Japan's Experience with its Liberalization of Foreign Direct Investment and Insights Derived - Phased yet Flexible Liberalization –

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NIKKEI-R

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Nikkei Research Inc.

Japan’s Experience
with its Liberalization of Foreign Direct Investment
- Overview of the 1960s

○Industrial Protection

--Ban on Foreign Direct Investment as a General Rule

--Liberalization on an Exception Basis

--Ceiling on Balance of International Payments

○Liberalization of Foreign Currency Exchange and International Trade

⇒Liberalization of Capital Transactions

Economic and Trade Situations Surrounding Japan in the 1960s

○1964: Became an IMF Article VIII nation
and joined the OECD

⇒ Not allowed to restrict foreign remittances
for reasons of balance of international payments

○1968: Became the 2nd largest economy on a GDP basis

○1964-1971: Exports grew at ≦20%

⇒ Current account surplus↑

Established Policy of Liberalization and Announced Specific Measures

○1967: Foreign Direct Investment Liberalization Measures
Liberalization of Foreign Direct Investment, etc.

- Liberalization Measures provided the framework for specifics of the liberalization of FDI and its schedule

- Liberalization Countermeasures
  - To strengthen competitiveness of Japanese corporations
  - To prevent havoc in the domestic market for receiving FDI

Phased Liberalization of FDI (1)

○FDI was approved on an industry-by-industry basis
by taking into account the stage of development of domestic industries and
their competitiveness, as well as
the external environment (international situation).

○Industries were separated into

"Class 1 Liberalization Industries" (automatic approval of up to 50% foreign ownership),

"Class 2 Liberalization Industries" (automatic approval of up to 100% foreign ownership),

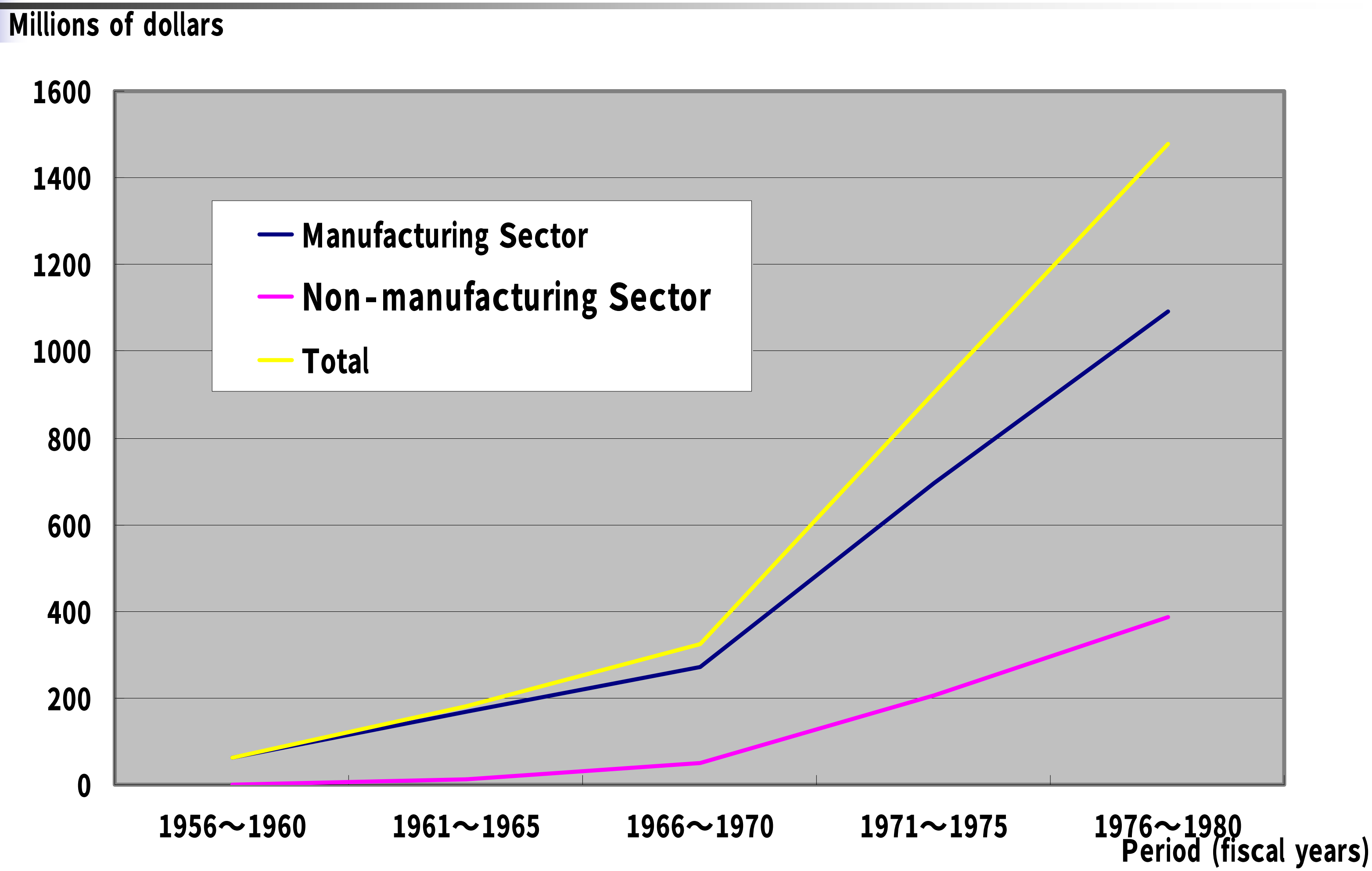
and others to provide fine-tuned action.

○In addition, liberalization of automobile-related industries was handled in a separate scheme and with flexibility.

Phased Liberalization of FDI (2)

[Year]	[Liberalization]	[Number of industries] (Class 1)	(Class 2)
○1967:	Initial round	33	17
○1969:	Second round	160	44
○1970:	Third round	447	77
○1971:	Automobile-related industries	453	77
	Fourth round	Adoption of a negative list	228
○1973:	Fifth round	Full liberalization as a general rule, with the exception of 5 industries	

Foreign Corporations in Japan between the 1960s and 1970s



Measures to Promote FDI in the 1970s and Subsequent Years

○ 1979: Overhaul of the Foreign Exchange Law

(Absorption of the Foreign Capital Law)

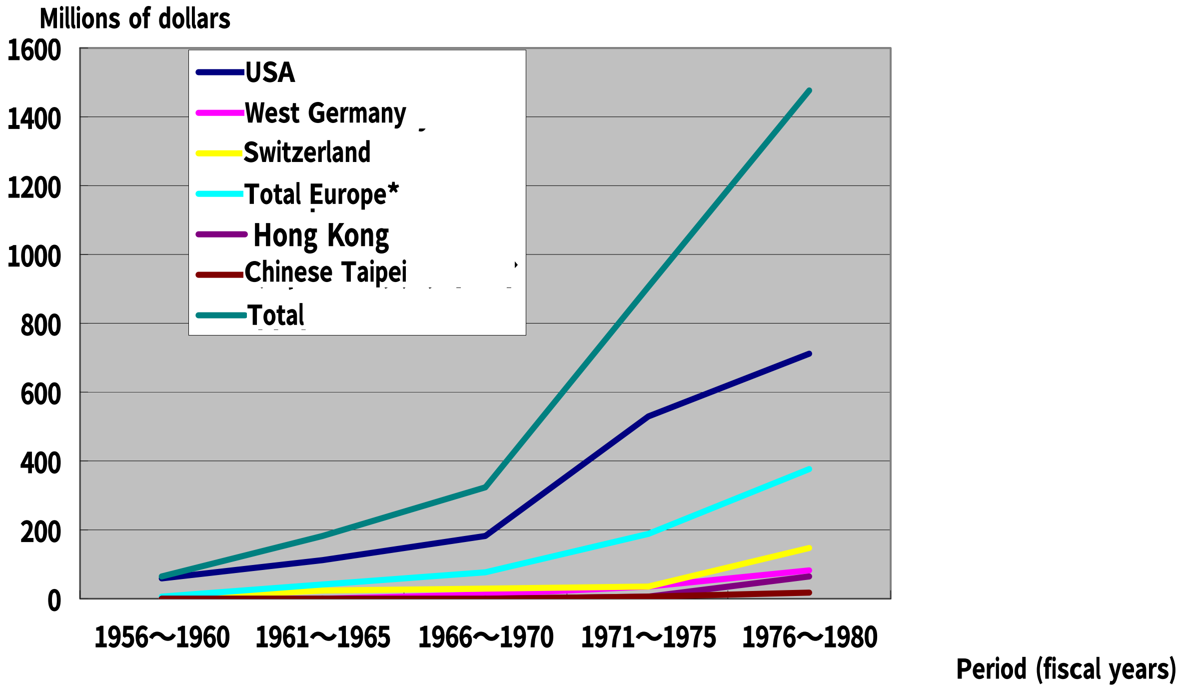
⇒ FDI underwent a change
from "banned as a general rule" to "liberalized as a general rule."

○ 1980s: Programs to attract FDI

・National level: ---The Committee to Facilitate Investment in Japan (MITI),
---Center of Industrial and Technological Cooperation (JETRO),

・Regional level: "Promotion Councils to Invite Foreign Corporations"
were established in several regions.

Foreign Corporations in Japan between the 1960s and 1970s (By Country and Region)



* Figures for “Total Europe” consist mainly of the UK, West Germany, France, Switzerland, the Netherlands, Sweden, Denmark, and Belgium.

○ US-based capital consistently held the top position.

European capital began to increase in the mid-1960s.

In the 1970s, capital from Hong Kong and Chinese Taipei was sporadically observed.

Insights Derived from Japan's Experience (1)

1960s-1970s: <u>Rapid growth and increased diversity of FDI</u>

←<u>Flexible and phased liberalization</u> implemented against a backdrop of demand placed on Japan to liberalize capital movements

In other words,

(1) Clear establishment of a stance to promote liberalization, and

(2) Flexible and steady implementation of specific steps toward liberalization with a focus on "sequencing."

◎ An <u>even more flexible approach might be necessary</u> in today's environment with its greater scale and increased speed of international capital movements in comparison with the 1960s-1970s.

Insights Derived from Japan's Experience (2)

FDI can strengthen and expanding recipient economies' industries.

← **Receipt of leading-edge technologies and high production efficiency, etc. from top-grade foreign corporations**

◎ A need to devise ways to receive leading-edge technologies, etc. from foreign corporations by taking into account the rapid change in technologies and means of production, as well as heightened international awareness of patents, etc. in today's environment .

Insights Derived from Japan's Experience (3)

FDI can have the effect of capital flow stabilization.

● Major factor of currency crisis: An economic system that is dependent on short-term capital

← Improper capital liberalization, absence of short-term capital flow monitoring

○ FDI will increase foreign currency reserves, stabilize balance of international payments, reduce risks associated with inflows and outflows of short-term funds

⇒ Recipient economies should come up with schemes to give direct investment medium- to long-term life.

◎ Recipient economies should take steps to create a sufficient labor market, improve infrastructure, and raise education levels, in line with the current circumstances in which the speed of international capital movement is accelerating towards the optimization of capital efficiency.

Insights Derived from Japan's Experience (4)

FDI can have the effect of inducing international trade.

(i) **Expansion of international trade**:

FDI can raise productivity of plants in recipient economies.

→ Goods manufactured in recipient economies will not only be exported back to investing economies, but also consumed within their local markets, or exported to third-party economies.

→ Recipient economies can increase both imports of materials/parts from investing economies and exports of parts/finished products.

* Japan, which once experienced a high weight of trade with the United States, has shifted a considerable amount to East Asia.

(An increase in the diversity of trading partner economies)

Insights Derived from Japan's Experience (4)

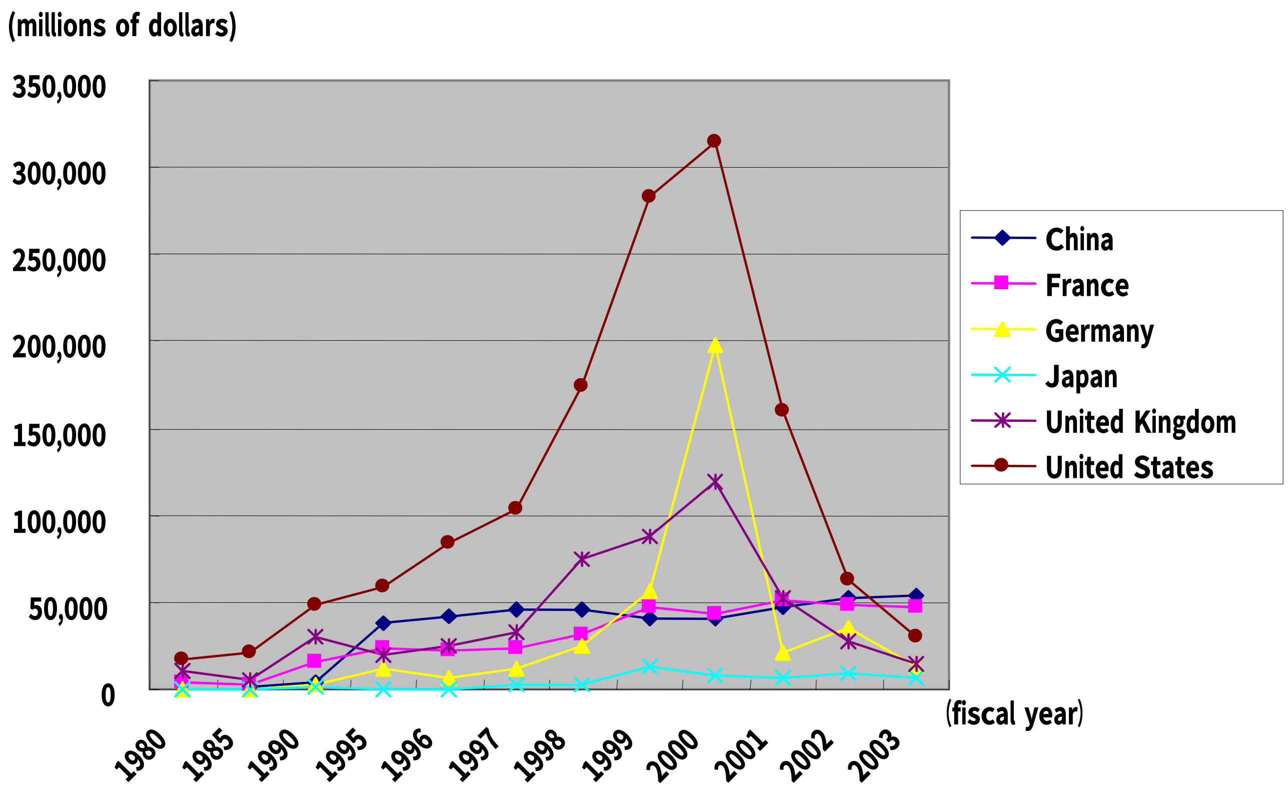
FDI can have the effect of inducing international trade. (Cont.)

(ii) **Enhancement of the quality of traded goods**:

Exports of industrial goods with low added value are gradually replaced by exports of industrial goods with high added value.

◎ A shift from an economy dependent on importing raw materials and exporting manufactured goods to an economy built on horizontal division of labor. Exports of goods with increasingly high added value begin to be demanded. Efforts to enhance the technological prowess of domestic industries and strengthen their competitiveness are indispensable.

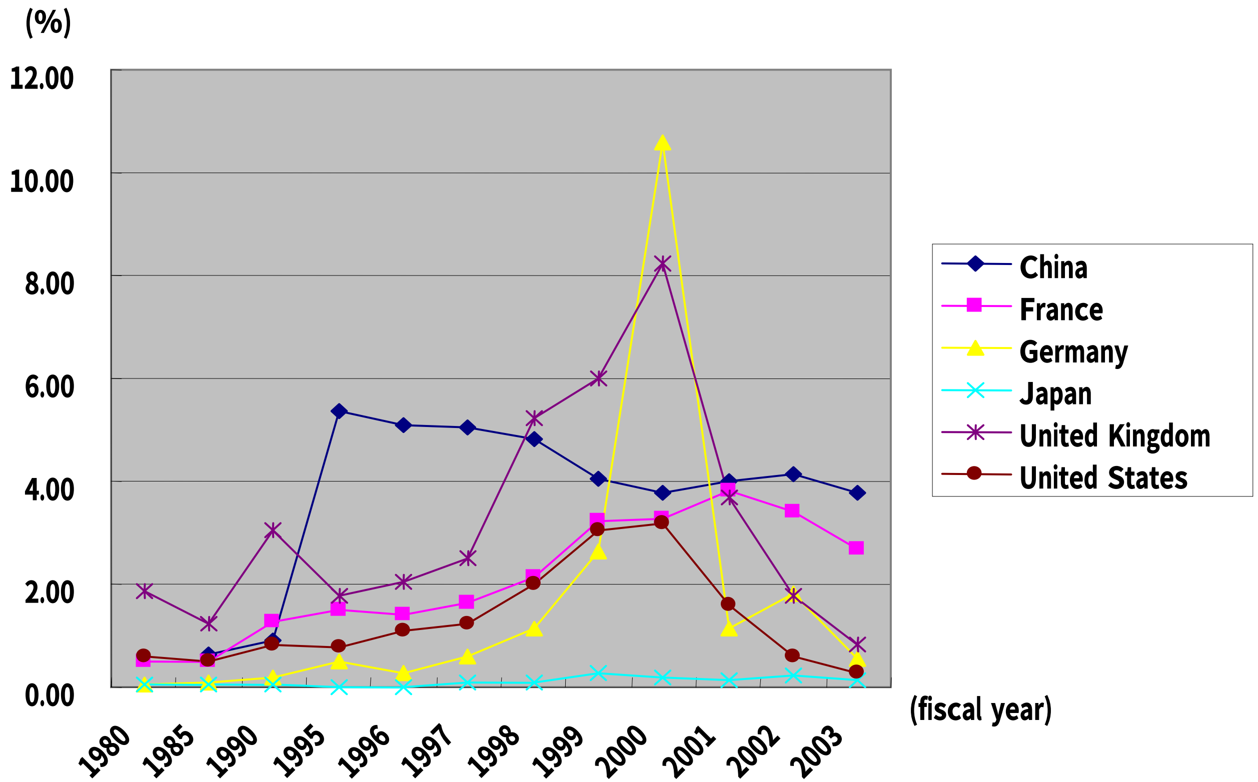
Changes in the FDI Flows (Inward Investment) of Major Countries



[Note] Net flow data on the basis of balance of international payments.

[Data] Prepared by JETRO based on the “World Investment Report 2004 CD-ROM” by UNCTAD

Changes in the FDI Flows of Major Countries (as a Percentage of GDP)



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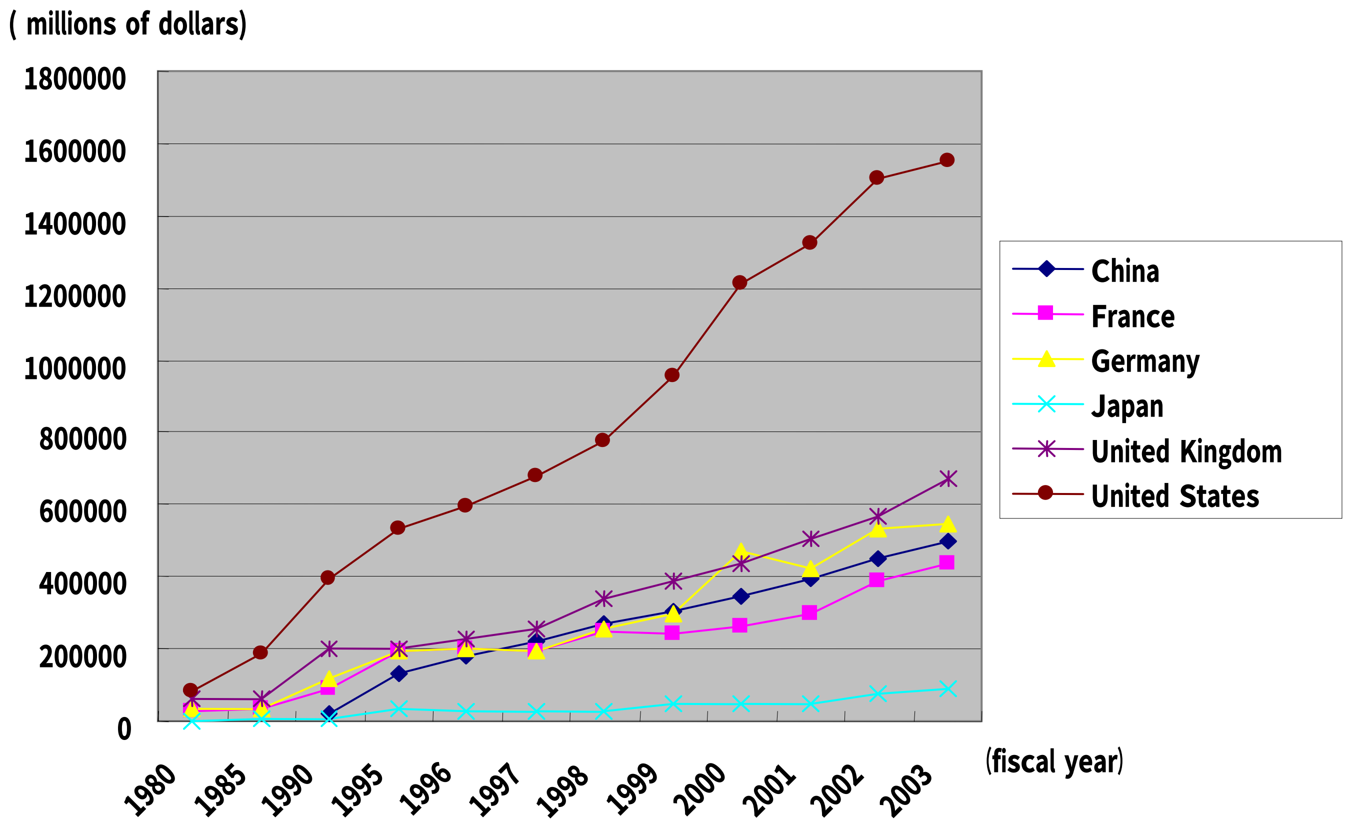
GDP figures are taken from the gross domestic product, current prices sections of IMF World Economic Outlook Database, April 2005.

Changes in the FDI Stock (Inward Investment) of Major Countries



[Note] Figures represent book values as a general rule.

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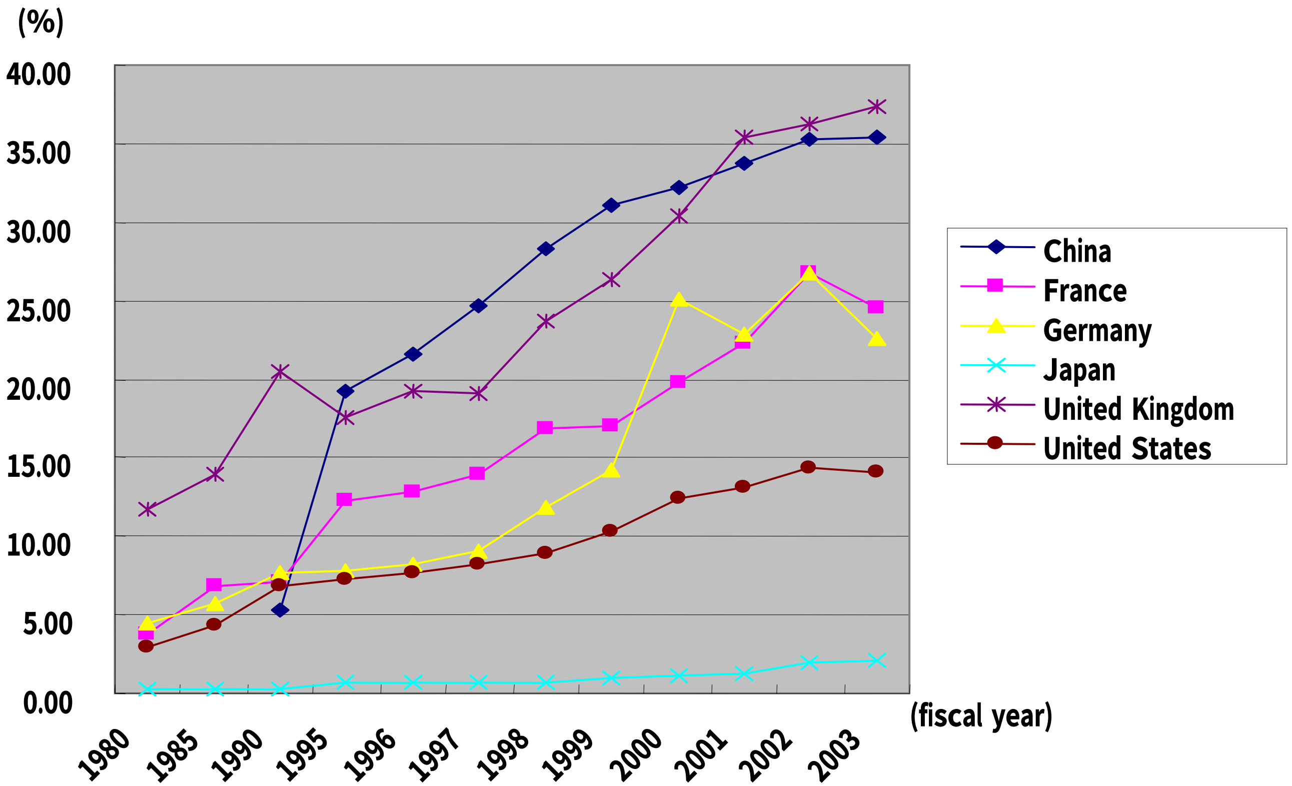
Changes in the FDI Stock of Major Countries (as a Percentage of GDP)



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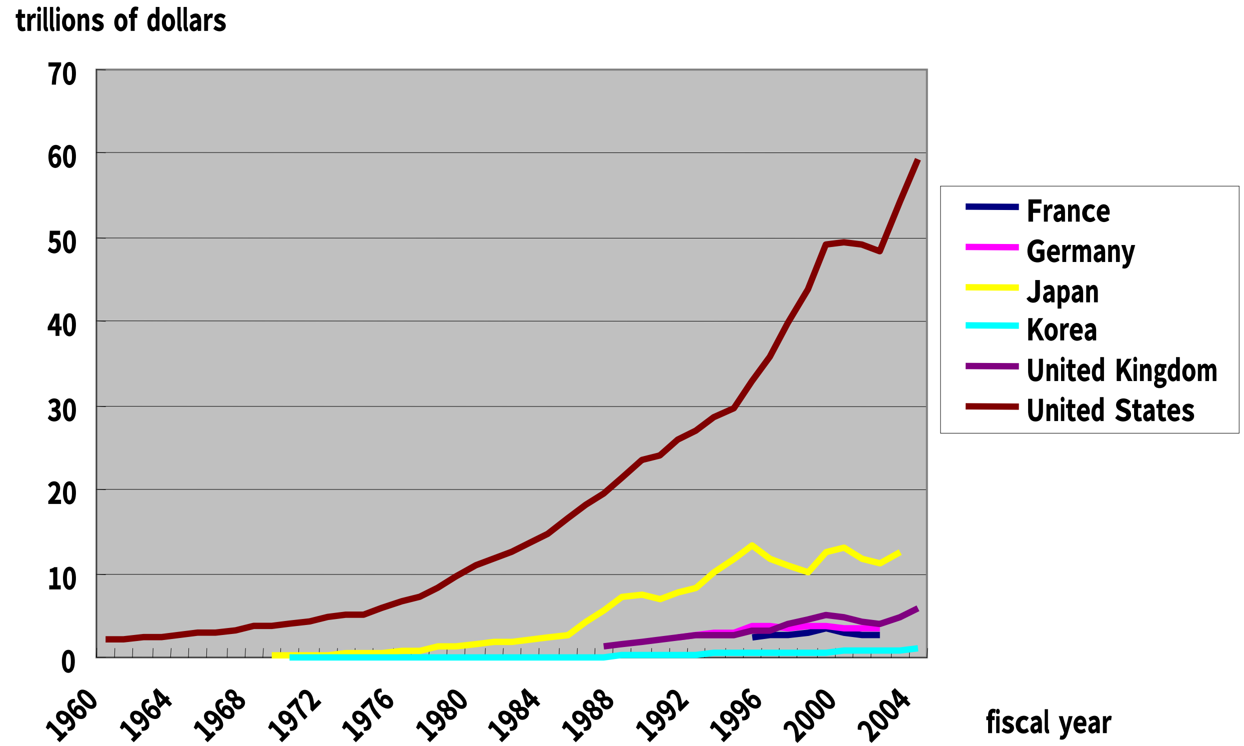
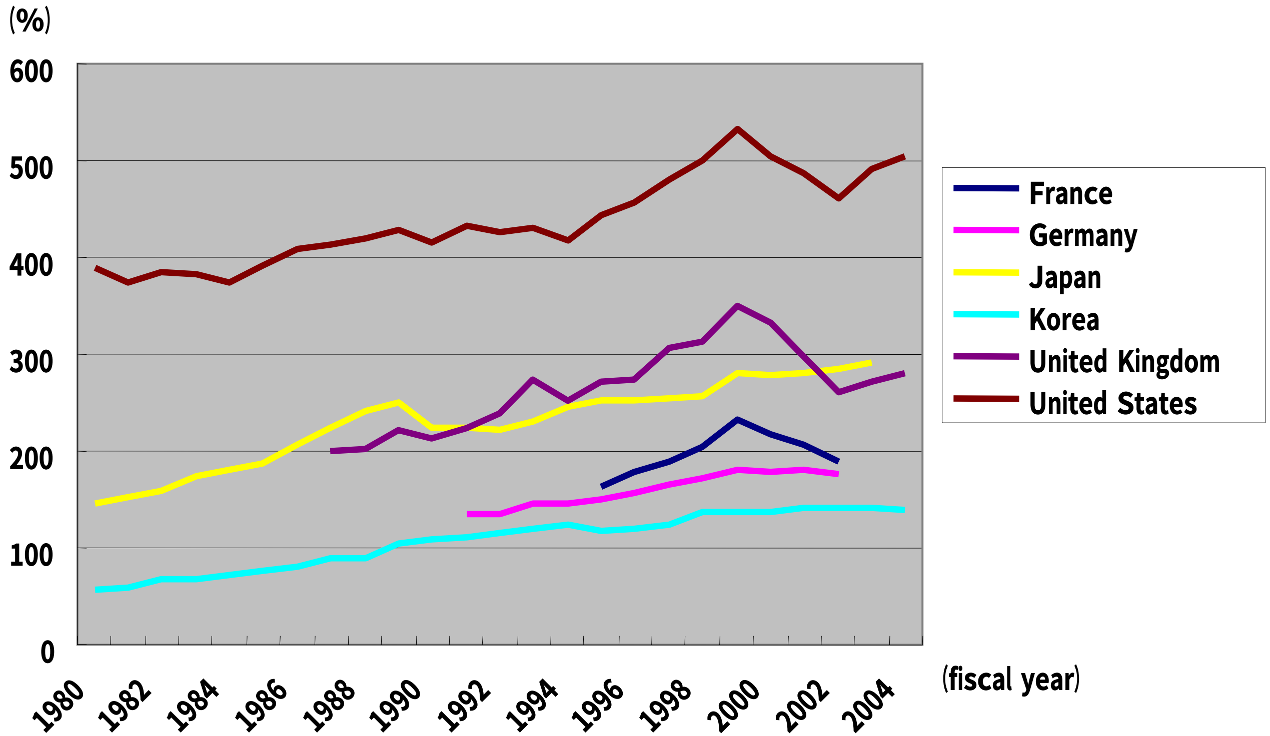
Changes in the Personal Financial Assets of Major Countries



[Note] For foreign exchange rate conversions, OECDwebNational Accounts were used.

[Data] Figures for France and Germany are from the OECD “Financial Balance Sheets Stock.” Figures for the United Kingdom are from the BLUEBOOK. Figures for the United States are from the FLOW OF FUNDS. Figures for Japan are from the National Economic Accounting Yearbook. Figures for Korea are from the National Accounting Report.

Changes in the Ratio of Personal Financial Assets to the GDP in Major Countries



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This study was conducted by Nikkei Research Inc. at the request of the Ministry of Finance, and Nikkei Research Inc. thus takes full responsibility for its wording and content.