift risk away from manufacturers, thus allowing them to invest and expand more rapidly.

[xvi] It is important to emphasise that shifts out of declining industries were not conducted precipitously. Off-shoring of production which allowed foreign subsidiaries to send back components and other inputs to their home base was clearly discouraged.

> Initially, the Ministry of International Trade and Industry discouraged such moves for fear of oppressing small-and-medium-size enterprises in Japan. In fact, the MITI had once insisted on a written pledge that none of the output from the overseas facilities would be shipped to Japan (Yoshino 1974: 371).

[xvii] Again there is an active coordinating role played by Japanese bureaucrats. Thus not only are firms in this era reacting to the changing domestic environment but to the government's posture on the perceived environment as well. The result shifted the processing of raw materials toward sites where wages were more competitive and/or raw inputs more secure.

> In the face of the uncertain supplies of overseas resource, the irremovable scarcities of labour and industrial sites at home, and the ever-deteriorating environmental conditions, the Japanese government adopted an epoch-making policy to restructure Japan's industry, a proposal made by the Industrial Structure Council, a consultative organ for Japan's Ministry of International Trade and Industry. The policy emphasized a shift from 'pollution-prone' and 'resource-consuming' heavy and chemical industries towards 'clean' and 'knowledge-intensive' industries, and assigned overseas investment, a new role to serve as a catalyst to houseclean the economy (Ozawa 1979: 88).

[xviii] Not surprisingly, these were 'greenfield' investments, since the opportunity to buy out an existing manufacturer wasn't a feasible possibility. As noted, the one exception was the intial joint venture between Toyota and General Motors, but this reflected basically the cautious nature of Toyota's decision making process. Subsequent investments were all 'greenfield' in nature.

[xix] See *Automotive News* – Annual Report 1987 for details.

[xx] See *Economist*, February 6, 1988: 69 for additional details.

[xxi] Nissan came to Northeast England as a result of a deal between the British Government and Nissan Motors in 1984. Seeking to alleviate unemployment and economic downturn in the region, the land was provided at subsidised rates. Production began in 1986. Between 1999 and 2004, Nissan Motor Manufacturing U.K. became the largest British car exporter with one in five exported cars in 2004 having Nissan as its origin. For a quick sketch of Nissan Motor Manufacturing U.K. see Wikipedia which can be easily checked against other sites for reliability and accuracy.

[xxii] The rapid rise of Japanese FDI reflects the way in which the 'miracle economy' of the sixties was changing the Japanese domestic economy. Buoyant growth led to an increased ability and a corresponding utility of investing overseas.

> The growth of Japan's direct foreign investment has become significantly large ever since the mid 1960s, particularly since 1968. (The value of overseas investments approved by the government in fiscal 1968 was $557 million, which added as much as 38.4 per cent to the previous level of outstanding investment, $1,451 million, made during the 17-year period of 1951-67. Then, from 1968 up to the end of fiscal 1975, overseas investment increased at the average annual rate of 35.4 per cent, reaching a cumulative value of $15, 943 million as of 31 March 1976, the end of Japan's fiscal year.) The outward expansion of Japanese industry is, therefore, a sudden and relatively recent phenomenon - instead of an evolutionary one like that of its US counterpart – and engulfs practically all industrial sectors, including the iron and steel industry in which Western multinationals rarely make overseas investments (Ozawa 1979:73-74).
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> …the Japanese presence in world outflows has indisputably risen, growing from 6 percent in the 1970s to 15 percent in the 1980s and to about 30 percent in 1988 … (Froot 1991:6).

[xxiii] The reference here is to work done by Kojima in 1973.

[xxiv] This rather bizarre episode evolved from a plan cooked up by Japanese Trade Minister Hajima Tamura and Australian Industry Minister John Button. The vision was of a 'greenfield' development incorporating future oriented

high technology and leisure activities. Controversial at the time, the project stirred up visions of a successful Japanese invasion and takeover. With Australian Federal funding withdrawn in 1996, and the Japanese for a number of years more occupied with other urgent matters, the ill fated project was allowed to die a natural death in 1998. See Australian newspapers of the late eighties and early nineties for the popular reaction to this plan.

[xxv] Foreign firms would continue to buy U.S. assets long after the boom crazed Japanese had folded up their tents. More recently, there hasn't been quite the public uproar over these purchases as there was some twenty years ago. Although in the post Olympic period, China can be seen to occupy a similar position that Japan did twenty years earlier. According to a July 2008 CNN poll, 70 percent of Americans fear China's economic might. (China's rise however includes a military aspect that Japan's lacked.)

> Investors from Dubai are behind the June purchase of the General Motors Building in New York City for $2.8 billion. The Abu Dhabi Investment council's sovereign wealth fund bought a 90% stake in the landmark Chrysler Building. General Electric's plastics division is gone, and its famed appliance unit could soon be in the hands of China's Haier or Korea's LG. Chrysler is hoping to hook up with India's Tata Motors or Italy's Fiat. Switzerland's Roche Holding is offering about $44 billion to acquire the 44% of the biotechnology outfit Genentech that it doesn't own. …Unlike the 1980s panic about the Japanese buying up American landmarks like Rockefeller Center, the response of the financial establishment has been to welcome the latest rush of foreign investment (Israely and Boston: 2008: 49-50).

[xxvi] This would have been a keen factor in promoting investment in developed economies whether it was the purchase of established firms or scooping up other assets. The exchange rate effect is rather simple. Assume a purchasing firm would be required to put up 10 percent of the purchase price in order to arrange financing for the rest. The same number of yen that had doubled in value against the dollar would buy, as a down payment, the purchase of a much larger asset or more assets than had previously been possible.

[xxvii] This involved borrowing from the Bank of Japan according to a set formula. Though ostensibly optional, banks felt obliged to make full use of their assigned quota. For an interesting analysis of monetary policy and aims in this period see Werner (2003, 2004).

[xxviii] The enormous boom helped create a nation with 2,345 golf courses or one course for every 59 square miles.

[xxix] A widespread and subtle panic reflected a growing feeling that policymakers should be deeply concerned by this development.

> The second point I want to discuss is the obsession of the moment in financial services – namely, the success of the Japanese banks. … what concerns policymakers here, however is the tremendous increase in Japanese bank penetration into the U.S. banking market both in deposits and lending (to 10 percent of all U.S. commercial and industrial loans) (Litan 1990: 342).

[xxx] Though the economy grew more rapidly than comparable developed counterparts in the late eighties the amount of FDI grew even more rapidly with overseas investment not only complementing domestic activity but if anything magnifying the frenzy.

> In the first half of the 1980s, overseas investment increased briskly, in part to avoid automotive trade frictions with North America and Europe, to reach 412.2 billion by 1985 (around 1 percent of GDP). Even more rapid growth was experienced in the second half of the decade, likely reflecting booming economies at home and abroad and yen appreciation in the latter part of the decade; during the period 1986-89, nominal FDI outflows in dollars exceeded the cumulative overseas investment from all previous post-war years combined. By the late 1980s, Japan's FDI outflow had become the largest in the world, and a peak of $67.5 billion was reached in 1989 (around 2.5 percent of GDP) (Bayoumi and Lipworth 1997:5-7).

This can best be seen in its cumulative effect when in a mere decade Japan had gone from playing a rather insignificant role in this area to being a force to be reckoned with and in the late eighties at least, feared.

> … between 1982 and 1993, outbound Japanese FDI rose from 2.5 percent to 3 percent of domestic investment, translating into a significant net movement in productive capacity abroad. By 1993, the stock of outward Japanese FDI stood at $422.5 billion (Bayoumi and Lipworth 1997:5).

[xxxi] The original motivation behind FDI provided the means for firms to insure the reliability of raw materials and for those firms operating in declining industries to shift to more competitive overseas locations. With explicit trade barriers rising, protecting export markets also became a distinct and even leading component of such investment. During an era of seemingly unlimited funds, speculation would overwhelm both domestic and foreign investment activity. Fields such as real estate, insurance and banking necessarily boomed.

> During the 1980s, the tertiary sectors, which during the 1970s had accounted for less than half of the total FDI outflow, gained a combined share of more than 70 percent. At the same time, the share received by the manufacturing sector declined to below one-fourth of total FDI from around one-third, and the share to primary

products (mostly accounted for by mining), fell from around 10 percent of the total to about 2 percent (Bayoumi and Lipworth 1997: 7 ftn.8).

[xxxii] The low-risk, middle class society would be another casualty of the 'bubble economy' as the Japanese labour force shifted to include many more part-time and temporary workers. This objective is today largely seen as dead, with political concern focused on the growing income disparity within Japanese society. See Yamada (2006) for a summary of the problem as well as Honda (2005) for some implications of the rise of young temporary workers.

> The average number of nonpermanent workers rose to 17.3 million by March 2007, government data show. That was 19 percent higher than five years earlier and nore than 50 percent higher than a decade ago. … For decades, a majority of Japanese considered themselves middle class. As employment conditions change, economic inequalities are widening, although the gap between rich and poor is still much narrower than in the United States (Kubota 2008:1).

[xxxiii] The diversity of approaches which grew during the eighties became particularly pronounced during this post-bubble period.

> Canon had among the highest R&D rates of all firms, and was the lowest of all major consumer electronic goods firms in terms of relative number of subsidiaries in LDCs versus DCs. In contrast, Hitachi had half of its subsidiaries in LDCs, rather than DCs (Makino, Beamish and Zhao 2004: 383-384).

[xxxiv] The change is striking. As of 1992, with the collapse of asset inflation, cross share holdings by Japanese corporations accounted for 42 percent of stock while foreign holdings consisted of only 6 percent of the total outstanding shares. Twelve years later in 2004 as the Japanese economy was crawling out of its decade of slow growth, cross share holdings were down to only 24 percent, while foreign owned shares now amounted to 22 percent. As Japanese corporations disentangled from the post war *keiretsu* style web, foreign investors were largely scooping up the shares Japanese firms were shedding.

[xxxv] The long history of over investment and falling returns by Japanese companies is well documented but there are now some grounds to think that this trend is turning around. When it does, return on Japanese FDI should accordingly rise as well.

> Looking at foreign direct investment, for example, US data show American companies' returns were the same in Japan as in the rest of the world. Using Japanese FDI data, Japanese returns abroad are lower than foreign returns in Japan. Looking at Japanese financial data from the MOF for large manufacturing companies, their returns were quite similar to the returns on Japan's foreign investments. … The question that I had was why Japanese companies continued to invest at such a prodigious rate when returns kept faling lower and lower. The answer I think lies in corporate governance and bank-centered finance, where profits were not the objective of businesses or their lenders. That is all now changing and we should expect returns on investment to start rising. … I have a chapter in my book *The Arc of Japan's Economic Development*, (Routledge, at better book stores everywhere) devoted to this issue (Alexander 2008:1).

[xxxvi] Cashed up Japanese financial institutions are finding opportunities by grabbing bargain assets. In the aftermath of Lehman Brothers collapse, Nomura snatched the failed bank's Australian holdings. At the same time Mitsubishi UFJ agreed to take a 20 percent share in Morgan Stanley for some $US8.5 million. Japan's number two bank, Sumitomo Mitsui was rumoured to be interested in investing several hundred billion yen in Goldman Sachs.