Part I: History of the Liberalization of Foreign Direct Investment in Japan (from the 1950s to the 1980s)

After adopting the General Framework of Liberalization of International Trade and Foreign Exchange in 1960, Japan's rate of import liberalization (the percentage of liberalized items (import volume restrictions on which were lifted) in the total value of imports) reached 92% in 1963, a level comparable with the European and American countries. Subsequently, Japan became an IMF Article VIII country in 1964, and also joined the OECD about the same time. These events marked Japan's transition to an open economy both in substance as well as name. In the following sections, we will take a bird's eye view of the historical development from the enactment of the Foreign Exchange Law and that of the Foreign Capital Law (1950) to the OECD admission (1964), and further on to the amendment of the Foreign Exchange Law (repeal of the Foreign Capital Law) (1980). Furthermore, insight developed through observation will be examined.

Specifically, detailed analyses will be performed in Chapter 1 "Trends Prior to the OECD Admission (1964) – Period of Industrial Protection," Chapter 2 "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 Chapter 3 "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." This will be followed by supplementary explanations in Chapter 4.

Chapter 1: Trends Prior to the OECD Admission (1964)
– Period of Industrial Protection –

(1) From the Enactment of the Foreign Exchange and Foreign Trade Control Law (the Foreign Exchange Law) and the Law Concerning Foreign Investment (the Foreign Capital Law) (1950) to the Establishment of the General Framework of Liberalization of International Trade and Foreign Exchange (1960)

1) Enactment of the Foreign Exchange Law, and that of the Foreign Capital Law, a special law of the Foreign Exchange Law (1950), and their revisions in phases.

Foreign exchange and capital transactions were centrally controlled and regulated under the Foreign Exchange Law, which had been promulgated in December 1949, and the 'Foreign Capital Law' (promulgated in May 1950), which was a special law of the Foreign Exchange Law, as well as other related cabinet orders and ministerial ordinances. Japan's policy goal of the time was to secure funds for growth that was needed for post-war reconstruction by importing foreign capital. There was therefore a need to limit foreign currency outflow as much as possible.

The foreign exchange and capital transaction regulations of the time had the following three major characteristics:

(i) Adoption of a foreign currency budget system with respect to imports
Budget amounts were established for each import item or category, and for each payment currency by the council of ministers, created pursuant to the provisions of Article 3 of the Foreign Exchange Law, so as to regulate foreign payments (1950 – 1964).

(ii) Adoption of a mechanism of "prohibition as a general rule, and liberalization on an exception basis."
The government adopted a mechanism under which foreign exchange and capital transactions were banned as a general rule with permissions and approval doled out on a case by case basis, such as by the lifting a ban with a cabinet order or a ministerial ordinance.

(iii) Adoption of a system of central control of foreign currencies by the government.
Only foreign exchange banks, etc. were allowed to hold foreign currencies so as to enable the government to grasp and control foreign currency transactions (1952).

The 1952 amendment of the Foreign Capital Law extended its controls and regulations to corporate bond and loan claims that were not tied to technological assistance, and gave conditional guarantee of repatriation with respect to the proceeds of stock sale or those of ownership sale by foreign corporations. The amendment also revised rules concerning approval of stock rollovers by foreign corporations.

In 1957, a yen-based system (a system of unrestricted acquisition of yen-based stocks) was implemented, and revisions were made to the rules concerning approval for acquisition of outstanding shares of Japanese corporations by specified foreign investors. (The revision applied only to countries which were required to be given national treatment by a treaty, and excluded "restricted industries" such as the infrastructure, financial and broadcasting industries.)

2) Foreign Corporations in Japan in the 1950-1960 Period
In the post-war era, foreign corporations began to make inroads to Japan in 1950, when the Foreign Exchange Law and the Foreign Capital Law were enacted, and repatriation of the original investment and earnings by foreign investors was guaranteed when the foreign capital inflow was deemed to contribute to the independence and sound growth of the Japanese economy and improvement of the country's international balance of accounts.

During this period, a large number of corporations were created with foreign capital as the domestic economy began to show signs of restoration while US corporations initiated aggressive investment abroad because of low profitability in their own country. The objective of the government policy was to promote the importation of high-quality and long-term foreign capital. The majority of these corporations were those that met this objective. They were characterized by the fact that many were US-based, and that the major part of the investment was in such core industries as petroleum and chemicals.

Furthermore, many investments took the form of additional equity participation in existing companies that had already accepted foreign capital. Very few were purely foreign corporations (i.e. corporations whose entire capital was supplied by a foreign corporation or a foreign individual).

3) Japan's International Trade in the 1950-1960 Period

Starting in 1950, Japan made its way back to the international economy. A look at its performance reveals that Japan's trade balance was fundamentally in a deep deficit throughout the 1950s. Especially between 1953 and 1954, and again in 1957, a rapid fall in foreign currency reserves forced the Japanese government to resort to stringent policies (so-called the 'ceiling on the balance of international payments'), and obtain a loan from the IMF, etc.

Reflecting such fragility of Japan's balance of international payments, wide-ranging (quantitative) restrictions were placed on imports throughout the 1950s. The liberalization rate of imports remained at a meager 22% in 1956 and 33% in 1958.

(2) From the Establishment of the General Framework of Liberalization of International Trade and Foreign Exchange (1960) to the Admission to OECD (1964)

1) Policies of the Japanese Government and the Ministry of Finance on Foreign Capital Inflow in the 1960-1964 Period

Convertibility of Japanese yen with currencies of Western European countries was restored at the end of 1958, while Japan's positions with foreign countries, including its balance of trade surplus, improved in 1958 and 1959 as the result of a surge in exports, as well as a request by the United States for liberalization at a GATT meeting. These events caused the liberalization of international trade and foreign exchange to gain momentum. In June 1960, the General Framework of Liberalization of International Trade and Foreign Exchange was adopted. The General Framework set a goal to raise the import liberalization rate to approximately 80% (or 90% in the event that petroleum and coal were also liberalized) in three years (from 40% as of April 1960). (In August 1963, the international import liberalization rate grew to 92%, a level comparable with those of European and American countries.)

While so doing, the government took a cautious stance, refraining from disclosing specifics of the liberalization or its time frame by indicating only that in the area of foreign exchange, current transactions would be liberalized as a general rule within two years and that "regulations on capital transactions would be eased sequentially while attention would be paid to ensure that no adverse effects would be inflicted upon the growth of the domestic economy."

The policies of the Foreign Exchange Bureau of the Ministry of Finance at the time can be condensed into the following three points:

(i) Fundamental Philosophy
Liberalization of current transactions would be followed by the liberalization of capital transactions. Liberalization of capital transactions would be implemented gradually by heeding its impact on small and medium-sized corporations, concerns about corporate control through stock acquisitions, and effects on the financial and foreign exchange markets.

(ii) Loans and Technology Transfers
Foreign capital imports that are accompanied by loans and technology transfers contribute to a reduction of interest burdens and advancement of Japan's technology. For this reason, restrictions would be eased by establishing criteria with respect to the scope of the industries that receive capital and the terms of agreements.

(iii) Stock Acquisitions
Restrictions would be eased gradually with respect to the ceiling for stock acquisitions by foreign investors through the open market, etc. and repatriations of the initial investment, corporate bonds, and securities that represent beneficiary interest.

Pursuant to these policies, regulations on foreign capital imports were eased in 1960. The key points of the relaxation were as follows:

(i) The maximum percentage of stock ownership by foreign investors was raised to 10% in restricted industries (from 5%), and 15% in unrestricted industries (from 8%). (With respect to stock purchases by foreign investors in the stock market, ceilings had been set for stock (type) ownership by foreign investors in individual corporations.)

(ii) The period in which repatriation of the original investment in stock was restricted was shortened from seven years to two years, followed by repatriation in installments over a five-year period.

(iii) Regarding foreign currency loans not to exceed $100 thousand, regulations were eased to automatic approval by the Bank of Japan.

Additional relaxation measures followed in the ensuing period. For example, the period in which repatriation of the original investment in stock was banned was shortened to six months in 1962. In 1963, the restrictions on such capital repatriations were completely lifted. It had taken 13 years between the time that the restrictions on repatriation of original investment were placed and their complete lifting.

2) Foreign Corporations in Japan in the 1960-1964 Period

By around 1960, Japan's rapid growth was fully on course. Japan's attractiveness rapidly increased not only as an export market but also as a place for foreign corporations to make investment in and capitalize on its growth potential.

Foreign corporations that were set up during this period were mostly in the chemical, machinery, and petroleum (refining and sales) industries. In addition, companies were increasingly moving into consumer goods markets, such as foods, textile, and paper and pulp. As before, most of these foreign corporations were US-based. However, many European corporations also began to move into the Japanese market around 1959.

One characteristic aspect of the major foreign corporations that came into being around 1960 is that many were yen-based. The reason was that foreign direct investment was possible without the approval required under the Foreign Capital Law as long as no foreign remittances were made to repatriate capital or dividends. A number of purely foreign-owned corporations were created not only in commerce but also in manufacturing because investors were free to start up yen-based companies in any industry.

Chapter 2: 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 –

(1) Transition to an IMF Article VIII Nation, the OECD Admission and Policy Responses

In 1964, Japan became an IMF Article VIII nation and also became a member of OECD. As a result, Japan became unable to place any restrictions on foreign remittances for reasons of balance of international payments as a general rule. Furthermore, the United States and other countries of the world began to exert ever greater pressure on Japan to liberalize capital transactions.

The key points of the measures to liberalize foreign direct investment that the Ministry of International Trade and Industry devised in 1967 in light of the circumstances at the time were as follows:

(i) Necessity of measures to prevent confusion in the domestic market, caused by the entry of foreign corporations

(ii) Necessity to improve conditions so as to give domestic industries a chance to grow competitive and stand on an equal footing with foreign corporations. In particular, the importance of providing funds necessary to prevent management control by foreign capital, promoting debt guarantees and measures to aid individual corporations to proceed with measures for stable stock ownership were confirmed.

In the same year, the final government policies on foreign direct investment were approved at a cabinet meeting as the "Liberalization of Foreign Direct Investment, etc." after deliberation by the Council on Foreign Capital. Its content was in line with the fundamental stance of the Ministry of International Trade and Industry, and included the Liberalization Measures, which indicated the framework for specific steps to press forward with capital liberalization and its schedule, as well as the Liberalization Countermeasures, which were the "countermeasures to strengthen the competitiveness of the Japanese corporations and prevent chaotic behavior by foreign capital."

(2) History of Liberalization of Capital (Foreign Direct Investment) starting in 1967 (From the Initial Round of Capital Liberalization in 1967 to the Fifth Round of Capital Liberalization in 1973)

Liberalization of foreign direct investment (capital liberalization) occurred over a six-year period, starting with the first round in 1967 and ending with the fifth round in 1973.

In the initial round of capital liberalization that took place in 1967, 50 industries were liberalized. (33 industries in Class 1, and 17 industries in Class 2). Foreign ownership up to 50% was automatically approved when a new corporation was established in the liberalized industries in Class 1. Similarly, in the liberalized industries in Class 2, foreign ownership up to 100% was automatically approved. In the second and third rounds of capital liberalization, the number of liberalized industries gradually increased over a three and a half-year period.

Liberalization in the automobile industry, which was separately handled from the ordinary liberalization, occurred in 1971. Six industries, consisting of the automobile manufacturing, manufacture of automobile bodies or accompanying vehicles, manufacture of automobile parts or accessories, manufacture of piston rings, manufacture of internal combustion engine electrical components, and automobile lamp manufacture, were designated to be the liberalized Class 1 industries.

The fifth round of capital liberalization came in 1973. All industries, with the exception of five industries, were placed in the Class 2 category and were 100% liberalized. Of the five exception industries, agriculture, forestry and fishery, petroleum, manufacture of leather and leather goods, and retailers with more than 11 stores were to be subject to case-by-case reviews whereas the mining industry and retailers with 11 or fewer stores became the industries with the 50% liberalization rules. Additionally, a decision was made to 100% liberalize 17 industries, including the computer and the pharmaceutical industries, after a waiting period of a few years.

(3) Foreign Corporations in Japan in the 1964-1980 Period

1) Analysis by Industry
The total amount of foreign direct investment, combining the manufacturing and non-manufacturing industries, has been on a rising trend as capital liberalization progressed. On the dollar basis, foreign direct investment reached its initial peak in the 1971 fiscal year at $254 million, and the second peak in the 1979 fiscal year, when the Foreign

Exchange Law was extensively revised (and the Foreign Capital Law was repealed), climbing to $524 million, and continued to be on a rising trend.

In the manufacturing segment, changes in foreign direct investment by industry and on a dollar basis were as follows: total for the manufacturing sector amounted to only $62 million between the 1956 and 1960 fiscal years, but grew rapidly to $168 million between the 1961 and 1965 fiscal years, $271 million between the 1966 and 1970 fiscal years (a 61.3% increase over the preceding period), $696 million between the 1971 and 1975 fiscal years (up 156.8%), and $1,092 million up 56.9%) between the 1976 and 1980 fiscal years. Funds in excess of $100 million have flowed in annually, starting in the 1971 fiscal year. Increases were especially noticeable in the 1971 and the 1979 fiscal years. The former was the result of liberalization in the automobile industry. An inflow of $151 million to the machinery-related industries occurred. The second massive increase is attributed to the repeal of the Foreign Capital Law. Petroleum-related industries posted conspicuously large increases.

A comparison across industries reveals concentration of foreign direct investment in such areas as electrical machinery, machinery, including automobile, chemicals, including pharmaceuticals, and petroleum. Very little investment was made in textile, rubber and leather goods, or foods. Investment in the metal industry, or the glass, earth and rock product industry (mainly cement-related products) was also scant.

In the non-manufacturing segment, total amount was nil between the 1956 and 1960 fiscal years, $12 million between the 1961 and 1965 fiscal years, $50 million between the 1966 and 1970 fiscal years (a 316.7% increase over the preceding period), $206 million between the 1971 and 1975 fiscal years (up 312%), and $387 million (up 87.9%) between the 1976 and 1980 fiscal years. Although these rates of growth were high, the levels of investment were low compared with the manufacturing segment. Funds in excess of $100 million did not flow in until after the repeal of the Foreign Capital Law in 1979, nearly ten years behind the manufacturing segment.

A comparison across industries reveals that commerce and international trade industry has maintained a certain size and increased. On the other hand, the transport and communication industry, and the financial and insurance industry were at very low levels.

2) Analysis by Country and Region

Of the total amount of foreign direct investment in Japan by major investing countries and regions (U.S.A., U.K., West Germany, France, Switzerland, the Netherlands, Hong Kong, and Chinese-Taipei) between 1966 and 1980, which amounted to $2,083 million, U.S.-based capital accounted for more than 70% or $1.4 billion. Essentially the same situation was observed in any other year. Foreign direct investment in Japan by U.S.-based capital was buoyant consistently. The United States all by itself invested an amount that was more than twice the total for Europe. Until the mid-1970s, American and European capital accounted for the major part of foreign direct investment in Japan. Staring in the second half of the 1970s, however, investment by Hong Kong and Chinese Taipei began to grow. Among European countries, Switzerland and West

Germany made large investment while investment by the United Kingdom was on a decline in the second half of the 1970s.

As a fundamental trend, the size of foreign direct investment grew as the capital liberalization in Japan progressed although there were variations in the levels among countries and regions, and differences in trends.

(4) Japan's International Trade in the 1964-1980 Period

Between 1968 and 1972, foreign currency reserves surged as the result of widening current account surplus. (Japan became the second largest economy in the world in 1968, surpassing West Germany on the GDP basis.) Partly because the fixed foreign exchange system was maintained at ¥360 to a dollar, the price competitiveness of Japanese export goods became outstanding.

For four straight years between 1968 and 1971, exports grew at rates surpassing 20%, surging from $10.6 billion in the 1967 fiscal year to $24.7 billion in the 1971 fiscal year. The growth was especially remarkable among heavy industrial goods, such as steel, automobiles, ships and durable consumer goods.

In contrast, the United States became concerned of its growing deficit in its international trade balance over the same period, and adopted bold emergency economic policies, which included a 10% across-the board import levy, an end to the gold-backing of the dollar, and demand on major countries of the world to devalue their currencies the so-called Nixon Shock of August 1971. The yen exchange rate, which had been maintained in a fixed exchange rate system at ¥360 to a dollar since 1949 and whose disparity from the market rate had been pointed out, was raised to ¥308 to a dollar at the end of 1971. In February 1973, the system was replaced by a floating rate system.

Two oil crises, which hit first in October 1973 and again in December 1978, needed to be dealt with during this period, too.

With respect to the liberalization of international trade, the rate of import liberalization had reached 93% at the time of OECD entry. Although this was a level comparable with those of the European and American countries, there still remained as many as 136 import restriction items, which included agricultural, forestry and marine products, as well as key industrial products, such as automobiles, machine tools, generators and computers. Subsequent to automobile liberalization in 1965, liberalization of boilers, machine tools and generators in 1970, and liberalization of automobile engines in 1971, import liberalization roughly ran its course in 1972 with the liberalization rate reaching 95% and only 33 import restriction items remaining (24 agricultural, forestry and marine products, and 9 industrial products).

Chapter 3: 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 -

(1) Amendment of the Foreign Exchange Law (1979) and Measures to Promote Foreign Direct Investment

In 1979, the Foreign Exchange Law was revised on an extensive scale (effective in 1980). It absorbed (abolished) the Foreign Capital Law and adopted a system of advance reporting in connection with overseas borrowings, as well as both external and inward investment in securities. With these changes, capital transactions became freed from controls as a general rule, instead of banned as a general rule as had been the case. Capital liberalization was thus complete. This amendment of the Foreign Exchange Law is outlined as follows:

(i) Capital transactions became free of controls as a general rule (with a system of advance reporting). (Overseas borrowing, as well as external and inward investment in securities as portfolio investment also transitioned to the advance reporting system.)

(ii) The regulation that gave the minister of finance to authorize the use of a permission system under certain circumstances (such as massive fund movements or rapid changes in the foreign exchange rates) was preserved. (Emergency Regulation).

(iii) The measure that gave the minister of finance authority to recommend or order a change in the content of capital transactions or suspend them under certain circumstances (such as when such transactions had the potential of inflicting negative impact on the financial market) was preserved. (Loans, securities issuance by foreigners in Japan and those by Japanese in overseas markets, external and inward foreign direct investment, etc. were covered.)

This extensive revision essentially completed the policy actions that were targeted at liberalization of foreign direct investment in Japan. In the ensuing 1980s, measures to attract foreign direct investment were implemented vigorously.

In 1984, the Committee to Facilitate Investment in Japan was established within the Ministry of International Trade and Industry. In addition, Japan External Trade Organization (JETRO) created the Industrial Cooperation Promotion Office, Center of Industrial and Technological Cooperation, Committee to Promote Overseas Investment by Small and Medium-sized Corporations, and the Committee to Promote Investment in Japan. With these organizations in place, a system of bi-directional investment and technological exchanges, and industrial cooperation promotion was established. The Japan Development Bank also started its financing programs.

In response to these foreign direct investment promotion activities at the national government level, local government-led initiatives were also adopted to revitalize regional economies. As for wide-area programs, a promotion council to attract foreign corporations was established in four regions, consisting of Hokkaido, Tohoku, Hokuriku and Kyushu, in 1982. The Liaison Conference to Invite Foreign Corporations was organized as a national organization in 1985. These organizations actively conducted such activities as orientation meetings about locational options in Japan and sending missions to foreign countries to promote investment. Furthermore, a liaison conference to attract foreign corporations was created in the Chugoku region in March 1986, and started to provide information services to foreign corporations.

(2) Foreign Corporations in Japan in the 1980-1989 Period

1) Foreign Corporations in Japan in the First Half of the 1980s (A Chronological Analysis)

In the 1980 fiscal year, foreign direct investment totaled $300 million (a 42.7% decrease over the preceding year). This consisted of $189 million (a 55.0% decrease) in the manufacturing sector, and $111 million (a 6.7% increase) in the non-manufacturing sector. The massive drop in the manufacturing sector over the preceding year was a recoil from large petroleum-related foreign direct investment projects in the 1979 fiscal year.

Foreign direct investment in the 1981 fiscal year amounted to $432 million (up 44.0%), broken down between $295 million (up 56.1%) in the manufacturing sector and $138 million (up 24.3%) in the non-manufacturing sector. The increases are believed to be attributable to increased accessibility of foreign direct investment, a result of the extensive revision of the Foreign Exchange Law. Corporations that were fully owned by foreign interest were created in large numbers instead of joint ventures with Japanese corporations. During the 1980 and 1981 fiscal years, the manufacturing sector accounted for less than 70 percent of the total. While the non-manufacturing sector commanded an increasingly large share, due to growth of the commerce and international trade industry. In addition, large-scale investment emerged in the non-manufacturing sector, including the services, leasing and financial industries. As for countries and regions, Europe and other countries began to be more prominent than U.S. companies in both the manufacturing and non-manufacturing sectors.

Foreign direct investment in the 1982 fiscal year totaled $749 million (up 73.4%), broken down between $518 million (up 75.6%) in the manufacturing sector and $231 million (up 67.4%) in the non-manufacturing sector. In the 1983 fiscal year, the manufacturing sector posted $619 million (up 19.5%) whereas the non-manufacturing sector reported $194 million (down 16.0%), raising the total to $813 million (up 8.5%). During this period, foreign direct investment in the manufacturing industry was buoyant, and machinery, metals and chemicals grew at especially fast rates. Investment in the non-manufacturing sector decreased temporarily in 1983, partly in a recoil from the previous year. Overall, however, investment was on a growing trend, as evidenced by a record 20.3% share (the 1982 fiscal year) commanded by the commerce and international trade industry.

One characteristic of this period was a record number of new foreign corporations (corporations that were newly created with foreign capital and corporations that received the infusion of foreign capital for the first time). (There were 412 such corporations in the 1982 fiscal year, and 568 more in the 1983 fiscal year.) Incidentally, more than 40% of these new foreign corporations were engaged in either commerce or international trade. In terms of countries and regions, U.S.-based corporations accounted for over 50% of the total during this period. (Their shares were in the 30% range in 1980 and 1981.) This was due to an increase in large-scale projects by U.S.-based corporations in the manufacturing, commerce and international trade industries.

Foreign direct investment in the 1984 fiscal year consisted of $277 million (down 55.3% over the preceding year) in the manufacturing sector and $217 million (up 11.9%) in the non-manufacturing sector, for a total of $493 million (down 39.4%). Even though a large yearly decrease was posted on a dollar basis, record 3,685 reports were filed during this period. This was due to the fact that the Foreign Exchange Law amendment increased the accessibility of foreign direct investment and even foreign corporations that are not large began to be attracted to investing in Japan. Another reason was a growing interest in Japanese startups, which generated heavy activity by foreign venture capital.

Foreign direct investment in the 1985 fiscal year reversed its course and began to rise. It consisted of $650 million (up 134.7% over the preceding year) in the manufacturing sector and $279 million (up 28.6%) in the non-manufacturing sector, for a total of $930 million (up 88.6%).

Starting in the 1984 and 1985 fiscal years, European-based foreign corporations, in addition to U.S.-based corporations, once again began to make heavy foreign direct investment in Japan. Investment by the United Kingdom, West Germany and Switzerland rose especially sharply. By industry, foreign direct investment by US corporations grew rapidly in the computer and computer software fields. In the non-manufacturing sector, trust banking and investment advisory service fields saw fast growth.

2) Foreign Corporations in Japan in the Second Half of the 1980s (Chronological Analysis)

Foreign direct investment in the 1986 fiscal year totaled $940 million (up 1.1% over the preceding year), broken down between $495 million (down 23.8%) in the manufacturing sector and $443 million (up 58.8%) in the non-manufacturing sector. In the 1987 fiscal year, the manufacturing sector posted $1,430 million (up 188.9%) whereas the non-manufacturing sector reported $782 million (up 76.5%), raising the total to $2,214 million (up 135.5%). Regarding foreign direct investment in the 1987 fiscal year, growth in the manufacturing sector was prominent. By country, the US corporations nearly doubled their conventional level of investment, to $938 million. European corporations too made record investment totaling $448 million. In particular, Switzerland posted a large increase, to $169 million. As for industries, machinery far surpassed others at $1,110 million, a 378.4% increase over the preceding year. Commerce and international trade continue to grow, and accounted for $130 million (up 51.2% over the preceding year) in the 1986 fiscal year, and $291 million (up 123.8%) in the 1987 fiscal year.

Foreign direct investment in the 1988 fiscal year totaled $3,243 million (up 46.5%), broken down between $2,425 million (up 69.6%) in the manufacturing sector and $818 million (up 4.6%) in the non-manufacturing sector. In the 1989 fiscal year, the manufacturing sector posted $1,172 million (down 51.7%) whereas the non-manufacturing sector reported $1,688 million (up 106.4%), raising the total to $2,860 million (down 11.8%). The increase in the manufacturing sector in the 1988 fiscal year continued to be at a high level, following in the wake of the 1987 fiscal year. The United States invested $1,774 million, nearly doubling the investment of the prior year as it did in the 1987 fiscal year. Machinery continued at a high level in the 1988 fiscal year as it did in the preceding year and rose to $1,732 million (up 56.0%). Although the amount fell to $808 million in the 1989 fiscal year, the commerce and international trade industry continued to grow and reached $454 million (up 56.0%) in the 1988 fiscal year, and $544 million (up 19.8%) in the 1989 fiscal year. Incorporation and participation of new foreign corporations again reached a new high and grew rapidly to 747 companies in the 1988 fiscal year and 843 companies in the 1989 fiscal year.

3) Foreign Corporations in Japan in the 1980s (Macroeconomic Perspectives)

The inroads made by foreign corporations in the 1980-1989 period that we had a bird's eye view of in 2) and 3) above, are summarized in the following section from the macroeconomic point of view with a focus on the impact of the 1979 revision of the Foreign Exchange Law. The manufacturing sector and the non-manufacturing sector will be separately discussed from macroeconomic perspectives.

With the start of the 1980s, foreign direct investment in the manufacturing industry grew phenomenally. As for changes in foreign direct investment in the manufacturing industry since the 1981 fiscal year by industry and on a dollar basis, total for the manufacturing industry was $1,092 million between the 1976 and 1980 fiscal years. Between the 1981 and 1985 fiscal years, the total surged to $2,359 million (a 116% increase over the preceding period), and $7,092 million between the 1986 and 1990 fiscal years (up 200.6%). Especially conspicuous were machinery, including electric appliances and automobiles, and chemicals, including pharmaceuticals. Petroleum, which until the 1979 fiscal year posted a large amount, dipped below foods starting in 1986. Metals achieved fast growth, whereas textile, rubber and leather goods, and glass, rock and earth products (mainly cement-related goods) posted moderate gains over the levels of the years leading up to the 1979 fiscal year.

In the non-manufacturing sector, levels of investment were low until the repeal of the Foreign Capital Law in the 1979 fiscal year. However, foreign direct investment in the non-manufacturing sector also jumped with the start of the 1981 fiscal year. As for changes in foreign direct investment in the non-manufacturing industry since the 1981 fiscal year by industry and on a dollar basis, total for the non-manufacturing industry, which stood at $387 million between the 1976 and 1980 fiscal years, surged to $1,059 million between the 1981 and 1985 fiscal years, (a 173.6% increase over the preceding period), and $4,939 million between 1986 and 1990 (up 366.4%). In the 1989 fiscal year, inflow of foreign direct investment in the non-manufacturing sector surpassed that of foreign direct investment in the manufacturing sector. This was a period that coincided with the so-called Bubble period of Japan. Accordingly, increases were prominent in the construction and real estate industry, as well as the financial and insurance industry.

Chapter 4: Supplementary Explanations to the History of Liberalization of Foreign Direct Investment in Japan

(1) Supplementary Explanations about Macroeconomic Trends of Foreign Direct Investment in Japan

In the 1950s, both investment in securities (which are purchased in the securities market with no intention of participation in corporate management) and foreign direct investment (which is made with the intention of management participation) were at low levels. In the wake of the regulatory relaxation on foreign capital imports in 1960 and new measures to ease importation of foreign capital in 1961 (designed to relax control of investment in Japanese securities), however, both investment in securities and foreign direct investment began to rise.

Following the liberalization of foreign direct investment, which started in 1967, investment in securities began to climb in the same year. Roughly parallel to the start of capital liberalization, credibility of Japanese corporation rose against the backdrop of sustained rapid economic growth. This led to appreciation of the future potential of Japanese company stocks. Also in the backdrop were the growing perception that shares of Japanese corporations were relatively undervalued and the preference for yen-based assets, triggered by international financial uneasiness.

Although the "management participation" – type investment did not begin to increase until after stock acquisitions through the market picked up speed. It began to surpass $100 million in 1971, when the automobile liberalization and the fourth round of liberalization took place, and leaped in 1979, when the Foreign Capital Law was repealed.

(2) Supplementary Explanations about Changes in Foreign Direct Investment in Japan (by Industry) from the 1960s to the 1980s

Foreign direct investment in the manufacturing segment, totaled $62 million between the 1956 and 1960 fiscal years, but grew rapidly to $168 million between the 1961 and 1965 fiscal years. On a five-year cumulative basis, foreign direct investment jumped to $271 million (a 61.3% increase over the preceding period), $696 million (up 156.8%) in the 1971-1975 fiscal years, and further on to $1,092 million (up 56.9%) in the 1976-1980 fiscal years.

Increases were especially prominent in the 1971 and the 1979 fiscal years. The former was the result of liberalization in the automobile industry. Inflows to the machinery-related industries alone amounted to $151 million. The second massive increase is attributed to the repeal of the Foreign Capital Law, and investment was directed mostly at the petroleum-related industries. A comparison across industries reveals a concentration of foreign direct investment in such areas as, machinery, including electrical appliances and automobile, as well as chemicals, including pharmaceuticals, and petroleum. Very little investment was made in textile, rubber and leather goods, or foods. Investment in the metal industry, or the glass, earth and rock product industry (mainly cement-related products) was also on a decline.

(3) Supplementary Explanations about Changes in Foreign Direct Investment in Japan (by Region) from the 1960s to the 1980s

Since the 1960s, the United States has consistently made large foreign direct investment in Japan. Until the 1980s, the United States alone accounted for more than double the amount of investment made by all European countries combined.

Since the mid-1980s, investment by European interest has also been growing. In the 1990 fiscal year, the total amount of foreign direct investment made by all European countries surpassed that of foreign direct investment by the United States for the first time. Among the European countries, investment by the Netherlands, West Germany and Switzerland has been growing especially fast. Furthermore, re-investment by corporations which are at least 50% owned by foreign interest (foreign corporations that are already in Japan) also grew rapidly in the second half of the 1980s.