FOREIGN DIRECT INVESTMENT AND ECONOMIC ETHNOCENTRISM IN JAPAN

by

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B.A., Hitotsubashi University, 1960

A THESIS SUBMITTED IN PARTIAL FULFILMENT OF

THE REQUIREMENTS FOR THE DEGREE OF

MASTER OF BUSINESS ADMINISTRATION

in the Faculty of

Commerce and Business Administration

We accept this thesis as conforming to the required standard

THE UNIVERSITY OF BRITISH COLUMBIA

May, 1972

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ABSTRACT

This study has a twofold purpose. The first is to investigate the background and development of Japan's policy on the liberalization of international capital movements and the second is to explore the characteristics of Japanese economic nationalism.

By the late 1960's Japan had succeeded in expanding her economy to the level of the economies in the European countries. Rapid increases in U.S. imports from Japan, which reflected Japanese economic expansion made U.S. enterprises realize that Japanese industry had become strong enough to decontrol foreign investment in Japan to a further extent than she had until then.
But the Japanese thought that their industry was not developed enough to compete with multinational corporations because of the inherent vulnerability of Japanese enterprises and industries arising from the financial incapability of firms and excessive competition in major industries.

Thus Japan has maintained a restrictive policy on foreign inward investment, with the principle that every Japanese industry should be controlled by nationals. In the course of her economic development, Japan proceeded with a five-year capital liberalization program from 1967 to 1971. Nevertheless, Japan's economic policy on foreign investment remains more restrictive than those of Western developed countries. Japanese policy is significantly affected by

feelings of economic nationalism rather than considerations of economic welfare.

In this paper a model of economic ethnocentrism is formulated with the purpose of explaining the characteristics of economic nationalism in Japan. Japan possesses unique social, cultural and political conditions which have lasted for a long time. These unique traditional traits of Japanese society remain influential enough that Japan's industrial organization, formal and informal, is able to be distinguished from that of Western countries. The basic attitudes of the Japanese towards foreign investment are derived from complex economic, socio-cultural and political conditions. This study attempts to synthesize several major factors which affect the Japanese attitudes which influence policies on foreign investment in Japan.

TABLE OF CONTENT

PAGE

LIST OF TABLE

TABLE		PAGE

LIST OF EXHIBITS

INTRODUCTION

PURPOSE OF STUDY

There are two objectives to this study. The first is to investigate the background and development of Japan's policy on the liberalization of international capital movements. For this purpose there will be discussions on three aspects of the Japanese economy. First, the degree of and reason for maintaining rapid economic development in Japan will be described. Second, the international competitive position of large Japanese firms will be examined and comparisons between domestic and foreign large firms will be made. Measures of sales, profitability, productivity, financial structure, and comparative costs will be used. Third, the behavior of foreign associated firms[1] in Japan will be discussed.

The second, and more important, objective of this study is to explore the characteristics of Japanese economic nationalism. We will argue that government policy on foreign investment is seriously influenced by Japan's economic nationalism. We will explore the nature of this economic nationalism and will attempt to compare the difference between it and that of Western countries.

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1. A foreign associated firm is defined as a firm in which more than 30 percent of its outstanding shares are owned by non-residents (A foreign branch in Japan is excluded). This classification is based on the standard adopted by the Ministry of International Trade and Industry in its research studies.

A model of economic ethnocentrism will be used to explain the phenomenon of economic nationalism in Japan.[2] This model will be used to examine economic nationalism in the light of the social, cultural, and political environments of modern Japan.

IMPORTANCE OF STUDY

To investigate the background and development of Japan's policy on the liberalization of international capital movements is important as it may give us a clue to understanding one of Japan's contemporary economic problems in international relations - opposition to her restrictions on foreign investment in Japan. Understanding the background and development of Japan's capital liberalization is important if one wants to understand Japan's basic attitude toward foreign investment.

It is also important to examine the characteristics of Japanese economic nationalism because this nationalism is a major factor affecting Japan's policy on foreign investment. Without a clear understanding of the characteristics of Japanese economic nationalism it is hard to understand the Japanese attitude towards foreign investment. It is not enough to criticize Japan's foreign investment policy as being too conservative simply from Western standards without analyzing the reason for her restrictive policy. It is reasonable to assume that each country has

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2. The term of economic ethnocentrism is used in this paper to explain Japanese economic nationalism. It is a particular type of economic nationalism and this term and the model it refers to excludes any notion that ethnocentrism is a tendency to view alien cultures with disfavor, resulting in a sense of inherent superiority.

several determinant factors of its economic policies which are unique to that country. It is important, therefore, to analyze the socio-cultural and political background from which derives the logic of Japanese attitudes towards foreign investment.

An analysis of economic nationalism in Japan with respect to the foreign investment policy has not been systematically developed and the model of economic ethnocentrism attempts to do this. It is formulated with the intention of synthesizing several major factors which affect Japanese attitudes.

CHAPTER ORGANIZATION

Chapter II provides a discussion of three aspects of the economic environment in which capital liberalization policies have developed. These are: to demonstrate Japan's rapid economic growth (and the factors which caused this growth), the international competitiveness of Japanese industries, the magnitude and significance of the activities of foreign associated firms in Japanese industry.

Chapter III is a study of Japan's capital liberalization program. Examination of the development of Japan's policy on foreign investment will show how government policy affected the degree of penetration of foreign capital in Japan and how the policy was affected, in turn, by the changing economic circumstances. Implications of Japan's capital liberalization programs, undertaken during the 1967-1971 period, will be drawn and the effects of the basic policy of the government will be studied.

In chapter IV a model of economic ethnocentrism will be formulated. In developing the model I will try to find an explanation of Japanese attitudes towards foreign investment. The main proposition of this chapter is that Japanese economic nationalism is based on a complex economic, socio-cultural, and political environment in Japan, and is quite different from that of Western countries.

CHAPTER II

ECONOMIC DEVELOPMENT AND FOREIGN DIRECT INVESTMENT IN JAPAN

The objective of this chapter is to provide background to Japanese and foreign attitudes towards foreign inward investment in Japan. Japan's rapid economic growth in the postwar period was attained under strong government protection of domestic industry. The high rate of growth and increasing national income in Japan made the Japanese market fairly attractive to many multinational enterprises. In spite of their keen interest in participation in the Japanese industry the entry of foreign enterprises was restricted by the Japanese government. These organizations have been requiring Japan to loosen her control on foreign investment but Japan has resisted and has her own logic for her policy of foreign investment control.

This chapter is divided into three sections. The first section deals with economic development and the factors which enabled the Japanese economy to grow faster than any other nation. In section two the international competitiveness of large Japanese firms is examined using measures of sales, productivity, financial structure, and comparative costs. Finally, the performance of foreign associated firms in Japan is discussed. Activities of foreign associated firms have been insignificant to the Japanese economy as a whole. Notwithstanding this, there are instances of success of individual foreign enterprises because of their advanced technology and/or differentiated products.

1) FACTORS LEADING TO A HIGH RATE OF ECONOMIC GROWTH IN POSTWAR JAPAN

The economic reconstruction and development in postwar Japan has been so strikingly rapid compared with that of other developed nations that one might view this phenomenon as miraculous in world economic history. In order to find clues to Japan's success in maintaining high rates of economic growth over the past two decades and, indeed, during the 1920's and 1930's, economists have analysed the Japanese economic structure and factors for economic development. Japan's growth of real GNP during the 1913-1938 period has been estimated at a compound rate of 4.0 percent while the rate in U.S.A. has been estimated at 2.0 percent, Norway's at 2.0 percent, with Italy's, Germany's and France's at 1.7 percent, 1.6 percent, and 0.9 percent respectively.[3]

Japan's rapid growth in the 1950's and 1960's has been impressive and has allowed Japan to gain a more important position in the world economy than she achieved in the prewar period. But Japan has not been alone. Some of the developed nations had growth rates higher than the prewar rates. Table 2-1 shows that while Japan's GNP grew by 7.7 per cent a year from 1950 to 1960, a rate well above that of any other developed countries except West Germany which grew by 7.9 per cent, both Austria and Italy grew by 5.8 per cent and 5.5 per cent respectively and the growth rate in France was 4.3 per cent.

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3. Angus Maddison, Economic Growth in Japan and the U.S.S.R., New York; W.W. Norton & Company Inc., 1969, Table 9a on p. 36.

Table 2-1 International Comparison of Average Annual Rates of Growth of Real GNP (per cent)

	Total			Per Capita	
	1950-60	1955-60	1960-68	1950-60	p960-68
Austria	5.6	5.0	4.1	5.7	3.6
Canada	3.9	3.1	5.6	1.2	3.7
France	4.3	4.4	5.5	3.4	4.3
West Germany	7.9	6.0	4.3	6.8	3.2
Italy	5.5	5.6	5.0	4.9	4.2
Japan	7.7	8.5	10.3	6.5	9.1
Sweden	3.5	3.6	4.6	2.9	3.8
U.S.A.	2.9	2.2	5.0	1.1	3.6
U.K.	2.7	2.4	3.0	2.3	2.3

Source: For 1955-1960 data, United Nations, Year book of National Accounts Statistics 1969, New York; United Nations, 1970, pp. 113-129. For others, United Nations, Statistical Yearbook 1969, New York; U.N., 1970. pp. 550-552.

However, Japan was able to accelerate her rate of growth in the 1960's from 8.5 per cent in the 1955-60 period to 10.3 per cent in the 1960-68 period, while the growth rate of Germany, Austria and Italy slowed to 4.3 per cent, 4.1 per cent and 5.0 per cent respectively during the 1960-68 period. France's increased to 5.5 per cent.

SEVEN FACTORS IN THE DEVELOPMENT PROCESS

It is not easy to isolate the determinants of rapid growth in the Japanese economy. Many economists try to explain Japanese economic growth in terms of several factors.[4] Some of them are common to all observers and others are not. Based on these analyses, we can identify the following possible factors causing rapid growth in the Japanese economy:

(1) recovery,

(2) high investment and savings,

(3) education,

(4) group loyalties,

(5) strong leadership in the government,

(6) banking and credit, and

(7) absense of economic waste via military expendirue.

(1) Recovery Factor: Japan relied heavily on foreign countries for her raw materials and the lack of these coupled with a shortage of manpower in the industrial sector during the war caused a decline in production. Furthermore there was considerable damage to Japanese cities and production facilities from war-time bombing. At the end of the war Japan's industrial production and real GNP were about 40 per cent and 57 per cent respectively of the prewar level, the average from 1934 to 1936. There was a strong desire to recover the lost ground. It fully took ten years for Japan's GNP to recover to the prewar level and GNP per capita was only able to exceed the past highest level in 1955. The relevant data are presented in Table 2-2. 'A White Paper on the Economy', published by the government in

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4. Angus Maddison, for example, pointed out five determinants of economic growth in Japan, and Norman Macrae observed seven factors, while Herman Kahn and Miyohei Shinohara explained Japanese economic growth in terms of twelve and fourteen factors respectively. See Angus Maddison, op. cit., Norman Macrae, 'The Risen Sun, The Economist, (May 27 and June 2, 1967), Herman Kahn, The Emerging Japanese Superstate, Englewood Cliffs, N.J.; Prentice Hall, Inc., 1970 and M. Shinohara, Structural Changes in Japan's Economic Development, Tokyo; Kinokuniya Book Store Co., 1970.

1956, declared that the Japanese economy had recovered from the damage caused by World War II with the subtitle "It is not the post-war any more". Since this period Japan entered in a new phase of economic development emphasizing her investment in non-key industries such as chemicals, electric products, and automobiles, which were relatively new to Japan.

Table 2-2 Industrial Production and Level of Consumption Indices (1934-1936 = 100)

year	production	real GNP	GNP per capita	Consumption
1934-1936	100.0	100.0	100.0	100.0
1946	39.2	57.1	52.0	-
1947	46.2	60.5	53.3	59.0
1948	61.8	70.6	60.6	65.0
1949	76.7	81.6	68.5	70.0
1950	88.0	97.2	80.1	82.0
1951	119.4	107.1	86.9	85.8
1952	131.8	117.5	94.0	98.9
1953	161.2	124.1	98.2	108.7
1954	173.5	127.8	99.4	111.9
1955	187.9	141.3	108.6	117.5
1956	228.7	155.5	118.2	119.5

Source: Kiyoshi Oshima & Masso Enomoto, Sengo Nihon no Keizai Katei (Economic Trend in Postwar Japan), Tokyo; Daigaku Shuppankai, 1968, p. 31.

(2) High Investment and Savings: Another important factor in economic development in Japan was the heavy fixed capital investment. Japan stepped into the technological innovation boom in 1956 as she passed out of the rehabilitation period. During 1955-1961, the relative importance of capital investment in industries such as electric utilities, steel, and the shipping industry was declined in the face of growing importance of chemical, electric, automotive, and machinery industries. Accompanying this was the showing spread of technological innovation to a wide range of industries,

Reflecting the Japanese investment boom, the proportion of fixed capital formation in real GNP was higher than that of any other developed country. During the 1956-1963 period, the proportion of capital formation in Japan was 34 per cent of GNP, while it was 25 per cent in West Germany, 23 per cent in Italy, 21 percent in France, 17 per cent in the U.S. and 24 per cent in Canada.[5]

Table 2-3 Annual Rate of Growth of the Effective Demand Items (%)

	GNP	consumption	investment of private	resid.	gov't inv.	gov't expend.	export
1953-1957	8.2	6.8	16.2	12.0	7.5	0.9	13.6
1957-1961	11.4	8.8	20.7	14.0	17.1	5.3	10.6
1961-1964	9.5	9.5	6.1	19.0	16.7	9.0	17.3
1964-1967	9.8	7.7	12.1		9.2	5.7	13.5

Source: Takahide Nakamura, Sengo Nihon Keizai (Post War Japanese Economy), Tokyo; Chikuma Shobo, 1968, p. 116.

If we compare the factors of effective demand which make up gross national product, the point becomes clearer, As shown in Table 2-3, the annual growth rate of private investment increased from 16.2 per cent in the 1953-1957 period to 20.7 per cent in 1957-1961, which was the period with the highest rate of growth followed by government investment (17.1%) and private residential investment (14.0%). During the 1961-1964 period though the growth rate of private investment slowed substantially, private residential investment and government investment maintained their high rates. Table 2-3 points to another important trend

5. P.B. Stone, Japan Surges Ahead, London; Weidenfeld & Nicolson, 1969, p. 65.

in economic growth: the rapid growth in exports made an important contribution to GNP growth in the 1960's, showing a rate of growth of 17.3 per cent in the 1961-1964 period and 13.5 per cent in the 1964-1967 period.

(3) Eduction: It is not easy to explore any detailed quantitative relationship between education and economic growth. Notwithstanding this, there has been some cross-country analysis on the economic consequences of human resource development including work by Harbison and Myers. They found in their analysis a close association between enrollment ratios at all levels of education and GNP per capita. Regarding education in Japan, they pointed out that,

> "The statistics would indicate that relative to GNP, Japan has overinvested in education, but the fact that its economic development has been rapid and that its current rate of economic growth is the highest of any industrial nation suggests a causal connection between an educated labor force and subsequent economic growth. Japan made an initial heavy investment in developing an educational system, and this has certainly contributed to later rapid economic growth."[6]

In the modern society of Japan after the Meiji Restoration, education has played a significant role in the vertical structure of Japanese society. Positions of high standing were only open to educated people in both private and government organizations. This over-emphasis on academic degrees (gakureki hencho) in Japanese society instilled in the people a very strong desire to have their children enter universities, leading to a heavy investment in education compared with other countries.

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6. Frederick Harbison & C.A. Myers, Education, Manpower and Economic Growth, New York; McGraw-Hill, 1964, p. 184.

(4) Group Loyalty: As will be discussed in chapter four, the notion the Japanese have of business management is that 'an enterprise is one family'. This paternal family system works as a bond of co-operation. The personnel system of Japanese business based on this family concept is characterized by lifetime employment, seniority-based reward system, and collective orientation. Under this management system employees identify their personal goals with organizational goals. They work for the company because prosperous activity of the firm results in prosperity of employees.

The loyalty of people to the company is deeply related to their loyalty to the nation. Japan is a society and culture which is probably more interested in national prestige than any other in the world today; one in which issues of national prestige arouse intense loyalty and commitment and tap deep sources of public identification. This situation creates a sense of common purpose among labor and management in a successful corporation, which in turn evokes public interest and applause.[7] Because of this feeling, people tend to willingly make whatever adjustments and sacrifices are necessary for the nation's economic growth.

(5) Government Leadership: It is true that the government's role has been an important factor in rapid economic development in two respects. First, as shown in Table 2-3, government expenditure in goods and fixed assets has been of significance in the growth of GNP. Secondly, the government has made active commitments to achieving the goal of a high rate of economic growth

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7. Herman Kahn, The Emerging Japanese Superstate, Englewood Cliffs, N.J.; Prentice-Hall, 1970, p. 113.

by means not only of statutory powers but also through consultation, advice, persuasion and threat. The government's role was particularly eminent in protecting domestic enterprises from foreign competitors in their earlier stage of development. Miyohei Shinohara stated in this regard,

> "Under import restrictions, many industries which were 'infant' about fifteen years ago have now grown up as powerful export industries. If foreign trade liberalization had already been enforced in the early postwar period, I feel that such quick emergence of highly competitive industries, e.g., iron and steel and automobile, etc., would not have been made possible... The growth of 'infant industries' was not limited to a few sectors, but spread to the other sectors of the postwar economy. Consequently many of the export industries developed and proved to be important contributions of high growth rate.[8]

We have discussed the demand side of the national economy such as private investment, government expenditure and exports. It is also important, however, to consider the supply factors of GNP. As a factor of production, the labor force was in a favorable position to meet the expanding demand which accompanied the vigorous private investments. As it has usually happened in the course of economic development elsewhere, the labor supply needed to expand the manufacturing and service industries in Japan has been provided by the agricultural sector, resulting in a decline of farm labor from 16.1 million in 1950 to 13.2 million in 1960 and 10.85 million in 1965.[9] This labor mobility between sectors had a strong effect upon the high rate of growth because the relatively low wages acceptable to workers coming out of agriculture, combined with the high level of technology introduced from abroad, resulted in internationally competitive prices, and the expansion of exports.

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8. Miyohei Shinohara, Structural Changes in Japan's Economic Development, Tokyo; Kinokuniya Bookstore Co. Ltd., 1970, p. 20.

9. Ibid., p. 15.

(6) A Unique Credit System: The most striking feature of the economic factors which supported a high growth rate on the supply side was a unique financial and credit system in Japan. It is frequently mentioned that Japanese entrepreneurs have been vigorously investing by means of external financing. For example, Robert Guillain observes this investment behavior of Japanese entrepreneurs as vulneralbe nature of the Japanese economy. "It would be unwise to overlook still another vulnerable aspect of Japanese economy: that of the very important companies. The vulnerability lies in the weakness of the financial underpinning of investment and production. The equipment and the expansion of large scale Japanese industry are based, as they were in the past, upon massive borrowing by the companies from the banks, a running into debt that would be looked upon as extremely rash in other countries....All these practices give the foreign observer the impression of a card house that would collapse in the event of a serious crisis.."[10]

Under the expanding economy, however, they had to continue to increase their investment outlay as long as they can borrow from the banks in order to maintain or increase their market or production shares. Japanese commercial banks advanced a large amount of funds for investment in plant and equipment, concentrating on affiliated big companies rather than on a wide range of enterprises. The government also supported this financial structure, directly through such channels as the Reconstruction Finance Bank, Counterpart Fund Account and Japan Development Bank, and indirectly

10. Robert Guillain, The Japanese Challenge, (English ed.), Philadelphia; J.B. Lippincott Co., 1970, pp. 279-280.

by means of loans from the Bank of Japan to the commercial banks. The particular system of capital supply in post-war Japan may be due to the underdeveloped domestic capital market. The point to be noted, however, is the fact that the entrepreneurs' demand for capital was too great to be met by the capital market since they were prepared to invest in spite of high debt-equity ratio because of their expectations of continuous product market expansion in the future. This built-in financial credit system, on the other hand, supported private investment and accordingly Japan's economic growth.

2) INTERNATIONAL POSITION OF JAPANESE INDUSTRIES

The purpose of this section is to investigate the efficiency and scale of Japanese industries relative to foreign corporations.

COMPARISON BY SALES

According to Fortune magazine, Japan's largest manufacturing corporation (Hitachi Co.) was in 12th position in terms of sales among the 200 largest firms outside the U.S. in 1967. Forty-three Japanese firms were listed among 200. This number was the largest of any country after Britain which had 53 firms listed. The third and fourth countries were Germany and France which had 25 and 23 firms respectively. By 1970 Japan had moved up to first position. Indeed as table 2-4 shows, twenty Japanese firms were included in the 100 largest firms which was the same number that Britain had in this category. Two firms were ranked within the largest ten: Nippon Steel and Hitachi were 6th and 9th respectively.

Table 2-4 The 200 Largest Industrials Outside the U.S. in 1970

countries	number	1-100	ranked 101-200
Japan	51	20	31
Britain	46	20	26
Germany, West	26	17	9
France	21	15	6
Canada	11	4	7

Source: Fortune, August 1971.

These illustrations may indicate that big business in Japan has developed enough to be competitive with European enterprises. However, compared with the U.S. firms Japanese firms are still small in scale, since only 32 Japanese firms were comparable in size to some of Fortune's 200 largest U.S. companies and only 10 firms were comparable to the 100 biggest U.S. firms in 1970.[11]

PROFITABILITY COMPARISON

The Ministry of International Trade and Industries (MITI) published comparative studies of the large corporations of the world in a book entitled Sekai no Kigyo no Keiei Bunseki (An Analysis of Enterprises in the World), in which it compared 190 U.S. firms, 107 Japanese firms and many firms of European countries in major industries.[12]

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11 The 200th largest firm in the U.S. in 1970 was Essex International with sales of $588.5 million, comparable with $600 million sales of Teijin the 32nd largest firm in Japan and the 136th in the 200 largest firms outside the U.S. See "The 200 largest Industrial Companies Outside the U.S.", Fortune, August 1971, pp. 150-155.

12 MITI, Sekai no Kigyo no Keiei Bunseki (An Analysis of Enterprises in the World), Tokyo; Okurasho Insatsukyoku, 1971.

For the thirty-two industries studied, net profit to total assets ratio, profit on sales, and the turnover ratio of total assets during the three years from 1966 through 1968 were taken.

In comparison with European enterprises, there were eight industries in which Japanese firms were judged to be less profitable in terms of the net profit to assets ratio. These industries included shipbuilding, chemicals, plate glass, paper products, petroleum, nonferrous metal, food products.[13] Japanese enterprises were more profitable than European big firms in seven industries, such as special steel, agricultural machinery, construction machinery, bearings, electronic components. When the net profit on sales criteria is adopted, European firms were superior to Japanese firms in only five industries; chemicals, paper products, petroleum, food products, and department stores. In eight industries, on the other hand, the Japanese firms were more profitable than European enterprises and in another seven industries, there were no significant difference between them. If the U.S. firms come into the scene, the situation becomes quite different. In terms of the net profit to total assets ratio, the Japanese firms were more profitable than U.S. firms in only three industries: sewing machines, electronic components, and sporting goods, while in nineteen major industries Japanese firms were less efficient and in ten industries they were equivalent to the largest U.S. firm in each industry.

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13. For the comparison the biggest firm of Japan and Europe in each industry were taken and if the ratio of foreign firms lay above that of Japanese firms by 20 per cent in an industry, the European firm was decided to be more profitable than the Japanese firm. If the difference of the ratio falls within 20 per cent, the industry in question is considered to be no different in profitability from Japan. This is based on the criteria which MITI adopted in its research.

PRODUCTIVITY COMPARISON

In the MITI research, eight measures of comparative productivity were used. Using these measures the competitive situation of Japanese big business becomes worse than the positions measured by scale and profitability. For example, the ratio of value added to sales indicates that none of the Japanese industries were superior to any European or U.S. firm. Only two industries, ordinary and special steel, were at the same level.[14] If we use the labor productivity to value added as a basis for measurement, Japanese firms were superior to European industries as a whole. Japanese labor productivity was higher than in Europe in half of the ten available industries in the MITI research and equivalent in the rest of them. Compared with the U.S., however, in all 18 industries the labor productivity of U.S. firms exceeded that of Japanese firms by more than 20 per cent.

In interpreting productivity analysis using gross value added, however, it is important to note that there exists a different industrial structure in Japan than in Western countries which may affect the components of gross value added. It is common for Japanese manufacturing corporations to separate the distribution channels from their business function, while major Western firms have their own sales network and, therefore, the sales margin is included in gross value added. The comparative analysis of the competitive strength of the biggest enterprises in each industry discussed above indicates that Japanese big business is, as a whole, strong enough to compete with large European firms, but the evidence of their competitive strength vis-a-vis their large U.S. counterparts is not conclusive either way. The Japanese, however, tend to consider that the larger in size, a

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14. MITI op. cit., Table 6 on p. 24.

firm is the stronger is its competitiveness. For this reason the MITI research concludes that Japanese large firms are inferior to large world enterprises which have adopted the policy of vertical intergration in their marketing channels.[15]

FINANCIAL STRUCTURE

Another aspect of comparative vulnerability of Japanese firms which has resulted from their high rate of expansion is their very weak position in capital structure. When a Western financial analyst takes a look at the balance sheet of a Japanese firm, he will be surprised at the financial structure as compared with the Western standards. As shown in Table 2-5, Japanese companies as a whole have obtained more than three-quarters of their total capital from external sources. It seems reasonable to argue that this high debt-equity ratio increased the burden of fixed costs to the extent that most Japanese firms are in a weak position in the face of business fluctuations.

Table 2-5 Capital Structure of Major Firms in Developed Countries*

name	no. of firms	liabilities (%)	Shareholder's equity (%) paid in	surplus	total
Japan	107	75.5	12.1	12.4	24.5
U.S.	190	43.1	10.9	46.0	56.9
Canada	12	47.0	14.0	39.0	53.0
Britain	33	43.6	16.4	40.0	56.4
Germany, West	33	56.6	17.8	25.2	43.4
France	13	58.4	22.5	19.1	41.6
Italy	8	66.2	20.2	13.6	33.8
Belgium	6	54.1	18.6	27.3	45.9
Switzerland	8	56.7	12.8	30.5	43.3
Sweden	5	61.3	12.9	25.8	38.7

*average of major firms in each country in 1968
Source: MITI Sekaino Kigyo no Keiei Bunseki (An Analysis of Enterprises in the World), Tokyo; Okurasho Insatsu Kyoku, 19 , pp. 62-63

15 MITI Sekaino Kigyo no Keiei Bunseki (An Analysis of Enterprises in the World)p. 12

Since most Japanese firms are more or less in this situation, this may not be a significant problem so long as they compete with each other domestically. However, Japanese feel the weak capital structure of Japanese firms will impose a severe handicap on them in competing with the world enterprises.

PRODUCTS IN INTERNATIONAL MARKETS

The discussions above show some ways of comparing the top Japanese and Western firms. Those comparisons were by the amount of sales, profitability, and productivity. But such comparisons neglect specific comparison of products in international markets. It is necessary, therefore, to analyse the change in the competitive strength of Japanese export goods in the world market. Table 2-6 describes the substantial expansion of Japan's share in each import market in the world during the 1960's. In the South East Asian countries, the share of imports from Japan has been the highest and has rapidly increased from 14.0 per cent in 1961-63 to 23.1 per cent and 25.9 per cent in the 1967-69 period and 1970 respectively.

But a more significant fact is that Japanese commodities have been increasingly imported in the U.S. In the 1961-1963 period imports from Japan were 8.5 per cent of total U.S. imports and this increased to 13.1 per cent in the 1967-69 period and to 15.5 per cent in 1970. Apart from the competitive strength of the individual firms, this is an important fact which should not be ignored in considering the economic relationship between the U.S. and Japan in the light of Japan's capital liberalization program, which will be discussed in the following chapter.

Table 2-6 Share of Japanese Commodity in the World Import Markets (%)

markets	1961-1963 average	1967-1969 average	1970
Whole Area	3.4	5.4	6.2
Developed Area	2.5	4.1	4.8
U S A	8.5	13.1	15.5
E C	0.8	1.2	1.5
E F T A	1.2	2.1	2.4
Australia & South Africa	5.2	9.9	12.1
Developing Area	7.6	12.2	13.3
South East Asia	14.0	23.1	25.9
Middle East	4.8	7.3	7.3
Africa	5.1	8.4	9.0
South Ameirca	3.9	5.3	6.6
Communist Countries	1.2	2.5	3.3

* FOB price for import and export

Source: Japanese Economic Planning Agency, Nenji Keizai Hokoku: 1971 (Annual Economic Report: 1971), Tokyo; Okurasho Insatsukuoku, 1971, p. 111.

This increasing importance of the Japanese economy in the world import market over the last decade can be explained by the classical theory of comparative costs. According to this theory, Japan would increase her exports if the increase in labor cost per unit of product for Japanese commodities were lower than the increase in the labor cost for U.S. commoditites.[16] The historical data support this statement in the sense that the labor cost/unit of goods in Japanese manufacturing industry remained stable from 1963 to 1968, while the U.S. labor cost/unit of goods increased by 7 per cent in the same period (see Table 2-7).

16 Concerning the theory of comparative cost, see Richard E. Caves, Trade and Economic Structure, Models and Methods, Boston, Massachussets; Harvard University Press, 1960, chapter 2. Or Gerald M. Meier, International Trade and Development, New York; Harper & Row, 1963, chapter 2.

Table 2-7 A Trend of Labor Cost in the Manufacturing Industry
(1963 = 100)

	Japan	U.S.A.	Germany	Italy	Britain	France
1960	92.1	103	86	87	94	89
1961	93.2	103	92	88	100	92
1962	99.2	102	98	90	101	95
1963	100.0	100	100	100	100	100
1964	98.7	99	99	103	101	100
1965	103.6	99	105	100	106	102
1966	102.4	101	110	95	111	101
1967	99.4	102	105	96	110	102
1968	99.9	107	101	95	112	106
1969						
Jan.-Mar.	97.4	109	104	93	116	105
Apr.-Jun.	99.9	109	104	97	117	105
Jul.-Sep.	101.2	110	109	100	117	108
Oct.-Dec.	102-5	113	109	105	120	108

Source: Japanese Economic Planning Agency, Nenji Keizai Hokoku: 1971 (Annual Economic Report: 1971), p. 308.

Technological innovation and private investment in Japan, since the 1950's has increased productivity enough to absorb increases in wages. The wage index in Japanese manufacturing industries skyrocketed from 100 in 1960 to 273.0 in 1969 (average annual rate was 11.8 per cent), while the index in the U.S. rose annually by 3.9 per cent on average in the same period to 141.1.[17]

In this section we have discussed two aspects of the international competitiveness of Japanese firms, the comparison of efficiency of big firms between Japan and Western countries, and the competitive situation of Japanese products in the U.S. market. On one hand, the Japanese are apt to be sensitive to the weakness of large Japanese firms compared with

17 MITI, Sekai no Kigyo no Keiei Bunseki (An Analysis of Enterprises in the World), p. 42.

U.S. counterparts when they have to consider liberalization of capital movements and let domestic firms compete with world enterprises on the same ground. U.S. businessmen, on the other hand, may become more and more sensitive to Japanese penetrations into their domestic market with the restriction on U.S. investment in Japan. Therefore, the Japanese capital liberalization policy and U.S. criticism of this policy, which will be discussed later, are based on the judgement of the international competitiveness of Japanese firms from the two different aspects of the characteristics of Japanese economy as discussed above.

3) PERFORMANCE OF FOREIGN ASSOCIATED FIRMS IN JAPAN

Before analysing foreign direct investment in Japan, it may be useful to see the inflows of foreign capital into Japanese economy. The total inflow of foreign capital during the 1950-1968 period was $6,826 million, among which $5,049 million or 73.9 per cent of total foreign capital flowed into Japan in the form of loans, $1,371 million or 20 per cent was portfolio investment, and only $394 million or 5.7 per cent was direct investment (Table 2-8). Since the private fixed capital investment of a single year (1968) was $28 billion, the total foreign capital inflows over the two decades were insignificant parts of the capital formation in Japanese economy. Inflows of foreign direct investment were particularly insignificant as a proportion of the domestic capital formation of Japan.

Table 2-8 Foreign Capital Inflows into Japan, 1950-1968 (thousands of US$)

	1950-1954	1955-1959	1960-1964	1965-1968	1950-1968
Direct	26,538	33,210	167,683	166,929	394,360
Portfolio	9,033	31,282	457,385	872,978	1,370,678
Depository Receipt	766	625	5,111	1,328	7,830
Total	36,337	65,117	630,179	1,041,235	1,772,868
Loan	103,124	623,773	2,027,861	2,294,178	5,048,936
Debenture	25	80	1,281	3,141	4,527
Total	139,486	688,970	2,659,321	3,338,554	6,826,331

Source: Gaikoku Shihon no Tainichi Toshi (Inward Investment of Foreign Capital in Japan II), Tokyo; Keizai Chosa Kyokai, 1970, p. 1

GENERAL OUTLOOK FOR FOREIGN INVESTMENT IN JAPAN

Foreign direct investment is usually made in the form of a wholly owned subsidiary or a joint venture.[18] As shown in Table 2-9, since the authorization of foreign investments in Japan between the introduction of the Foreign Investment Law in May 1950 and the end of March 1969, 1,259 cases of foreign direct investment have been recorded, involving $411 million. Out of total direct investment, 25.8 per cent was distributed to the chemical industry and another 25.8 per cent flowed into petroleum. The machinery industry received 22 per cent of total foreign investment, metal, and rubber and leather products industries had 8.7 per cent and 4.5 per cent respectively. (It is important to note that the figures in Table 2-9 do not include the volume of foreign investment established on a Japanese

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18 A joint vneture includes a partial acquisition of the equity capital of an existing local firm in this paper.

yen basis prior to 1967, which was not under control of the Foreign Investment Law. Yen-based investments will be discussed in chapter 3).

The origins of foreign investment in Japan appear in Table 2-10. The United States was the most important investing country, with 59.2 per cent of the number of cases and 66.1 per cent in invested value during the 1950-1968 period. Other major investing countries in Japan were Switzerland (8.7 % in number and 9.7% in value), and the United Kingdom (6.1% in both number and value). The total U.S. capital flow into Japan between 1950 and 1968 (fiscal year) on the recorded basis was only $271.8 million. However, the U.S. investment claims in Japan, including yen-basis investment and the reinvestment of earnings, showed rather different figures from the flow of capital above. The total U.S. investment position at the 1968 year end was $1,050 million in book value, with the distribution of $405 million to petroleum, $522 million to manufacturing, $99 million to trade, and $24 million to other industries.

If we turn our attention to U.S. investment activities abroad, we can find that out of the total U.S. investment abroad, only 1.6 per cent was invested in Japan as of 1968, which made Japan the 13th largest recipient country of U.S. investment abroad. This figure was fairly insignificant to the United States compared with figures in Canada ($19,535 million or 30.1%), U.K. ($6,694 million or 10.3%), and Germany ($3,785 million or 5.8%). (Table 2-11).

Table 2-9 Breakdown of Activities of Foreign Subsidiaries and Joint Ventures Authorized under the Foreign Investment Law (Amounts in million U.S. dollars)

	1956		1958		1960		1962		1964	
	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.
Petroleum	2	1.0	0	0	1	2.2	1	5.6	4	4.6
Chemical	4	1.0	6	2.1	13	18.9	13	8.5	21	7.2
Machinery	10	1.2	9	1.5	12	6.5	23	6.5	41	12.6
Metal Product	0	0	1	-	3	1.4	1	-	5	1.7
Rubber & Leather	0	0	0	0	3	6.3	4	1.8	1	0.1
Glass & Ceramic	1	1.7	0	0	1	-	0	0	1	-
Commerce & Trade	0	0	0	0	0	0	0	0	28	1.2
Textile	1	-	1	-	0	0	1	0.2	2	0.2
Transportation	3	0.1	1	-	0	0	0	0	0	0
Construction	1	-	0	0	0	0	0	0	0	0
Service	1	0.1	0	0	0	0	0	0	5	0.1
Warehousing	0	0	0	0	0	0	0	0	0	0
Others	0	0	0	0	1	0.1	0	0	17	3.5
Total	23	5.4	18	3.7	34	31.6	43	22.6	125	30.6

	1966		1968		1950-68		Percentage	
	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.
Petroleum	2	2.5	11	11.6	57	106.0	4.5	25.8
Chemical	23	9.8	27	19.2	203	106.0	16.1	25.8
Machinery	41	7.8	47	9.2	396	90.5	31.5	22.0
Metal Product	6	5.0	29	12.2	81	35.6	6.4	8.7
Rubber & Leather	2	1.3	2	3.1	27	18.4	2.1	4.5
Glas & Ceramic	5	1.4	3	2.0	25	8.8	2.0	2.1
Commerce & Trade	36	5.8	93	2.0	268	15.4	21.3	3.7
Textile	1	0.1	1	-	35	2.4	2.8	0.6
Transportation	0	0	0	0	20	0.6	1.6	0.1
Construction	0	0	0	0	8	0.5	0.6	0.1
Service	13	0.1	5	0.7	38	1.5	3.0	0.4
Warehousing	0	0	1	0.2	2	0.2	0.2	-
Others	13	5.9	29	7.0	99	25.3	7.9	6.2
Total	142	39.8	248	67.1	1,259	411.2	100.0	100.0

Source: Gaikoku Shihon no Tainichi Toshi (Foreign Investment in Japan) Tokyo; Keizai Chosakai, 1971, pp. 5-10.

Table 2-10 Origins of Foreign Investments in Subsidiaries and Joint Ventures Authorized under the Foreign Investment Law (Amounts in million $ U.S.)

	1956		1958		1960		1962		1964	
	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.
U. S. A.	15	3.9	15	3.2	26	28.6	27	13.0	90	21.0
U. K.	4	0.7	1	0.3	2	1.3	4	7.3	7	3.0
Canada	0	0	1	-	0	0	0	0	3	0.3
West Germany	1	-	0	0	0	0	1	0.2	3	0.3
Netherlands	2	0.2	1	0.2	1	0.8	1	0.8	0	0
Panama	1	0.4	0	0	1	0.2	0	0	0	0
France	0	0	0	0	0	0	2	-	0	0
Switzerland	0	0	0	0	1	0.3	4	0.8	17	5.6
Saudi-Arabia	0	0	0	0	0	0	0	0	0	0
Kuwait	0	0	0	0	0	0	0	0	0	0
Others	0	0	0	0	3	0.4	4	0.5	5	0.4
Total	23	5.4	18	3.7	34	31.6	43	22.6	125	30.6

	1966		1968		Total		Percentage	
	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.	Nos.	Amts.
U. S. A.	77	20.7	101	41.3	74.5	271.8	59.2	66.1
U. K.	6	0.6	11	2.8	77	25.1	6.1	6.1
Canada	5	4.1	7	0.1	29	12.2	2.3	3.0
West Germany	13	0.9	27	2.5	78	9.0	6.2	2.2
Netherlands	1	1.0	9	0.3	18	9.9	1.4	2.4
Panama	2	0.6	0	0	16	5.0	1.3	1.2
France	1	0.1	11	0.3	28	2.6	2.2	0.6
Switzerland	23	9.8	16	5.6	109	40.0	8.7	9.7
Saudi-Arabia	0	0	0	0	1	6.9	0.1	1.7
Kuwait	0	0	0	0	1	6.9	0.1	1.7
Others	14	2.0	66	14.2	157	21.8	12.5	5.3
Total	142	39.8	248	67.1	125.9	411.2	100	100

Source: Gaikoku Shihon no Tainichi Toshi (Foreign Investment in Japan), pp. 11-16.

Table 2-11 U.S. Investment Position Abroad, Selected Countries, at the end of 1968 (millions of dollars)

		amounts	(%) share			amounts	(%) share
1	Canada	19,535	30.1	10	Italy	1,275	2.0
2	U. K.	6,694	10.3	11	Argentina	1,156	1.8
3	Germany	3,785	5.8	12	Netherlands	1,069	1.6
4	Australia	2,652	4.1	13	Japan	1,050	1.6
5	Venezuela	2,627	4.0				
6	France	1,904	3.1		All areas	64,983	100.0
7	Brazil	1,484	2.3		Developed areas	43,500	66.9
8	Mexico	1,466	2.3		Developing areas	18,753	28.8
9	Switzerland	1,437	2.2		Unallocated	2,731	4.3

Source: Survey of Current Business, October 1970, p. 28.

It would not be correct, however, to conclude from these figures, that Japan has been an uninteresting market for U.S. investors. In spite of minimal penetration by U.S. investors into Japanese industries, there is evidence of strong interest in investing in the Japanese market in spite of high barriers to entry set by the Japanese government in the form of the investment law and import restrictions. Proof may be the existence of U.S. firms' licensing agreements with Japanese enterprises. The number of foreign technological licenses showed a rapid increase from 100 in 1958 to 300 in 1960, 500 in 1963, and to 700 in 1968, although these figures did not show a continuous upward trend but fluctuated up and down according to the dictates of the business cycle of the Japanese economy.[19]

19 Gaikoku Shihon no Tainichi Toshi (Inward Investment of Foreign Capital in Japan II), Tokyo; Keizai Chosa Kyokai, Table 2, pp. 2-4.

Of course, this illustration does not necessarily show that the dominant fashion of licensing agreements rather than direct participation has been the alternative chosen because of Japanese government restrictions on direct investments. However, the fact that the number of instances of foreign direct investment jumped up by 200 and 248 in 1967 and 1968 respectively from 142 in 1966, when the government began to loosen the restrictions on inward investment, may suggest that the licensing arrangements had been a sign of strong interest in the Japanese market on the part of foreign investments.

THE MAGNITUDE OF FOREIGN PARTICIPATION IN JAPANESE INDUSTRY

The foregoing discussions show that foreign direct investment in Japan has been comparatively insignificant to the economy of both recipient and investing countries in terms of the flow of capital. The next question is how have foreign investors participated in the Japanese economy? What was the impact of foreign owned firms on the economy and on each industry? To find answers to these questions is to be a task of this subsection. An emphasis will be put on motives for investing in Japan, magnitudes of foreign investment, foreign ownership and control, and the positions of major foreign associated firms in each industry.[20]

Motives: According to the MITI research, the strongest reason for participation in Japanese industry was "growth potential of the Japanese market."

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20 The analysis in this part concerning 'motives', 'magnitude', and 'control is mainly based on the annual research undertaken by the Ministry of International Trade and Industry (MITI) by means of questionnaires, interviews, and disclosed data analysis.
MITI, Gaishikei Kigyo (Foreign Associated Enterprises), Tokyo; Okurasho Insatsukyoku, 1968, and MITI, Gaishikei Kigyo no Doko (A Trend of Foreign Associated Enterprises), Tokyo; Okurasho Insatsukyoku, 1971.

Among 411 foreign associated firms examined in the MITI research in 1968, 79 per cent pointed out this reason as their primary motive. It is reasonable for a foreign investor to see the Japanese market as a fairly attractive one since the Japanese economy is growing at the fastest rate and with the least amount of foreign penetration among the developed countries. It was also made clear in the same study that 89 per cent of foreign investors were investing in foreign countries other than Japan and that most of them were linked with the largest 200 U.S. manufacturing firms or the biggest 100 world manufacturers excluding U.S. firms listed by the Fortune magazine.[21]

This fact may imply that most foreign investors in Japan have, by and large, some experience in investment abroad so that they proceed to investment in Japan as a horizontal integration policy based on their world-wide marketing scope. When a world enterprise decides to invest in Japan, it may take the Asian markets into account as well as the Japanese market itself, and therefore it may intend to hold a majority share in the ownership of the subsidiary in Japan in accordance with its world marketing strategies.

For the local partners, on the other hand, the most important motive for introducing foreign capital was to acquire foreign technology. Out of the total number of Japanese partners investigated by MITI, 93 per cent stated that they desired to introduce advanced skills or established brands without foreign equity participation, but the foreign partners insisted on acquiring the equity capital of the Japanese partner or on setting up a joint venture in return for bringing their skills and know-how into Japan.

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21 Gaishikei Kigyo (Foreign Associated Enterprises), 1968, pp. 18-24.

Magnitudes: Table 2-12 shows the ratio of foreign associated firms to the total industry in terms of sales amounts, net profits, and total assets during the 1964-1969 period. The share of foreign associated firms in sales ranged from 1.37 per cent to 1.45 per cent for all industries and 2.45 to 2.83 per cent for the manufacturing industry over the five-year-period.

Net profits ranged between 0.3 per cent and 3.0 per cent for all industries and between 2.6 per cent and 4.4 per cent for the manufacturing industry. Foreign associated firms possessed between 1.8 per cent and 2.0 per cent of all industrial assets and manufacturing firms owned by foreigners possessed between 3.1 per cent and 3.6 per cent of total Japanese assets in the manufacturing industry from 1964 to 1969. Although in these three categories, the foreign associated firms showed a slightly increasing tendency from 1964, they still remained at a far less significant level than locally owned enterprises.

Regarding the significance of foreign associated firms in the major industries, the picture becomes a different one from the position in the industry as a whole. The foreign associated firms have maintained their dominant position in the petroleum industry as shown in Table 2-13. Though the significance has tended slightly to decrease for six years, 58.3 per cent of total sales in petroleum industry in 1969 still belonged to the foreign associated firms. Inthe rubber industry, on the other hand, the foreign associated firms increased their share of sales from 17.6 per cent in 1964 to 20.3 per cent in 1969. All other industries have enjoyed Japanese dominance, leaving to foreign associated firms only 7.7 per cent in medicine manufacturing, 6.1 per cent in non ferrous metal, 6.0 per cent in general machinery, in 1969.

Table 2-12 Shares of Foreign owned Firms in Japanese Industry, 1964-1969 (per cent)

	1964	1965	1966	1967	1968	1969
1. Sales Amount						
All Industries	1.37	1.38	1.40	1.37	1.40	1.45
Manufacturing Industries	2.47	2.45	2.76	2.79	2.79	2.83
2. Profit after Tax						
All Industries	0.3	2.5	2.2	2.4	3.0	2.9
Manufacturing Industries	2.6	3.8	3.4	3.5	4.4	4.4
2. Total Assets						
All Industries	1.8	1.9	1.9	1.9	1.9	2.0
Manufacturing Industries	3.1	3.2	3.4	3.4	3.6	3.6

Table 2-13 Share of Foreign Owned Firms in Major Industires, 1964-1969 (Per Cent)

	1964	1965	1966	1967	1968	1969
Food Manufacturing	0.5	0.6	0.7	0.9	0.9	0.8
Chemical Manufacturing	3.3	3.7	3.8	3.9	4.3	4.6
Medicine Manufacturing	6.2	6.7	7.4	8.4	8.0	7.7
Petroleum	62.2	60.0	58.5	59.6	58.8	58.3
Rubber	17.6	17.7	18.8	18.6	19.2	20.3
Non Ferrous Metal	4.0	4.8	4.8	4.4	6.0	6.1
General Machinery	4.2	4.4	5.7	5.1	5.7	6.0
Electric Machinery	2.5	2.4	2.9	3.3	3.2	3.3
Total(Manufacturing)	2.5	2.5	2.8	2.8	2.8	2.8
Total (All Industries)	1.3	1.4	1.4	1.4	1.4	1.4

Source: MITI, Gaishikei Kigyo no Doko (A Trend of Foreign Associated Firms' Activities), Tokyo; Okurasho Insatsukyoku, 1971.

What is the reason for foreign dominance in the petroleum industry? Among the major world oil companies, seven big firms have directly invested in Japan, in most cases, with 50 per cent of their interests in local refineries. These foreign oil firms mostly came into Japan right after the issue of the Foreign Investment Law in 1950, when foreign oil majors were able to take advantage of a seller's market in the crude oil market of the world. In addition to these favorable market conditions to suppliers, Japan's petroleum industry had to promote reconstruction of refineries with the aid of foreign capital and technology.

Given the bargaining positions of both sides, the foreign investors were able to gain an advantageous position over subsidiaries or joint ventures in Japan, which were forced to buy oil fromtheir foreign parent. This obligation was not a crucial issue to the Japanese economy so long as it was the only way for Japanese refineries partly owned by foreigners to purchase their necessary raw materials from their parent companies. The major world oil firms influence the Japanese petroleum industry not only through their subsidiaries but also by making loans to local firms. For example, Idemitsu Kosan K.K., one of the biggest local refineries, had borrowed $26 million from Esso International Co. and $40 million from Gulf Oil as of December 31, 1969. Though the interest rate and the terms of these loans are more favorable to the borrowers than the terms of domestic bank loans, the borrowers are obliged to purchase the crude oil from the foreign supplier which made the loans to them.

The situation, however, has become more complex than before. Japan's energy policy has developed into a new scene to the extent that Japan is trying to secure resources for petroleum and petrochemical industries by her own efforts, at least for a part of her total consumption in resource exporting countries. In particular Japan is trying to ensure a supply of crude oil at a stable quantity and price, independent of the dominant major world suppliers in the petroleum industry. Since the refineries and distribution channels are controlled by foreigners in the choice of crude oil, inward investment in the petroleum industry in particular, may bring about a possible conflict with the national interest in future.

On the other hand, foreign associated firms in the rubber industry, which have a share of 20 per cent of total sales, are not seen as a menace to the Japanese. There are seven foreign associates in the rubber industry of which four firms producing automobile tires share 99 per cent of the seven firms' total sales. In the tire manufacturing industry, however, the Bridgestone Tire K.K., which is a national firm, shares about one-half of the market sales, leaving the total sales of the four foreign associated firms to take only 41 per cent of the market share. Moreover the efficiency of the foreign associated firms in this industry measured by growth rate of sales, profit rate, and equity ratio were inferior to the local firms, as shown in Table 2-14.

Table 2-14 Comparison of Efficiency between Local and Foreign Associated Firms in Rubber Industry (%)

	1963		1964	
	total	foreign	total	foreign
share by sales	100.0	17.0	100.0	17.6
growth rate of sales	*100.0	100.0	* 115.5	110.9
profit rate to sales	0.6	0.3	2.9	- 0.2
equity to capital	27.6	22.6	26.7	20.4
	1965		1966	
share by sales	100.0	17.7	100.0	18.8
growth rate of sales	* 118.1	110.4	* 130.8	127.3
profit rate to sales	3.2	-0.2	4.4	-0.8
equity to capital	24.4	20.2	28.8	19.6

* includes only tire producers
Source: MITI Gaishikei Kigyo (Foreign Associated Enterprises).

<u>Ownership and Control</u>: The types of foreign investment in terms of ownership are divided into three categories in the MITI research; wholly owned subsidiaries, joint ventures, and acquisition of equity capital of existing local firms. The distinction between the second and third categories is important in the sense that the Japanese government is more concerned about foreigners taking over an existing local entity than controlling a newly established firm. For this reason the government deals with these types of foreign investment using different standards in the course of the liberalization program of inward direct investment.

According to this classification, the magnitude of ownership among the foreign associated firms in Japan appears in Table 2-15. The joint venture is the most popular form of investment, including 309 firms out of 519 total foreign associated firms followed by wholly owned subsidiaries (152 firms or 27 per cent), most of which were established on a Japanese-yen basis. If we simply assume that provided more than 50 per cent of its equity capital is owned by foreigners, a company is called a foreign controlled firm, the number of foreign controlled firms was 198 or 38 per cent of total foreign associated firms. The industries in which the foreign controlled firms are more than half of the total foreign associated firms in number are the food industry (12 firms out of 73), commerce (98 out of 134), and miscellaneous (46 out of 73). But the dominant structure of foreign ownership in Japanese industries is not more than 50 per cent of ownership and the mode of the distribution lies in the class 30%-50% range.

As the MITI research concluded, all foreign associated firms where majority ownership belongs to the Japanese are almost completely controlled by the Japanese, except for firms in the petroleum industry. Japan, therefore, has achieved great success in maintaining national independence in her

Table 2-15 Ownership of Foreign Owned Firms in Major Industries

	Joint Ventures						Partially Owned by Acquision					
%	30	30-50	50	50 - 95	95	Total	30	30-50	50	50-45	95	Total
Food	0	1	5	3	1	10	0	0	0	0	0	0
Textile	1	2	5	1	0	9	0	1	0	0	0	1
Chemistry	5	32	32	3	0	68	2	1	0	1	1	5
Medicine	0	1	8	2	0	11	0	0	0	0	0	0
Petroleum	0	0	2	0	0	2	0	1	4	0	0	5
Rubber	0	4	0	0	0	4	2	1	0	0	0	3
Non Ferrous Metal	1	9	0	0	0	10	0	0	2	0	0	2
General Machin.	6	46	17	5	0	74	8	8	0	5	0	21
Electric Mach.	4	18	3	1	0	26	0	0	1	0	0	1
Commerce	1	14	16	12	1	44	1	3	1	5	1	11
Others	7	24	12	4	0	47	4	5	0	0	0	9
Total	25	151	100	31	2	309	17	20	8	11	2	58

	Wholly Owned	Total Foreign Associated					
	100%	30	30-50	50	50-45	95	Total
Food	8	0	1	5	3	9	18
Textile	0	1	3	5	1	0	10
Chemistry	7	7	33	32	4	8	84
Medicine	5	0	1	8	2	5	16
Petroleum	0	0	1	6	0	0	7
Rubber	0	2	5	0	0	0	7
Non Ferrous Metal	0	1	9	2	0	0	12
General Machinery	9	14	54	17	10	9	104
Electric Machinery	2	4	18	4	1	2	29
Commerce	79	2	17	17	17	81	134
Others	42	11	29	12	4	42	98
Total	152	42	171	108	42	156	519

Source: MITI, Gaishikoi Kigyo (Foreign Associated Enterprises), Tokyo; Okurosho Insatsukuoku, 1968, p. 265.

industry through some elaborate strategies.

POSITION OF THE MAJOR FOREIGN-ASSOCIATED FIRMS

It may be interesting to see the performance of each individual foreign associated firm in the Japanese industry. There were 862 firms whose outstanding shares were more than 20 percent owned by foreign investors as of June 30, 1970, of which 276 firms recorded before tax net profits of more than 20 million yen during 1970.[22] The top ten profitable firms are shown in Table 2-16.

Table 2-16 Profits of Major Foreign Associated Firms in Japan in 1970

rank	name	industry	profit before tax Y millions	foreign parent firm	owner ship (%)
1	IBM Japan	electric mach.	40,453	IBM World Trade corp.	100
2	Coca-Cola Japan	food	19.635	The Coca-Cola Export Corp.	100
3	Matsushita Electronic	electric mach.	12,586	Philips	35
4	Toanenryo	petroleum	10,927	Esso Standard Mobil Petroleum	50
5	NCR Japan	machinery	8,360	The NCR	70
6	Japan Petroleum Refinery	petroleum	5,110	Caltex Petroleum	50
7	Shell Petroleum	petroleum	4,713	Shell Petroleum	100
8	Taito Pfizer	pharmaceut.	4,567	Pfizer Co.	80
9	Fuji Xerox	machinery	4,086	Rank Xerox	50
10	Asahi-Dow	chemicals	3,802	Dow Chemical A.G.	50

Source: Shukan Daiyamondo, May 15, 1971, p. 44

22 Shukan Daiyamondo, 'Shuyo Zainich Gaishi no Kasegidaka Ranking (Ranking of the Major Foreign Investors in Japan)", May 15, 1971, pp. 44-67.

This table indicates that the successful foreign investors are participating in industries such as petroleum, electrical machinery, pharmaceuticals, machinery, and chemicals. In these industries they take advantage of their advanced technology or marketing skills. They have brought differentiated products into Japan which local firms had not developed. Since the foreign investors deal with specified products, their influence on the industry as a whole may not be significant, as discussed above, but each efficient firm has a sound position in the Japanese market. For example, IBM Japan is the biggest computer producer in Japan maintaining about a 30 per cent share of total computer market. Moreover, IBM Japan has grown to be the third most profitable firm in the electrical machinery industry, following Matsushita Electric Industry Co. and Hitachi Co. (Table 2-17). The large enterprises which are partly or wholly owned by Multinational firms are clearly doing well in Japan in that the ten largest firms with foreign associates are all listed within ten profitable companies in each industry.

The businessmen and the government officials of the host countries may be worried about the foreign dominance in an industry not only in terms of the total market share of foreign associated firms, but also in terms of the existence of single dominant foreign associated company. The existence of an efficient big foreign firm which is well competing efficiently with the domestic firms may create a stronger psychological pressure on local competitors than the actual magnitude of influence of foreign investors in an industry as a whole. In this sense the investigation of performance of major foreign associated firms will be important in interpreting the government policy on liberalization of capital movements.

Table 2-17 Position of Major Foreign Associated Firms in Japanese Industry Expressed by Net Profits before Tax in 1970 [a]

rank	name	net profit million yen	rank	name	net profit million yen
Electrical machinery			Food		
1.	Matsushita Electric	84.414	* 1.	Coca-Cola Japan	19,635
2.	Hitachi	61,500	2.	Kirin Brewery	13,544
* 3.	The IBM Japan	40,453	3.	Ajinomoto	6,862
4.	Tokyo Shibaura Elec.	27,857	4.	The Calpis Food Industry	5,200
5.	Nippon Electric	25,538	5.	Meiji Seika	4,910
* 10.	Matsushita Electronic	12,586	*8.	Nestle Japan	3,599
Petroleum [b]			General Machinery		
*1.	Toa Nenryo	10,927	*1.	Japan NCR	8,360
2.	Nippon Oil	9,465	2.	Brother Industry	5,637
*3.	Nippon Petroleum Refinery	5,110	*3.	Fuji Xerox	4,086
4.	Mitsubishi Oil	3,700	4.	Janome Machine	3,268
5.	Maruzen Oil	3,550	5.	Shiruba Machine	1,009
Chemicals			Pharmaceuticals		
1.	Sumitomo Chemicals	8,890	1.	Takeda	26,738
2.	Mitsubishi Kasei	8,419	2.	Taisho	9,205
3.	Kanegafuchi Kagaku	7,959	3.	Banyu Seiyaku	8,749
4.	Ube Kosan	6,455	4.	Sankyo	7,689
5.	Showa Denko	6,069	5.	Shionogi Seiyaku	6,998
* 9.	Asahi-Dow	3,802	* 9.	Taito Pfizer	4,567

* Foreign-associated firms

a. profits in 1970 financial year for local firms, and in 1970 calendar year for foreign-associated firms.

b. in petroleum industry Idemitsu Kosan K.K. is the second largest firm in terms of sales, but its profits record is not disclosed.

Source: Foreign-associated firms = Shukan Daiyamondo, May 15, 1971
Local firms = Kaishanenkan (A Yearbook of the Quoted Firms), Tokyo; Nihon Keizai Shinbun, 1971.

4) SUMMARY FOR THE CHAPTER

(1) Japan's annual rate of growth of real GNP in the 1950's was the second highest rate after West Germany. Since the investment boom began in 1955 Japan accelerated her rate of growth in the 1960's to 10.3 per cent, This compared with the Canadian rate of 5.6 percent, and the French with 5.5 percent. These were the second and third highest respectively in the same 1960-1968 period.

There were several reasons for the success of Japan discussed by a number of economists. Seven factors have been pointed out by the writer. They include a) low level of GNP at the starting point and recovery potential, b) high investment and savings, c) high education in the society, d) group loyalties which made employees industrious for attainment on economic development, e) function of banking and credit systems which enabled enterprises to finance heavy investment, and f) absence of economic waste via military expenditure.

(2) An analysis of economic growth does not tell the strength of a country's economy. But the comparative analysis of large enterprises in Europe, the U.S., and Japan made it clear. In comparing Japanese firms with European counterparts Japanese firms have reached stronger position in terms of sales and weaker position in terms of prodictivity. Comparison by pofititability suggests to be little difference between large firms in Japan and Europe. However, large Japanese firms were less competitive in many respects than multinational corporations in the U.S. The crucial point for Japanese firms is the fact that they have comparatively weak financial capability because of their high debt-equity ratio.

International competitiveness of Japanese industry can be examined from a different aspect; comparative cost of exporting goods. Japan made a success in rapid expansion of her export in a short period of time because of her comparative advantage of product cost. Especially a dominant fashion of increase in exports to U.S. market forced U.S. enterprises to realize the competitive strength of Japanese industry.

(3) Foreign investment flowed into Japan mostly from the United States and mostly in the form of bank loans. It is important to note that foreign capital inflows during the 1950-1968 period were far less significant to the Japanese economy than domestically accumulated capital. Direct foreign investment in the same period was a little above 5 percent of total capital inflows.

Motives of foreign investment in Japan was the growth potential of Japanese industry. The magnitude of activities of foreign associated firms measured by ratios of sales, profits, and assets to Japanese industry were minimal showing less than 5 percent of the industry for all ratios. Regarding ownership and control of foreign associated firms there was no fear of foreign control of Japanese industry except the petroleum industry, in which foreign associated firms held a share of more than 50 percent of total sales in the industry.

It is important to be pointed out that major foreign associated firms enjoyed profitable performance in industries where they could take advantage of their advanced technology and/or differentiated products in the Japanese industry (e.g., I.B.M. and Coca-Cola are good examples). It is reasonable to note that the existence of an efficient large foreign firm in an important domestic industry may create a stronger psychological pressure on local competitors than the actual magnitude of influence of foreign investment in the industry as a whole.

CHAPTER III

THE CAPITAL LIBERALIZATION PROGRAM IN JAPAN

With the economic background discussed in chapter II we will investigate the development of the government capital liberalization program in postwar Japan. It will be the first task in this chapter to discuss the role of Foreign Investment Laws. We will find how the government restricted foreign investment and how Japan's capital liberalization was behind the capital liberalization of major member countries of Organization for Economic Cooperation and Development (OECD).

Section 2 will deal with development of Japan's capital liberalization policy since 1967. The strategies and degree of capital decontrol programs which were introduced in the 1967-1971 period will be examined. The descriptions in this section will reveal the fact that after the completion of the capital liberalization schedule in this period, Japan was still behind, to a great extent, the developed countires in capital liberalization policy.

In section 3 interpretations of Japan's policy on foreign investment will be given. There will be two points to be argued. One is that the government's policy was affected by foreign pressure on Japan's capital liberalization program.

1) JAPANESE RESTRICTIVE POLICY ON FOREIGN DIRECT INVESTMENT

THE FOREIGN INVESTMENT LAWS

The international capital movements in postwar Japan have been under the severe control of two domestic laws; the Foreign Exchange and Foreign Trade Control Law of 1949 and the Foreign Investment Law of 1950. The former, in general, governs the transactions of short-term capital (one year or less), while the latter is more directly concerned with foreign investment control.

Since the Japanese economy had suffered from nation-wide devastation in World War II at the time of their issuance, as indicated in Table 2-2 in chapter 2, the major purpose of these laws were to encourage foreign capital inflows in order to provide funds for economic development and to improve Japan's international balance of payments. The objective of the Foreign Investment Law, for example, is stated in Article 1:

> "It is to create a sound basis for investment of foreign capital in Japan, by authorizing the investment of such foreign capital only as will contribute to the self-support and sound development of the Japanese economy, and to the improvement of the balance of international payments, and by insuring remittances arising from foreign investment as well as providing adequate measures for the protection of such foreign capital."

It is important to note, however, that the government policy on foreign investment was fairly restrictive in the sense that only indirect foreign investment in Japan was encouraged while direct investment was discouraged in accordance with the application of validation conditions on Article 8 of the Foreign Investment Law.[23]

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23 The validation conditions which a foreign investor must meet are

(cont'd on next page)

The effectiveness of this policy is evidently substantiated by the fact that 94.3 per cent of the total capital inflow during the 1950-1968 period was indirect investment in the form of long-term loans, portfolio investment, etc., (Table 2-8, in chapter 2). The basic policy of the government under the Foreign Investment Law can be described by the following passages in a publication by the Morgan Guaranty Trust Company of New York entitled "The Financing of Business in Japan", 30th April 1965:

> "Throughout the post-war period, the Japanese Government has maintained as a general policy principle, embodied in 'naiki' or internal rules, the so-called '49% rule' which limits foreign equity in joint ventures to that percentage. With the exception of 'yen-base' enterprises, only a limited number or joint ventures have been permitted on a 50%-50% basis and it has been difficult in most cases to obtain validations in the 40%-49% range. During 1962 the Japanese Government announced that more favorable consideration would be given to participation on a 50%-50% basis. Since that time there has been some increase in the number of validations granted which permit equal participation by foreign investors in joint ventures, and it is somewhat easier to obtain validations in the 40%-49% range. Nevertheless, 50%-50% joint ventures still remain very difficult to obtain."[24]

A YEN-BASIS INVESTMENT

As an exception of the Foreign Investment Law, between 1956 and 1963,

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(cont'd from previous page)

that the investment shall directly or indirectly contribute (1) to the improvement of the balance of international payments, (2) to the development of key industries or public utilities, and (3) the investment shall be essential to the continuation or renewal of the technical licensing agreement with a key industry or public utility.

24 Quoted from the OECD publication. See Liberalization of International Capital Movements: Japan, Paris; Organization for Economic Co-operation and Development, 1968, p. 48.

a foreign firm was freely allowed to establish a subsidiary on a Japanese yen basis, without inflow of foreign currencies, subject to the condition that neither income nor liquidation proceeds would be transferable abroad. These yen-basis investments were of two categories: (1) The establishment of subsidiaries, joint ventures or wholly owned branches in the non-restricted industries.[25] There were no regulations other than those applying to resident investors in a particular line of business, (2) Capital increases of any existing direct investments, whether they had been made on a yen-basis or individually authorized. There were no formalities or regulations.

The yen basis regime, however, came to an end in June 1963 as a result of the simplification and unification of the foreign investment system taken in compliance with Japan's approval of Article 8 of the International Monetary Fund's charter which required all subscribing nations to guarantee repatraition of principal and earnings of international corporations and Japan's joining the Organization for Economic Cooperation and Development (OECD) in 1964. In joining the OECD Japan agreed to sign the Code of Liberalization of Capital Movement and the Code of Invisible Current Transactions. In accordance with the code of capital liberalization, 37 items for capital liberalization are specified which oblige the signatory country to take measures to liberalize these areas as quickly as possible. Japan made eighteen reservations out of 37 items with respect to capital movements, which was the third largest number of reservations lodged by the 17 member countries (Table 3-1).

25 The non-restricted industries mean industries other than banks, electricity, gas and water utilities, railways and other transport utilities, road building, port and harbour operations, and trust businesses.

Table 3-1 The Number of Reservations for OECD Liberalization Code Lodged by the Member Countries (As of August 31, 1966)

name	total (37)	list A (27)	list B (10)	name	total (37)	list A (27)	list B (10)
West Germany	0	0	0	Sweden	13	4	9
Belgium	0	0	0	Italy	13	6	7
Luxembourg	0	0	0	Britain	14	8	6
U.S.A.	1	1	0	Ireland	15	9	6
Switzerland	3	0	3	Norway	17	8	9
France	7	1	6	Japan	18	9	9
Holland	9	2	7	Spain	19	9	10
Austria	9	4	5	Portugal	28	18	10
Denmark	12	4	8				

* Greece, Turkey and Ireland are exempted from the obligation of capital liberalization

* Canada does not sign the Code of Liberalization of Capital Movement.

Source: Masao Kanno, Shihon Jiyuka to Kokusai Kyosoryoku (Capital Liberalization and International Competitiveness), Tokyo; Shiseido K.K., 1968, p. 20.

CAPITAL LIBERALIZATION IN OECD COUNTRIES

Table 3-1 clearly shows that in 1966 Japan was far behind the developed countries in her effort at the liberalization of capital movements. When Japan joined the OECD, the Japanese government exchanged a memorandum of understanding with the OECD which it stated:

> "Concerning inward investments, consideration will be given in particular to the following factors: a) co-ordination of industrial development with special regard to small and medium enterprises; b) maintenance of full employment; c) internal and external financial equilibrium."[26]

26 Memorandum of Understanding between the OECD and the Government of Japan, exchanged on July 26, 1963, Annex B, paragraph 9.

"The government...adopts the policy to validate contracts for technological assistance as simply and quickly as possible, since such contracts contribute greatly to economic development. Moreover, the government...wants to realize a complete liberalization in this item (category) as its final objective while taking into consideration problems peculiar to Japan, i.e., the existence of excess competition and the present state of small and medium-sized firms."[27]

"However, as long as the difficulties stated above continue to remain, the need exists to maintain a minimum adjustment measure in order to cope with the position. The objective of the control system is to make possible such adjustment in exceptional cases."[28]

The Japanese government showed a progressive intention to decontrol foreign investments so far as the above statements were concerned. However, the actual situation regarding capital liberalization in Japan three years after the exchange of memorandum was far from what the OECD had expected as shown in Table 3-1. The problem arose from the fact that what the Japanese government meant to promise differed from what the OECD expected the government to implement. In other words, from the Japanese government's point of view the difficulties stated in paragraph 14 of the memorandum quoted above continued to remain so that they prevented the government from liberalizing any items of reservation which Japan lodged with the OECD. In spite of rapid growth of the Japanese economy, the government continued to consider that the difficulties and problems peculiar to Japan were not resolved enough to liberalize the capital movements.

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27 Ibid., paragraph 14.

28 Ibid., paragraph 15.

2) THE CAPITAL LIBERALIZATION PROGRAM IN JAPAN, 1967-1971

Although Japan was allowed 18 reservations under the revised liberalization code of 1964, when Japan became a member of OECD, she came under increasing criticism for her restrictive attitude. Japan, therefore, had to loosen her restrictions on inward investment as domestic industries became competitive enough with foreign investors. But it was in July 1967 when Japan actually began to take the first step toward a free capital movement after receiving several requirements from the OECD itself and many member countries.

BASIC POLICY OF JAPAN'S CAPITAL LIBERALIZATION PROGRAM

In designing a capital liberalization program the Foreign Investment Council, instructed by the Ministry of Finance to recommend a policy of capital liberalization, played an important part. The council submitted the first recommendation to the government in June 1967. In the recommendation, the council stated that Japan was determined to carry out a policy of capital liberalization on her own initiative because it was deemed to be in her best long-term national interest. The council's report suggested that liberalization should be carried out in a series of steps to be consummated in a wide range of sectors of the economy by the end of the fiscal year 1971.

Based on the recommendation of the council, the government proceeded with its program of capital liberalization in July 1967 for the first time. The liberalization program introduced automatic authorization for direct foreign investment in two categories of liberalized industries i.e., Class 1 and Class 2 industries, subject to certain provisions. 'Class 1 liberalized industries' are automatically authorized, provided that;

(1) the enterprise in question is being newly established;

(2) not more than 50% of total issued equity capital is held by foreign investors;

(3) at least 50% of the total issued equity capital is held by Japanese investors who are already active in the same line of business and at least 33 1/3% are held by one such Japanese investor;

(4) there are no contributions in kind to the equity by Japanese investors except by means of real estate other than factories, shops or warehouses;

(5) the enterprises do not immediately after its establishement receive any transfer of business from an existing company and does not combine with an existing company;

(6) the proportion of Japanese members of the board of directors or of Japanese representative directors is not less than the proportion of Japanese-owned equity to the total equity capital;

(7) decisions are taken under the normal procedures provided for in the Japanese Commercial Code and in particular, the execution of business operations does not require the consent of any specific member of the board of directors or the unanimous consent of all the share-holders; and

(8) the investment does not have an exceptionally detrimental effect on Japanese interests.[29]

And 'Class 2 Liberalized industries' are automatically authorized provided

that:

(1) the enterprise in question is being newly established;

(2) there are no contributions to the equity by the Japanese investors in the form of factories, shops or warehouses;

(3) the enterprise does not immediately after its establishment receive any transfer of business from the existing company and does not combine with an existing company; and

(4) the investment does not have an exceptionally detrimental effect on Japanese interests.[30]

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29 The OECD, <u>Liberalization of International Capital Movement: Japan</u>, Paris; the OECD, 1968, p. 52

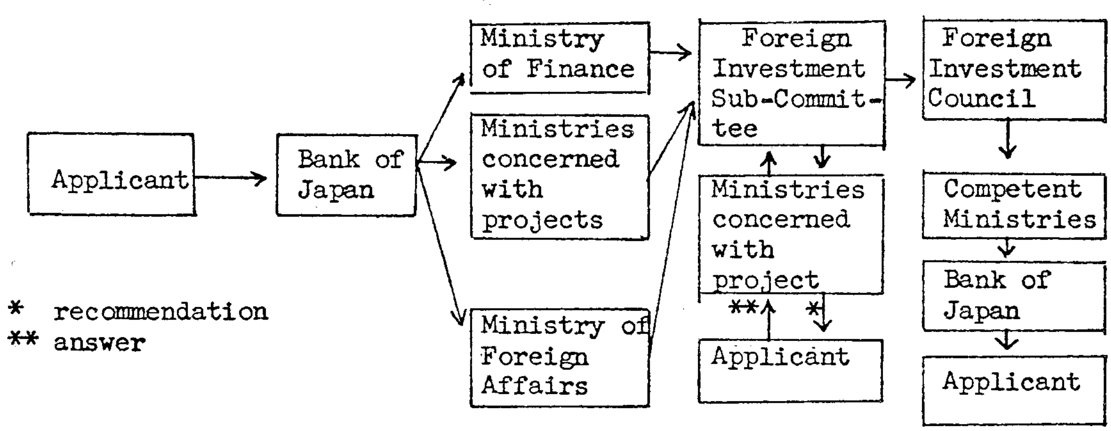
20 Ibid., p. 55.

All direct investments not covered by the two categories above, including inward investment through acquision of equity capital of existing Japanese enterprises, were not automatically authorized but were to be individually screened by the Ministry of Finance and the Ministry concerned. In July 1967 automatic authorization was given to some industries in which foreigners owned 100 per cent of the equity. These included such industries as beer brewery; ice manufacturing; ordinary steel; motorcycle, cement and rayon manufacturing; piano manufacturing; shipbuilding industries, etc.

Class 1 industries (where more that 50% ownership of total equity is not approved) included Western restaurant business, radio and T.V. receivers excluding color T.V. receivers, magnetic tape recorders, photographics cameras and their parts, watches, sheet glass, synthetic fibers, etc.[31]

The procedure of getting authorization by case-by-case examination is illustrated below.

Exhibit 3-1 Procedure of Authorization under Case-by-Case Examination



Source: <u>Setting Up in Japan,</u> Tokyo; Institute of International Investment, 1969, p. 23.

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31 Ibid., pp. 53-54, Table 10 and 11.

Although the government's statutory power under the Foreign Investment Law is limited, it exerts a pervasive influence over the applicant. The authorization procedures in Exhibit 3-1 are governed in many cases by the 'naiki' or internal ministerial rules and regulations which are not published.

THE FOUR STEPS OF CAPITAL LIBERALIZATION

The first round of liberalization was significant in that it was a clear expression of Japan's determination for capital liberalization, but it was too limited in its effect to give foreign countries satisfaction. The government, therefore, taking a considerably more positive attitude, proceeded with the second round of liberalization in March 1969, the third round in September 1970, and fourth round in September 1971. For the first three liberalization programs the government adopted the Japan Standard Industry Classification to list liberalized industries under the two categories.

The number of industries liberalized by the government appears in Table 3-2, where the method of liberalization measurement for the fourth program differed from the other three. Since the fourth round of liberalization was considered to be the last step, the industries which were not to be liberalized were listed as follows:

a) agricultural, forestry, and fishing industry (excluding processing)

b) petroleum refinery and its distribution

c) leather

d) computer and attached equipment*

e) information processing (including computer soft ware)*

f) retail industry in which one has more than 11 stores

g) real estate

(the industries with * are to be liberalized in 1974).

Table 3-2 The number of Liberalized Industries

	Class 1 50% foreign owned	Class 2 100% foreign owned	Rate of Liberalization (%)
1st round	33	17	6.7
2nd round			
new listing	135	20	
transfer	- 9	9	
adjustment	1	- 2	
Accumulated total	160	44	27.2
3rd round			
new listing	315	8	
transfer	- 27	27	
adjustment	- 1	2	
Accumulated total	447	77	69.9
4th round			
new listing	150*	10*	
transfer	- 141	141	
Total	466*	288*	92.5

* estimate

Source: S. Yamamoto, "Chokusetsu Toshi no Jiyuka (Liberalization of Direct Investment)," Keizai Hiyoron, September, 1971, p. 53.

These seven groups of industries in the negative list were considered to be the most unsuitable industries for competeting with foreign investors. The reasons for listing these industries as unliberalized items were stated as follows:

(1) There is no economic reason for controlling inward investment in agricultural, forestry, and fishing and leather industries, but they are controlled because of social issues.

(2) Petroleum refinery and distribution are deeply related to the government policy on the security of natural resources.

(3) Liberalization of chain-stores will affect the domestic industry.

(4) Information industry is an essential industry of the country to be controlled by nationals.

(5) Liberalization of real estate industry may increase the problem of sky-rocketing prices of land.[32]

Regarding the restriction of foreign portfolio investment in Japan, the government, to some extent, gradually loosened its restrictions. Prior to 1967, a single foreign investor was able to acquire 5 per cent of total equity, whereas the maximum percentage was raised to 10 per cent in September 1971. The aggregate foreign equity holdings in a particular enterprise had been limited to 10 per cent for restricted industries, and 15 per cent for non-restricted industries, whereas this limitation was relaxed to 15 per cent and 25 per cent for restricted and non-restricted industries respectively in September 1971.

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32 The Nippon Keizai Shinbun, July 23, 1971

3) THE IMPLICATION OF JAPANESE CAPITAL LIBERALIZATION PROGRAM

Japan's capital liberalization program officially completed the government's initial schedule with the fourth round of liberalization which came into effect in September 1971. The government's whole liberalization program succeeded in liberalizing more than 90 per cent of the total amount of industries, leaving only seven industries under control. It is necessary to state, however, that the liberalized industries include many industries with so called 'Japan items' in which foreign investors would never be interested and that those industries listed in class 2, where wholly-owned subsidiaries are automatically authorized, count only for 30 per cent of the total liberalized industries. This means that in spite of the government's efforts to liberalize capital movements, her measures of decontrol are still behind the level of liberalization in other developed countries such as Canada, West Germany, and France.

GOVERNMENTS VIEW OF CAPITAL LIBERALIZATION

In evaluating the Japanese capital liberalization program it is important to investigate the basic attitude of the government and business towards foreign investment. In its first recommendation the Foreign Investment Council reviewed the costs and benefits of inward investment:

Benefits:

1) Introduction of efficient technology becomes easier and raises the standard of Japanese technology by giving incentives to domestic technological development;

2) Increased competition, directed properly, will make the Japanese economy more efficient;

3) Superior foreign managerial and marketing skill will accelerate rationalization and modernization of Japanese management system, and

4) Improvement of product quality will be beneficial to the Japanese consumer and availability of international marketing channels will contribute to foreign trade.

Costs:

1) The gap of technology and financial capability between foreign and domestic firms may result in foreigners controlling Japanese enterprises or industries;

2) If research and development activity is concentrated in the parent country, technological development in the local firm or industry may be blocked;

3) Considering the fact that there are a number of small and middle scale enterprises in Japan, foreign entries may cause excessive competition so that industrial order will become hard to maintain; and

4) Long-range Japanese industrial policy and short-term economic policy with the aim of adjusting the business cycle may be affected by foreign investors provided they are not cooperative with the government's economic policy.[33]

The statement includes a certain contradiction within the council's benefit-cost argument because the council does not make clear the basis of the argument. If the council made the recommendation from the national economy's point of view, it should be considered that the four items on the cost side

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33 The Foreign Investment Council, "Gaishi Shingikai Toshin, (Recommendation for Liberalization of Inward Direct Investment)," Jurisuto, July 15, 1967. p. 38.

will be less important than the benefits of foreign investment. For example, from a welfare economic point of view, foreign control of Japanese small firms because of a technological gap will not be harmful but be beneficial to the national economy. Entry of foreign investors into an industry where a number of small firms are dominant may increase the efficiency of production, management skill, and the product quality at the cost of the disappearance of small businesses. Therefore, the new entry of efficient firms, foreign or domestic, will result in better allocation of economic resources, provided the possibility of abuse of monopolistic power is well controlled. For this reason, the foreign control of Japanese enterprises is not necessarily a cost of foreign investment, according to economic theory.[34]

However, if we observe the actual process of capital liberalization, it is obvious that both the Foreign Investment Council and the Japanese Government's arguments were not based on welfare economics, but were mainly based on political considerations or economic nationalism and compromised views of some interest groups. This is the reason, in my view, why the recommendation of the Foreign Investment Council in 1967 stated that the council held a number of public hearings, consulted various interest groups, and in the best Japanese tradition sought as broad a consensus as possible. It is essential, therefore, to understand that the capital liberalization policy of the Japanese

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34 Analysis of costs and benefits of foreign investment from the standpoint of pure economic theory is elaborately developed by several economists. See, for instance, G.D.A. MacDougall, "The Benefits and Costs of Private Investment from Abroad."
Murray C. Kemp, The Pure Theory of International Trade, Englewood Cliffs, N.J. Prentice-Hall, Inc., 1964, Ch. 13 & 14., B.F. Massell, "Exports, Capital Imports, and Economic Growth," Kyklos, Vol. 17 (1964), pp. 627-635., and A. Amano, "International Capital Movements and Economic Growth," Kyklos, Vol. 18 (1965), pp. 693-699.

government is to a large extent a political issue.

The actual procedure of Japan's capital liberalization shows that the theme of government policy on foreign investment in Japan is to maintain local control of as many domestic enterprises as possible. On this basis, the government maintains the principle of equal capital ownership in approving an establishment of joint venture. The government policy on foreign participation in an existing domestic firm is naturally severer than on setting up a joint venture since allowing foreigners to control existing local firms is against the principles of government industrial policy. Therefore, the government is very sensitive to foreign takeover of local firms even if this foreign control does not have any significant effect on the economy or the industry as a whole.

In the food processing industry, for example, H.J. Heinz Co., made a joint venture with a Japanese firm on a 49%-51% basis in 1961. The joint venture, Nichiro-Heinz Co., produced such products as tomato ketchup, tomato juice, etc., and accumulated losses of 780 million yen which was 1.8 times the paid-in capital for the first five years. Since the Japanese partner was not large enough to bear the heavy burden, it sold a majority of the shares to Heinz in 1967. As a result, Heinz owned 80.35% of total equity while the Japanese parent's share decreased to 19.65 per cent.

The government unwillingly approved this foreign takeover action on the condition that (1) increase of the capital shall not be permitted for the time being, (2) more than half of members of the board of directors shall be Japanese, and (3) before producing a new line of product the company shall be required to have permission from the Ministry of Agriculture.[35]

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35 Tetsuro Morikawa, Gaishi ni Nerawareru Kaisha(Enterprises watched for a Takeover by Foreign Investors), Tokyo; Futabasha, 1969, pp. 48-54. Another of many examples of foreign takeover were described in this book.

In considering the capital liberalization program, Japan opened her domestic market for foreigners in such a way that in most liberalized industries local enterprises were strong enough to be hardly damaged by new foreign entries. For example, the top management of several big businesses in various Japanese industries such as banking, security dealers, department stores, machinery, and cosmetics listed on class 1 industries in the third round program, unanimously stated that there was no fear of domination by foreign investments since major firms in these industries were strong enough to compete with foreign newcomers.[36] Moreover, liberalization in the banking industry will not change anything because the establishment of a new bank in Japan is under the control of the Ministry of Finance which has no intention of permitting establishment of a new bank by foreigners as well as by Japanese.

FOREIGN PRESSURE ON GOVERNMENT POLICY

The Foreign Investment Council stated in its recommendation that Japan was determined to carry out a policy of capital liberalization at her own initiative and that Japan was not undergoing such liberalization in response to external pressure. Although the motives for and the intentions of capital liberalization might be consistent with the statement above, the degree of liberalization carried out by the government during the 1967-1971 period was affected by external pressures to some extent. The third and

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36 Nippon Keizai Shinbun (August 22, 1970) As an exception, an executive in cosmetic industry cited in a different manner that there would be some foreign entries in this industry and this would force a reorganization of the industry.

fourth round programs especially were obviously affected by the economic problems between Japan and foreign countries, the United States in particular, to the extent that the government had to force the business sector to agree with some of the listings in the liberalized industries.

When the third liberalization program came in sight, Japan had been involved in the unsettled problem of the textile trade negotiations with the United States which had tried to protect her domestic textile industry from dominant imports from Japan.[37] In this situation the Japanese government considered that the promotion of capital liberalization was a necessary step for easing the increasing protectionism prevailing in the United States. For instance, the recommendation of the Foreign Investment Council on the third round of capital liberalization stated that the council made the recommendation based on the recognition that the economic policies of the major countries were running into protectionism, which would check the sound expansion of the world economy.[38]

In the same way the fourth round of liberalization in 1971 was accelerated by foreign pressure derived from the international monetary crises. Since Japan had continuously accumulated foreign exchange reserves at a substantially high rate, it was natural that the Japanese yen became a target for revaluation. Because the government's basic monetary policy was to avoid the revaluation of the yen, it was decided to follow several policies

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37 Regarding the discussion on the textile trade negotiations between Japan and the United States, and the background of protectionists in the United States, see Chiaki Nishiyama, "Hogoshoku Tsuyomeru Beikoku no Jijo (Background of the Increasing Protectionists in the United States)" Ekonomisuto, Tokyo; (July 7, 1970), pp. 10-13.

38 "Gaishi Shingikai Toshin (The Recommendation of the Foreign Investment Council)", Ekonomisuto, (September 1, 1970), pp. 10-13.

to prevent foreign exchange reserves from increasing to any further extent and to ease foreign pressure for revaluation of the Japanese yen, in which capital liberalization as well as trade liberalization was included.[39] A striking example of government action under this policy was that the government decided in 1974 to decontrol the computer industry which was considered to be the most difficult for local firms to compete within a free market. The government promised, in return, to give subsidies to the firms which agreed to the reorganization of the industry so as to make two or three bigger producer groups.[40]

The logic of the liberalization policy of Japan may be supported by the belief that it will help to achieve the purpose of strengthening the business foundations of Japanese enterprises and increase the over-all efficiency of the Japanese economy.[41] For this reason the introduction of advanced technology is the most important step for economic development. However, it may be important to note that the increase in efficiency of Japanese industries by the aid of foreign technology is considered only under the condition that the domestic enterprises are able to maintain their nationality.

Based on this recognition, the Japanese government seems to maintain the equal-partnership principle in proceeding with the capital liberalization

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39 The government chose eight strategies of minimizing the increase of foreign exchange reserves at an urgent cabinet meeting on June 4, 1971. (Nippon Keizai Shinbun, June 5, 1971)

40 See Nippon Keizai Shinbun, July 23, 1971

41 See Finance Minister's statement on announcement of the third capital liberalization plan, The Japan Times, (September 1, 1970.)

program. Since the government thinks that Japanese firms are not strong enough to negotiate the setting up of a joint venture on an equal-partnership basis with world enterprises, the government tries to keep the restriction as a national policy without leaving private enterprises a right of adopting this principle on their own judgement.

4) SUMMARY FOR THE CHAPTER

(1) In postwar Japan, foreign investment has been controlled by two domestic laws -the Foreign Exchange and Foreign Trade Control Law and the Foreign Investment Law. The role of these laws was to control, according to Japan's economic policy, the kinds and amounts of capital flowing across the border. Japan encouraged indirect investment and restricted direct investment, which is essential to Japanese economic development, only up to a limit of 50% in foreign acquisition of equity capital.

As an exception of the Foreign Investment Law, a yen-basis investment was allowed. On this basis, a foreign subsidiary in Japan was subject to the condition that neither income nor liquidation proceeds would be transferable abroad.

Japan held 18 reservations for OECD Liberalization Code in 1966, which was larger than any other developed country in the OECD.

(2) Japan proceeded with capital liberalization programs four times during the 1967-1971 period. In these programs, industries to be liberalized were listed in two categories. Class 1 included industries where foreign investors were automatically authorized to hold not more than 50% of total equity capital and class 2 included industries where foreign investors were able to establish a wholly owned subsidiary. At the final stage of the liberalization program only seven industries were listed as non-liberalized industries.

(3) In evaluating Japan's capital liberalization program it is important to note that, although there are only seven industries left under government control, those industries listed in class 2 counted for only 30 percent of the total industry. In this category there are many industries peculiar to Japan in which foreign investors would never be interested.

The capital liberalization program, therefore, implies that Japan opened her domestic market for foreigners in such a way that even in the most liberalized industries local enterprises were strong enough to be hardly damaged by new foreign entries. This is due to Japan's basic policy on capital liberalization which arose from political considerations or economic nationalism and by compromised views of some of the interest groups.

The degree of capital liberalization was affected by external pressures such as the textile trade negotiations between the U.S. and Japan and the international monetary problems. These external pressures caused Japan to liberalize capital movements to an extent further than the government had initially planned.

CHAPTER IV

A MODEL OF JAPANESE ECONOMIC NATIONALISM

In this chapter we will focus our discussion on exploring the characteristics of Japanese economic nationalism. Section 1 deals with the meaning of economic nationalism, and the difference between Japanese economic nationalism and that of Western countries, and, based on this analysis, a conceptual framework of economic ethnocentrism which is an explanatory model of Japanese economic nationalism will be given. This model will include, in addition to the economic conditions which were discussed in chapter II: social, cultural, and political conditions which are essential elements of economic ethnocentrism in Japan.

It will be necessary to analyze the characteristics of these conditions so as to make it clear how these affect economic ethnocentrism. Therefore, in section 2 we will discuss the social structure of modern Japan. There, it will be argued that Japanese society is a vertically-oriented society.

In section 3 and 4, the cultural and political conditions will be discussed. The effect of cultural uniqueness on Japanese attitudes towards foreign investment will be discussed in the third section and the fourth section will concentrate on the relationship between government and business and the role of the bureaucracy in the formation of economic nationalism.

1) THE THEORY OF ECONOMIC ETHNOCENTRISM IN JAPAN

ECONOMIC NATIONALISM

The impact of foreign investment on a host country can be evaluated from the political as well as the economic point of view. As a nation state, the host country is deeply concerned with the maintenance of economic and political independence. In this regard government policy on foreign inward investment involves an ideology called 'economic nationalism'. Economic nationalism is a very complex concept which involves both comparability of achievement with other nations and differentiation of a nation from other nations; both imitation and separation. Harry Johnson pointed out two other aspects of economic nationalism:

> "Where the national economy lacks production facilities that are considered important to the power of powerful nations, national policy attempts by all available means to create such facilities; it is also a question of creating facilities 'under national control'. This in turn tends to mean a preference for public ownership as a means of ensuring control, hostility to investment by foreign enterprises, and a desire to prevent, control, or restrict and regulate such foreign investment. Second, where the facilities exist but are not controlled by nationals, there is a tendency to attempt to take over control of them. This may involve confiscation, nationalization, or seriously restrictive government regulations." 42

However, nationalization does not change the economic reality at all, because there is no transfer of wealth from foreigners to nationals, if compensation is fair. There is no net gain in national

42. Harry G. Johnson, "The Ideology of Economic Policy in New States," in H. G. Johnson (ed.), Economic Nationalism in Old and New States, The University of Chicago Press, 1967, p.127.

wealth by nationalization because fair compensation involves paying the previous owner the present value of the future income he would have earned from the enterpise.[43] However, there is a political advantage to be gained by nationalization since nationalization would help prevent undue influence by other countries. Thus, economic nationalism can be said to be strictly a political issue rather than a concept based on welfare economics.

JAPANESE ECONOMIC NATIONALISM

Japan's capital liberalization policy discussed in the previous chapter was obviously based on economic nationalism. If we turn our eyes to other countries such as Britain, France, Germany and Canada, it is not difficult to find a number of arguments against the desirability of foreign dominance, by the U.S., in particular, within their own industries. But the nature of economic nationalism in Japan is so different in scope and magnitude from that in Western countries, in my view, it is necessary to distinguish these two types of nationalism. As my model will show, perhaps economic nationalism in Japan would be more appropriately called 'economic ethnocentrism'.

Difference in Economic Nationalism: There are two important features which characterize the Japanese attitude toward foreign inward investment. In the first place, the Japanese establishment has held to the principle

43. Harry G. Johnson, "A Theoretical Model of Economic Nationalism in New and Developing States", Political Science Quarterly. LXXX (June, 1965), pp.169-185.

that government should not allow a foreign investor to hold more than 50 per cent ownership in any joint venture. In Western countries there is no such rule regarding policy on foreign investment. Japan's capital liberalization program undertaken during the 1967-1971 period maintain this principle in choosing industries to be decontrolled. In investigating industries to be liberalized the government lists in category 2 (100% liberalized industries) only those industries in which there is no possibility of foreign control, and it authorizes foreign investment in other industries to a maximum of 50 per cent foreign ownership. This is the '50 per cent principle' which was confirmed at the Cabinet council meeting on deciding the first round of capital liberalization in 1967.[44]

Second, the consideration of economic benefits of foreign investment has been negligible in Japan. Despite the fact that the Foreign Investment Council states economic benefits and costs of foreign investment in its recommendation on capital liberalization, it does not mean that either the Council or the government considered seriously the economic benefits of foreign investment. The costs of economic nationalism and the economic benefits are seldom argued at the same level, rather, the control of all industries by nationals has top priority in deciding foreign investment policy.

Degree of Foreign Control in Western Countries: Economic nationalism of host countries has become prominent because of the development of

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44. Fujio Yoshida, "Shihon Jiyuka no Susumekata (How to proceed the Capital Liberalization)", in Nihon Seisânsei Honbu (ed), Kokusai Shihon in Nihon Kigyo (International Capital and Japanese Enterprises), Tokyo; Nihon Seisansei Honbu, 1968, pp.73-96.

multinational corporations. The discussion of maintaining economic independence has become prevalent, particularly in those countries where foreign dominance is apparent in major industries. In Canada, for instance, it is well known through Safarian's research or the Task Force study on foreign investment in Canada that foreign investors are dominant in Canadian industries.[45] It is important to note that there has emerged from these discussions, at least the Canadian ones, strong views that foreign capital has contributed to economic development.[46] In Japan, on the other hand, the discussions of the role of foreign investment has been far different from Canadian ones. The Japanese are worrying about such things as the influence of foreign-owned firms on the resident-owned counterparts in the situation where the share of foreign-associated firms (not the foreign-owned firms) are less than 3 per cent in terms of the sale of the total Japanese manufacturing industry.

The reason for the heavy flows of foreign capital into some Western countries such as Canada and France was that capital inflows were necessary for domestic capital formation.

Jack N. Behrman states:

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45. A. E. Safarian, The Performance of Foreign-Owned Firms in Canada, Toronto; Canadian-American Committe, 1969. The Task Force on the Structure of Canadian Industry, Foreign Ownership and Structure of Canadian Industry, Ottawa; Queen's Printer, 1968.

46. See, for instance, R. E. Caves, Canadian Economic Policy and the Impact of International Capital Flows.

> "The absence of capital necessary to provide adequate levels of investment in Europe and Canada has been critical since World War II. Even at the end of 1966 French observers agreed that France had still not achieved an equilibrium of long-term investment needs and savings,..... French capital did exist, but it was not available for long-term investment in industry. The pattern of investment has shown a strong difference in liquidity preference between French and American enterprises, with European capital flowing out for portfolio investments. This continuing need for foreign capital inflows reflected a 'certain lack of dynamism' by French industrialists in not taking advantage of investment potentials and the growing domestic market. Had French industry met the local opportunities, there would,have been no greater attraction to foreigners." 47

It is true that a shortage of investment capital also existed in postwar Japan because of the destruction of the economy by the war. It is important to note that Japan deliberately chose a method of economic development which did not depend heavily upon foreign capital. The Japanese government restricted capital flows both inward and outward in order to attain the national goal of a high rate of economic growth without foreign control. Since the major problem was not the capital inflow itself but the foreign ownership accompanying capital, Japan allowed foreign capital to come in the form of loans, (see Table 2-8 in chapter two). Japan introduced a unique credit system in order to supply the necessary capital to private firms; not that this sytem is more efficient, in an economic sense, than the policy of introducing foreign capital, but because it was the only possible alternative for capital supply under the condition which the government set.

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47. Jack N. Behrman, National Interests and the Multinational Enterprise, Englewood Cliffs, N.J.; Prentice-Hall, Inc., 1970. p.14.

Japan, therefore, gave priority to political reasons in deciding her economic policy. In other words, Japan adopted a credit system, which is unique to Japan, from the standpoint of economic nationalism because foreign direct investment was accompanied with ownership and control.

In Western countries the behavior and activities of foreign investors were blamed or criticized from the point of view of economic nationalism when foreign penetration became so deep, that it had a significant impact on the host country. The crucial degree of foreign penetration which may cause a conflict between foreign investors and national interests of the host country depends upon the economic and political conditions in a host country. Jack Behrman stated:

> "We have no clue as to what degree of penetration is critical. In the case of General Electric in its acquisition of Machines Bull in France, Prime Minister Pompidou had stated in late 1966 that whatever may be the interest of a foreign investor, it does not have to be carried out by the capital colonization of a sector, nor by the transformation of French enterprises into simple furnishers of hand labor to foreign brains." [44]

From this statement at least, it seems reasonable to say that economic nationalism is important in France as well as in Japan. However, economic nationalism in Japan is far stronger and has a more dominant impact on the economic policy than European nationalism. Japan decided to exclude any possibility of strong foreign penetration, at the cost of economic benefits to the nation, before foreign investment became harmful from the political point of view.

For these reasons economic nationalism in Japan must be distinguished from that of Western developed countries.

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44. Jack N. Behrman, pp.41-42.

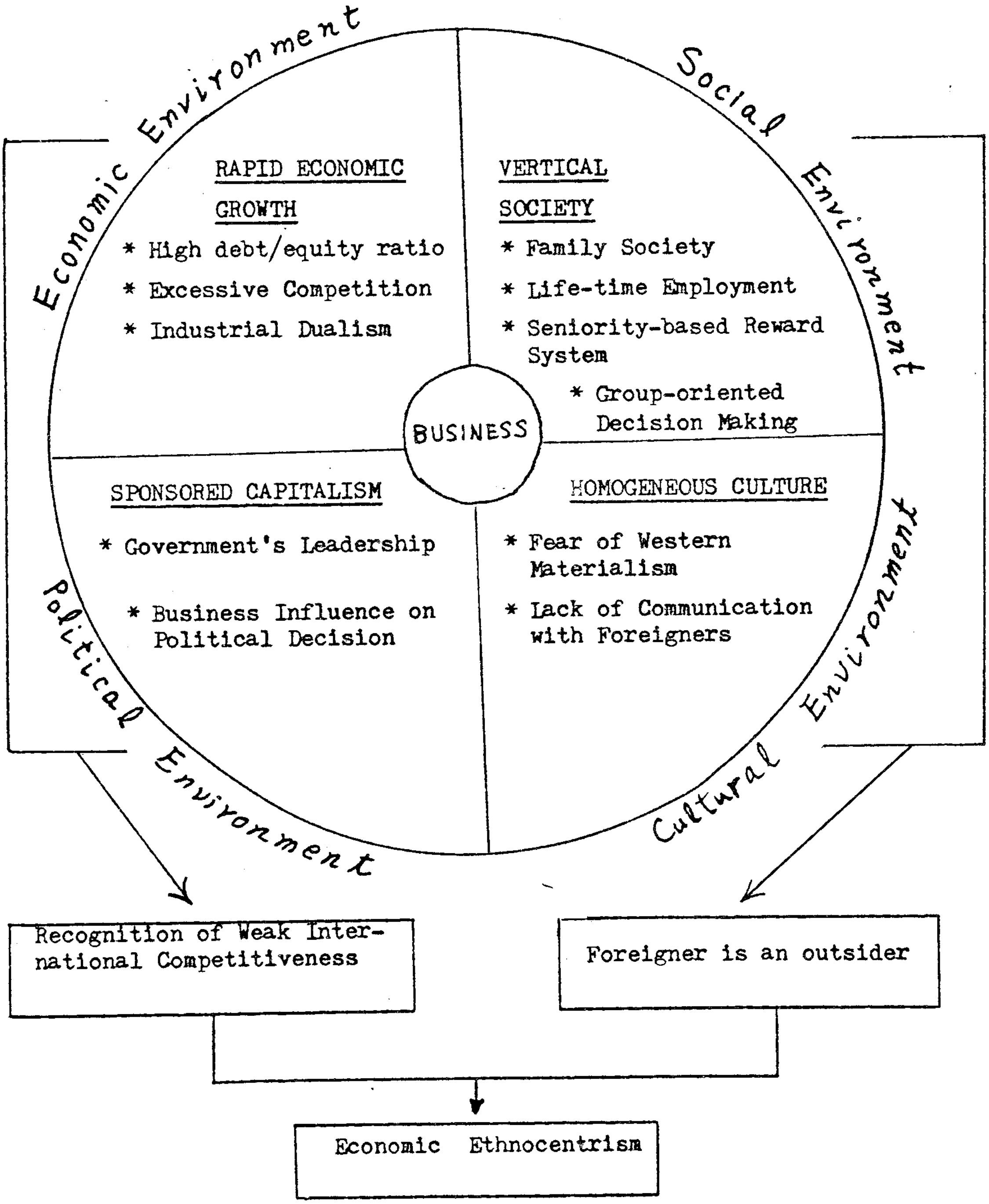
A CONCEPTUAL FRAMEWORK OF ECONOMIC ETHNOCENTRISM

Economic ethnocentrism consists of two key attitudes which the Japanese have towards foreign investment. These attitudes are the recognition of the weak international competitive position of Japanese enterprises and the recognition that a foreigner is an outsider.

As shown in Exhibit 4-1, these key concepts are derived from economic-political and socio-cultural environments respectively.

The economic environment is characterized as (a) the high debt-equity ratio of Japanese firms (i.e., weakness in financial capability), (b) the excessive competition in Japanese domestic markets, and (c) the existence of many small-sized firms. The characteristics of the political environment are collaboration of government and business sector. Combination of the characteristics of these two environments results in government's persistence of vulnerability of Japanese firms in the international context. The socio-cultural environment in Japan is characterized as a vertically-oriented society with a homegeneous culture. Because of the very nature of a vertical society a foreign investor, who is an outsider, tends to be hindered in joining the Japanese society. Since these four environments are essential elements of the model it will be necessary to describe the nature of environments in connection with the framework of economic ethnocentrism.

Exhibit 4-1 A Conceptual Framework of Economic Ethnocentrism in Japan



Economic Environment: The modernization of Japan began with the Meiji Restoration in 1868. Contacts with the Western powers through the unwelcome visits of their vessels served as an eye-opener for the Japanese people. Through these visits they realized the might and resourcefulness of the Western powers. In every country, nationalism plays an important role in its economic modernization, especially in the initial stage. In Japan, nationalism was almost an integral part of the traditional traits of the people. As a result of this feeling, the national goal in the Meiji era was that of preserving Japan's independence, by preventing the Western powers from making Japan into a colony. The expression 'Fukoku Kyohei' or 'rich country and strong power' expressed this goal.

Although the goal of strengthening the nation's arm was brought to an end by the defeat in World War II, the other goal has been maintained. An effort to catch up with the West in terms of economic power has been strongly supported by nation-wide consensus in postwar Japan as well. Thus, Japan has concentrated on expanding her economy as rapidly as possible. As a result, Japan has managed to become the third largest industrialized nation in terms of GNP by the late 1960's. Japan's exports have become significant in the world economic community, giving other countries the impression of being a strong competitor.

It is recognized by the Japanese, however, that the attainment of a highly industrialized society in a short period of time has brought about some side-effects to Japan such as the worsening the capital structure of firms, and the existence of excessive competition in major markets. From the Japanese point of view, therefore, this built-in vulnerability of the economy forces them to feel that Japanese industry is not strong enough to compete with dominant world enterprises. This economic environment is one of the important factors which strengthen Japanese protectionism against foreign counterparts. It is necessary to point out, however, that the economic factor is a matter of comparative vulnerability defined by the Japanese themselves and this economic environment has been improved step by step by the efforts of each enterprise. In this sense, the economic environment is the weakest one to support among the four factors which give rise to the feelings of economic ethnocentrism.

<u>Political Environment</u>: The recognition of backwardness of the Japanese economy since the early stage of its development induced an intimate relationship between government and big business.

The government undertook an elaborate protective policy for domestic industries. The government's role has been fairly important in developing a unique economic nationalism. Since an enterprise is by its nature profit-oriented, a businessman's attitude toward foreign investment depends on the situation in which his organization works: on the one hand, there are some firms which may want to introduce foreign capital and technology in order to compete with domestic rivals, and, on the other hand, there are some big businesses, which may require the government to restrict foreign investment so as to maintain their dominance in the industry.

However, the Japanese bureaucracy tries to avoid this type of dispute as much as possible because the major concern of bureaucrats is not support prosperity of individual enterprises but to direct Japanese industry towards attainment of the economic goals of the nation. And it is in this sense that the government officials can be said to play a part of advocates of economic nationalism.

Socio-Cultural Environment: The third and fourth factors which support the economic ethnocentrism hypothesis are the characteristics of the social and cultural environments. As will be discussed in a later section, Japan developed her own social philosophy and social structure for a long period; a vertically-oriented or hierarchical society supported by Confucian philosophy. The introduction of capitalism and modern technology drastically changed the Japanese way of life in certain respects but only changed slightly the traditional structure even in the postwar period. In this regard, F. Harbison and C. Myers remark in reference to the entrepreneual activities in modern Japan:

> "Managerial concepts and practices, which are rapidly becoming obsolete in the Western capitalist countries, still appear to be effective. Indeed, one is tempted to conclude that the traditional Japanese culture, instead of being swept aside by industrialism, has assimilated it. Modern machinery and processes have become the instruments rather than the destroyers of a traditional social order." 45

This traditional social structure is embodied in the modern business organization in the form of a group-oriented decision making system, life-time employment, and a seniority-based reward system. It is important to note that the vertical structure affects the informal organization within the society to a great extent, so that individual behavior and ways of thinking are greatly affected by this vertical structure.

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45. F. Harbison & C. A. Myers, Management in the Industrial World. New York; McGraw-Hill, 1959, p.249.

In particular, the cultural environment affects to a great extent the Japanese way of thinking and their attitude toward foreign investors.

Undoubtedly the homogeneous culture of Japan, that is, the existence of a group of people who belong to the same ethnic group and who have the same language, arouses in the Japanese a strong identification with the nation. It is true however that the vertical society divides the Japanese into many sub-groups according to their own hierarchical status. Once foreigners come onto the scene, however, the Japanese never fail to distinguish themselves from people in a different racial category and in a hetelogenious culture. From a Japanese point of view, a person who is ethnically different from a Japanese must be a foreigner, no matter how long he lives in Japan and no matter how much he has assimilated himself with the Japanese culture. A foreigner is always recognized by the Japanese as an outsider of the social structure. It is this situation which has strongly motivated the Japanese to keep their business in their own hands.

In a hierarchical society all individuals or groups are ranked, by and large, under some categories. Within a specific group, such as a business organization, people are ranked by such measures as time of entry, education, and position in the company. Furthermore people are ranked by their ages in a society as a whole. It seems to me that the Japanese have behaved in the same manner in the world economic community as in the domestic society. The major concern of the Japanese, when they set the goal of catching up with Western countries, was not to enjoy the higher standard of living obtained by attaining this goal but just to reach a higher position of economic wealth in terms of GNP or GNP per capita. In my opinion, to be ranked at a higher position in the world is the goal itself for the Japanese since they may get much satisfaction from attaining a high level in the world hierarchical community. Thus the socio-cultural characteristics of Japanese society are the most important elements leading to economic ethnocentrism.

It is important to understand that the idea of the weak international competitive position of Japanese enterprises is a flexible notion subject to the degree of economic development and rationalization in Japanese industry. In recent years the Japanese economy has been expanding at a fast rate, as we have shown in chapter 2. Therefore, this factor will probably cease to be of importance when the Japanese are convinced that their industries are succeeding in strengthening the international competitive positions.

The notion of a distinction between Japanese and foreigners, however, takes its root in a socio- cultural tradition which has been in existence for centuries. Thus, it may be reasonable to assume that the socio-cultural elements will provide a longer lasting support for these Japanese attitudes towards foreign investment than the economic factors will.

We have claimed that the characteristics of the four environments are important elements in the formation of economic ethnocentrism. It will now be necessary, therefore, to describe in greater detail the nature of these characteristics and to show why it is that they are so important to the development of economic ethnocentrism.

2) THE VERTICAL STRUCTURE OF THE JAPANESE SOCIETY

JAPANESE TRADITIONAL SOCIETY:

The modern society of Japan is characterised as a vertically structured or hierarchical society. A hierarchical structure was a common phenomenon in a traditional society. Everett E. Hagen states that a traditional society, in short, tends to be custom-bound, hierarchical, ascriptive, and unproductive.[46]

In the Tokugawa era (1600 - 1867), Japan was a traditional society. During this period Japan maintained a rigid society controlled by the Tokugawa Shogunate with the ideological framework derived from Confucianism. Confucian philosophy, which had originally been brought to Japan by Zen scholars, was concerned mainly with the correct observance of social relationships within a hierarchically oriented society. The Tokugawa society had a definite order of social ranking of 'samurai' or warriors, farmers, artisans, and merchants. Since agriculture was the economic basis of life in this era farmers were next to the 'samurai', and the merchants were at the bottom because they were regarded as nonproductive. Because the 'samurai' was a ruling class, there existed a severe prohibition against shifts from the three groups to the samurai. The hierarchical distinction between the other three groups, however, was not necessarily clear in actual life.

The important fact regarding the role of Confucian doctrine in the society was that it worked within each group of the society. Confucian philosophy stresses five key dyadic relationships and prescribes

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46. Everett E. Hagan, On the Theory of Social Change. Homewood, Illinois, The Dorsey Press, Inc., 1962, p.56.

an appropriate interaction for each; affection between father and son; respect and loyalty between master and servant; harmony between husband and wife; precedence between older and younger brother; and trust between friends. As in any traditional society, the Tokugawa society had been a collective society in which the individual hardly existed as a distinct entity. The collective orientation in traditional Japanese society tended to attach enormous importance to the formal leader as a representative of the group. So, on the one hand, each member of the group had an abiding loyalty to the leader and on the other hand, he would enjoy the maximum amount of security that the group was capable of bestowing.[47]

SOCIETY IN MODERN JAPAN

This traditional social structure has continued to change along with the industrialization of Japanese society since the Meiji era. Particularly after World War II, this change has been so drastic that one might imagine that Japan has become quite a modern society. It is fair to assume that there was a far greater degree of continuity, at least in the ideological sphere, between the Tokugawa and the Meiji Japan than there has been between prewar and postwar Japan. It is true that the modernization of Japanese society has been more dynamic than that of any other Asian country, despite the fact that traditional Chinese and Japanese cultures had in common an element of Confucianism, which emphasized the importance of conformity to social order.

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47. See M. Y. Yoshino, Japan's Managerial System: Tradition and Innovation, Cambridge, Massachusetts, The MIT Press, 1968, p.11.

As an explanation for this, Takeshi Ishida states:

> "In the case of Japan, however, conformity did not mean that attitudes were static, or that there was a reluctance to change the existing situation. Rather, it implied conformity to the changing situation. For instance, at the beginning of the modernization of Japan, the people, led by the governing elite, responded rapidly and almost unanimously to the need for Westernization. When people are unanimously changing in the same direction, opposition to change is failure to conform; Once members of the same group start running in the same direction, not to run as fast as the others is disrupting to group conformity." 48

This means that Japan has modernized herself in terms of a way of life, industrial structure, and urbanization of villages, etc., but this modernization is essentially based on a vertical structure of the society supported by Confucian conformity.

It is important to note, therefore, that there still exists a great gap which distinguishes the Japanese society from that of Western countries. The efforts of rationalization of the society and business organization had made the Japanese enterprises fairly modern, but they have copied Western organizations only on a superficial basis. The basic structure of the organizations or the informal organizational structure includes, in my view, the characteristic traits which distinguish the nature of the society from the Western societies, although these traits may have changed from the traditional ones in certain respects. How is the Japanese society characterized then? To find an answer to this question, it will be useful to see the nature of personal relationships within a group in a vertically related

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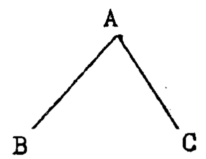
48. Takeshi Ishida, Japanese Society, New York; Random House, 1971, pp.37-38.

society.[49]

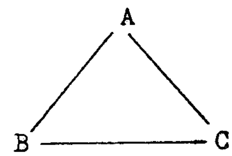
Exhibit 4-2 Personal Relations in a Different Group

Group X



4-2a

Group Y

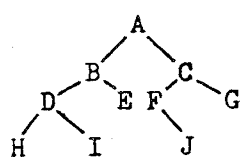


4-2b

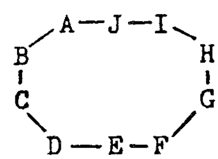
shown in Exhibit 4-3(a) and 4-3(b) these diagrams make the situation clearer. H and J in group X are related only through A who is a single leader of this hierarchical organization, while all members of group Y are equally related to each other.[50] Group X can expand its size only by adding new members at the bottom of the hierarchical structure.

Exhibit 4-3 Expansion Process of Two Types of Group

Group X



Group Y



J's joining the group under F does not directly affect other members of group X, while in group Y, J's joining of the group may affect all members of the group. That is, if J joins group X he will not affect the power relationship among any of the previous members since those relationships lie above him in the group structure. However, if J joins group Y, he will affect the power relationship among all the rest

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49. The theoretical model of the personal relationship developed here is extensively based on the model built by Chie Nakane. See Chie Nakane, Tate Shakai no Ningen Kankei (Human Relations in a Vertically Related Society), Tokyo: Kodansha, 1966.

50. ibid., pp.114-116.

of the members since he must be admitted as an equal and the power would have to be shared by one more person. The nature of entry in a vertical group means that a person who joined the group at an early stage of development can obtain a higher position than a new comer.

Another important point to note is that the persons who are at the same rank in a hierarchical organization are not directly related, but there is a competititive relationship between the two. The relation between B and C of group X, for example, is such a case. B and C are at the same distance from A. Both B and C have the equal possibility of becoming a successor to A. Since the number of subordinates is a factor which gives B and C the influential power within the group, it is important for both B and C to expand their lower branches as widely as possible. This is a reason why there exist so many factions or 'batsu' in every Japnese organization.

<u>Industrial Family Notion</u>: A faction can be described as a quasi-familistic relationship - paternalistic protection or patronage on the part of the leader,and dependence on the leader by the rank and file. In corporations, these quasi-familistic relationships are still common in modern Japanese business. Especially when another company comes onto the scene, a sense of loyalty to and identification with the company will be displayed by the employees. T. Ishida states:

> "Among company employees, for instance, a strong sense of identity with the company and conformity to its goals is accompanied by a sense of competition both externally with other companies and internally in loyalty to their own company." 51.

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51. Takeshi Ishida, <u>Japanese Society</u>, New York: Random House, 1971, p.39.

For this reason, an employee is more concerned about the name of the company to which hebelongs rather than the type of job he is engaged in. In ordinary conversation the Japanese employee often talks about what company he works for and at what position he is with the company. What type of job he is engaged in may be the last topic.

This characteristic of the vertical structure of a group implies that there is a competitive relationship between the subgroups within a group (a subgroup consisting of B, D, E, H, I and another subgroup consisting of C, F, G and J in Exhibit 4-3a). When a group is identified as a unit by the members because of the existence of other groups, the competitive relationships between the subgroups dissolves for the benefit of the bigger goals of the group as a whole. It is reasonable to think that when the Japanese distinguish themselves from foreigners, the sense of their nationalism in many cases overcomes the conflicting situation between the interest groups in Japan.

It may be understood from the discussion above that the life-time employment system and seniority-based reward system which are important factors in the Japanese corporate organization are heavily based on this hierarchical structure of organization. The leader of an organization under the vertical structure is not a strong individual directing and inspiring the group to achieve objectives that he himself has set for the group. Since assignments and responsibilities are not determined on an individual basis, the leader must see to it that those who are capable but do not have an appropriate status are given the opportunity to demonstrate their full ability without disrupting group harmony.[52] Under this system it is not easy to adopt a merit reward system based on the personal ability of employees.

Also it is not surprising when James C. Abegglen mentions that it is true that a worker of whatever competence is hard put to find new employment if it is known (and his age will indicate) that he has been fired or laid off from a job.[53] In order to join an organization in the vertical society there is theoretically no way other than being ranked at the bottom of the hierarchical structure. Therefore an employee may think it wiser to stay with the same company for his life rather than to transfer to another company even if he is not satisfied with his present position.

The employer-employee relation in Japanese enterprises can be explained by paternalism. The characteristics of paternalism in an economic organization are expressed as:

1) There is a degree of hierarchy which is greater than the minimal amount any employer-employee relationship should display. That is, the status difference between employer and employee is not purely a matter of instrumental necessity, but contains a cultural or ideological element which suggests that the employer is more than just an employer; he is a 'superior' person in control becuase of this superiority.

2) The second general characteristic is the concern shown over aspects of the lives of his employees which has nothing to do with the actual work performed, or the organization in which it is being performed.

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52. M. Y. Yoshino, Japan's Management System: Tradition and Innovation, Cambridge, Massachusetts, 1968, p.205.

53. James C. Abegglen, The Japanese Factory, New York; Asia Publishing House, 1958, p.12.

That is, he is responsible in some way for his workers, and, in most cases, their families.[54]

Thus employment in Japan is not contract-oriented but status oriented. A Japanese may consider that he is not employed by a contract but is a member of an industrial family. This concept is heavily based on a long tradition among the Japanese to emphasize the 'iye' or house-community more heavily than the individual. Individuals were combined or synthesized to it, and forced to sacrifice themselves for the perpetuation and prosperity of the 'iye' itself. The material basis for the prosperity of the house-community was afforded by business. The prosperity of the firm was the utmost concern of their members, and this loyalty to the industrial 'iye' can easily be expanded into a nation-wide aspiration for national economic prosperity.

Structure of Informal Organization: It is reasonable to assume that the seniority based reward system, life-time employment system, and the iye concept, which are characteristics of the formal organizational structure in Japanese business have been changed by inherent factors such as labor shortage in rapid economic development and continuous technological innovation. Nevertheless, the existence of informal groups commonly known as 'habatsu' (the clique) within an organization still distinguishes Japanese society from that of other developed countries. An analysis of Japanese organization would be incomplete, therefore, if we overlooked or underestimated the role of this informal organizational structure.

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54. John W. Bennett and Iwao Ishino, Paternalism in the Japanese Economy, Minneapolis; Minn.' University of Minnesota Press, 1963, p.225.

The 'habatsu' is common in various Japanese organizations such as corporations, government ministries, political parties, and universities. Originally, the 'habatsu' was based on traditional solidarity related in some way to the circumstances of birth, but later its basis was broadened to include other qualifications. Since the 'habatsu' is highly goal-oriented and it has its own network of communication, the function of 'habatsu' can be highly beneficial to the goal-attainment of the formal organization on the one hand. However, the existence of intensive internal 'habatsu' rivalry, on the other hand, may cause lack of harmony between their own goals and those of the formal organization. The existence of a dominant 'habatsu' within an organization will possibly affect the decision of the formal organization to the extent that it is necessary to reshape a particular decision to make it acceptable to that 'habatsu'. When leaders of each 'habatsu' are faced with a critical situation which is brought about from external causes and they agree to cooperate, the function of this type of vertically oriented organization can function efficiently because of the goal oriented nature of the group. In case of emergency, each 'habatus' can easily reach agreement on necessary actions of the formal organization, otherwise the organizations upon which the 'habatsu' are based may become weak. In this regard Chie Nakane points out that the Japanese success in the modernization of the society in a relatively short period of time is due to the efficient utilization of the characteristic functions of vertical structures.[55]

55. Chie Nakane, Tate Shakai no Ningen Kankei, p.126.

Decision-Making in a Vertical Organization: However, there are several shortcomings which may be produced by the very nature of a vertical structure. A typical process of decision making in a Japanese organization may be used as an illustration. A process of decision-making widely used in large Japanese corporations and government organizations is called the 'ringi' system.[56]

Because of a collective-oriented organization, authority and responsibilities of corporate members are not always well defined. All plans to be prepared by the lower officers must be started on a document known as 'ringisho' to be circulated to related departments and then to be submitted to the top executives for their authorization. The 'ringisho' is presented in such a way as to seek top management's approval on a specific recommendation of a subordinate. In the course of the circulation of a 'ringisho', each level of managers must be ready to spend a good deal of time making adjustments. This process of adjustment is a very necessary step to keep things going, therefore, the decision-making process by the ringi system is a fairly time-consuming process.

It is also important to note that since the system is based on decision-making by group participation and consensus, the responsibilities for decision-making are highly diffused and cannot be associated with any one individual except the president who holds the right to authorize a 'ringisho'. There is little room even for the president to exercise

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56. The 'ringi' system in the Japanese government was analysed in detail by K. Tsuji. See Kiyoaki Tsuji, "Decision-Making in the Japanese Government: A Study of Ringisei", in Robert E. Ward (ed.) Political Development in Mo dern Japan, Princeton, N.J.; Princeton University Press, 1968, pp.457-475.

his independent judgement in making decisions because he is provided with no alternative for the initial recommendation, nor with sufficient data to evaluate the proposal objectively under the 'ringi' system.

Thus, for good or bad, the social environment substantially affects business organizations and activities in many ways. Within a vertical society any group or organization tends to alienate an outsider from it. Therefore, when a foreign investor comes in the Japanese society, he tends to be eliminated, because he is an outsider, unless he has something beneficial to contribute to Japan.

3) THE CULTURAL CHARACTERISTICS

Japan enjoyed isolation from Western civilization for most of her history until the 1860's, when she undertook modernization of the country. Being geographically separated from other countries and with the ruling body at this time having deliberately adopted a policy of isolation, Japan maintained her ethnic pureness. Her culture has had time to become extremely homogeneous, particularly during the two centuries of Tokugawa isolation.

JAPANESE MODERNIZATION

In the 19th century after the Meiji Restoration of 1868 the dominant factor which forced Japan to modernize herself by introducing Western civilization was the ideology of nationalism. Because of the recognition of the superiority of Western military power, industrialization was advocated first and foremost as a means of avoiding humiliation at the hands of the Western powers. Reflecting on the bargaining position of Japan in the Meiji era, the Japanese government had little control over foreign goods being imported under the commercial treaties which were without protective tariffs. Military and economic considerations were the most compelling reasons put forth by the advocates of rapid industrialization in Japan. But there was another important reason for industrialization. Byron K. Marshall has pointed out that:

> "There was a third aspect to the nationalistic reaction to foreign intrusion; i.e., the intense desire of the Japanese leaders to stand on an equal psychological footing with the advanced nations of the West." 57

The Japanese realized that foreigners had a material superiority over them and so the Japanese had a very distinct inferiority complex and a certain uneasiness when they compared themselves to Westerners. But we may reasonably predict that this inferiority complex will be weakened when Japan begins to catch up with the Western industrial nations.

ATTITUDE TOWARD FOREIGNERS IN THE WEST AND JAPAN

In this regard the attitude toward foreigners is not necessarily unique to the Japanese. The same situation can be widely seen among many of the countries which are in a developing stage. Even in developed nations this type of complex may exist in people of European countries with respect to U.S. investors. When J-J Servan-Schreiber wrote "The American Challenge", he was much concerned about the economic and political independence of France. He analysed how the U.S. invasion of Europe became a menace to the nation states which were supposed to be

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57. Byron K. Marshall, Capitalism and Nationalism in Prewar Japan, Stanford, California; Stanford University Press, 1967, p.14.

independent in the economic and political sense.

Servan-Schreiber's basic approach to this problem was not to prevent U.S. enterprises from investing in Europe but to make the country competitive by strengthening the economic and political bonds of the European Common Market. He states:

> "A variety of choice, checks and balances, and competition are a vital element of progress and freedom in every community. They are even more vital on the international level." 58

> "If Europeans want to control their economic growth --- and thereby their destiny --- they can no longer afford the luxury of economic nationalism. ... To build a powerful and independent Europe means strengthening the economic and political bonds of the Common Market. No single nation is strong enough to support efficient production in all areas of advanced technology, for the national framework is too narrow and cannot provide adequate markets for such products." 59

Servan-Schreiber's argument on strengthening the French economy is, therefore, based on a laissez-faire philosophy in the sense not of restricting U.S. activities, but encouraging the progressive expansion of domestic enterprises by cooperating with firms in other European countries. This view is well understandable when we recognize the European economic environment. If one European country took a restrictive policy on U.S. investment, it would cause the transfer of American investment funds to other Common Market countries. It follows therefore, that "a Common Market country that takes a more restrictive attitude than its partners toward American investment only helps its competitors at her own expense." 60

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58. J. J. Servan-Schreiber, "The American Challenge", 1967, (English Edition), New York; The Hearst Corporation, 1969, p.109.

59. ibid., pp.147-148.

60. ibid., p.47.

Apart from this characteristic environment of EEC countries, it may be true that several examples of the take-over of European firms by U.S. firms irritates the national sentiment of the host country. Thus there is a similar basis for economic nationalism in European countries and Japan. The difference in the two types of nationalism is in the magnitude of the national sentiment. The Japanese economic nationalism deeply involves the racial identity of the Japanese. The foreigner is by definition an outsider because of the homogeniety of the Japanese race and society. And the fact that he is an outsider of the Japanese society makes himself less understandable to the Japanese. Therefore, even though they agree that increased competition will benefit the consumer and foreign investment will help Japan's economic development, they suspect foreign investor's true intentions in participating in the Japanese market.

For example, an officer of the Ministry of International Trade and Industry (MITI), being suspicious of foreign behavior, suggests several countermeasures for foreign takeover; (1) it is helpful for a firm to describe in the articles of incorporation that the transfer of the company's stocks to a foreign investor requires the approval of the board of directors, (2) it is possible to describe in the articles of incorporation that a foreign investor is not able to be a member of the board of directors, and it is also effective in preventing a foreigner from taking control of the company to let the employees hold stocks of the company.[61]

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61. Yogoro Komatsu, "Shihon Jiyuka Hoshin to Taisaku (Capital Leberalization and Countermeasure), in Nippon Seisansei Honbu (ed.), Kokusai Shihon to Nippon Kigyo (International Capital and Japanese Enterprises), Nippon Seisansei Honbu, Tokyo; 1967, pp.47-72.

As is often pointed out, another important point which characterizes Japanese sensitivity to foreign investor's behavior is the lack of communication between the Japanese and foreigners.[62] The Japanese in general, have a language handicap when compared with European people. It is more difficult for a Japanese to be familiar with the English language than a European. The Japanese are afraid of losing a majority ownership in a joint venture, for otherwise their poor communication capability would cause them to fail in representing their interests in proportion to the degree of their minority ownership.

CULTURAL DIFFERENCE

In addition, the lack of mutual-understanding of socio-cultural characteristics of the various countries makes the Japanese cowardly in opening the doors to foreigners. As was discussed in the first section of this chapter, one of the important elements of Confucian philosophy is the harmony of a group or a society. The Japanese are, therefore, sensitive to any action (particularly an action by an outsider of the society) which may affect the structural order. The alteration or improvement of the Japanese method by the Japanese themselves means the development of the Japanese society but such alterating actions taken by outsiders will be resented. For example, it happens very often in the course of rationalization of the industrial structure that small Japanese firms go bankrupt and throw their employees out of work. When foreign firms, however, fire some

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62. See, for instance, Masao Kanno, Shihon Jiyuka to Kokusai Kyosoryoku (Capital Liberalization and International Competitive Power), Tokyo; Shiseido, 1966, chapter 4, pp.171-176 in particular.

employees, it is considered as arbitrary action of the foreign enterprise. Although this kind of reaction may not be rare in other countries the Japanese sensitivity seems to be stronger than that of Western countries because of this characteristic in the Japanese society.

ARGUMENT ON RECIPROCITY

The inferiority complex of the Japanese often changes into a superiority complex when they meet people in the developing countries. In this case it becomes easier for the Japanese to bring their own methods into their subsidiaries of developing countries. Asahi Shinbun, one of the leading newspapers in Japan, reports that most Japanese subsidiaries in South East Asia adopt Japanese customs such as a morning gathering and morning gymnastic exercises.[63] Both of them are very commonly adopted by Japanese organizations by which the management intend to deepen the collective orientation of employees and their identity with the company.

The personnel manager of the Thailand Daimaru, a subsidiary of a Japanese Department Store, explains the reason for a morning gathering.

> "We bring the Japanese way directly into Thailand. Since the custom is different between Japan and Thailand,...., they are not familiar with the Japanese way. Therefore it is necessary to have the morning gatherings in order to communicate our intention to the employees such as explanations and comments of their behavior in work and teaching the work discipline." [64]

The Japanese try to maintain their own socio-cultural structure in doing business in foreign countries as well as in their own country.

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63. Asahi Shinbun, January 17, 1972.

64. ibid.

When a foreign observer notices this situation, he points out the inconsistency and irrationality of the Japanese behavior, as Herber Glazer did in his book:

> "A Japanese automobile manufacturer in a joint venture in Mexico may take over management of the joint venture by increasing his share of the equity and Unilever in Japan may take over management of its joint venture (Honen-Lever) by increasing its share of the equity. This is a common situation in joint ventures. But in Japan, no connection is made between the two cases mentioned. To the Japanese, in Japan, when a foreign partner takes over a joint venture it is another case of foreign encroachment. As for the reciprocal situation in a foreign country, the Japanese would say 'no connection' (kankei nai)." 65

Being a member of a vertical society, a Japanese is not accustomed to work with a foreign partner in a horizontally oriented society and in a different race. Therefore, they incline to hold a majority ownership of joint ventures both domestic and abroad in order to get successful results.

In case that the purpose of Japanese outward investment is to secure foreign natural resources, they do not adhere to holding a majority of interests in foreign ventures (the Japanese investment in Canadian mining industry is the case). The Japanese are much concerned about the ownership and control of joint ventures where their participation is great.

4) GOVERNMENT-BUSINESS COLLABORATION

In the course of Japan's industrialization since the Meiji era, the government's role had been of importance in her economic development.

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65. Herbert Glazer, The International Businessman in Japan, Tokyo; Sophia University, 1968, p.58.

In backward Japan it was necessary to compress into a short period and carry out at one stroke the process which the advanced countries, such as England, had passed through gradually over a long period of 200 to 300 years. In any backward country some measure of government protection was necessary when the people decided to push forward with a program of capitalist industrialization and this was the situation which existed in Japan.

GOVERNMENT'S ROLE IN ECONOMIC DEVELOPMENT

In the course of introducing Western technology, the Meiji government built several experimental factories in the early stages of development. Most of these State industrial properties were soon sold at prices low enough to attract private entrepreneurs. They went mostly to certain big capitalists enjoying official favor and capable of financing and operating them. In 1885, for example, the government sold to Ichibei Furukawa, a founder of Furukawa Zaibatsu, the Ani Copper Mine in which the government had invested 1.6 million yen on the condition that Furukawa paid 250,000 yen with a down payment of 10,000 yen. He could pay the balance in 24 annual instalments, beginning after a period of five years, and could do so without paying any interests.[66]

In the prewar period, a series of disposals of government properties to a few large enterprises enabled these enterprises to enjoy a quasi-monopolistic position and provided the foundation of strong

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66. Hiroshi Kato, "The government and Business in Japanese Economy", in H. Kato (ed.), Business and Government in an Internationalized Period, Tokyo; Kogakusha, 1971, p.26.

business groups called 'zaibatsu' such as Mitsubishi, Mitsui, Sumitomo, Furukawa, Yasuda. The inter-dependence of big business and the State characterized the Japanese economic system as "the sponsored capitalism", in William W. Lockwood's words. He remarks:

> "As their (zaibatsu) influence rose, they also became makers of national policy, sharing privilege and authority with the military and civilian bureaucrats and party politicians. So close indeed was the affiliation of the State and big business that it was sometimes difficult to tell where one left off and the other began." 67

GOVERNMENT AND BUSINESS IN POSTWAR JAPAN

The industrial structure and interrelationship between government and business in the postwar period were, in certain respects, significantly different from those in the prewar period. First, public ownership of industry decreased after the war to a great extent. Under the Occupation the government was stripped of its big steel monopoly and most of its other wartime operations and controls such as shipping, shipbuilding, oil refining, and electric power distribution. The government operates only few industries such as the telephone and telegraph, the revenue monopolies in tobacco and salt, and two-thirds of the nation's railways.

Second, energy essential for economic development in postwar Japan was derived from vigorous activities of private enterprises. The dissolution of 'zaibatsu' under the Occupation and the transfer of public ownership to private enterprises produced a new industrial

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67. William W. Lockwood, The Economic Development in Japan, Princeton N.J.' Princeton University Press, Expanded Edition, 1968, p.563.

structure. Quasi-monopolistic conditions in prewar industry changed into an oligopoly in which there existed severe competition because of the immaturity of the oligopolistic structure.[68]

Japanese entrepreneurs traditionally tend to think in broad national and economic terms and are quite conscious of the interaction between business and national goals and private economic organizations enter directly and vigorously into national economic planning and politics.[69] They have an influential power of the existence of the government; as Chitoshi Yanaga points out,

> "The power of life and death over the government has been exercised by organized business overtly and dramatically at times, but quietly on the whole, unnoticed by the casual observer. No candidate for the premiership can be successful without the tacit, if not expressed, approval of the business community. Nor can a Prime Minister long continue his post after he has lost the support of organized business. 70

The government, on the contrary, had the responsibility for the planning of the reconstruction and development of the Japanese economy and supplied an important part of the necessary capital to key industries through the Development and Reconstruction Bank and other financial

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68. According to Takeo Takahashi's study, Japan was more oligopolistic in many industries than the United States but less oligopolistic than Britain based on the 1966 data. However it was also pointed out that the Japanese wholesale price indices were more elastic than those of the U.S. and Britain. See Yasuo Maruyama, Nippon no Kato Kyoso (Excessive Competition in Japan), Tokyo; Daiyamondosha, 1968, pp.37-41.

69. There are four major private organizations of business and industry. That is; 'Keidanren' (abbreviation of Keizai Dantai Regno) or the Federation of Economic Organization, 'Nikkeiren' or the Japanese Federation of Employers Association, 'Nisho' or the Japan Chamber of Commerce and Industry, and 'Keizai Doyukai' or the Management Association of Japan.

70. Chitoshi Yanaga, Big Business in Japanese Politics, New Haven, Yale University Press, 1968, p.141.

functions. (see chapter 2) Government officials were constantly on the lookout for effective policies for maintaining the economic system, often anticipating needs of business before businessmen themselves were aware of them. Ministries devote the greater part of their administrative energies to serving the needs of business and industry. In performing its chief function of promoting and protecting trade and industry, the Ministry of International Trade and Industry (MITI) looks upon corporations, trade associations, and the economic organizations as its clients. The hand of government is everywhere in evidence, despite its limited statutory powers. ... This is "economics by administration" to a degree inconceivable in Washington or London. Business makes few major decisions without consulting the appropriate governmental authority; and the same is true in reverse. The Ministries list 300 consulting committees for this purpose.[71]

JAPANESE BUREAUCRACY

It is important to note that the bureaucrats are more concerned about the conditions of each industry than that of individual firms. They tend to consider the rationalization of the industrial structure when the industry in question is forced to be listed under liberalized industries. In considering the decontrol of foreign investment in the automotive industry, for instnace, the MITI officials tried to reorganize the industry under the two big producers, Toyota and Nissan, with the conviction that it was a necessary policy for the industry to compete with the big three automobile producers in the United States. This may

71. William W. Lockwood, The Economic Development in Japan, 1968, p.649.

indicate that the MITI officers feel that the most important thing is the survival of or strengthening of the Japanese automotive industry and that they do not care about the survival of individual enterprises.[72] However, the domestic rivals of these two Japanese firms such as Mitsubishi Heavy Industry, Isuzu, and Toyo Kogyo were too proud of their own name to be taken over by one of two big domestic rivals. This was the reason why Mitsubishi, Isuzu, and Toyo Kogyo decided to tie-up with Chrysler, General Motors, and Ford respectively in order to survive in the domestic market.

PERSONAL RELATIONS OF BUREAUCRATS WITH BUSINESS:

The vertical structure of the business organization mentioned before is also applicable to the government organization. In a vertical society there is no formal connection between people on the horizontal level, and this is true of the officials in the various Ministries. They are only concerned about the particular industry with which they are connected in their Ministries. What makes the system as workable as it is, no doubt, is a strong 'esprit de corpse in the high ranks of the civil service, and a common social background and university training among leaders in both government and industry.[73]

Furthermore, as C. Yanaga has stated:

> "The bureaucratic fraternity is characterised by solidarity born of common experience and esprit de corps. It utilizes the complex ties, both horizontal and vertical, which form a vast network of influence and power. This is the basis of the strength of this extensive group, which is composed of

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72. See Taro News, "The Economic Bureaucrats", Chuoo Koron, September 1971, pp.209-241.

73. W. W. Lockwood, op.cit., p.649.

> not only present officials but also those who have retired and are in politics and serving as Diet members or Cabinet Ministers and those who have become top executives in large private and public corporations, government banks, public authorities, and quasi-public bodies." [74]

It is common practice for retired senior officers of the Ministry of Finance to enter the political arena, public corporations, and private banks, while MITI officers find their second career in large private corporations and trade associations. For examples, there are 24 members of the National Diet who are ex-administrators of the Ministry of Finance and most of whom have had experience as a Cabinet Minister. Also, there exists an association called 'Kayokai" or Tuesday Club which consists of about 800 ex-administrators of MITI. They are members of the board of directors of large corporations or leaders of various trade associations.[75]

Administrative Guidance by the Bureaucrats:

One of the reasons for the government's restrictive policy on foreign investment is the existence of 'excessive competition' in the Japanese market. For many years the growth potential of the Japanese economy has been considered to be so strong that each firm in an industry has continued to invest heavily in production facilities so as to expand or at least to maintain its market share. In an industry where scales of economy are very important such as steel, chemicals, and petrochemicals, the introduction of new tehcnology is essential to each producer and this action increases the total production

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74. C. Yanaga, op. cit., p.106.
75. Taro News, "Keizai Kanryo (The Economic Bureaucrats)", Chuoo Koron, September 1971, p.215 and p.224.

capacity in the industry. Because of the majority of the investment has been financed by debt loans and because a life-time employment system causes labor costs to be inflexible (i.e., to be fixed costs), the break even point of a firm tends to be at a high level, which in turn, puts a pressure on firms to produce an excess supply condition in the market.

Another important factor which accelerates the 'excessive competition' is State intervention in the form of fixed investment regulations in some oligopolistic industries, e.g., iron, steel, and petroleum refining, which has caused keen investment competition among firms in the hopes of acquiring a higher share in their market.[76] This type of regulation by administrative guidance is mainly based on the existing production capacity of individual corporations. It follows that each producer is eager to expand its production facilities when the market condition is favorable and there is no investment regulation.

Since this informal leadership of government officials is a powerful weapon for controlling industries, they are very worried about the effectiveness of this type of informal administrative method against foreign investors in Japan. Should these informal controls be of little use against foreigners, the government feels that the entry of foreign investors in Japanese industry will produce severer competition, thus creating chaos. In this sense the bureaucrats, it seems to me, are the most enthusiastic advocates of economic ethnocentrism in Japan. The government administrators are only concerned with the survival of the

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76. Miyohei Shinohara, Structural Changes in Japan's Economic Development, Tokyo; Kinokuniya Bookstore Co., 1970, p.20.

Japanese industry itself, not only because this philosophy is essential to the national economy, but because this concept is based on the nature of the bureaucratic function.

The Japanese bureaucracy served the Emperor in prewar Japan and it also served the people in the postwar period. However, the function of the bureaucracy remained unchanged under the different political and economic conditions. The most important concern of bureaucrats is to maximize the function of bureaucracy in order to attain the given national goals under the given political and economic system. It is no wonder, therefore, to see the statement:

> "In fact, it is rumored that in prodding certain reluctant industries to agree to liberalization, the Ministries have given them implicit assurance that the government will stand ready to employ administrative guidance to keep foreign firms in line." 77

The social and cultural tradition in Japan has made the Japanese bureaucracy more nationalistic in their sentiments than other people in general. This is the reason why the government administrators are fairly sensitive to challenges or pressure from outsiders of the society to their own informal administrative functions.

A vertical structure and a unique cultural environment induced the Japanese to reach a certain consensus about their attitudes toward foreigners or foreign investors. It is the economic bureaucrats who take an important part for such consensus because they provide economic policies for the nation and their philosophy is based on strong economic nationalism.

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77. M. Y. Yoshino, "Japan as Host to the International Corporation", in C. P. Kindleberger (ed.), Massachusetts; M.I.T. Press, 1970, p.369.

5) SUMMARY FOR THE CHAPTER

ECONOMIC NATIONALISM IN JAPAN AND THE WEST

Foreign investment has an impact on the economic and political independence of a host country. Economic nationalism stands for people's aspirations for economic and political independence of the nation from foreign investments. It is the writer's view that Japan's policy on foreign inward investment is basically derived from the sentiment of economic nationalism which seems much stronger than the feelings of economic nationalism in Western industrialized countries.

The Japanese attitude toward foreign investment has two important characteristics. First, Japanese basic policy on capital liberalization is that foreign investment in important Japanese industries should be authorized, at the most, on a 50%-50% ownership basis. Second, the costs of economic nationalism and the economic benefits are seldom argued at the same level, rather the control of all industries by nationals had top priority in deciding foreign investment policy in spite of the fact that Japan needed foreign capital in the course of her economic development.

However, Western countries do not have restrictive policies on foreign investment as Japan has. In countries such as France and Canada economic nationalism comes to the front only when foreign behavior becomes a menace to the economic and political independence of the nation. For this reason economic nationalism in Japan and Western countries should be distinguished to such an extent that Japanese economic nationalism would more appropriately be called something else. In this paper the term 'economic ethnocentrism' is given to the Japanese economic nationalism.

ECONOMIC ETHNOCENTRISM

The key factor in Japanese economic nationalism are the Japanese perceptions that the Japanese industry is not strong enough to compete with the world enterprises and that a foreign investor is an outsider of the Japanese society. The former concept is based on the characteristics of the economic and political environments, while the latter is based on the characteristic environment of the Japanese socio-cultural structure.

In spite of the attainment of rapid economic growth over two decades, the Japanese consider that Japanese industry has several weak points such as lack of financial capability of Japanese firms, excessive competition in the industry, and the existence of small-scale firms. The economic bureaucrats are the advocates of economic nationalism and they insist on the need for government protection in major industries from foreign control.

The socio-cultural environment is quite unique to Japan in that Japan is a vertically-oriented society based on the philosophy of Confucianism and the Japanese consist of single race with single language. The formal and informal organization in Japanese society can be characterized as hierarchical, paternalistic, quasi-familistic, collectively-oriented, and conformity-oriented. The cultural uniqueness of Japan and the general inability to speak foreign languages make Japanese contact with foreigners difficult. These socio-cultural characteristics tend to keep foreigners out of the society.

CONCLUSION

One of the most important economic goals in postwar Japan was to maintain Japan's rate of economic growth as high as possible in order to catch up with economic powers in the West. Japan was able to attain this goal by the late 1960's as far as total GNP was concerned. Will Japan hold this goal through the 1970's? Will Japan maintain the same high rate of economic growth in the future as she attained in the 1960's? It is not easy to predict the future of the Japanese economy. It is certain, however, that the economic environment of the 1970's in Japan is changing.

The basis of Japan's economic policy in the international sphere was recognition of the people (of Japanese beauraucrats in particular) that Japanese enterprises were weak in comparison with foreign enterprises in Western countries and that Japan's international balance of payments was apt to go in deficit. We have noted that the international competitiveness of Japanese enterprises has been considerably strengthened. This tendency will continue in the future. With respect to the balance of payments, Japan experienced the revaluation of the Japanese yen in January 1972, but her foreign exchange reserves have continued to increase since then. The strengthening of the balance of payments and competitive position will influence Japan's economic policy on foreign investment, inward as well as outward.

How should we interpret the impact of the economic environmental change of the industrial world on economic ethnocentrism? Since one of the major factors in the model of economic ethnocentrism --- the recognition of the backwardness of Japanese industries --- will be possibly weakened, this change will make the government loosen foreign investment control. Nevertheless, it does not necessarily mean a change in the nature of economic ethnocentrism. As was discussed above, Japan allowed capital liberalization only to such an extent that the liberalization would not affect the independence of

Japanese industries. This basic policy will be unchanged; that is, economic nationalism will remain the most important factor in influencing government policy.

Another factor of the model ---a foreigner being an outsider --- will be hardly affected by changes in the Japanese economic environment. Further modernization of Japanese society will have taken place, but the basic characteristics of the society will remain as they have been for eight decades. It is not unreasonable to believe that formal organization and the processes of decision making of large enterprises will gradually become like Western organization. However, it will take a long time for Japanese organizations, formal and informal, to be considered structurally the same as organizations of Western countries.

It is very important for the Japanese to consider seriously steps for the improvement of attitudes towards foreign investment. Our domestic market, with its hundred million consumers, will soon be saturated. Aggressive penetration in foreign markets by means of exports will inevitably cause conflicts with host countries. Japanese direct investment in foreign countries could be a necessary alternative to avoid such conflicts. However, if Japanese enterprises export economic ethnocentrism with investment capital to a host country, as some firms are doing in the South East Asian countries, there will be no possibility for great success in investment activities abroad.

In interpreting the background of economic ethnocentrism it may be true, on the one hand, that the foreigner perhaps has lost sight of certain factors and sees only Japan's spectacular growth. They see only the 10 percent or more per year growth in GNP; they see the expansion of Japan's export, the improvement in her balance of payments; they forget other factors which justify a certain amount of protectionism and the go-slow approach to full liberalization.[78]

On the other hand, Japan has to seriously consider her future direction of foreign investment policy. In order to take a rapid step forward for assimilating the Japanese economy with the international economy, Japan has to decide her economic policies from the standpoint of the nationa's economic welfare instead of putting too much weight on economic nationalism.

Japan succeeded in maintaining remarkable economic growth at the expense of worsening the environment of human life. People in Japan are beginning to realize the value of a healthy environment, which is essential to their daily lives, compared with the level of production which they were able to reach. It could be possible to assume that Japan would have been able to attain a high growth by means of much inflows of foreign capital without worsening the environment of human life to the present extent. The strong economic nationalism in the Japanese mind, however, prevented people from choosing this alternative. It is now time for the people to consider how they should choose between two alternatives; a rapid but unbalanced growth; less rapid but balanced growth. For this choice the influencial power of economic ethnocentrism on economic policies should be diluted to a great extent.

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78 T.F.M. Adams and N. Kobayashi, The World of Japanese Business, Tokyo; Kodansha International Ltd., pp. 215-216.

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