FOREIGN AID AND INVESTMENT: NEW CHALLENGES TO JAPAN

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I. RECENT DEVELOPMENTS IN JAPAN'S BALANCE OF INTERNATIONAL PAYMENTS

IN DISCUSSING THE central issues with which Japan is now confronted in the fields of foreign economic aid and investment, the present paper takes as the starting point the fact that in its international economic position this country now finds itself in a crucial stage of transition. Japan has only recently acquired the status of a net capital exporter, but is already faced with heavy pressure from continuing balance of payments surpluses to expand rapidly its overseas resource transfers.

According to the estimates prepared by an authoritative foreign exchange bank,[1] Japan's balance of international indebtedness turned for the first time into an asset surplus in 1968, which has expanded three and a half times during the last two years to reach the level of $20 billion at the end of November 1972 (Table I). This dramatic change took place largely under the shadow of the international monetary crisis of 1971 and its aftermath. Increase in short-term assets made up 80 per cent of the increase of total assets in the year 1971, and even after the Smithsonian agreement 60 per cent of the addition to assets during the first eleven months of 1972 was of a liquid nature. About two-thirds of Japanese short-term international assets are in the form of foreign exchange reserves of the central bank. Last year (1972), however, long-term assets grew proportionately more rapidly than short-term ones, and the absolute increase in long-term assets net of long-term liabilities was greater than the increase in net short-term assets. The changing international position of the Japanese economy has been clearly reflected in the steadily increasing scale of loans, securities, and direct investments overseas, which are in excess of the reverse flows of capital in the similar categories.

To judge from these developments, Japan is now in the process of consolidating its position as a net creditor on the international scene. In addition to the quantitative predominance of liquid assets, more than one-third of long-term assets is covered by export credits of a relatively shorter maturity. Accumulated direct investment overseas is still of an extremely modest scale, amounting to no more than $2.6 billion at the end of November 1972, as compared with $86

1 In contrast to other advanced industrial countries, there is no official estimate of the balance of international assets and liabilities available in Japan.

TABLE I
JAPAN: INTERNATIONAL INVESTMENT POSITION

($ million)

	December 1970	December 1971	November 1972
Assets total	19,881	31,715	42,076
Long-term assets	8,745	11,200	15,278
Direct investment	1,647	2,051	2,619
Export credits	4,270	5,300	5,577
Loans	1,859	2,450	3,850
Investments in international organizations	371	700	485
Other assets	529	500	1,608
Securities investment	69	200	1,132
Short-term assets	11,136	20,515	26,798
Foreign-exchange banks	6,599	5,200	8,302
Other private assets	84	80	84
Foreign exchange reserves	4,399	15,235	18,412
Government and Bank of Japan	56	—	—
Liabilities total	14,089	18,340	22,310
Long-term liabilities	6,326	7,540	8,117
Direct investment	837	1,050	1,195
Foreign bonds	1,033	1,070	954
Loans	2,654	2,670	2,508
Securities investment	1,485	2,450	3,159
Import credits	103	100	107
GARRIOA and others	214	200	194
Short-term liabilities	7,763	10,800	14,193
Foreign-exchange banks	5,539	6,800	8,147
Other private liabilities	2,224	3,500	5,450
Government and Bank of Japan	—	500	596
Net assets	5,792	13,375	19,766

Sources: *Nihon keizai shimbun*, October 3, 1971 and January 17, 1973.

billion for the United States [5, Apr. 1972] and $22.6 billion for the United Kingdom [1, June 1972], both at the end of 1971 (as published in the official tabulations of those countries' balances of international assets and liabilities).

It is instructive to look into the recent behavior of Japan's balance of international payments, which however does not tell us unequivocally about the dating of the net capital-exporting phase. Until as late as ni 1964 the balance on current account tended to show an almost continual deficit which was largely covered by inflows of long-term capital from abroad. Quite suddenly, as shown by Table II, a net outflow began to appear in the long-term capital balance in 1965, which has since remained in such a net position. While countries are generally assumed to pass through the stage of a mature debtor in which a surplus in trade balance is required to repay past debts, Japan seems to have nearly skipped over this stage in its transition from the position of a young debtor to that of a young creditor. After a single year of near-equilibrium on both the current and long-term capital accounts (1964), the country began to lend abroad while repaying at the same time. The years 1965 and 1966 which saw a considerable repayment of capital borrowed in the form of securities, bonds, and loans were followed by a severe deficit in the basic balance in 1967. It is only since 1968 that Japan's basic balance has appeared to be firmly set on the course of ever increasing surpluses. However, Japan's outflows of investment income continued to exceed inflows for a further few years until 1971 when receipts slightly surpassed payments (see Table II).

The new status of Japan is thus of a recent date, and the change has been abrupt. It will be remembered that as late as in 1961, P. N. Rosenstein-Rodan, suggesting that Japan should not be included among aid-giving nations because of its low per capita income, wrote: "Japan should certainly provide short- and medium-term loans, but she is not yet a structural capital-export country" [21, p. 111]. Within a decade's time there has been a really dramatic change in the international economic position of Japan. Its gross national product now runs on a scale second only to the United States in the non-Communist world, and its per capita income has attained the level comparable to that of the most advanced nations in Western Europe. But the rapidity with which these changes took place has, it seems to me, imposed an additional and enormous burden on the process of "structural" adjustment in Japan's move to the new status of a net capital exporter.

In the process of economic growth at differential rates among countries, the international relationships of costs, prices, and productivity will change in a well-definable direction, resulting in something that can be called "structural" changes in the behavior of the trade balance. From the long-run point of view, this is what has been happening in Japan during the 1960s. If there is something like an equilibrium or normal level of long-term capital movements, this will mean that long-term capital outflows have to increase on a sufficient scale to offset such long-run changes in the trade balance. Being under the influence of institutional and other real market factors, however, international movements of capital may not be flexible enough to attain such an equilibrium level within a short time. When, as in the present case of Japan, long-term capital flows get out of adjustment with the deep-seated factors affecting productivity, cost-price relationships, and the structure of domestic income expenditure (savings and investment), Kindleberger's concept of "secular disturbances to international equilibrium" [15, pp. 435 ff.] assumes particular relevance.

The present problems of Japan's international disequilibrium are, in the writer's view, aspects of the frictions which arise inevitably from long-run changes in underlying factors as a country moves from one historical stage of economic development to another. If secular disequilibrium in Kindleberger's sense is due mainly to the incongruence of foreign lending or borrowing with the underlying pattern of domestic income expenditure, a remedy can be sought either in changing the factors of income flow which determine the actual behavior of the commodity and invisible trade balance, or in changing the pattern of international movements of long-term capital. In the nature of long-run maladjustments, any single means of adjustment policy in either approach will be severely limited in

TABLE
JAPAN: BALANCE OF

Fiscal Years	1963	1964	1965
Balance, current account	−1,071	29	1,049
Commodity trade	−357	872	2,084
Exports	5,594	7,199	8,591
Imports	−5,951	−6,327	−6,507
Invisible trade	−659	−760	−940
Of which:			
Investment income: receipts	138	141	209
payments	−268	−344	−398
Transfer payments	−55	−83	−95
Private	25	4	5
Government	−80	−87	−100
Balance, long-term capital	458	17	−553
Assets (Japanese capital)	−340	−454	−523
Direct investment	−125	−44	−105
Deferred payment credits	−153	−349	−261
Loans	−57	−47	−134
Liabilities (foreign capital)	798	471	−30
Direct investment	88	70	51
Deferred payment credits	73	54	−3
Loans and foreign bonds	588	383	8
Securities investment	80	−4	−49
Basic balance	−613	46	496
Balance, short-term capital	260	54	−40
Errors and omissions	−8	7	−27
Overall balance	−361	107	429
Balance of financial transactions	−361	107	429
Changes in foreign exchange reserves	133	57	56
Others	−314	50	373

Source: [19].

its effectiveness, and there is presumption that some coordination and combination of all the policy instruments will be required in order to cope with such "structural" problems successfully.

Consider domestic policy measures first. Monetary and fiscal policies which aim at an appropriate control of aggregate demand at home will not be carried out far enough to eliminate the existing large imbalance in trade, so long as they are to operate within the limits determined by the objectives of domestic stability and full utilization of growth potential. An appreciation of the currency may therefore be indicated for a young creditor nation with inadequate foreign lending, but the effectiveness of exchange rate adjustments will crucially depend on the degree of elasticity in demand factors which has been considerably reduced in the present phase of development in almost every industrialized economy. It remains true that the basic remedy lies in fundamental changes in the import regime, including liberalization of imports and long-run adjustments in the tariff structure. However, changes in tariffs and quotas are much more effective in

II
INTERNATIONAL PAYMENTS

($ million)

1966	1967	1968	1969	1970	1971
996	−311	1,473	2,044	2,365	6,463
2,057	1,126	2,971	3,713	4,455	8,552
9,795	10,575	13,418	16,479	19,865	24,758
−7,738	−9,449	−10,447	−12,761	−15,410	−16,206
−900	−1,262	−1,329	−1,487	−1,861	−1,767
259	297	353	551	758	1,135
−440	−494	−614	−845	−930	−1,105
−161	−175	−169	−187	−229	−322
−17	−24	−29	−28	−40	−89
−144	−151	−140	−159	−189	−233
−835	−740	−80	−642	−1,347	−1,708
−725	−938	−1,145	−1,892	−2,010	−2,486
−101	−137	−228	−230	−397	−420
−453	−513	−582	−732	−815	−890
−131	−234	−281	−554	−600	−416
−110	198	1,065	1,250	663	778
43	37	93	56	113	211
−44	−25	−9	8	−2	15
−65	159	673	441	101	102
−8	56	344	782	489	599
161	−1,051	1,393	1,402	1,018	4,755
55	489	88	370	670	3,099
−157	28	146	217	311	189
59	−534	1,627	1,989	1,999	8,043
59	−534	1,627	1,989	1,999	8,043
−32	−114	1,250	655	1,590	11,205
91	−420	377	1,456	537	−3,002

particular situations of short-term or cyclical disequilibrium than in long-run developmental situations. Japan's experience since 1971 provides ample evidence of the narrow limits within which any single policy means in this category is effective in such a situation. There is certainly a case for purposeful combination of these measures, but the administrative difficulties in organizing such a policy mix have in fact proven almost inhibitive, indeed.

In these circumstances there are grounds for drawing renewed attention to the possibility of increasing foreign lending as a means of international adjustment. Assuming that economic growth is really underway at different rates in different countries, there is much to be said for international movements of long-term capital which will positively contribute to the expansion of world trade. This applies especially to the cases of a young debtor and a young creditor: the former should borrow and import capital from abroad in order to supplement domestic savings, and the latter should lend and export capital in order to offset the excess of domestic savings over investment. In the present situation of disequilibrium, it would be far better for Japan to increase foreign lending rather than to try and suppress growing exports by some mix of administrative devices, as it is forced to do at present.

The trouble is that long-term capital outflows do not take place by themselves. Even in Japan where the long-term capital balance showed a remarkable degree of changeability, the scale of capital flow has been far from being adequate to offset the underlying changes in the trade account. Perhaps we should recognize that adjustment to this kind of "structural" imbalance will necessarily involve a considerable time; one may not be justified to press too strongly for an immediate elimination of all imbalances. The reaction of capital flows to incentive measures, if any, may be slow. Assuming that such measures are desirable, the creation of adequate institutions for lending abroad may be a time-consuming process. A considerable part of long-term capital flows takes place in response to market forces, and it is perfectly arguable that this part of foreign investment should be left as much as possible to decentralized decisions at the firm level. On the other hand, a part of desired capital flows may require additional incentives to be provided by a public agency. It is an important matter for public policy to determine the extent to which, and the particular ways in which, such incentives should be provided. Finally, there is a part of long-term capital transfer which is entirely in the hands of the government to decide. International aid, which has in the postwar period largely replaced the prewar functions of portfolio investment in the traditional form, belongs to this category.

Section II deals with the present problems and prospects of Japan's foreign aid which will play a significant part in the process of international adjustment in the future. The transfer of financial resources other than by means of aid in the strict sense, however, will be discussed in the general context of foreign investment, which is the subject of Section III.

II. POLICY AGENDA FOR FOREIGN ECONOMIC AID

Reflecting the recent growth of the country's economic capacity, Japan has continued to expand greatly the resources transferred to the developing countries of the Third World. The level of $2.1 billion annual net transfer attained in 1971 is about 5.6 times that of ten years ago and second only to the United States contribution among the DAC member countries. As indicated in Table III, in fact, the increase in resource transfer to the developing countries has been much more rapid than the economic growth of Japan itself, resulting in a rise in the ratio to GNP from a low of 0.36 per cent in 1964 to 0.96 per cent in 1971—close to the 1 per cent target. This constitutes a significant part of the transfer payments and long-term capital outflows in the Japanese balance of international payments.

However, the resources thus transferred in their totality cannot be properly interpreted as aid. What is relevant for the balance of payments is the fact that real resources or immediate claims on resources are tarnsferred from one country to another, but it would hardly make sense to regard as aid those transfers which take place for profit motives of an enterprise in response to market incentives. From the point of view of government policy, therefore, the broadest definition of aid would be to include all resource transfer "which would not have taken place as a consequence of the operation of market forces or in the absence of specific official action designed to promote the transfer by the donor country" [17, p. 194]. But this definition does not adequately serve the purpose of measuring even official aid statistically. The fact that a commercial credit is guaranteed by the government would not mean that the transaction itself would have been forsaken in the absence of such a guarantee. It is hardly possible to distinguish conceptually the part of a transaction which is undertaken in response to market forces from the part which is due to government policy. Perhaps, the size of the public funds participating in international transactions may be taken as an approximate indicator for the degree of government involvement in the transfer of resources.

Table IV shows the relative proportions of public and private funds used for specific purposes in the total transfer of financial resources from Japan to the developing countries, as compared with those in the average of the DAC countries. It would appear that the Japanese government has been involved to a relatively higher degree in this transfer than the governments of other countries. This may be explained by the fact that private capital in Japan has been less equipped to undertake overseas investment activity in the initial stage of its capital-exporting status. However, this particular pattern of the use of public funds in dealing with the developing countries raises a serious question as to the appropriate aid policy. The Japanese performance in the field of what is properly termed "official development assistance" (ODA) has remained rather unsatisfactory, indeed.

There are reasons why the question of a revision of the aid target had to be put seriously on the agenda of UNCTAD III. The 1 per cent target is generally rejected by the developing countries on the grounds that it refers to the total resource transfer which includes non-aid items such as foreign private investment and export credits and from which the payment of interest is not properly subtracted. This is a position which is supported by economic logic, as well as by a number of smaller advanced nations, against the opposition of the major donor countries. The government of Sweden, for instance, has expressed the view that the setting of an aid target for the kinds of international transactions which cannot be controlled by government policy is void of any real meaning, and that the inclusion of interest payments in the "net" transfer would be highly misleading.

In economic terms, proper definition of aid should be at the minimum based on some notions of "costs" to the donor and "benefits" to the recipient. Such a definition will be both narrower and broader in content than is implied in the previous formal definition. The content will be narrower because any offsetting economic benefit to the donor has to be subtracted from the immediate cost of aid transfer. In so far as development loans are concerned, it is a generally recognized method of arriving at the aid costs to the donor to subtract from the amount of aid extended the discounted present value of the interest and amortization payments, the rate of discount reflecting the social rate of return on capital

TABLE
JAPAN: RESOURCE OUTFLOW

	1961	1962	1963	1964	1965
Public funds, total					
Official development assistance	106.9	86.8	140.3	115.9	243.8
Bilateral	95.5	79.6	128.2	106.2	226.3
Grants-in-aid	67.8	74.6	76.7	68.7	82.2
Capital	65.4	71.0	72.2	62.9	76.2
(Of which: reparations)	(65.0)	(67.0)	(62.0)	(57.8)	(62.80)
Technical assistance	2.4	3.6	4.5	5.8	6.0
Development loans	27.7	5.0	51.5	37.5	144.1
(Of which: re-scheduling)	(0.9)	(−7.5)	(−8.8)	(−11.6)	(60.9)
Multilateral organizations	11.4	7.2	12.1	9.7	17.5
Other uses of public funds					
Export credits					
Direct investment					
Investments in international organizations					
Private fund, total	274.5	199.4	127.3	175.3	242.1
Export credits	180.7	130.3	50.6	135.7	154.7
Direct investment	98.4	68.4	76.7	39.3	87.4
Investments in international organizations	−4.6	0.7	—	0.3	—
Grand total	381.4	286.2	267.6	291.2	485.9
For reference:					
Gross national product ($ billion)	53.2	58.9	68.0	80.1	88.3
Grand total-GNP ratio (%)	0.71	0.49	0.40	0.36	0.55
Official development assistance-GNP ratio (%)					
Export credits, total					
Direct investment, total					

Source: [7, 1970 and 1972].

in alternative employments in the donor country. The real value of "tied" aid, in terms of both "costs" to the donor and "benefits" to the recipient, is considerably reduced by higher prices connected with the delivery of the real goods transferred. To the extent that private investment in the developing countries is promoted by tax incentives, the direct cost in the form of loss of tax revenues in the donor country involves a transfer to the private investor in that country, rather than a transfer to the aid-receiving country.

On the other hand, the concept of aid will become broader in coverage than the officially measured transfer of financial resources. Resources can be transferred from one country to another through the channels of trade and transfer of technology and know-how. International commodity agreements, for example, would appear to be a form of aid. In so far as the prices of export products from the developing countries are raised, there occurs a transfer of resources from

III
TO THE DEVELOPING COUNTRIES

($ million)

1966	1967	1968	1969	1970	1971	Composition in 1971 (%)	Rate of Increase 1970–71 (%)
485.3	611.1	678.3	811.4	1,151.6	1,161.8	54.3	0.9
285.3	385.3	356.2	435.6	458.0	510.7	23.9	11.5
234.7	340.6	307.4	339.6	371.5	432.0	20.2	16.3
104.7	138.4	117.0	123.4	121.2	125.4	5.9	3.5
97.1	127.4	103.3	104.5	99.6	97.7	4.6	−1.9
(55.6)	(81.7)	(46.4)	(41.3)	(18.2)	(21.8)	(1.0)	(19.8)
7.6	11.0	13.7	19.0	21.6	27.7	1.3	28.2
130.0	202.2	190.5	216.2	250.3	306.7	14.3	22.5
(15.2)	(40.3)	(12.5)	(−5.2)	(13.9)	(3.8)	(0.2)	(−72.7)
50.6	44.7	48.8	95.9	86.5	78.7	3.7	−9.0
200.0	225.8	322.1	375.8	693.6	651.1	30.4	−6.1
171.4	190.1	290.3	309.9	349.5	271.7	12.7	−22.3
28.6	35.7	31.8	55.9	143.1	136.3	6.4	−4.8
—	—	—	10.0	201.0	243.1	11.4	20.9
139.8	186.4	371.0	451.7	672.3	978.7	45.7	45.6
71.7	137.6	280.2	299.6	386.9	494.0	23.1	27.7
68.5	48.9	90.8	144.1	265.0	351.2	16.6	34.4
−0.4	−0.1	—	8.0	20.4	128.5	6.0	616.6
625.1	797.5	1,049.3	1,263.1	1,824.0	2,140.5	100.0	17.4
101.5	119.7	141.9	166.4	196.1	222.0		
0.62	0.67	0.74	0.76	0.93	0.96		
0.28	0.32	0.25	0.26	0.23	0.23		
243.1	327.7	570.5	609.5	736.5	765.5	35.8	4.0
97.1	84.6	122.6	199.9	408.1	492.5	23.0	20.7

Note: Classification since 1966 is based on the revised DAC formula.

the importing to the exporting countries. But the actual benefits accruing to the exporting countries will depend on various factors such as elasticity of demand and competition of substitutes. The creation of international reserve assets, over and above the compensatory or supplementary financing, may involve considerable "aid" elements in expanding world demand. The relevant point of these arguments in the context of the present discussion is that the issues of Japan's aid policy cannot be dealt with adequately without also considering the essential aspects of trade policy.

It is perhaps of pragmatic wisdom that international deliberations, both in the DAC forums and among the developing countries, are centering around the volume and terms of what is termed "official development assistance," which is the closest approximation to the narrower definition of aid, since it excludes all kinds of commercially motivated transfer of financial resources. In terms of

TABLE IV
JAPAN AND DAC: PERCENTAGE COMPOSITION OF THE RESOURCES TRANSFERRED TO THE DEVELOPING COUNTRIES

	Japan			Average of the DAC Countries		
	1966	1969	1971	Average 1964/66	Average 1967/69	1971
Public funds, total	77.6	64.3	54.3	61.1	55.1	51.8
Official development assistance	45.6	34.5	23.9	58.9	50.4	44.4
Grants-in-aid	16.8	7.8	5.9	37.0	26.3	21.1
Development loans	20.8	17.1	14.3	18.3	17.7	16.0
Multilateral	8.0	7.6	3.7	3.6	6.4	7.3
Other uses of public funds	32.0	29.8	30.4	2.2	4.7	7.4
Private funds, total	22.4	35.8	45.7	38.9	44.9	49.2
Export credits	11.5	23.7	23.1	9.0	12.0	16.1
Direct investment	10.9	11.4	16.6	29.9	32.9	32.1
Combined total of public and private funds for commercial uses	54.4	65.6	76.1	41.1	49.6	55.6

Source: [7, 1972].

ODA, however, the recent aid performance of Japan has not been commendable. Its ODA has lagged behind those of the United States, France, West Germany, and the United Kingdom. Although the general tendency for ODA to decline in relative importance is shared by all the major donor countries in the DAC group, the recent rate of increase in Japan's ODA has remained below the average rate for the DAC group as a whole. In terms of relative share of GNP of the donor countries, it is as low as 0.23 per cent, as compared with 0.35 per cent for the average of the DAC member countries (Table V).

This contrasts with the recommendation of the Pearson Commission "*for net disbursements* [of ODA] *to reach 0.70 per cent of its* [each donor country's] *gross national product by 1975 or shortly thereafter, but in no case later than 1980*" [20, pp. 148–49]. The declining trend in recent years is, indeed, part of the deteriorating world climate of development aid, and unless a major change in the basic orientation in aid policy takes place in the aid-giving countries, the prospect for this goal to be achieved does not seem bright. This applies a fortiori to Japan. It should be emphasized that, apart from administrative barriers, the feasibility of ODA programs depends entirely on the level of government controlled budget allocation. In fact, three smaller donor countries in Western Europe, Belgium, the Netherlands, and Sweden, have officially committed themselves to a budget level corresponding to the 0.7 per cent target by 1975, but no major donor countries, including Japan, would appear prepared to take this target seriously. The Japan Economic Research Center in Tokyo has projected total resource transfer from Japan to the developing countries to reach the level of $12.4 billion annually by 1980—a level only slightly less than the projected performance of the United States, involving 1.3 per cent of the Japanese GNP

TABLE V
JAPAN AND OTHER DAC COUNTRIES: OFFICIAL DEVELOPMENT ASSISTANCE AS PERCENTAGE OF GNP

	Japan	United States	United Kingdom	France	West Germany	DAC Average
1960	0.24	0.53	0.56	1.38	0.33	0.52
1965	0.28	0.49	0.47	0.75	0.40	0.44
1971	0.23	0.32	0.41	0.68	0.34	0.35

Source: [7, 1972].

expected in 1980. It is highly significant, however, that this optimistic forecast would not allow for ODA to rise to more than 0.46 per cent of the prospective GNP [12, p. 455, Table 3-61].

The most effective way to increase the volume of ODA will be for the Japanese government to devote an increasing proportion of public funds to grants-in-aid, and especially to programs of technical assistance. These are items which take extremely low shares of Japan's official aid allocation, as compared with the general pattern in other donor countries. A disproportionately large part of Japanese official aid is given in the form of direct bilateral loans with major considerations to promotion of commercial exports, which represents a relatively high degree of aid tying (Table VI). Obviously, the essential requirement is a radical change in the policy orientation regarding priority setting.

The low ratio of grants-in-aid is partly explained by the relatively underdeveloped arts of transferring technical know-how to the developing countries—a field of activity in which an unusual degree of difficulty seems to handicap Japan both in programing and implementation, particularly in respect of social and institutional constraints. There has been only a limited range of original research geared to the special requirements of the developing countries. However, these difficulties are not innate to the nature of the technological assets Japan has now at its disposal. On the contrary, the recent Japanese experience in its rapid transition from a labor-surplus economy to the high-income status must be, it is suggested, highly relevant to the development problems of the emerging nations which start from a similar situation. Japan has undoubtedly significant contributions to make in this respect, and it will be one of the imperatives on

TABLE VI
JAPAN AND OTHER DAC DONOR COUNTRIES: COMPOSITION OF OFFICIAL DEVELOPMENT ASSISTANCE IN 1971

(%)

	Japan	United States	United Kingdom	France	West Germany	DAC Total
Grants-in-aid	24.5	46.6	43.9	70.6	37.9	47.6
Of which: technical assistance	5.4	17.8	24.8	44.2	28.1	21.9
Loans	60.1	40.4	42.8	19.0	34.2	36.0
Multilateral aid	15.4	13.0	13.2	10.4	27.9	16.3

Souce: [7, 1972].

the aid front that the authorities give urgent attention to the improvement of the domestic apparatus for programing and implementing technology transfer to the less developed countries. In addition to the need for country-specific programing involving concrete target-setting, it will be essential to adopt an integrated approach, combining capital assistance with technical cooperation. In most cases of important projects, capital, and technical and managerial know-how are so closely complementary to each other that assistance in the one is seldom effective without assistance in the other.

Increasing the grants-to-ODA ratio will also be the best way to improve the terms and conditions of official aid, on which account Japan's recent aid performance has been subjected to increasing criticisms. Table VII suggests that the complaints from the international circle are not without justification. Despite the remarkable quantitative increase in total resource transfer, Japan belongs to the minority group of DAC member countries which has not yet fully satisfied the conditions postulated in the 1965 DAC recommendations, let alone those in the supplementary recommendations of 1969. In the meantime, the high-level meeting of DAC in 1972 has adopted new recommendations, determining the minimum conditions in terms of grant elements for official loans to be included in ODA and raising the target for grant elements of ODA as a whole to above 84 per cent. The attainment of these conditions would require very great efforts, indeed, on the part of the Japanese aid authorities. Assuming the grant-to-ODA ratio to be 33 per cent as in 1971, it has been estimated that, if the new conditions were to be complied with, official loans of Japan would have to be liberalized so as to average out with the following overall terms: 0.75 per cent annual rate of interest (as compared with 3.5 per cent in 1971), thirty years maturity (as compared with twenty-two years), and ten years grace period (as compared with 6.7 years) [7, p. 99]. In view of the mounting debt burdens of the developing countries, the strategic importance of raising the relative share of grants-in-aid needs no further elaboration. Where bilateral flows of grants are under the constraint of technical absorptive capacity, either on the side of the donor or on the

TABLE VII
JAPAN AND OTHER DAC COUNTRIES: TERMS OF OFFICIAL DEVELOPMENT ASSISTANCE (COMMITMENTS) IN 1971

	Japan	United States	United Kingdom	France	West Germany	DAC Average
Grant-to-ODA ratio (%)	33	59	48	77†	54	60†
Terms of official loans						
Average maturity (years)	22.1	37.4*	24.0†	16.2*	28.6	29.1†
Average interest rate (%)	3.5	2.6*	1.1†	3.7*	2.0	2.6†
Average grace period (years)	6.7	8.7*	5.9†	2.3*	6.6	6.4†
Grant elements of loans (%)	48	62*	66†	35*	65	56†
Grant elements of ODA (%)	65	87*	83	82*	84	82†

Source: [7, 1972].
* refers to 1970.
† provisional.

side of the recipient, attention will have to be given to the possibility of channeling more aid through multilateral agencies. It will be remembered that the Pearson Commission suggested a minimum of 20 per cent of the total flow of ODA should be so directed by 1975 [20, p. 215].

Trade policy is the subject of another paper in the present issue, but a few remarks on the role of international trade in connection with Japanese aid policy may be in order. As pointed out earlier, Japanese aid in the past has been strongly biased toward the promotion of exports, and this raises a fundamental question as to the principles and motivations of aid policy. Apart from the commercial interests connected with official aid, about a half of the recent total transfer of resources to the developing countries has been in the nature of export credits. This pronounced export orientation of the aid operation may have been justified to some extent so long as the country was a net debtor nation hard pressed to repay through an active trade balance, but such a transfer of public funds (which is essentially to the Japanese exporter rather than to the foreign aid recipient) has had little to do with what is properly regarded as international aid.

To the extent that the resource transfer is associated with exports, the donor country's bilateral trade balance with individual capital-receiving countries tends naturally to show an export surplus. This is a problem of bilateral balance distinct from the general tendency for capital-importing nations to have an import surplus in the overall sense. Japan's trade relations with the developing countries, especially with those in Southeast Asia, have recently been much more unbalanced than could be explained by unilateral transfers alone. Japan's export surplus with Southeast Asian countries has now reached the level of $2.3 billion a year, with the ratio of exports to imports amounting to 169 per cent. In particular, three countries in the area, South Korea, Taiwan, and Thailand, depending on imports from Japan to the extent of 40 per cent of their total imports, have legitimate reasons for complaining about Japan's import policy. International frictions caused by the highly unbalanced pattern of trade may assume an almost unmanageable proportion if nothing happens to change the present trend. Japan's export surplus vis-à-vis Southeast Asia might then reach even the level of $8.8 billion by 1980, as projected by the Japan Economic Research Center [12, p. 434].

The behavior of the trade balance between two particular countries involves many complex factors. In economic terms, it is neither possible nor desirable to aim at a strict balancing in the bilateral sense. But trade imbalance of such a magnitude as is the case in Japan's dealing with some Asian countries would suggest that there must be something wrong in the trade policies of the countries concerned. Unless inadequate supply capacities of exportables are responsible for the lack of balance, the failure is on the part of policies affecting the volume and structure of Japanese imports from the area. At the minimum it can be argued that Japan's foreign trade policy has been inadequately coordinated with the objectives of economic aid. A successful aid operation should have contributed more significantly to increased productive capacities and to increased commodity flows in the reverse direction, resulting in larger imports into Japan.

It is true, of course, that improved terms of trade for the developing countries, and special preferences for manufactured exports from the latter in particular, represent forms of aid. In the actual forms in which the scheme of generalized special preferences has been put into practice by Japan as well as by other industrialized countries, however, its developmental effects seem to have been insignificant, as compared with straightforward import liberalization with respect to those products of special export interest to the developing countries. If the required change in the country's attitude to imports from the aid-receiving countries is not acted upon, even an ever increasing scale of total transfer of financial resources to the developing countries will fail to make real contributions to the cause of international development.

III. ISSUES OF FOREIGN INVESTMENT

The changing international economic position of Japan is reflected in the rapid growth in the gross outflow of Japanese long-term investment abroad in recent years. Having reached the level of $100 million at the beginning of the 1960s and surpassed the level of $200 million in 1966, the annual outflow of Japanese capital, on the basis of government approval, jumped to the range of $500–600 million in 1968 and 1969, and to the level of $800–900 million in the last two years for which data are now available (Table VIII). Accumulated balance of foreign investment approved by the end of fiscal 1971 (March 1972) amounted to $4,465 million; it increased during the next half year by a further $655 million to the

TABLE VIII

JAPAN: ANNUAL OUTFLOW OF LONG-TERM CAPITAL ABROAD

($ million)

Fiscal Year	Government Approval Basis				Balance of Payments Basis			
	Equity Investment	Loan Investment	Others	Total	Long-term Capital Outflow from Japan (Gross)			Long-term Capital Balance
					Direct Investment	Loans & Bonds	Total	
1951–62	211	167	175	553				
1963	63	23	40	126	125	57	340	458
1964	69	39	12	120	44	47	454	17
1965	75	69	12	156	105	134	523	−553
1966	74	122	31	227	101	131	725	−835
1967	118	132	25	275	137	234	938	−740
1968	201	326	30	557	228	281	1,145	−80
1969	224	404	40	668	230	554	1,892	−642
1970	299	572	42	913	397	600	2,010	−1,347
1971	n.a.	n.a.	n.a.	864	421	416	2,486	−1,708

Notes: 1. Figures are from publications of the Bank of Japan, and Ministries of Finance and Foreign Affairs, Japan.
2. A minus sign indicates the excess of outflow over inflow.

total of $5,120 million at the end of September 1972. It is misleading, however, to regard these figures as representing direct investment, as is the usual practice in the official documents because the authorization data conceptually include also indirect investment which does not involve active control of foreign enterprises.[2] In the Japanese investment statistics, authorized foreign investment is classified in the four main forms: (a) obtaining equities of firms located abroad in return for supplying funds, commodities, or know-how, (b) providing credits in the form of equipment, patents, or long-term funds, (c) "direct business activity," including obtaining real estate abroad, and (d) establishing branch offices abroad. Whereas "equity investment" may mainly involve participation in the management of firms located abroad, part of "loan investment" may be confined to indirect financing. Hence, it is instructive to look at the balance of international payments on long-term capital account, which has since 1965 shown an increasing surplus of capital outflow (Table VIII). Most recent information confirms a further acceleration of the trend; during the first eight months of 1972 net outflow of Japanese capital amounted to $2,750 million, whereas net inflow of foreign capital was in the range of $390 million, resulting in an excess of outflow of considerable magnitude.

One of the remarkable developments in the recent past is a phenomenal increase in foreign portfolio investment from Japan, associated with institutional changes in the regulation of the capital market. Within a fourteen month period since the liberalization in July 1971, securities investment has reached the level of $900 million by the end of September 1972. As Japanese banks have been permitted to subscribe to foreign private bonds only since May 1972, the outflow of funds on this account has amounted to half a billion dollars within a few months. The issue of foreign yen-bonds in 1971 and 1972 was in the range of $100 million and $300 million, respectively. Medium- and long-term lending by foreign exchange banks is also increasing. The importance of these developments in foreign investment arises from the fact that in its immature stage as a net creditor nation the Japanese economy still lacks some of the necessary conditions for successfully deploying its financial and managerial resources in the form of direct foreign investment and production, as implied in the notion of "multinational" or "international" corporations. The concentration of attention on direct investment alone in the usual discussion of Japan's foreign investment problems may carry some danger of distorting the proper perspective.

That Japan is just beginning to rank among the capital-exporting nations of the world is evidenced by Table IX, in which the ratios of foreign investment to some macroeconomic indicators are compared as between major creditor nations. Although direct overseas investment[3] has recently been growing more rapidly in Japan than in other capital-exporting countries, the accumulated total came in

2 It will be remembered that in the estimates of the balance of international indebtedness, outstanding direct foreign investment was recorded at $2.6 billion for the end of November 1972—about a half of the investment figure on the approval basis. See p. 385 supra.

3 In the absence of better alternatives, it is here assumed that the trend and size of direct foreign investment are roughly reflected in the statistics of foreign investment on the authorization basis.

TABLE IX
OUTSTANDING DIRECT FOREIGN INVESTMENT OF THE MAIN CAPITAL-EXPORTING COUNTRIES, 1966 AND 1970

	Japan	United States	United Kingdom	France	West Germany	Canada	OECD Total
Total investment ($ million)							
1966	1,000	54,562	16,002	4,000	2,500	3,238	89,583
1970	3,596	78,090	19,874	5,079	5,769	4,107	128,381
Share of the OECD total (%)							
1966	1.1	60.9	17.9	4.5	2.8	3.6	100.0
1970	2.8	60.8	15.5	3.9	4.5	3.2	100.0
Ratio to GNP (%)							
1966	1.0	7.3	15.2	3.9	2.1	6.0	6.2
1970	1.8	8.0	16.4	3.4	3.1	5.1	6.5
Ratio to exports (%)							
1966	10.2	182.5	109.1	36.7	12.4	33.9	67.2
1970	18.6	180.7	104.2	28.3	16.9	24.4	60.2
Investment per capita (dollars)							
1966	10	277	292	81	42	162	133
1970	35	381	362	100	97	192	206
Annual rate of increase in total outstanding investment, 1966–70 (%)							
	32.0	9.4	6.0	6.1	23.3	6.1	9.5

Source: [8, 1970 and 1972].

1970 only to 1.8 per cent of the current GNP, as compared with 8 per cent for the United States, 16 per cent for the United Kingdom, and about 3 per cent for West Germany. Output by foreign subsidiaries, which is estimated at twice the invested capital, is less than 40 per cent of the annual exports in the case of Japan, while production of U.S. subsidiaries is more than 3.5 times as much as U.S. exports. Throughout the postwar period, when the balance of payments appeared to impose recurring constraints on domestic economic growth, the major thrust of Japanese economic policy has been understandably directed towards export promotion, leaving little leeway to approach international economic relations on a broader front, including the possibility of moving factors of production across the borders. It is only now that the country faces this possibility, and also the need to organize economic contacts with foreign countries in a more balanced fashion.

The infant status of Japanese foreign investment is reflected in several characteristics of its own. First of all, Japanese foreign investment has been predominantly trade-oriented [4, p. 276]. This applies both to the market-oriented type of investment with the objective of promoting exports of either capital equipment or parts and intermediate products, and to the resource-oriented type of investment aiming at securing imports. As indicated in a questionnaire survey undertaken by the Japan Export-Import Bank [13], the main motives behind Japanese overseas investment in manufacturing have been either defending existing markets in the face of import restrictions by the host countries or expanding sales in line

TABLE X
JAPAN: OUTSTANDING FOREIGN INVESTMENT AS OF MARCH 1971 BY BROAD INDUSTRIAL CATEGORY AND BY REGION
(On Government Authorization Basis)

($ million)

	Manufacturing		Commerce		Mining		Total	
	Number of Projects	Amount	Number of Projects	Amount	Number of Projects	Amount	Number of Projects	Amount
North America	67	239	532	293	48	178	912	912
Latin America	177	276	82	17	34	87	585	556
Southeast Asia	1,013	334	203	18	69	269	1,746	780
Europe	44	37	215	29	3	6	398	638
Middle East	8	4	16	1	2	328	33	334
Africa	53	25	6	1	11	59	98	92
Oceania	29	50	58	12	28	200	163	281
Total	1,391	963	1,112	370	195	1,127	3,935	3,596

Source: [14, p. 3].

with increasing demand, rather than in exploiting marketing opportunities within an overall strategy of international expansion of company activities [3, pp. 96–97]. That about a third of total direct foreign investment is concentrated on the exploitation of mineral resources abroad is in line with the specific conditions of Japan's domestic natural resource endowment—a characteristic shared with the United Kingdom. If agriculture, forestry and fisheries, and wood and pulp industries are added to mining, the share of resource-oriented foreign investment comes close to 40 per cent, as compared with 27 per cent for manufacturing and 10 per cent for commerce (Table X).

While the direction of resource-oriented investment is largely predetermined by the location of the resources themselves, Japanese manufacturing investment overseas is mainly undertaken in the developing areas of Southeast Asia and Latin America, and investment in commercial activity finds its principal outlets in the advanced countries of North America. In general, Japanese overseas investment is characterized by the large share of the developing countries, which absorb about two-thirds of the funds invested in manufacturing and mining. In contrast, the United States, for instance, directs a major part of its foreign investment funds to the advanced industrial countries in all fields of activity (Table XI). Within manufacturing, it is traditional labor-intensive industries such as textiles and wood and pulp processing which predominate in the Japanese pattern of direct foreign investment. This pattern is in sharp contrast to the United States and West German investment in which technologically advanced nidustries, including chemicals and machinery, are heavily represented (Table XII). This characteristic is also related to another aspect of investment activity of Japanese enterprises abroad: the scale of investment is generally of a relatively small size, especially in so far as subsidiaries engaged in manufacturing and commerce in the developing countries are concerned (Table X above). The majority of foreign activity

TABLE XI
JAPAN AND THE UNITED STATES: DISTRIBUTION OF DIRECT FOREIGN INVESTMENT BETWEEN DEVELOPING AND ADVANCED COUNTRIES

(%)

	Japan			United States		
	Advanced Countries	Developing Countries	Total	Advanced Countries	Developing Countries	Total
Manufacturing	34.0	66.0	100.0	83.0	17.0	100.0
Mining	36.3	63.7	100.0	59.6	40.4	100.0
Petroleum				53.9	46.1	100.0
Commerce, finance, and insurance	80.1	19.9	100.0	61.1	38.9	100.0
Others	37.0	63.0	100.0			

Source: [6, 1972, p.121].
Note: Data for Japan refer to the end of fiscal 1970, whereas those for the United States to the end of the calendar year 1970.

involving Japanese investment is of the type of joint venture with local partnership, even in countries where there is no inhibition against fully-owned subsidiaries on the part of government policy. The behavior of Japanese enterprises abroad, at least up to the present, has obviously been basically different from the pattern of investment by the major enterprises in other industrial countries, in which giant companies equipped with the most advanced technology tend to dominate the field in exporting large-scale production facilities across the borders, with definite preference for 100 per cent ownership and control.

The behavior of direct investment overseas is much more complex and difficult to explain in a systematic way than traditional investment in securities and bonds, which depends largely on interest rate levels. The essential fact is that international transfer of capital as a factor of production is not necessarily the most important element in undertaking direct investment; what matters is rather the organization of production abroad with the help of the investing country's

TABLE XII
JAPAN, THE UNITED STATES, AND WEST GERMANY: INDUSTRIAL BREAKDOWN OF DIRECT FOREIGN INVESTMENT IN MANUFACTURING, 1970

	Japan		United States		West Germany	
	$ million	%	$ million	%	$ million	%
Manufacturing, total	963	100.0	32,231	100.0	4,453	100.0
Foods	61	6.3	2,680	8.3	234	5.3
Textiles	190	19.7	—	—	110	2.5
Wood and pulp	212	22.1	—	—	63	1.4
Chemicals	60	6.0	6,272	19.5	1,589	35.7
Iron and metals	138	14.3	3,576	11.1	436	9.8
Machinery	67	7.0	4,012	12.4	438	9.8
Electric equipment	71	7.4	2,606	8.1	677	15.2
Transport equipment	103	10.7	5,871	18.2	563	12.6
Others	61	6.3	7,214	22.4	343	7.7

Source: [8, 1972].

capital as well as technical and managerial resources. Thus, the traditional notion that capital tends to move from countries relatively well endowed to those poorly endowed with capital does not necessarily apply to the cases of direct foreign investment. Since direct investment represents a transfer of equity capital, entrepreneurship, and technological and other productive skills in an industry-specific package, there is no reason to preclude investment flows from occurring from a country with a lower degree of capital accumulation to countries more richly endowed with capital. But there must exist some special advantage in such an industry-specific package on the part of the investing country to offset the disadvantage of organizing production in unfamiliar foreign countries. Theorists tend to identify such an advantage with a degree of market imperfection either in the investing or in the host countries. A recent theory argues, for example, that "horizontal" investment to produce the same lines of goods as produced in the home market is normally characterized by the existence of oligopoly with product differentiation, and that oligopoly, not necessarily differentiated, at home is typical in industries which undertake "vertical" direct investment in resource exploitation abroad [2, p. 1].

In general, the typical Japanese enterprise does not seem to have attained the level of concentration, nor the market in Japan the level of imperfection implied in the above theory. It is true that some of the market features mentioned above are now developing in the Japanese industries, but they are less dominant than in the markets of other advanced countries. Industries in isolated cases may boast special advantages of technological and managerial resources, but this is hardly the case in Japan's relations with other industrial countries in general. Apart from the concentration on "vertical" exploitation of resources abroad, the lack of special technological advantage vis-à-vis the advanced countries is the obvious explanation for the dominant share of the developing areas in the Japanese pattern of foreign investment.

Actually, Japan's direct foreign investment is concentrated in the fields in which Japan scarcely enjoys any international advantage in technological resources; technologically advanced industries in Japan have thus far typically refrained from full-scale manufacturing operations abroad [4, p. 279]. This trend has again received added support from the fact that recently small- and medium-scale enterprises of Japan are increasingly involved in an effort to organize "horizontal" expansion abroad. In other words, foreign investment here tends to an important degree to originate from the industries which are less competitive internationally and suffer from a declining share in the home market—in sharp contrast to the practice of dominant U.S. corporations. Such an investment will logically be of the trade-creating type, highly conducive to the formation of a new pattern of international division of labor as between the developing and advanced countries, rather than of the export-replacing type.[4]

Even when dealing with international production in the developing countries,

[4] Kiyoshi Kojima has made an ingenious attempt to dramatize the contrast between direct foreign investment of the "Japanese" type and of the "American" type [16].

Japanese enterprises have generally not been effective in exploiting the comparative advantage in their own managerial and technological resources, except in chemical and automobile industries [9, p. 53]. The preference shown by the investing Japanese firms for the joint-venture type of operation overseas is also related to the fact that the investor is providing only a limited range of skill resources, mainly connected with trading [4, p. 282]. In most cases of "horizontal" investment, Japanese firms have first concentrated their effort on increasing sales in a particular market, and it is only when the policy of the host government or expanding demand makes it desirable and profitable that they embark upon the natural course of local production overseas. This is a typical case of market-oriented foreign investment. When the wage level of Japan has risen to a level comparable to that of other advanced countries, however, it seems to be particularly advantageous to make use of relatively cheap and efficient labor in the host country, even for exports to Japan and to third countries. This trend is now increasingly observed in some Asian countries, typically for electronics and textile industries, and will assume greater importance in the future when the schemes of special preferences are made more effective.

The record of profit performance of Japanese direct foreign investment in the past has not been particularly satisfactory. According to the survey by the Japan Export-Import Bank [13, p. 19], 60 per cent of 483 replying firms in operation earned some profits during the most recent accounting period, whereas 34 per cent registered losses. With respect to accumulated profit-loss accounts, only 49 per cent of the firms were in surplus, and only 32 per cent had ever paid dividends.[5] This is partly explained by the short duration of operation of most of the foreign investment firms. Table XIII, based on a similar survey undertaken by the Ministry of International Trade and Industry [9], indicates that the rate of profit in manufacturing subsidiaries abroad has been generally lower than that of their parent firms in Japan, the exceptions being in textiles and iron and metal industries. In contrast, subsidiaries in construction, mining (other than petroleum), and commerce have recorded a relatively higher rate of return on capital. Since one of the main motives for investing abroad of the firms in other advanced countries is recognized to be the search for higher profits, the expanding investment activity of Japanese firms operating under such a low profit expectation may require additional explanation in terms of a push from the home market or a pull into foreign markets in the long-run perspective.

There are reasons for expecting that Japanese enterprises in the future will have to make special efforts to devote an increasing part of their direct overseas investment to the advanced industrial countries. The recent rapid growth of Japanese exports has already come up against intensified resistance in some important markets. Foreign investment may be an important means of harmonizing economic interests of trading nations, as it contributes to creating employment opportunities and even to expanding commodity exports from the host country.

[5] In the Ministry of International Trade and Industry's survey, the percentage of firms having paid dividends is reduced to only 24 per cent [9, p. 66].

TABLE XIII
COMPARISON OF RATES OF PROFIT BETWEEN PARENT FIRMS IN JAPAN AND THEIR SUBSIDIARIES OVERSEAS, BY INDUSTRY

(%)

	Parent Firms in Japan			Subsidiaries Overseas		
	Rate of Return on Total Capital	Rate of Turnover of Capital	Rate of Return on Total Sales	Rate of Return on Total Capital	Rate of Turnover of Capital	Rate of Return on Total Sales
Total	3.4	1.1	3.0	3.1	2.3	1.3
Mining	2.1	1.0	2.1	2.3	0.3	7.6
Petroleum & natural gas	2.6	1.1	2.3	−0.4	—	—
Metals & coals	1.5	0.9	1.7	3.8	0.4	8.0
Construction	4.8	0.9	5.3	7.8	1.2	6.1
Manufacturing	4.4	0.8	5.5	3.7	0.6	5.7
Textiles	5.5	1.0	5.6	6.1	0.5	10.3
Paper & pulp	2.0	0.7	2.8	−11.9	0.3	−32.3
Chemicals	3.3	0.7	4.7	1.0	0.5	1.9
Iron & steel	2.5	0.7	3.8	4.0	0.4	9.5
Nonferrous metals	4.1	0.9	4.7	3.9	0.9	4.1
Electric equipment	6.5	1.0	6.7	6.5	0.9	6.6
General machinery	4.5	0.7	6.8	2.8	0.5	5.2
Precision machines	8.5	1.3	6.4	5.7	1.1	4.7
Transport equipment	3.8	0.7	5.3	3.2	0.7	4.3
Sundry	6.3	1.0	6.3	3.8	0.6	5.7
Commerce, etc.	1.5	1.9	0.8	3.0	3.4	0.9
Commerce	1.3	2.1	0.6	3.1	3.4	0.9
Services, etc.	2.7	0.7	3.7	−0.5	0.6	−0.8

Source: [9, Tables 3-1-5 and 3-1-7].

In some basic ways, a further intensification of trade among the industrialized countries may be conditional upon economic integration through mutual investment. Observing that comparative export sales of some European countries in the American market are positively correlated with the size of their respective investment, Stephen Hymer and Robert Rowthorn argue that if European firms wish to establish themselves extensively, or even securely, in the United States market, they will have to invest there heavily [11, p. 77]. The argument will be applicable to Japan as well, when the Japanese economy has grown to the technological level comparable to the West European.

Easy as it is to argue about the desirability of diverting the foreign investment of Japan more in the direction of the advanced industrial countries, the basic factors which helped determine the past pattern of investment flows are unlikely to change in a short time. To the extent that Japanese development has taken place mainly on the basis of borrowed technology, there has been little inducement for Japanese enterprises to export a combined package of capital and technical know-how to higher-wage countries. The availability of profitable investment opportunities and the relatively limited size of accumulated capital stock at home have kept interest rate levels in Japan generally high by international standards. It can be argued, therefore, that most Japanese ventures in the advanced countries will probably continue to be limited to organizing sales, until the rising trend of the Japanese wage level leads to a significant reduction of the relative disadvantage. One possible approach may be an attempt to combine Japanese capital with more advanced technology in the host country, as exemplified by the recent Japanese venture in electronics in the United States.

In the foreseeable future, direct overseas investment from Japan will continue to be dominated by ventures in the developing areas of the world, in which Japan has a relative advantage in "horizontal" business expansion and natural resources await exploitation by "vertical" investment. In general, however, the Japanese advance in this direction will have to face some handicaps in international competition on account of the deficiency in accumulated equity capital, high investment risks and inadequate market and investment information. Investing in the developing countries will also require solutions to the problems common to them, such as the limited size of markets, lower quality of labor, structural deficiency in infrastructure and related linkage industries, and other social and institutional difficulties partly connected with mounting economic nationalism. In all these respects, the government will have an important part to play in facilitating the process of capital transfer to the developing countries, over and above the aid policy in the proper sense.

It is not easy to estimate the future flow and stock accumulation of Japan's foreign investment, as the theoretical explanation of direct foreign investment is still less well developed than for other types of investment. There cannot be any doubt, however, that Japanese overseas investment is bound to increase very rapidly as the country is beginning to establish itself firmly as a net capital-exporting nation. The circumstantial factors determining the future course of capital exports include the rising trend of the wage level in Japan, the disquieting changes in the world trading climate, the increasing difficulty in locating pollution-prone industries at home, and the paramount need for increasnig imports of resources from abroad.

Drawing attention to the similarity of economic development patterns between Japan and West Germany, Hamada has suggested that the ratio of foreign investment assets to GNP in Japan might reach the level of 2.5 per cent around 1974–75 [10, p. 192]. It was estimated by the Research Group on Comprehensive Policies, a private research organization, that by 1980 the Japanese balance of long-term capital movements would show a net outflow of about $4 billion, of which direct investment outflow might amount to $2.1 billion annually [23, pp. 145–46]. Partly based on this trade matrix projection, Namiki has forecast the accumulated direct foreign investment would reach the level of $20–30 billion by 1980, of which about one-third would be oriented towards resource exploitation [18, pp. 58–59]. The Japan Economic Research Center has projected, however, that the relative share of resource-oriented investment will increase from the present 40 per cent to a little over 50 per cent by that time [12, p. 51, Summary].

The projections separately undertaken by the Council on Industrial Structure, an advisory body to the Ministry of International Trade and Industry [3], and the Japan Economic Research Center [12], are in remarkable agreement regarding the expected size of accumulated foreign investment in 1980. It would be at the level of $26–27 billion[6] by 1980, when the annual outflow would be about $3.5 billion. The investment asset to GNP ratio would come to about 3 per cent, equivalent to the West German ratio in 1970. Japan's share of the OECD total would rise to the range of 7–7.9 per cent, very much higher than the present share of West Germany. On a per capita basis, Japan would have accumulated foreign investment to the level of $220 to $235 by 1980, a level which would still be lower than in other creditor nations. An eight-times increase in the total volume of overseas investment within a period of ten years may appear an excessive estimate of the capital-exporting capacity of Japan. But this is an expectation which would seem to be justified in the light of the past trends and the real determinants of foreign investment.

The crucial question about the prospects of Japanese overseas investment flow is related to the fact that there is no automaticity in international capital movements. What is commonly neglected in the general discussion of the subject is the possibility that the relative importance of particular forms of capital transfer may change in response to changing economic circumstances. There is a presumption that capital transfer would tend to take the form of indirect investment to a greater extent when capital moves from countries with relatively lower to those with higher levels of technological and managerial resources. Even in many years during the 1960s, the annual flow of indirect investment from Europe to the United States tended to exceed that of direct investment.[7] So long as considerable differentials persist in the size of managerial resources and the technological level, it is not unlikely that an important part of the capital flow from Japan to the advanced industrial world may be in the form of indirect investment. Given the legitimate aspirations of economic nationalism in many developing countries, the possibility should not be denied that the traditional form of indirect investment may assume added importance in the process of capital transfer even to the developing countries. The recent proposals for a "new form of partnership" [22, p. 178], for example, look to the combination of public bonds issued on the international capital market and management and technical contracts with individual firms as a means to harmonize capital needs of the host country with its national interests.

While the flow of indirect investment depends largely on the relative levels of interest rates, direct investment will be to a greater degree determined by the market structure and the demand and supply conditions. In the long run, conditions of market demand and supply for factors of production may change considerably, and actual transfer of capital and technology may be subjected in various forms of government control and regulation, in both the investing and

6 The lower figure is from [3] and the higher figure from [12] throughout the present paragraph.

7 Even now, two-thirds of West European investment in the United States are in the form of securities investment, whereas three-fourths of the U.S. investment in Western Europe are of the direct type [24, p. 30].

the host country. It will be a matter of public policy to decide on the extent to which these conditions affecting private capital flows should be influenced by the government. Under active discussion today is, for example, the idea of establishing more joint public-private corporations for pooling funds for overseas investment and providing increased assistance in technical and informational matters to facilitate capital transfer abroad, in addition to measures relating to tax incentives and credit provision. The general argument is that international capital movements should in principle be left to decentralized decisions of individual enterprises. In the case of Japan, however, the present situation of international disequilibrium and the particular difficulties which are encountered in directing resources in desirable channels would suggest that the government has an important responsibility to influence capital outflows in such a way as to make a more balanced integration of the country into the world economy possible.

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