# INTERNATIONAL TRADE DEVELOPMENTS

## Analysis of Japan's Recent Foreign Investment Trends

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*There are few formal restrictions on foreign direct investment (FDI) in Japan and in recent years the government has taken steps to address remaining investment-related impediments. Nonetheless, the level of foreign direct investment in Japan remains low and is less than that for Japanese FDI abroad. Japan experienced a surge in FDI in recent years due to structural changes in the economy, with major investments in finance/insurance, telecommunications, and petroleum. This article provides background information on Japan's investment climate followed by an analysis of Japanese inward and outward FDI flows during Japanese Fiscal Years 1998-2000.*

As the world's second largest economy, Japan is a huge potential market for foreign direct investment (FDI). Flows of inward FDI have increased during the past few years; however, this surge has been from a very small base. In 1999, for Japan, with an economy half the size of the United States, investment inflows totaled $21 billion, or only 0.5 percent of its GDP, while for the United States, inflows of FDI totaled $283 billion, or approximately 3.0 percent of GDP.[2] This article analyzes Japan's investment flows during Japanese Fiscal Years (JFY)[3] 1998-2000.

## Background

There are few formal restrictions on FDI in Japan and the government does not impose import-balancing requirements or other trade-related FDI measures. Japan's foreign-exchange laws require only ex-post notification of planned investment in most cases; however, a number of sectors (e.g., agriculture, mining, forestry and fishing) still require prior notification to government ministries.[4] Some of the major impediments, including regulations and nontariff barriers, that foreign businesses still face include: a high overall cost structure for doing business (registration, licenses, land-prices and rents); corporate practices that inhibit foreign acquisition of Japanese firms;[5] high taxation; exclusive buyer/supplier relationships; close ties between government and industry (e.g. weak antitrust enforcement by the Japan Fair Trade Commission); and laws and regulations that directly or indirectly restrict the establishment of business facilities (e.g. the Large-Scale Retail Store Location Law) and hinder market access for foreign products and services.[6] In addition, the lack of financial transparency and disclosure and

[1] The views and conclusions expressed in this article are those of the author. They are not the views of the U.S. International Trade Commission as a whole or of any individual Commissioner.

[2] Speech by Under Secretary of Treasury Alan Larson, "A Private Sector Formula to Revitalize Japan's Economy," Tokyo, Apr. 25, 2001.

[3] Japan's Fiscal Year is from April 1 to March 31.

[4] United States Trade Representative, *2001 National Trade Estimate Report on Foreign Trade Barriers*, March 2001, p. 250.

[5] One such practice is senior management emphasis on firm loyalty over shareholder return which leads to premature rejection of M&A offers.

[6] U.S. Department of State telegram, "2001 Investment Climate Statement for Japan," prepared by U.S. Embassy, Tokyo, message reference No. 004866, July 16, 2001. Japan also continues to restrict the development of industrial and commercial facilities in some areas in an attempt to prevent excessive concentration of development in the environs of Tokyo, Osaka and Nagoya.

differing management techniques are among the obstacles to completing mergers and acquisitions in Japan.[7]

However, some of these impediments are weakening. For example, vertical keiretsu relationships–which inhibit foreign acquisition of Japanese firms–are gradually loosening due to weakened mutual stockholding,[8] the establishment of open supplier systems, and rising unemployment.[9] In addition, improved accounting standards and changed bankruptcy proceedings that facilitate corporate restructuring have led to a recent surge in FDI.[10]

Those sectors which have experienced the most foreign investment are finance/insurance, telecommunications, and broadcasting, because the government has taken steps towards liberalization in these areas. However, in sectors such as medical services, utilities, and education, there has been little foreign investment. Also, foreign investment has been low in the fields of mail service, temporary staffing services, agriculture-related services, ship repair, and electricity/gas.[11]

In recent years, the government of Japan has taken steps to address several investment-related impediments. For example, in June 1995, the United States and Japan concluded an arrangement containing FDI promotion measures, and in April 1996 the government of Japan issued a report endorsing mergers and acquisitions as part of the government's investment policy. The Economic Structure Reform Plan, which was initiated in May 1997, gives support to improved local investment incentives and local government promotion programs.[12] More recently the government has developed an initiative to revise the commercial code.[13] These revisions, along with reform of bankruptcy procedures, are expected to provide merger and acquisition opportunities. At the regional level, prefectural and city governments are intensifying their efforts to attract foreign investors.[14]

# Japan's Recent Inward FDI

Table 1 shows an increase in total FDI between JFY 1998 ($11.0 billion) and JFY 2000 ($28.7 billion). The surge in FDI was linked to foreign companies' acquisitions of Japanese companies, especially in the finance, machinery, and telecommunications industries, and greenfield investments in the retail, service and software industries.[15] Structural changes in the Japanese economy have stimulated FDI to Japan, including legislative and regulatory changes in recent years that improved corporate accounting standards, changed bankruptcy proceedings to facilitate corporate restructuring, made it easier to undertake mergers and acquisitions (M&A), facilitated spin-offs, and introduced flexibility into labor regulations and labor dispute settlement.[16] Specifically, consolidated accounting was introduced in JFY 1999 and new disclosure rules and market-value accounting of financial instruments were introduced in JFY 2000. The new Civil Reconstruction Law has given companies more creative options in restructuring. A series of legal changes have helped to facilitate corporate restructuring and M&A. Changes to the Commercial Code in 1999 allow exchanges of shares between companies for M&A and the provision of stock option schemes for employees of companies listed in Japan. The increase in M&A has also been due to changes in the attitude of Japanese firms towards such business deals, deregulation and government measures to facilitate M&A.[17] Foreign buyouts soared in the late 1990's from 40 in 1996 to 100 in 1999, to an annualized rate of 150 during Jan.-Sept. of 2000.[18] Measures relating to corporate governance, regulatory transparency, and labor laws have contributed to the increase in FDI. For example, in the area of corporate governance the introduction of the option for companies to adopt a U.S. style corporate governance system

[7] United States Trade Representative, *2001 National Trade Estimate Report on Foreign Trade Barriers*, March 2001, p. 251.

[8] The keiretsu are a key feature of Japan's economy, directly or indirectly affecting economic transactions in both upstream and downstream channels, within and across industries. By some estimates approximately 50 percent of Japan's capital is controlled by all of the keiretsu. The keiretsu are composed of firms from a wide range of commercial and industrial fields, including trading companies, banks, suppliers, distributors and retailers. Diane Manifold, "Japanese Corporate Activities in Asia: Implications for U.S.-Japan Relations," U.S. International Trade Commission, Office of Economics Working Paper, February 1997.

[9] Kyoji Fukao, "The Status of Direct Investment in Japan," *Japan Economic Currents*, Keizai Koho Center, May 2001.

[10] U.S. Embassy, Tokyo, "Investment-in-Japan Symposium 2001," found at *http://www.usembassy.state.gov/tokyo/wwwhec0148.html*, retrieved on Aug. 27, 2001.

[11] Kyoji Fukao, "The Status of Direct Investment in Japan," *Japan Economic Currents*, Keizai Koho Center, May 2001.

[12] U.S. Department of Commerce, *Country Commercial Guides FY 1999: Japan*.

[13] The commercial code governs various corporate transactions including corporate boards, restrictions on companies' capital transactions, accounting standards, and other corporate transactions. Some recent recommendations for revising the commercial code include reducing restrictions

[13]—*Continued*
on a variety of corporate financing tolls, including the issuance of new shares, stock options, special voting rights for classes of shares, and non-voting shares.

[14] U.S. Department of State telegram, "2001 Investment Climate Statement for Japan," prepared by U.S. Embassy, Tokyo, message reference No. 004866, July 16, 2001.

[15] Ryoko Takahashi and Tsuyoshi Oyama, "Insights into a Recent Increase in Foreign Direct Investment in Japan," Bank of Japan, Working Paper 00-14, October 2000.

[16] U.S. Embassy, Tokyo, "Investment-in-Japan Symposium 2001," found at *http://www.usembassy.state.gov/tokyo/wwwhec0148.html*, retrieved on Aug. 27, 2001.

[17] United Nations, *World Investment Report 1999*, p. 43-44.

[18] Katz, Richard, "Friendlier Territory," *The Oriental Economist*, May 2001, p. 8.

that includes audit, remuneration, and nomination committees of the board of directors instead of statutory auditors has contributed to FDI. In addition, the decline in the price of land and structural changes in the real estate market have led to improvements in the investment environment in Japan.[19]

Examining regional trends, there was a decline in FDI from the United States during JFY 1998-99 followed by a major increase during JFY 1999-2000. The decline in FDI outflows between JFY 1998 and JFY 1999 was due mainly to lower equity investment and reinvested earnings. The recession in Japan had a direct impact on the flow of equity investment. The increase in FDI during JFY 1999-2000 ($2.2 billion to $9.3 billion) was primarily due to a surge in investment in the financial sector owing to liberalization and growth in investment in technology-related firms.[20]

[19] U.S. Embassy, Tokyo, "Investment-in-Japan Symposium 2001," found at *http://www.usembassy.state.gov/tokyo/wwwhec0148.html*, retrieved on Aug. 27, 2001.

[20] Japan External Trade Organization, "White Paper on Foreign Direct Investment 2001," found at http://www.jetro.go.jp/it/e/pub/whitepaper/invest2001/part2_1.html, retrieved on July 30, 2001.

In JFY 1999, there was a surge in investment from the EU, particularly from French investments that rose-from $131 million in JFY 1998 to $6.7 billion in JFY 1999. French companies made large acquisitions in the automobile, auto parts, and finance/insurance industries. Investment from the EU grew to a record $12.7 billion in JFY 1999. In JFY 2000, however, European FDI in Japan declined to $6.3 billion.

Economic recovery in Asia led to strong inflows of FDI from the ASEAN economies in JFY 1999 to Japan. Singapore exhibited particularly strong flows to Japan, with government affiliated corporations such as Singapore Telecom leading the way with large-scale foreign investments. The strong inflows in JFY 1999 were followed by a decline in investment from Asia from $986 million to $383 million during JFY 2000.[21]

Japanese FDI inflows from Latin America increased sharply from $268 million in JFY 1998 to $2.6 billion in JFY 1999. This trend was mainly because of investments in commerce, trade and finance.[22] Overall investment from Latin America declined in JFY 2000.

[21] Ibid.

[22] Ibid.

**Table 1**
**Foreign Direct Investment in Japan, by country**

*(Million dollars; annual flow; reporting basis)*

| Region/Country | JFY 1998 | JFY 1999 | JFY 2000 | JFY 1989-2000 |
|---|---|---|---|---|
| North America | 6,323 | 3,742 | 9,887 | 36,858 |
| United States | 6,310 | 2,230 | 9,268 | 32,851 |
| Canada | 13 | 1,512 | 618 | 4,006 |
| Europe | 2,361 | 12,674 | 6,320 | 36,643 |
| Netherlands | 1,000 | 4,224 | 475 | 11,273 |
| United Kingdom | 289 | 805 | 513 | 3,767 |
| Germany | 262 | 419 | 2,566 | 5,893 |
| Switzerland | 225 | 344 | 1,993 | 4,541 |
| France | 131 | 6,685 | 276 | 8,095 |
| Asia | 165 | 986 | 383 | 5,089 |
| Singapore | 57 | 661 | 88 | 2,466 |
| Taiwan | 44 | 118 | 222 | 787 |
| Hong Kong | 37 | 108 | 17 | 1,122 |
| Korea | 16 | 95 | 49 | 537 |
| Latin America | 268 | 2,595 | 1,541 | 7,405 |
| Cayman Isles | 178 | 2,257 | 1,209 | 4,344 |
| British Virgin Islands | 10 | 209 | 63 | 1,537 |
| Bermuda | 53 | 56 | 235 | 937 |
| Japan (reinvestment) | 1,351 | 1,448 | 10,471 | 18,106 |
| Total | 10,468 | 21,445 | 28,602 | 104,401 |

Source: Ministry of Finance, Japan.
Note—All investor countries are not listed.

Foreign direct investment, by industry, in Japan, is shown in table 2. There was a sharp increase in investment in the nonmanufacturing sector from $12.7 billion in JFY 1999 to $21.4 billion in JFY 2000. This was due to a drop in stock/land prices in Japan and a reduction in the value of the yen. As such, Japan seemingly offered bargains for foreign investors.[23] Finance and insurance received the most investment during JFY 2000 ($9.4 billion), followed by telecommunications ($6.9 billion), due primarily to major liberalization in these areas.[24] Petroleum also showed a large increase from JFY 1999 ($121 million) to JFY 2000 ($2.4 billion).

[23] Kyoji Fukao, "The Status of Direct Investment in Japan," *Japan Economic Currents*, Keizai Koho Center, May 2001.

[24] With regard to telecommunications, in February 1998, all restrictions on foreign ownership were removed with respect to Type I telecommunications carriers. A June 2001 amendment to the Nippon Telegraph and Telephone (NTT) law raised the ceiling on foreign investment in NTT from 20 percent to one-third. The cable television broadcast law was revised to remove foreign ownership restrictions on cable television companies in June 1999. U.S. Department of State telegram, "2001 Investment Climate Statement for Japan," prepared by U.S. Embassy, Tokyo, message reference No. 004866, July 16, 2001.

## U.S. Direct Investment in Japan

Finance and insurance FDI rose sharply during JFY 1999-2000 to account for 64 percent of all U.S. direct investment in Japan (see table 3). The financial services sector has undergone comprehensive liberalization since 1995, culminating in the "Big Bang," a major liberalization program. During JFY 1998-2000, ongoing economic restructuring and changes in the financial markets contributed to growth in foreign direct investment in Japan.[25] Services ($980 million) and machinery ($828 million) were the next highest categories of U.S. investments, by value. The increase in investment in transport can be attributed to some large-scale mergers and acquisitions–Ford-Mazda in 1998, Renault-Nissan in 1999 and Daimler Chrysler-Mitsubishi in 2000.[26] In terms of the number of investment projects, services was the largest sector for investment (343 cases), followed by commerce/trade (148 cases), and finance/insurance (98 cases).

[25] U.S. Department of State telegram, "2001 Investment Climate Statement for Japan," prepared by U.S. Embassy, Tokyo, message reference No. 004866, July 16, 2001.

[26] United Nations, *World Investment Report 2000*, p. 38.

**Table 2**
**Foreign Direct Investment in Japan, by industry**

*(Million dollars; annual flow; reporting basis)*

| Sector | JFY 1998 | JFY 1999 | JFY 2000 | JFY 1989-2000 |
|---|---|---|---|---|
| Manufacturing | 2,442 | 8,783 | 7,254 | 37,082 |
| Machinerya | 1,663 | 7,757 | 3,228 | 21,355 |
| Chemicalsa | 310 | 541 | 1,640 | 8,398 |
| Metals | 16 | 160 | 17 | 1,430 |
| Rubber/Leather | 37 | 63 | 10 | 690 |
| Petroleum | 66 | 121 | 2,352 | 3,181 |
| Textiles | 28 | 2 | 22 | 153 |
| Foods | 202 | 13 | 0 | 665 |
| Glass/Ceramics | - | 51 | 0 | 102 |
| Other | 120 | 76 | 11 | 1,108 |
| Non-manufacturing | 8,028 | 12,727 | 21,417 | 67,368 |
| Finance/Insurance | 3,569 | 4,586 | 9,443 | 23,285 |
| Trade | 1,374 | 3,124 | 2,536 | 16,429 |
| Services | 2,485 | 1,845 | 2,170 | 13,148 |
| Real Estate | 325 | 151 | 317 | 2,910 |
| Telecom | 131 | 2,959 | 6,888 | 10,464 |
| Transport | 48 | 20 | 52 | 337 |
| Construction | 11 | 20 | 0 | 91 |
| Other | 87 | 22 | 11 | 704 |
| Total | 10,470 | 21,510 | 28,671 | 104,450 |

Source: Ministry of Finance, Japan.

**Table 3**
**U.S. Direct Investment in Japan, by industry**

*(Million dollars; annual flow; reporting basis)*

| Sector | JFY 1999 Value | JFY 1999 Number of cases | JFY 2000 Value | JFY 2000 Number of cases |
|---|---|---|---|---|
| Manufacturing | 1,711 | 64 | 1,909 | 37 |
| Machinery | 1,557 | 35 | 828 | 24 |
| Chemicals | 26 | 12 | 553 | 7 |
| Metals | 30 | 2 | 27 | 1 |
| Foods | 5 | 2 | n/a | n/a |
| Non-manufacturing | 2,030 | 570 | 7,977 | 637 |
| Finance/Insurance | 543 | 68 | 6,360 | 98 |
| Commerce/Trade | 149 | 141 | 228 | 148 |
| Services | 961 | 280 | 980 | 343 |
| Real Estate | 48 | 47 | 28 | 24 |
| Telecom | 312 | 27 | 403 | 20 |
| Construction | 11 | 4 | n/a | n/a |
| Total | 3,741 | 634 | 9,887 | 674 |

Source: Ministry of Finance, Japan.

# Japan's Recent Outward FDI

Japan's total outward investment increased during JFY 1998-1999, but then fell during JFY 1999-2000 from $66.7 billion to $49.3 billion (table 4). During JFY 1998-1999, most areas of the world experienced increases in Japanese foreign direct investment due to economic growth, particularly in the United States and Europe.[27] There was strong FDI in the United Kingdom and the Netherlands as a result of M&A in the food sector involving an acquisition by Japan Tobacco of RJR Nabisco's overseas tobacco business in JFY 1999. In addition, large-scale investments were made through holding companies in the Netherlands to acquire stakes in companies in third countries. The reason for this was to take advantage of tax breaks in the Netherlands.[28] Japanese investment in the United States grew as a result of strong investment in the electrical machinery sector and the acquisition of information technology-related firms by companies such as Kyocera.[29]

[27] Japan External Trade Organization, "White Paper on Foreign Direct Investment 2001," found at *http://www.jetro.go.jp/it/e/pub/whitepaper/invest2001/part2_1.html*, retrieved on July 30, 2001.

[28] The attraction of establishing a holding company in the Netherlands, besides excellent infrastructure, included an exemption on dividends earned from capital gains tax and the advance tax ruling (ATR) regime enabling investing companies to sign tax agreements in advance with the tax authorities.

[29] Ibid.

Governments in Asia have relaxed controls on foreign capital in order to rebuild their economies since the 1997 Asian financial crisis. Since 1999, deregulation in Asia has focused on services–including communications, finance, and retailing–which have received the most FDI.[30] FDI trends in East Asia during JFY 1998-2000 were relatively constant following a period of rising manufacturing production abroad by Japanese affiliates. There were many examples of Japanese parent companies providing their foreign subsidiaries with additional capital. One major example was in the Thai auto industry. Due mainly to large-scale M&A, Japan's FDI flows to South Korea increased sharply from $302 million in JFY 1988 to $980 million in JFY 1999. Japanese FDI outflows to ASEAN[31] and China began to recover in JFY 1999 due to economic recovery. Japan's outflows to this area continued to recover during the first six months of JFY 2000. During the latter half of JFY 2000, according to a survey of Japanese firms, confidence by Japanese firms in the business climate in the Asian countries began to decline. This trend was primarily attributed to weakness among information technology firms. The prolonged U.S. slowdown has also hurt Japanese exports that once fueled Japanese economic growth.[32]

Japanese FDI to Latin America declined in JFY 2000. This was primarily because of an economic downturn, particularly in Colombia, Ecuador and Venezuela. The Brazilian economy stabilized and net

[30] Ibid.

[31] The members of ASEAN are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

[32] Kyodo, "JETRO Survey: Japanese Firms Showing Less Confidence in Asia," Aug. 23, 2001.

**Table 4**
**Japanese Direct Investment Overseas, by Country**

*(Million dollars; annual flow; reporting basis)*

| Region/Country | JFY 1998 | JFY 1999 | JFY 2000 | JFY 1989-2000 |
|---|---|---|---|---|
| North America | 10,944 | 24,770 | 12,442 | 271,624 |
| United States | 10,316 | 22,295 | 12,306 | 259,923 |
| Canada | 627 | 2,474 | 137 | 116,991 |
| Europe | 14,011 | 25,804 | 24,747 | 167,401 |
| United Kingdom | 9,781 | 11,718 | 19,408 | 82,529 |
| Netherlands | 2,118 | 10,360 | 2,795 | 38,774 |
| Germany | 552 | 649 | 324 | 10,337 |
| France | 520 | 1,127 | 330 | 11,617 |
| Ireland | 361 | 460 | 49 | 3,610 |
| Spain | 122 | 518 | 33 | 3,676 |
| Sweden | - | - | 847 | 1,016 |
| Asia | 6,528 | 7,162 | 6,014 | 108,602 |
| Thailand | 1,371 | 816 | 944 | 14,262 |
| Indonesia | 1,076 | 918 | 419 | 17,612 |
| China | 1,065 | 751 | 1,008 | 19,072 |
| Singapore | 637 | 962 | 429 | 13,161 |
| Hong Kong | 601 | 971 | 949 | 15,124 |
| Malaysia | 514 | 525 | 235 | 8,646 |
| Philippines | 379 | 617 | 464 | 5,230 |
| South Korea | 302 | 980 | 824 | 5,870 |
| India | 257 | 208 | 170 | 1,870 |
| Taiwan | 224 | 285 | 517 | 5,161 |
| Vietnam | 51 | 99 | 22 | 1,261 |
| Latin America | 6,463 | 7,437 | 5,306 | 62,950 |
| Cayman Isles | 4,495 | 2,242 | 2,774 | 19,763 |
| Panama | 1,040 | 1,413 | 1,318 | 18,232 |
| Brazil | 466 | 654 | 228 | 7,618 |
| British Virgin Islands | 177 | 1,041 | 11 | 4,323 |
| Mexico | 83 | 1,484 | 211 | 3,725 |
| Bermuda | 16 | 145 | 553 | 4,706 |
| Oceania | 2,213 | 894 | 676 | 31,625 |
| Australia | 1,387 | 857 | 521 | 27,106 |
| Africa | 444 | 515 | 54 | 5,939 |
| Liberia | 386 | 217 | 42 | 4,882 |
| South Africa | 52 | 157 | 12 | 681 |
| Middle East | 146 | 113 | 19 | 2,776 |
| Saudi Arabia and Kuwait | 120 | 106 | - | 861 |
| United Arab Emirates | 5 | n/a | - | 632 |
| Israel | 5 | 2 | 8 | 53 |
| Total | 40,751 | 66,694 | 49,257 | 650,920 |

Source: Ministry of Finance, Japan.

inflow of Japanese investment was steady. The Argentine economy experienced negative growth, helping trigger the acquisition of an oil firm that lead net inflows of FDI to soar. Chile and Mexico also experienced an increase in FDI from Japan.[33]

[33] Japan External Trade Organization, "White Paper on Foreign Direct Investment 2001," found at http://www.jetro.go.jp/it/e/pub/whitepaper/invest2001/part2_1.html, retrieved on July 30, 2001.

Japanese outward investment in North America declined by 50 percent during JFY1998-2000. The United States accounted for most of this decline from that went $22.3 billion in JFY 1999 to $12.3 billion in JFY 2000. By top ranking country, the United Kingdom accounted for the largest investment ($19.4 billion) in JFY 2000, followed by the United States ($12.3 billion), the Netherlands ($2.8 billion), and the tax haven of the Cayman Islands ($2.8 billion). There was a decline in investment in Kuwait and Saudi Arabia due to the completion of energy projects in those countries.[34]

The largest sector for Japanese investments overseas was transport, nonmanufacturing ($22.2 billion), followed by commerce/trade ($3.4 billion), manufacturing ($3.1 billion), and services ($1.8 billion) (table 5). Japanese investments in manufacturing experienced a decline of 72 percent in value. This was because the restructuring process begun at home has been extended to foreign affiliates of Japanese multinationals in the manufacturing sector, especially in Southeast Asia.[35] The fluctuations in electrical machinery FDI[36] during JFY 1998-2000 reflected large changes in demand for electric appliances and electronic machinery in China and the ASEAN countries during that period.[37] The sharp increase in transport investment during FY 2000 reflected increased Japanese investments in auto transplants in the United States.

[34] Japan External Trade Organization, "White Paper on Foreign Direct Investment 2001," found at *http://www.jetro.go.jp/it/e/pub/whitepaper/invest2001/part2_6.html,* retrieved on Oct. 1, 2001.

[35] United Nations, *World Investment Report 1999*, p. 43.

[36] The category provided by the Ministry of Finance is "electrical."

[37] World Trade Organization, *Trade Policy Review: Japan*, Jan. 5, 1998.

Japanese investments in nonmanufacturing sectors overseas far outweighed those in manufacturing in JFY 2000, $37.2 billion compared to $11.8 billion. In the nonmanufacturing area, there were increased investments in commerce, services, transport, mining, agriculture and fisheries during JFY 1999. Overseas investments in finance declined from $16.4 billion in JFY 1998 to $8.5 billion in JFY 2000. The restructuring of Japanese firms due to domestic economic difficulties was pronounced in the financial services industries and affected their foreign affiliates. There was a slump in finance/insurance investments during JFY 1999 due to overall declines in investment in the United Kingdom and Latin America. However, during JFY2000, FDI in these sectors remained constant as economic recovery in Europe gathered pace. There was also growth in investment services, transport, and communications. The growth in services was because of expansion by advertising agencies, electric power utilities, and trading companies.[38]

[38] Japan External Trade Organization, "White Paper on Foreign Direct Investment 2001," found at *http://www.jetro.go.jp/it/e/pub/whitepaper/invest2001/part2_1.html,* retrieved on July 30, 2001.

**Table 5**
**Japanese Direct Investment Overseas, by industry**

*(Million dollars; annual flow; reporting basis)*

| Industry | JFY 1998 | JFY 1999 | JFY 2000 | JFY 1989-2000 |
|---|---|---|---|---|
| Manufacturing | 12,253 | 42,310 | 11,845 | 222,218 |
| Electrical | 3,419 | 16,350 | 3,090 | 66,465 |
| Chemicals | 2,247 | 1,694 | 1,942 | 28,155 |
| Transport | 1,607 | 4,781 | 3,182 | 8,945 |
| Food | 1,270 | 14,908 | 261 | 25,424 |
| Metals | 1,223 | 1,458 | 717 | 16,384 |
| Machinery | 795 | 995 | 1,430 | 17,825 |
| Lumber/Pulp | 677 | 116 | 150 | 4,917 |
| Textiles | 341 | 260 | 226 | 7,675 |
| Other | 673 | 1,749 | 849 | 24,442 |
| Non-manufacturing | 28,140 | 24,178 | 37,158 | 421,613 |
| Finance/Insurance | 16,376 | 9,885 | 8,523 | 118,475 |
| Commerce/Trade | 3,777 | 3,877 | 3,391 | 61,552 |
| Real Estate | 2,810 | 2,114 | 370 | 84,744 |
| Services | 2,053 | 4,314 | 1,784 | 83,094 |
| Transport | 1,898 | 2,771 | 22,185 | 50,197 |
| Mining | 874 | 922 | 650 | 15,572 |
| Construction | 294 | 182 | 91 | 4,806 |
| Agriculture/Forestry | 33 | 81 | 27 | 1,610 |
| Fisheries | 20 | 26 | 134 | 1,048 |
| Other | - | - | 341 | - |
| Total | 40,751 | 66,694 | 49,257 | 211,677 |

Source: Ministry of Finance, Japan.

# Conclusions

As noted above, Japan has experienced a surge in inward FDI (from $11.0 billion in JFY 1988 to $28.7 billion in JFY 2000) in recent years, albeit from a small base. The major reason for the increase in FDI was because of structural changes in the economy which have led to an increase in foreign acquisitions and greenfield investments. Some of the reforms have included improved corporate accounting standards and changed bankruptcy proceedings. In addition, there has been a weakening in keiretsu ties due to the economic downturn. Corporate alliances and exclusive buyer-supplier networks that include companies belonging to the same business grouping, block market-access opportunities for foreign firms. As these ties, including cross-shareholding have loosened, there have been greater opportunities for foreign firms to enter the market. There are expected to be additional investment opportunities for U.S. firms, in particular, as the financial, insurance, and information technology sectors undergo further liberalization.

Although inward FDI has been on the rise recently from a small base, foreign investors will continue to face relatively high costs of doing business, the legacy of former investment restrictions and remaining structural impediments to greater investment. Despite liberalization efforts thus far, there remain bureaucratic obstacles and such problems as lack of financial transparency and disclosure in financial transactions, scarcity of personnel experienced in M&A activities, and anti-competitive practices.

In the near term, Japanese outward FDI may be affected by the continued economic downturn in Japan and elsewhere. In Japan, GDP contracted at a 0.8 percent rate in the first quarter of 2001 and is expected to shrink again during the second and third quarters. The International Monetary Fund (IMF) predicts that the Japanese economy will grow 0.2 percent in 2002.[39] A consensus of forecasters in Japan predicts real GDP growth of 0.3 percent in 2001 and 1.3 percent in 2002.[40] Capital flows to Japanese foreign subsidiaries, particularly in East Asia, could subside. However, at the present time, surveys of manufacturers in Japan indicated that most expect to expand their overseas investments in 2002. This is reflective of growing interest in overseas investment in manufacturing, including general machinery, and electronic/electrical equipment sectors.[41]

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[39] IMF, *World Economic Outlook*, October 2001, found at *www.imf.org/external/pubs/ft/weo/2001/02/index.htm*, retrieved on Oct. 1, 2001.

[40] "Blue Chip Economic Indicators," Vol. 26, No. 7, July 10, 2001, p. 12.

[41] Japan External Trade Organization, "White Paper on Foreign Direct Investment 2001," found at *http://www.jetro.go.jp/it/e/pub/whitepaper/invest2001/part1_5.html*, retrieved on July 30, 2001.