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SESSION ON GLOBALISATION

IMPACTS OF JAPANESE OVERSEAS BUSINESS ACTIVITIES ON
JAPAN'S DOMESTIC ECONOMY

Paris, OECD, 23-24 October 1997

This document was prepared by Mr. Satoshi Noguchi, Deputy-Director of MITI (Ministry of International Trade and Industry). It analyses the impact of the activity of Japanese firms abroad on Japan's domestic economy, especially in the fields of trade balance, industrial output and employment.

Action required: Delegates are invited to take note of this work and explore the possibility of applying its methodology to other countries.

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IMPACTS OF JAPANESE OVERSEAS BUSINESS ACTIVITIES ON JAPAN'S DOMESTIC ECONOMY

1. Summary

1. We made a trial calculation measuring the impacts of overseas business activities of foreign affiliates in manufacturing on the balance of trade and domestic production and employment by using Input-Output Tables.
2. The result: in terms of the impact on the balance of trade, a negative impact has been steadily increasing, because more and more of what were once exports from Japan have been replaced by goods produced by Japanese foreign affiliates and imports from foreign affiliates to Japan have increased as overseas production has expanded in recent years. In contrast, Japan's exports of intermediate goods used for production by foreign affiliates (i.e., the export inducement effect) have not shown much increase since FY 1993 due to the rising percentage of local content. As a result, the total effect of foreign affiliates on the balance of trade has gradually declined from its peak amount (2.7 trillion yen) in FY 1992 to a insignificant amount (100 billion yen) in FY 1995. During this period, Japan's overall trade surplus decreased by 4.5 trillion yen. (⇒ See Fig. A)
3. As to the impact on domestic production and employment through the balance of trade, this once strongly positive effect has been decreasing from its peak in FY 1992, becoming nearly null in FY 1995. (⇒ See Fig. B, Fig. C)
4. In evaluating the overseas business activities of Japanese companies, it is necessary to evaluate earnings on a consolidated basis including earnings received from foreign affiliates.
5. Thus it is more important than ever for Japanese government to create a business environment that allows Japanese companies to maintain or increase its earnings received accruing from direct investment, and these earnings to be invested in high value-added business activities in Japan.

Note: Four possible impacts which overseas business activities have on trade balance are as follows.

1. *Export substitution effect :*

Goods produced by foreign affiliates substitute Japan's finished goods exports → This leads to a decrease of Japan's exports

2. *Export inducement effect :*

1. Supplying capital goods such as plant and equipment to overseas factories → This leads to an increase of Japan's exports
2. Supplying intermediate goods such as parts or components → This leads to an increase of Japan's exports

3. *"Imports from locally foreign affiliates " effect :*

Goods produced by locally foreign affiliates are exported to Japan → This leads to an increase of Japan's imports

4. *Import conversion effect :*

Increase/decrease of imports of raw materials, etc. for domestic production by shifting production abroad

2. **Impact on trade balance**

1. As to the impact of overseas business activities of foreign affiliates in manufacturing on the balance of trade, the trade surplus from such activities was 100 billion yen in FY 1995.
2. As a result, the surplus-expanding effect decreased by 2.6 trillion yen when compared to FY 1992. This decrease was equivalent to about 60 percent of the overall decrease of Japan's trade surplus.
3. The exports of intermediate goods such as parts from Japan (the export inducement effect) have not shown much increase largely due to the rising percentage of local content.
4. On the other hand, more and more goods produced by foreign affiliates have been exported to Japan (the "imports from foreign affiliates" effect) and have substituted for Japan's exports (the export substitution effect). As a result, the surplus-expanding effect on the balance of trade has been rapidly decreasing.

3. *Impacts on domestic production and employment*

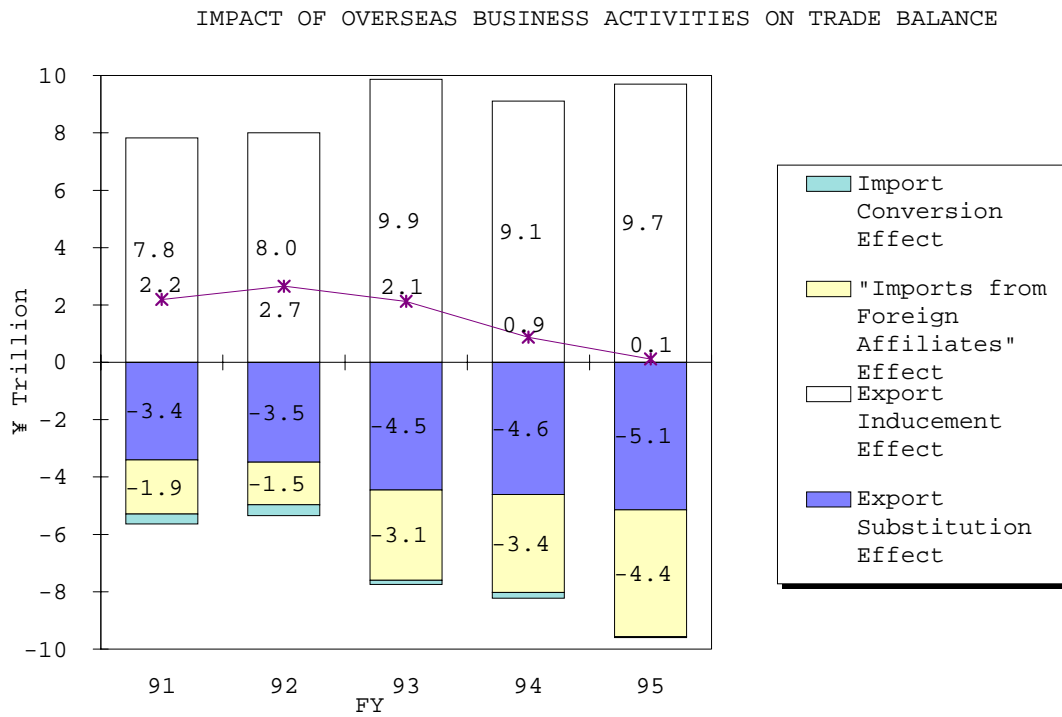
1. The impact of overseas business activities on domestic production through the balance of trade (the production inducement effect) has been steadily decreasing since FY 1992, much like the above-mentioned impact on the balance of trade.
2. In fact, the production inducement effect measured a negative 100 billion yen in FY 1995, as it decreased by approximately 7.7 trillion yen from its level of 7.6 trillion yen in FY 1992 to <100 billion yen> in FY 1995.
3. The impact on domestic employment (the employment creating effect) decreased by about 320,000 persons from 310,000 persons in FY 1992 to <8,000 persons> in FY 1995.
4. Note This trial calculation was made only at to the impacts on domestic production and employment through the balance of trade and thus it is necessary to consider that imports of low cost goods from foreign affiliates have positive effects such as the increase of real income in Japan and maintenance of competitiveness of companies.

4. **Earnings from direct investment**

1. Direct investment earnings from overseas business activities have been steadily increasing in dollar terms to 10.6 billion dollars (about 1.0 trillion yen) in FY 1995. (⇒ See Fig. D)
2. As economic globalization progresses, Japanese companies have a tendency to attach importance to earnings on a consolidated basis, thus including overseas business.

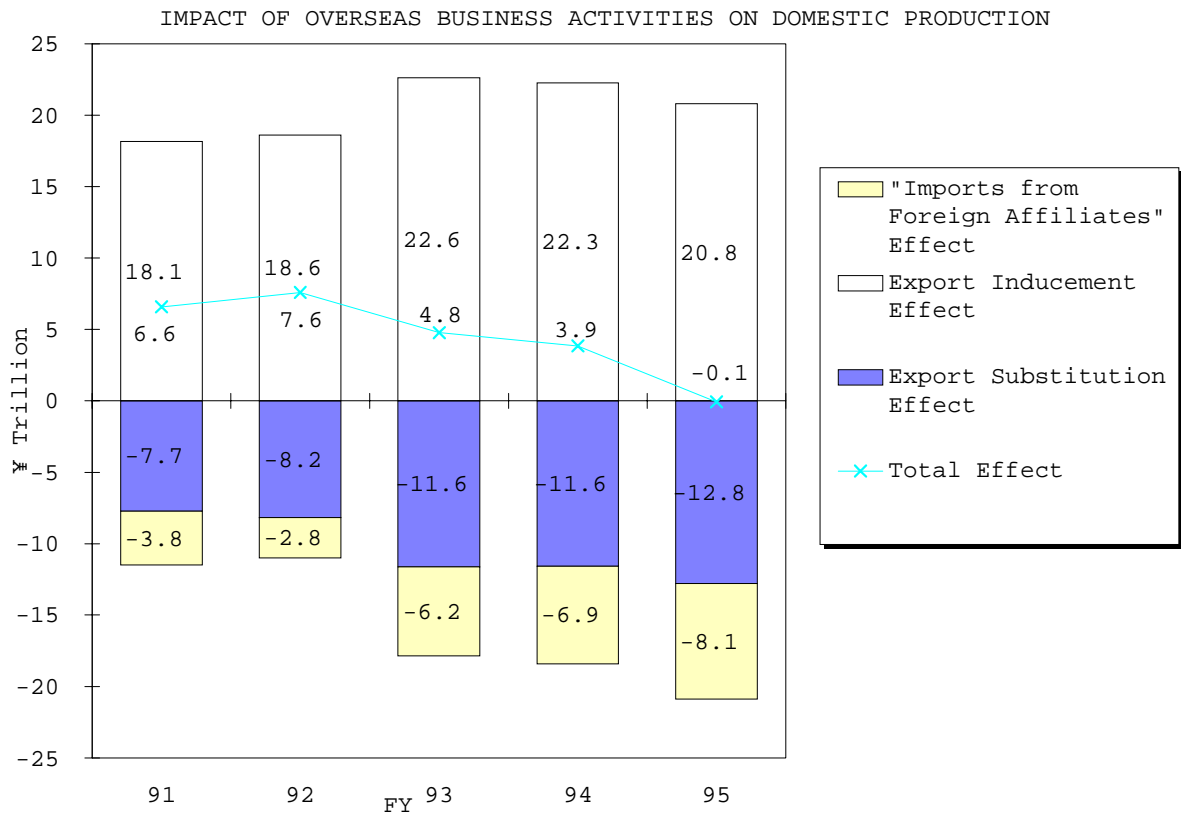
3. In evaluating the overseas business activities of Japanese companies, it is necessary to evaluate earnings received that accrue from direct investment as well. Therefore, it is more important than ever for Japanese government to create a business environment that allows Japanese companies to maintain or increase its earnings received from direct investment, and these earnings to be invested in high value-added business activities in Japan.

Fig. A



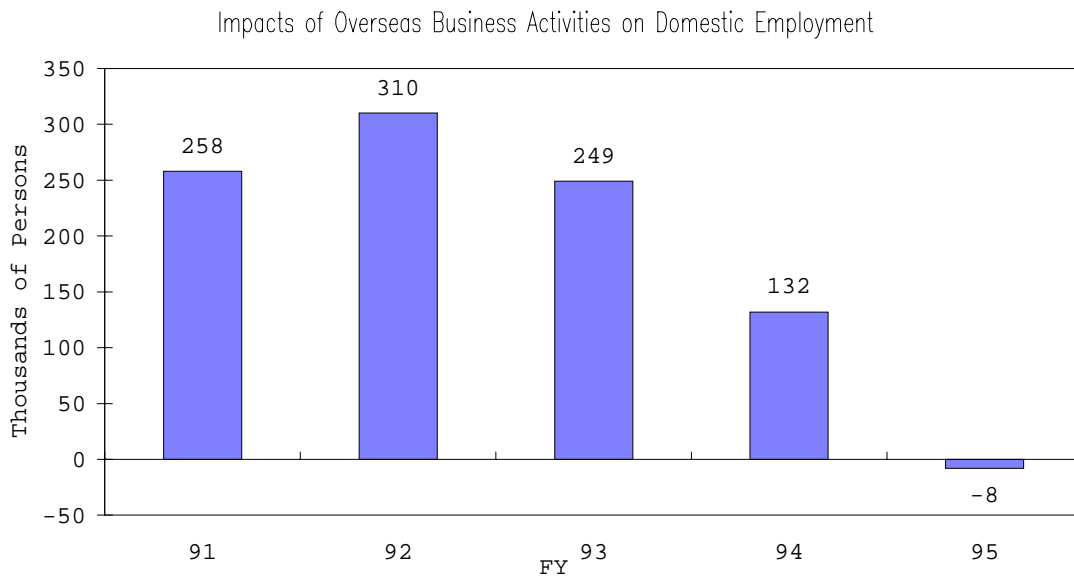
(Note) We made a trial calculation by using 1994 Input-Output Tables (Updated tables)

Fig. B



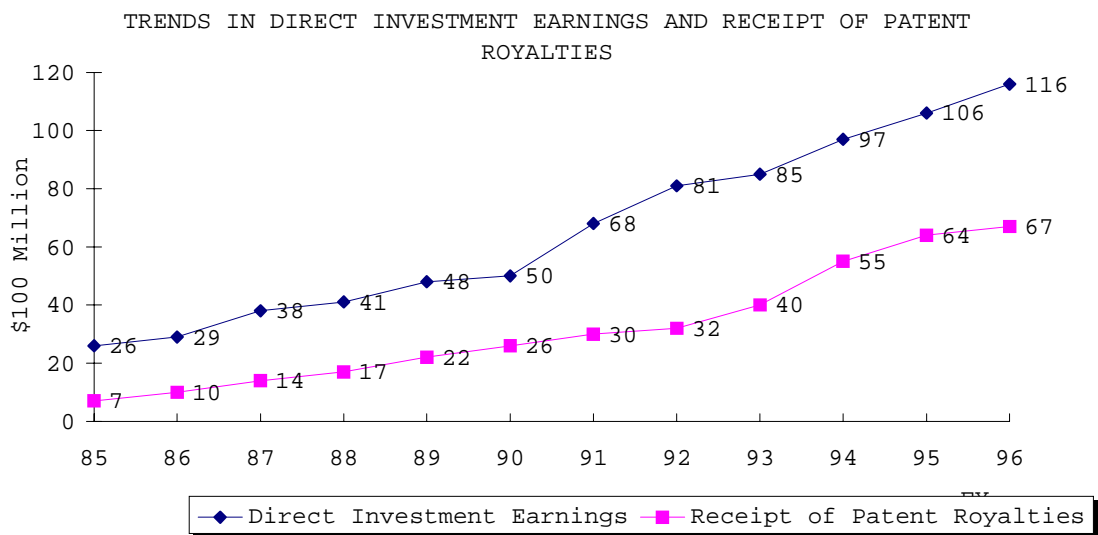
(Note) We made a trial calculation by using 1994 Input-Out Tables (Updated Tables)

Fig. C



(Note) We made a trial calculation by using 1994 Input-Out Tables (Updated Tables)

Fig. D



Source: Balance of Payment (Bank of Japan)

ANNEX

HIGHLIGHTS OF “THE 6TH BASIC SURVEY OF OVERSEAS BUSINESS ACTIVITIES”

[PRELIMINARY REPORT; MARCH 1997]

Outline of Survey

1. Coverage of survey

The companies covered in this survey are Japanese companies which own foreign affiliates abroad as of the end of March 1996 (excluding companies in the banking and finance, insurance and real estate industries).

In this survey the term “foreign affiliates” refers to foreign incorporated enterprises where the Japanese equity ownership ratio is greater than 10 percent, as well as those foreign affiliates in which a Japanese owned subsidiary (having at least a majority of Japanese ownership interest) itself has a more than 50 percent equity share in a foreign affiliates.

2. Analysis of response

| | |
|--|------------------------|
| Number of parent companies in Japan covered: | 3 959 |
| Number of respondent parent companies: | 2 376 |
| | (Response rate: 60.0%) |
| Number of respondent foreign affiliates: | 10,345 |

3. Period of survey and Conversion into yen

The data available is for the 1995 fiscal year accounting period (the one year period ending March 31, 1996 or the nearest settlement day prior to that date). In converting dollars into yen, the average exchange rate of FY 1995 (94.06 yen / U.S. dollar) was used.

Note: In this paper, NIEs 4 refers to the Republic of Korea, Taiwan, Singapore and Hong Kong, and ASEAN 4 refers to Thailand, Malaysia, the Philippines and Indonesia. In some cases, reference to regions within countries may be made.

1. Overview of Establishing a Presence Abroad

Increasing Presence in Asia

1. Due to the strengthening of the yen as was seen from the beginning of 1993, the value of foreign direct investment sharply increased, particularly in manufacturing industries. Even in FY 1996, when the value of the yen took a turndown, the value of foreign direct investment continued to increase.
2. 670 foreign affiliates were newly established in FY 1995, of which 424 were in manufacturing. This finding shows a continued high level of the number of newly established foreign affiliates.
3. Nearly 80 percent of the newly established foreign affiliates in manufacturing were in Asia. Foreign affiliates in transport equipment in China and in the ASEAN 4 showed a particularly increased presence.

⇒ See Fig. 1 - Fig. 3

2. Movements of Withdrawals

1. 106 foreign affiliates withdrew; 43 of these were from manufacturing.
2. The most frequently cited reasons for withdrawals: “inaccurate demand forecast” and “keen competition.” It should be noted that in Asia, particularly in the NIEs 4, many companies cited “increasing wage costs.”

⇒ See Fig. 4

Table. 1 : Number of Withdrawn Foreign Affiliates by Region, FY 1995

(Unit : Number)

| | North America | Europe | Asia | NIEs4 | ASEAN4 | China |
|-------------------|---------------|--------|------|-------|--------|-------|
| Manufacturing | 6 | 12 | 18 | 10 | 5 | 3 |
| Non-Manufacturing | 26 | 21 | 11 | 9 | 2 | 0 |

3. Overall Trends in Overseas Business Activities

1. Trends in sales

Overseas production ratio in manufacturing is expected to increase to 10 percent in FY 1996

1. Sales of foreign affiliates in manufacturing increased 7.1 percent to about 37 trillion yen in FY 1995. Such sales are expected to show an increase of more than 10 percent in FY 1996. As a result, the overseas production ratio in all-manufacturing is expected to rise to 9.9 percent in FY 1996. (Overseas production ratio of manufacturing companies with foreign affiliates is expected to rise to 27.5 percent in FY 1996.)
2. The sales of foreign affiliates in manufacturing in Asia have sharply increased, and are expected in FY 1996 to reach the same level as such affiliates have in North America. As to the three regions in Asia, the difference of sales between the NIEs 4 and the ASEAN 4 has been narrowing, and the amount of such manufacturing sales in China is expected to reach 1 trillion yen in FY 1996.

⇒ See Fig. 5 - Fig. 8

Table. 2 : Sales by Industry in Manufacturing (All regions)

(Unit : Billion yen, %)

| | FY 1993 | | FY 1994 | | FY 1995 | | FY 1996(est.) | |
|--------------------------------------|---------------|------------------|---------------|------------------|---------------|------------------|---------------|------------------|
| | Sales | Percent of total | Sales | Percent of total | Sales | Percent of total | Sales | Percent of total |
| Food | 1,081 | 3.7 | 1,401 | 4.1 | 1,260 | 3.4 | 1,338 | 3.2 |
| Textiles | 626 | 2.2 | 947 | 2.7 | 708 | 1.9 | 779 | 1.9 |
| Wood, Paper and Pulp | 314 | 1.1 | 325 | 0.9 | 384 | 1.0 | 390 | 0.9 |
| Chemicals | 2,349 | 8.1 | 2,721 | 7.9 | 2,747 | 7.4 | 3,121 | 7.6 |
| Steel | 956 | 3.3 | 815 | 2.4 | 1,605 | 4.3 | 1,687 | 4.1 |
| Nonferrous metals | 556 | 1.9 | 744 | 2.2 | 628 | 1.7 | 718 | 1.7 |
| Machinery, except electrical | 1,530 | 5.3 | 2,306 | 6.7 | 2,214 | 6.0 | 2,506 | 6.1 |
| Electrical machinery | 8,567 | 29.5 | 10,509 | 30.5 | 11,516 | 31.2 | 13,586 | 33.0 |
| Transport equipment | 9,319 | 32.1 | 10,898 | 31.6 | 11,330 | 30.7 | 12,365 | 30.0 |
| Precision machinery | 433 | 1.5 | 518 | 1.5 | 591 | 1.6 | 607 | 1.5 |
| Oil and Coal | 827 | 2.8 | 663 | 1.9 | 1,350 | 3.7 | 1,206 | 2.9 |
| Other | 2,482 | 8.5 | 2,646 | 7.7 | 2,624 | 7.1 | 2,911 | 7.1 |
| All manufacturing industries. | 29,040 | 100.0 | 34,493 | 100.0 | 36,957 | 100.0 | 41,213 | 100.0 |

2. Profitability

Continued large profits in Asia, increasing profits in North America

1. The ordinary profits of foreign affiliates in manufacturing recorded an all-time high for the second year in a row, again nearing 1 trillion yen.
2. Foreign affiliates continued to earn large profits in Asia. Profits in North America have been increasing as well since business has expanded.

⇒ See Fig. 9 - Fig. 11

3. Cost structure

High cost structure of Domestic companies

1. Looking at the ratios of various costs to sales, the ratio of payroll costs in Asia was about one-third of such domestic costs.
2. The ratio for packing and transportation costs (i.e., physical distribution costs) to sales for domestic corporate enterprises was about three times that of foreign affiliates ; likewise, domestic companies had twice the ratio of lease fees to sales as foreign affiliates did. These findings reveal part of the high cost structure of Japanese companies.

Table. 3 : Ratios of Various Costs to Sales (Manufacturing)

(Unit: %)

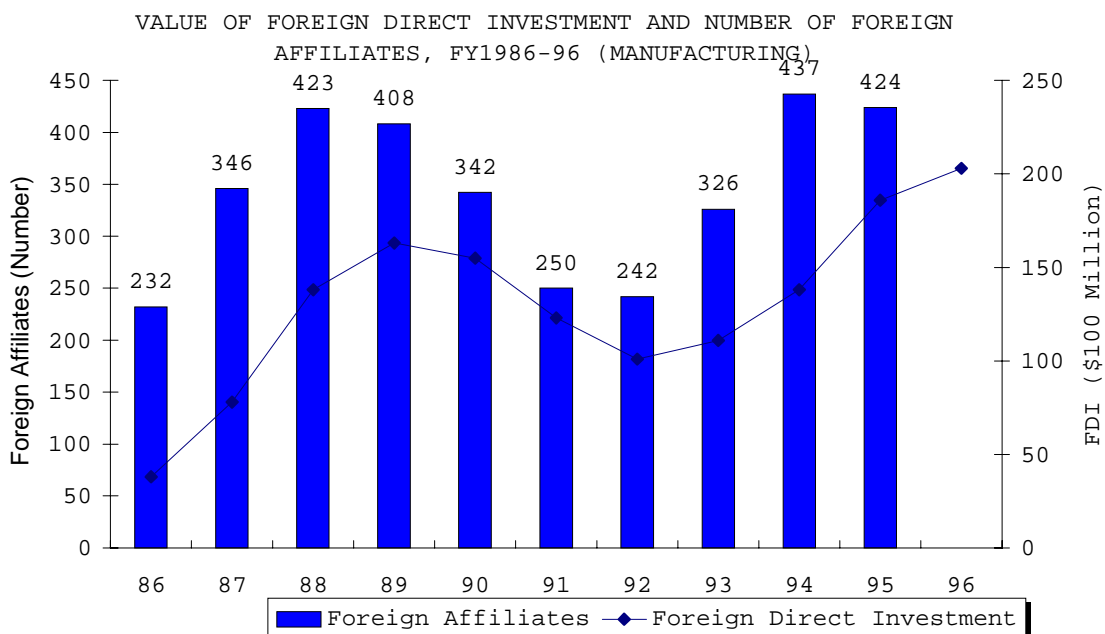
| | North America | Asia | | | Europe | All regions | Domestic enterprises |
|--------------------------------|---------------|-------------------|------------|-------|--------|-------------|----------------------|
| | | NIEs ⁴ | ASEAN 4 | China | | | |
| Sales cost ratio | 84.4 | 85.9 | 85.2 | 86.9 | 82.7 | 84.2 | 78.3 |
| Selling & administration ratio | 11.2 | 6.4 | 6.4 | 6.1 | 7.4 | 9.8 | 18.4 |
| Payroll ratio | 6.7 | 3.9 | 4.1 | 3.9 | 3.4 | 6.0 | 12.8 |
| Packing & transportation ratio | 0.9 | 1.0 | 0.9 | 1.1 | 0.7 | 1.0 | 3.3 |
| Lease fees ratio | 0.6 | 0.4 | 0.4 | 0.3 | 0.5 | 0.5 | 1.1 |

4. Plant and equipment investment

1. Investment in plant and equipment for foreign affiliates in manufacturing continued to increase sharply.
2. In Asia, a large share of additional investment is for the purpose of expanding production.

⇒ See Fig. 12

Fig.1



(Note)

1. Source of data for value of foreign direct investment :
Statistics based on notification, Ministry of Finance
2. Value of foreign direct investment of FY1996 is obtained by multiplying the growth rate of the value of April through December 1996 over the corresponding period a year ago by the value of FY1995.

Fig.2

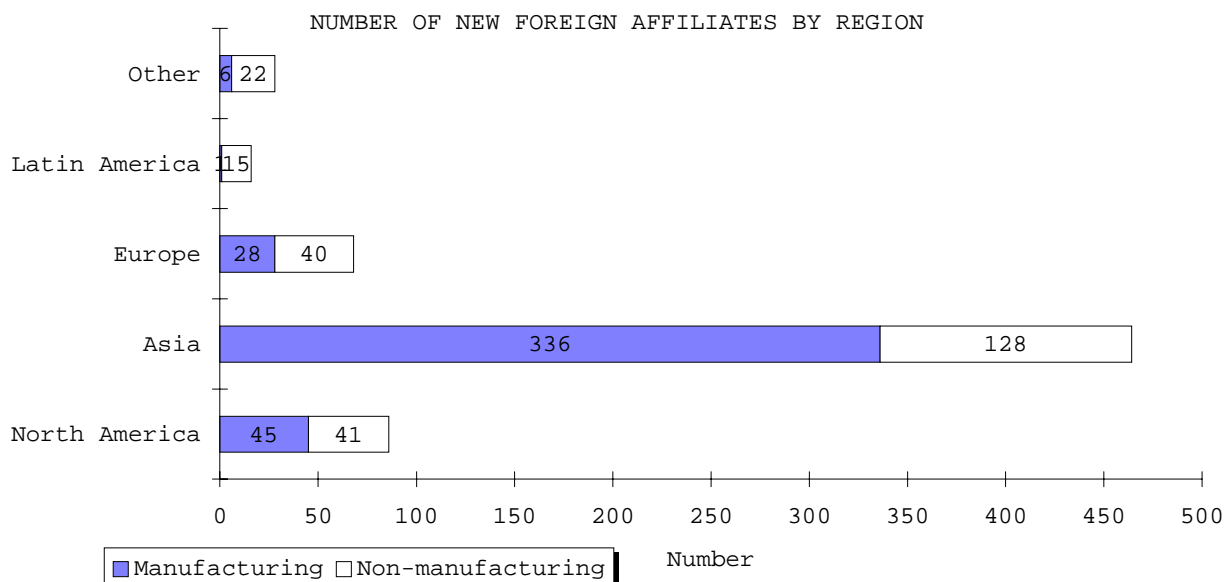


Fig.3

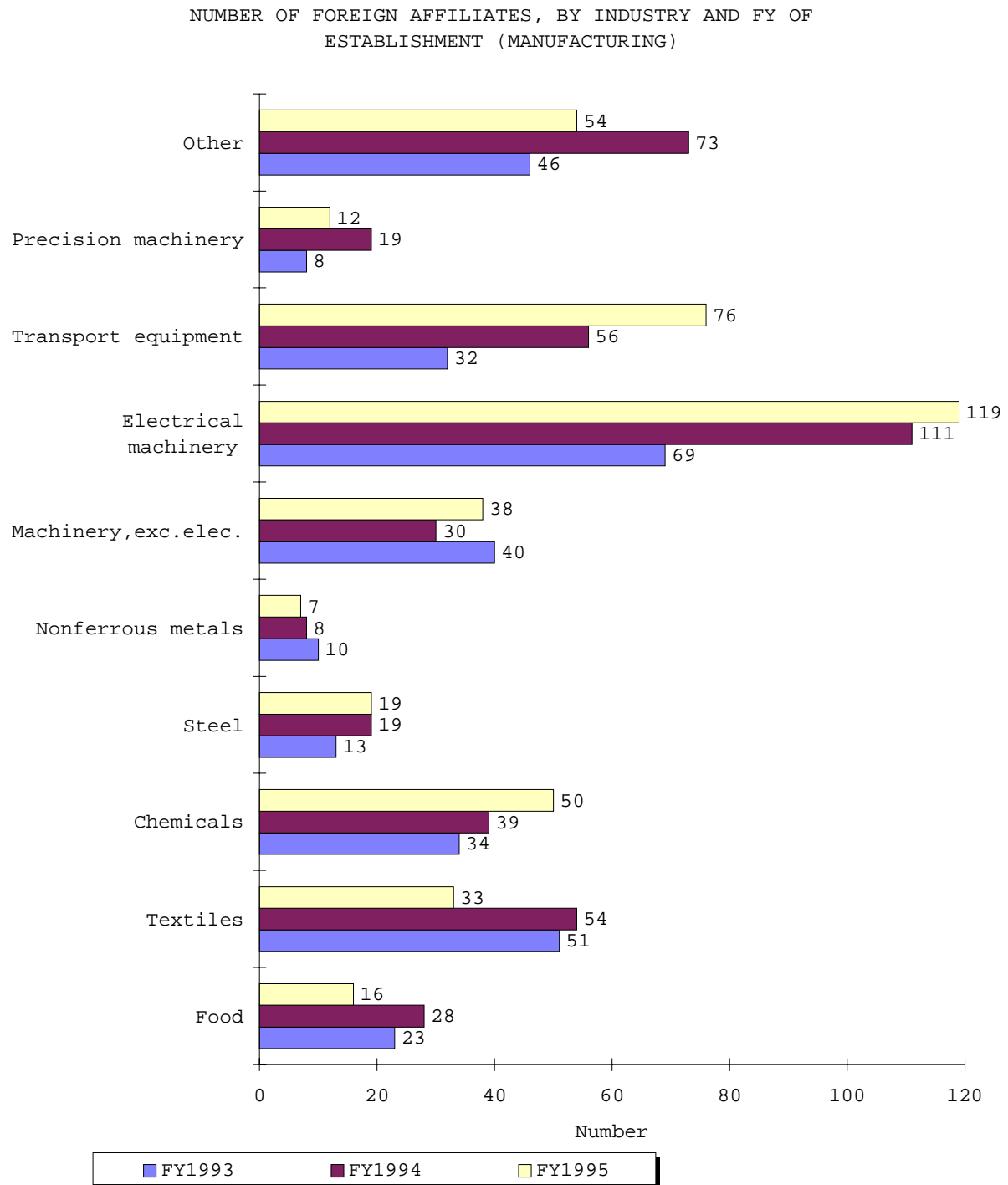
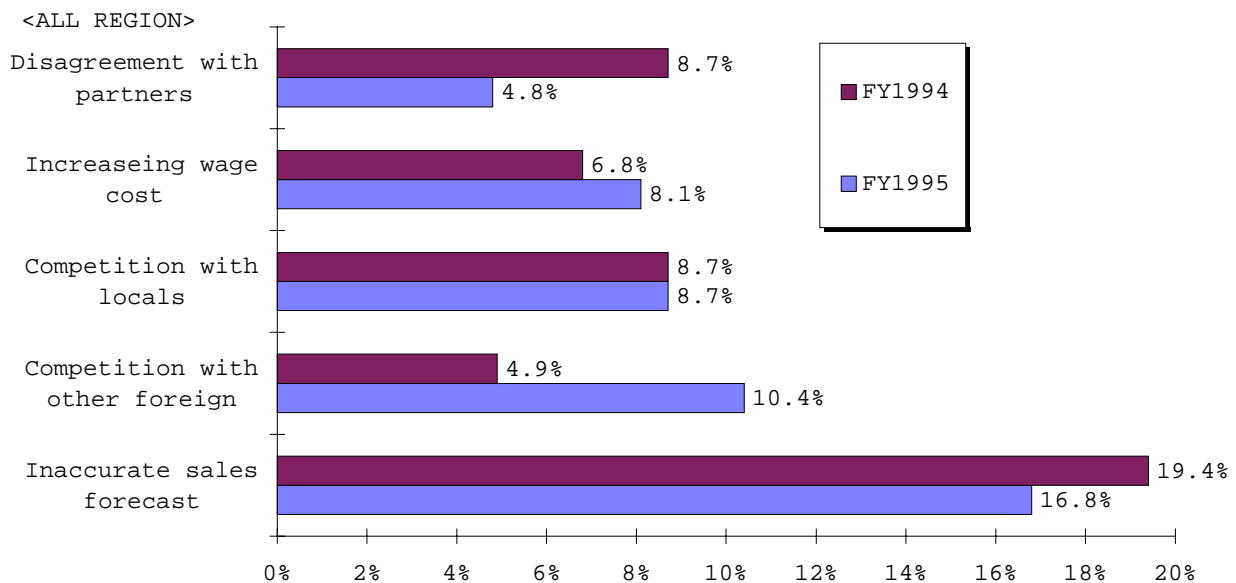


Fig.4-(1) REASONS FOR WITHDRAWALS OF FOREIGN AFFILIATES, BY REGION (MANUFACTURING)



(Note) The respondents chose three reasons for withdrawals from among the following reasons. The phrases in brackets are condensed sentences corresponding to the above-mentioned charts.

1. Sales slump and decreasing profits due to inaccurate demand forecast [Inaccurate sales forecast]
2. Keen competition with local companies [Competition with locals]
3. Keen competition with Japanese affiliate companies [Competition with Japanese affiliates]
4. Keen competition with other foreign affiliate companies [Competition with other foreign affiliates]
5. Sales slump and decreasing profits due to factors other than the above-mentioned ones [Sales slump]
6. Decreasing profits due to increasing wage costs [Increasing wage costs]
7. Decreasing profits due to increasing prices of raw materials and parts [Increasing prices of parts]
8. Difficulties in securing manpower [Securing manpower]
9. Difficulties in procuring raw materials and parts [Difficulties in procuring parts]
10. Death and retirement of Japanese managing staff, and shortage of expatriate managing staff on part of Japan [Problems of Japanese managing staff]
11. Disagreement with local partners [Disagreement with partners]
12. Request for localization [Request for localization]
13. Restrictions on remittance of profits and royalties and so on to Japan [Restrictions on remittance of profits etc.]
14. Changes in the taxation system [Changes in the taxation system]
15. Changes in the monetary and exchange control policy in the host country, such as the depreciation of local currency [Local currency]
16. Other matters

Fig.4-(2) REASONS FOR WITHDRAWALS OF FOREIGN AFFILIATES, BY REGION (MANUFACTURING)

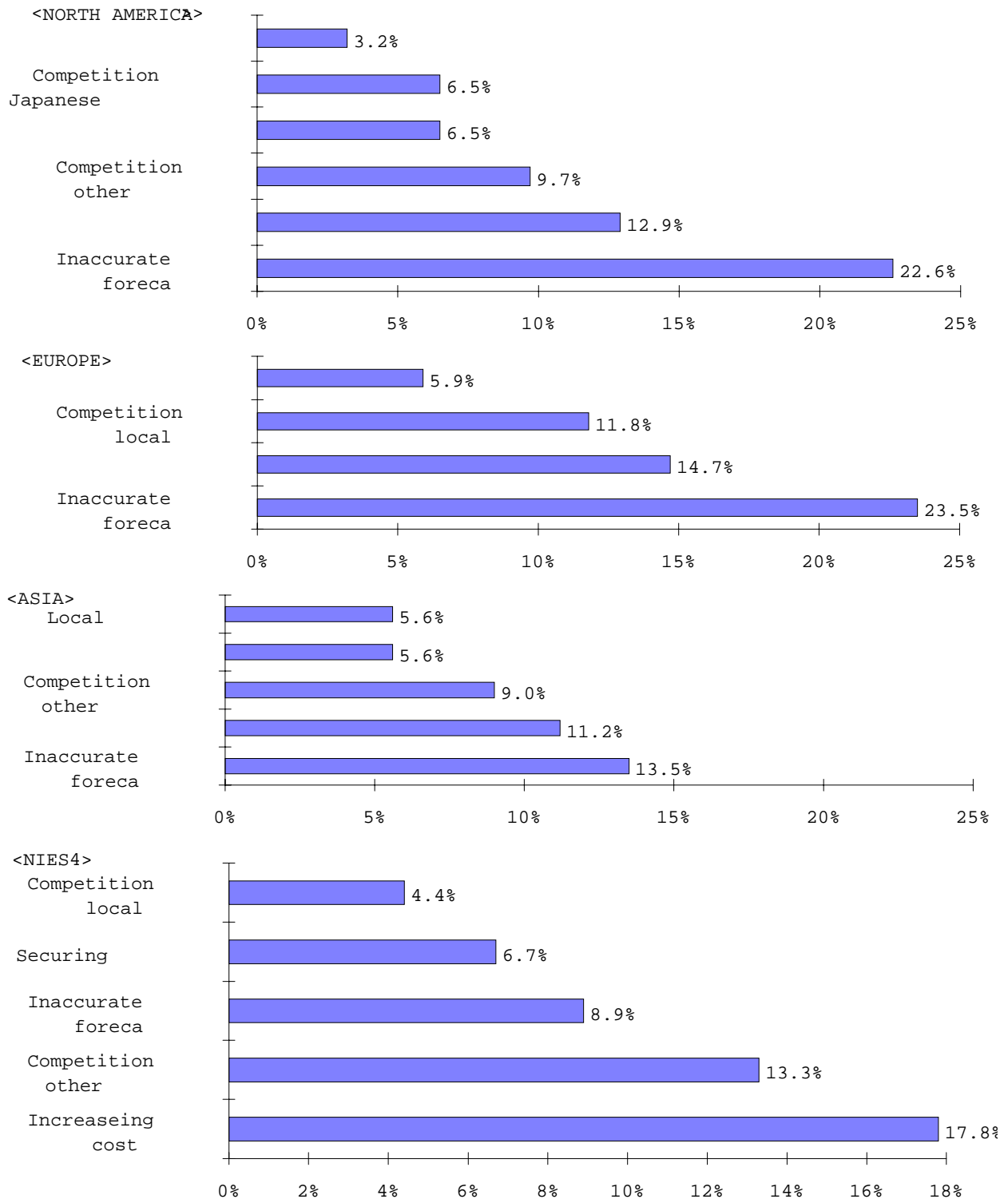


Fig.5

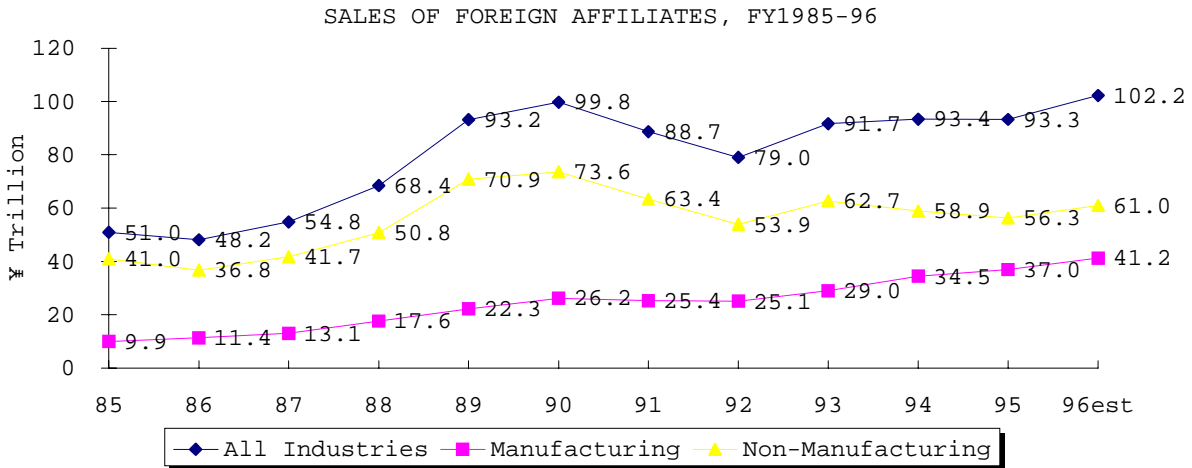


Fig.6

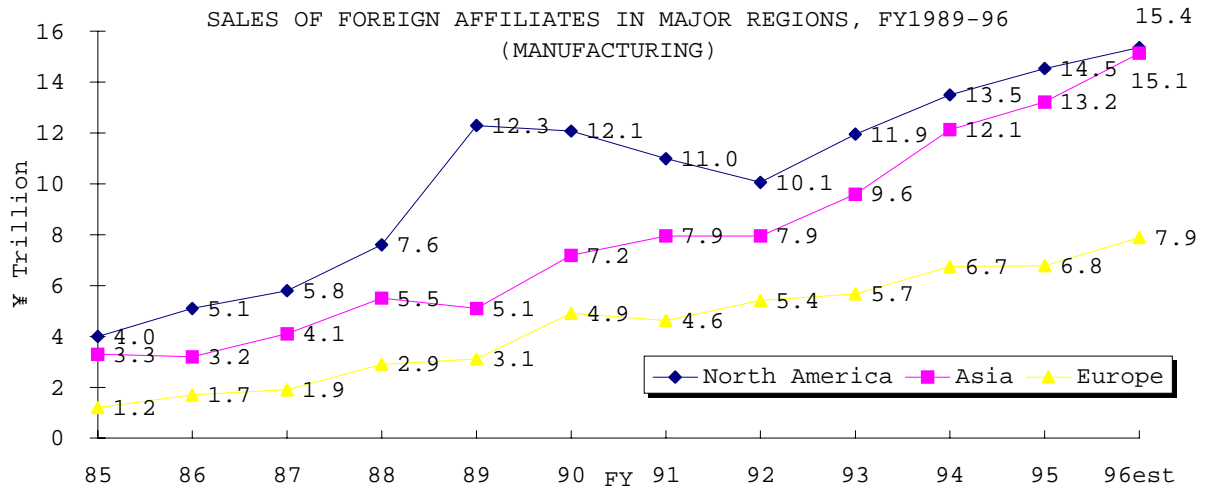


Fig.7

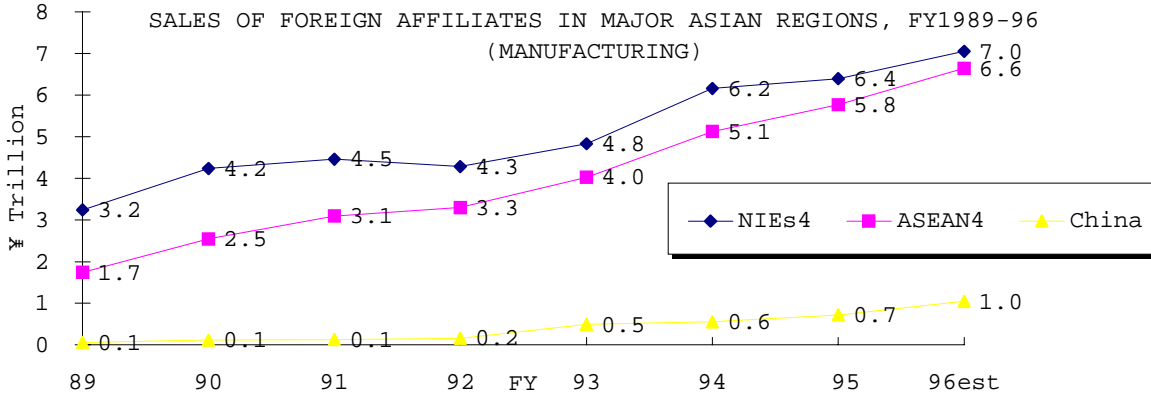
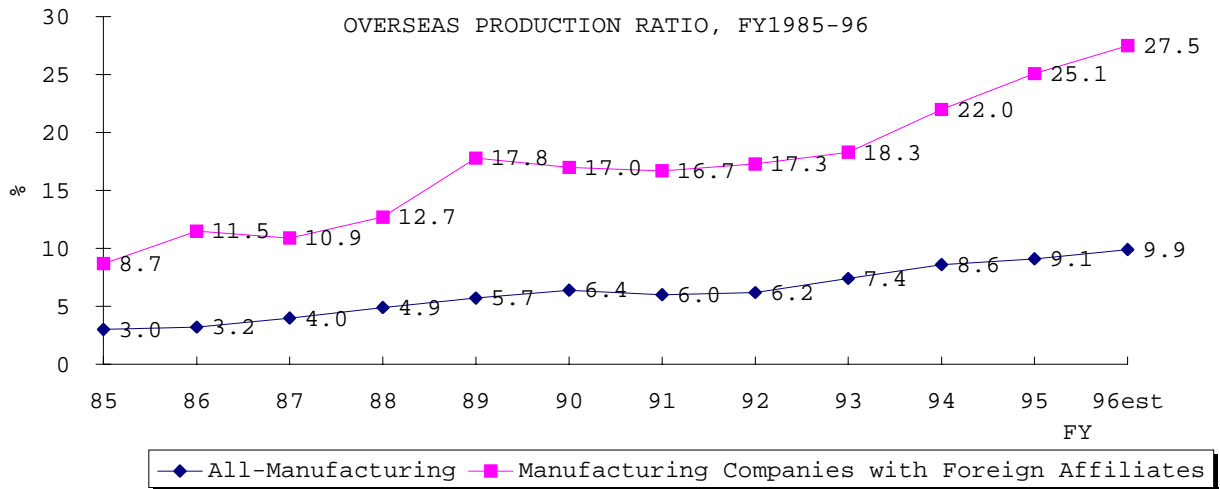


Fig.8



(Note) Overseas Production Ratio = Sales of Foreign Affiliates / Sales of Domestic Corporate Enterprises.

(Source) Domestic Corporate Enterprises :

Corporate Enterprises Statistics, Ministry of Finance

Fig.9

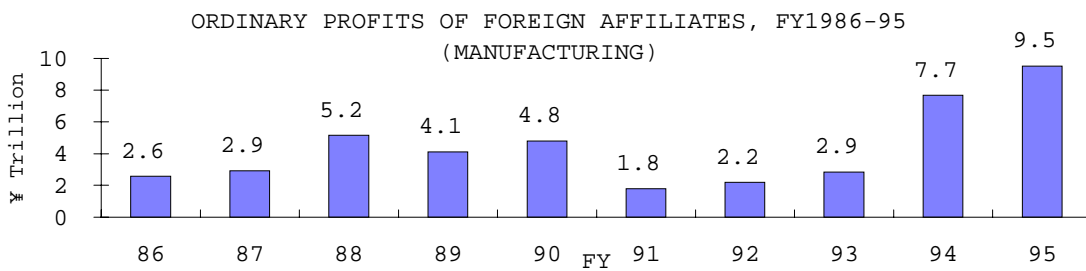


Fig.10

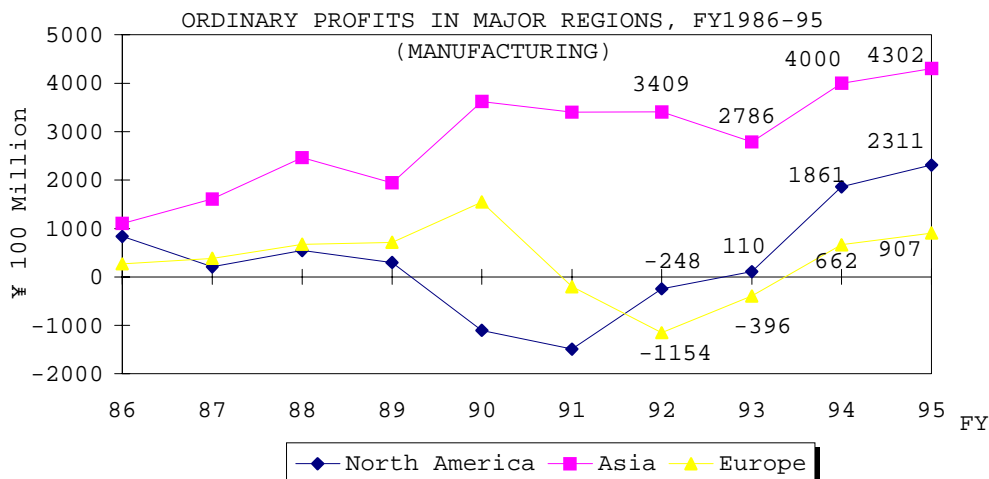
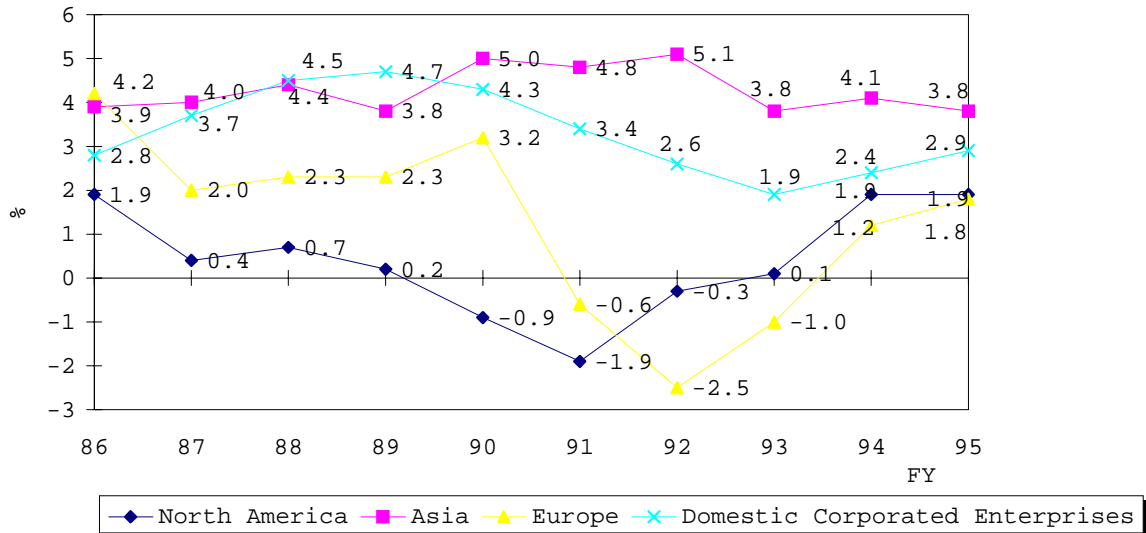


Fig.11

RATIO OF ORDINARY PROFITS TO SALES, FY1986-95 (MANUFACTURING)



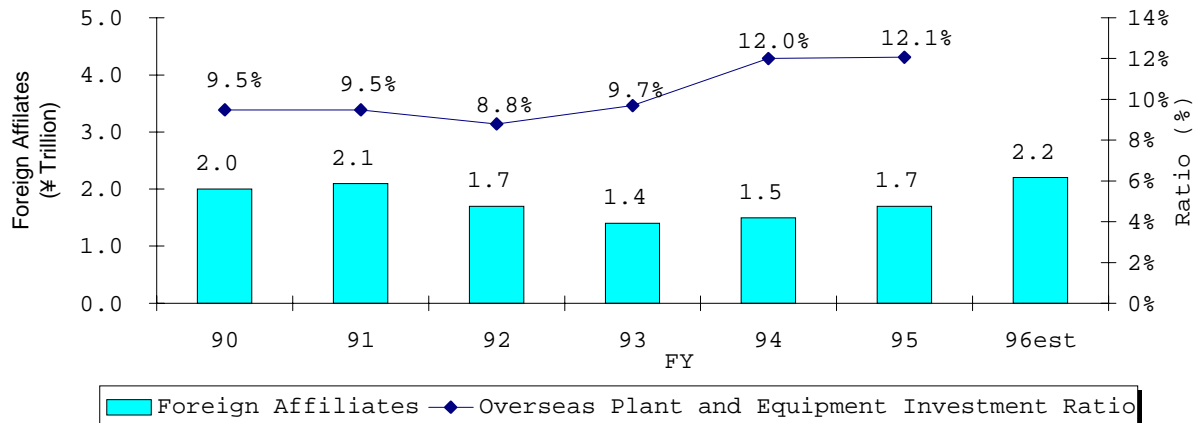
(Note) Ratio of Ordinary Profits to Sales = Ordinary Profits / Sales

We aggregate companies which responded to both sales and ordinary profits.

(Source) Domestic Corporate Enterprises : Corporate Enterprises Statistics, Ministry of Finance

Fig.12

OUTLAY FOR PLANT AND EQUIPMENT INVESTMENT, FY1990-96 (MANUFACTURING)



(Note) Overseas Plant and Equipment Investment Ratio

= Plant and Equipment Investment of Foreign Affiliates

/ Plant and Equipment Investment of Domestic Corporate Enterprises

(Source) Domestic Corporate Enterprises : Corporate Enterprises Statistics, Ministry of Finance