Abstract of the Report

Parts I and II of this report are summarized as follows:

Part I provides a bird's eye view of the historical development of foreign direct investment from the time the Foreign Exchange Law and the Foreign Capital Law were enacted (1950), through the OECD affiliation (1964), until the amendment of the Foreign Exchange Law (and repeal of the Foreign Capital Law) (1980).

A chronological analysis is performed in the sequence of "Trends Prior to the OECD Admission (1964) – Period of Industrial Protection," "Trends from the OECD Admission to the Repeal of the Foreign Capital Law (Integration to the Foreign Exchange Law, 1980) – Foreign Capital Inflow during the Regulatory Relaxation Period and its Background –," and "Trends after the Repeal of the Foreign Capital Law (an approximately 10-year period up to 1989) – Foreign Capital Inflow in the Period of Liberalization and its Background."

The history of foreign direct investment is presented, starting with how it began to be substantial around 1970 and grew rapidly with the start of the 1980s. The analysis also shows that foreign direct investment was initially made mostly in the manufacturing sector but later spread to the non-manufacturing sector. It also shows that foreign direct investment was fed mainly by US capital at first but that European and other regional money also started to flow in later. In addition, the analysis compares the government policies and programs, etc. that were adopted at each stage of this historical development.

This analysis and digest presents a clear picture of the details of the government policies and programs, as well as their background and usefulness.

For example, the report reveals that the "capital liberalization" process, which was carried out in five phases between 1967 and 1973, was implemented after the government clearly established a stance of "promoting the liberalization of foreign direct investment" as it recognized events on the international stage, including Japan's transition to the status of an IMF Article VIII nation and its membership in OECD, as well as economic changes such as a surge in Japan's trade surplus and its becoming the second largest economy of the world.

Furthermore, the report shows the fact that the "capital liberalization" was implemented flexibly by applying fine-tuned methods. For instance, all domestic industries were classified into either Class I Liberalization Industries or Class II Liberalization Industries, based on their stages of development and their competitiveness, whereas liberalization of the automobile industry, one of the most important industries of the time, was handled separately from other industries.

The effects of this "capital liberalization" are evident. Foreign direct investment in both the manufacturing and the non-manufacturing sectors grew rapidly. In the

manufacturing sector, a cumulative total foreign direct investment of $168 million was made prior to the "capital liberalization" (five accumulative fiscal years between 1961 and 1965). After the "capital liberalization," the cumulative total foreign direct investment between the 1976 and 1980 fiscal years rose to $1,092 million. In the non-manufacturing sector, cumulative total foreign direct investment was $12 million before the "capital liberalization" (between the 1961 and 1965 fiscal years). After the "capital liberalization", the cumulative total foreign direct investment between the 1976 and 1980 fiscal years rose to $387 million. Among the investor countries, the United States remained the top provider of capital. However, the results of the analysis point at increased diversity. After the "capital liberalization," European capital inflows grew, and some investment began to be made by Asian countries as well.

In Part II, the insights gained from the observation of historical developments relating to foreign direct investment in Japan are summarized together with the insights gained from the analysis of Japan's external foreign direct investment.

The analysis of external foreign direct investment is performed by first summarizing industry-by-industry and regional trends over the period between the 1970s, when a regulatory relaxation took place, and 2003. This is followed by a description of major examples in the manufacturing sector, situations in recipient countries of foreign direct investment, changes in local production by Japanese companies, a shift of focus to China, and other changes relating to international trade and economic structures surrounding Japan.

As for the insights gained from the observation of the historical developments relating to foreign direct investment in Japan, the importance of "sequencing" and flexible response is pointed out. Japan's capital liberalization was carried out in a flexible manner and in phases by first constructing a framework of "inward direct investment liberalization" at the government level, and evaluating economic situations at every step of the way. This paved the way for an increase in foreign direct investment in the 1980s.

Similarly to foreign direct investment, Japan's external direct investment started in the 1970s and grew rapidly at the start of the 1980s. Investment was initially made mostly in the non-manufacturing sector but grew to include the manufacturing sector. The United States was the primary destination of investment at first, but European and other regions began to be included.

The first conclusion that can be drawn from the analysis of external direct investment is the potential for the growth of the industries of countries accepting foreign direct investment.
Recipient countries of foreign direct investment enjoy such benefits as advanced technology and high production efficiency from top-grade foreign corporations, etc., and gain the potential to enable specific domestic industries in their countries to become stronger and their industries to grow.

Secondly, an expansion and sophistication of investment and international trade in the recipient countries of foreign direct investment can be pointed out. A recipient country of foreign direct investment can increase its foreign currency reserves, stabilize its international balance of payments, and reduce the risks associated with inflows and outflows of short-term funds. At the same time, goods manufactured at local plants that are constructed with foreign direct investment money are initially marketed in the local market but soon begin to be exported to foreign countries, thanks to productivity improvement. As a result, imports of materials and parts from the country making the foreign direct investment, as well as exports of parts of finished goods to foreign markets, increase and boost international trade. By accumulating such experiences, countries gradually move from exporting industrial products with low added value to exporting industrial products with high added value. Through this process, the quality of international trade rises.

Thirdly, the effectiveness of policies to attract foreign direct investment can be pointed out.
In the background of a rapid expansion in Japan's external direct investment were various countries' programs to attract investment. These programs to attract foreign direct investment and their PR activities have been found to be quite effective. Additionally, it appears necessary to devise plans that take advantage of individual countries' uniqueness and strengths in the competition for attracting capital. This may include considering the possibility of attracting non-manufacturing companies, as well as manufacturing companies outside of the electric appliance and transport machine industries.

The merits of accepting foreign direct investment are clear. It would therefore be highly meaningful for countries and regions to take positive steps toward capital liberalization in a sequence that they deem to be proper. At the same time, the advanced countries of the world, including those in Europe and America, as well as Japan, which are already in a period of competition for funds that flow in from top-grade foreign corporations, should endeavor to make their countries into attractive markets to foreign corporations.

The insights developed from the observation of Japan's history of foreign direct investment and analysis of its external direct investment may not be viewed to be widely applicable considering the fact that individual countries and regions are in different stages of capital liberalization. Nevertheless, such insights should serve as useful information for the emerging market economies of the APEC countries, which are expected to shoulder responsibilities as core members of the global economy along with Japan.