

GAO

Fact Sheet for the Chairman,  
Committee on Commerce, Science, and  
Transportation, U.S. Senate

July 1990

# FOREIGN INVESTMENT

## Aspects of the U.S.- Japan Relationship



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National Security and  
International Affairs Division

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July 31, 1990

The Honorable Ernest F. Hollings  
Chairman, Committee on Commerce, Science,  
and Transportation  
United States Senate

Dear Mr. Chairman:

In response to your request, we are providing information on (1) the extent and sectoral composition of Japanese investment in the United States and U.S. investment in Japan, (2) the forms of Japanese direct investment in the United States, and (3) barriers to U.S. investment in Japan.

Foreign investment includes (1) foreign direct investment, defined as purchases of 10 percent or more of a firm's equity, (2) "portfolio" investments, defined as other purchases of equity or private sector bonds, (3) purchases of government securities, and (4) financial assets (such as U.S. banks' borrowing from Japan and Japanese deposits in the United States).

Japanese investments in the United States during 1980-1988 increased faster than U.S. investments in Japan, with the result that total Japanese investments in the United States exceeded total U.S. investments in Japan by \$128.5 billion at the end of 1988. Japan made direct investments in the United States amounting to \$21.7 billion in 1988, while U.S. direct investment in Japan was \$2.2 billion. More than half of each country's cumulative direct investment in the other was in two sectors—wholesale trade and manufacturing. Appendix I provides details on the extent and sectoral composition of Japanese investment in the United States and U.S. investment in Japan.

Most Japanese direct investments are in the form of majority ownership investments, rather than joint ventures or minority ownership. Distinguishing whether Japanese investments are in sales or production facilities is difficult, because official Commerce Department statistics do not always separate these types of investments. Appendix II describes the forms of Japanese investment in the United States in greater detail.

Japanese barriers to U.S. investment tend to be informal, systemic barriers, such as long-term supply relationships, a complex distribution system, and close ties between government and industry. Appendix III

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Contents

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Figure I.5: Total Assets of Japanese Affiliates in the United States	12
Figure I.6: Total Assets of U.S. Affiliates in Japan	13
Figure I.7: Total Employment by Japanese Affiliates in the United States	14
Figure I.8: Total Employment by U.S. Affiliates in Japan	15
Figure II.1: Forms of Japanese Foreign Direct Investment in U.S. Manufacturing	17

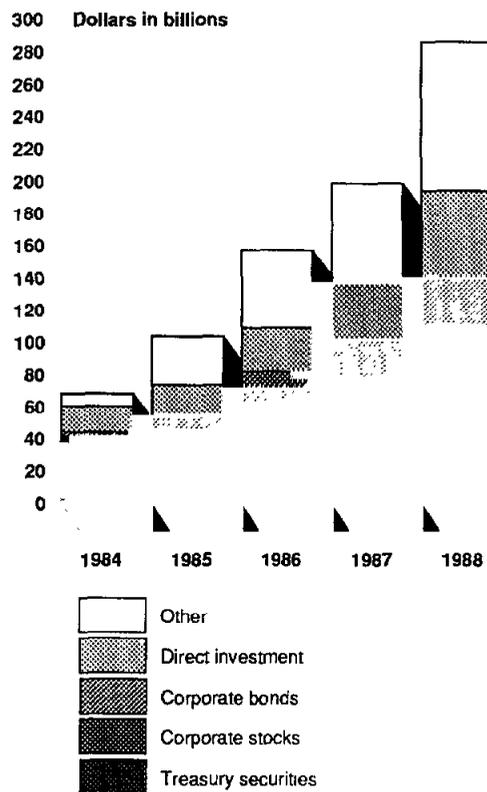
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**Abbreviations**

FDI Foreign Direct Investment

Appendix I  
 The Extent of Japanese Investment in the  
 United States and U.S. Investment in Japan

**Figure I.1: Japanese Investment Position  
 in the United States** (Based on Balance of  
 Payments Statistics)



Note "Other" includes foreign official assets in the United States and U.S. liabilities to Japanese interests reported by U.S. banks

Sources: Bureau of Economic Analysis, Commerce Department, Congressional Research Service statistics from Treasury Department data

the same time period, U.S. direct investment in Japan, although representing a smaller percentage of total investment, grew from \$7.9 billion to \$16.9 billion (16.4 percent to 10.8 percent of total investment). Figure I.2 shows the size of these different components for the years 1984 to 1988.

## Direct Investment

In 1988 almost half of Japan's \$47 billion foreign direct investment (FDI) was invested in the United States, while less than one-eighth of U.S. FDI was invested in Japan (see tables I.2 and I.3). The share of Japanese FDI invested in the United States grew from 33.1 percent in Japan's fiscal year 1984 to 46.2 percent in fiscal year 1988 (the Japanese fiscal year runs from April 1 to March 31). Similarly, the share of all U.S. direct

**Appendix I**  
**The Extent of Japanese Investment in the**  
**United States and U.S. Investment in Japan**

**Table I.3: U.S. Foreign Direct Investment**  
 (Measured in Yearly Flows)

Dollars in millions			
	Total	In Japan	Percent in Japan
1984	\$4,277	\$275	6.4
1985	18,268	1,310	7.2
1986	30,052	2,226	7.4
1987	48,183	3,199	6.6
1988	18,917	2,197	11.6

Source: Commerce Department

## Sectors of Investment

The economic significance of foreign direct investment in the United States can be measured in several ways. We used three types of statistics: (1) balance of payments data, which measure cumulative net capital flows into and out of the United States, (2) data on total assets of affiliates that show the value of U.S. businesses, except banking, in which the foreign investor has an equity share of at least 10 percent, and (3) total employment of these affiliates.<sup>1</sup>

These statistics indicate that the Japanese position in the United States has increased substantially. Balance of payments capital flows statistics indicate that the Japanese FDI position more than tripled between 1984 and 1988. Assets of Japanese-affiliated businesses increased fivefold between 1983 and 1987, while their employment increased by more than 70 percent.

While not on the same scale, U.S. investment in Japan also increased during these periods. Capital flows and affiliates' assets statistics both show that the U.S. foreign direct investment position in Japan more than doubled. However, employment by U.S. affiliates in Japan grew by only 10 percent between 1983 and 1987.

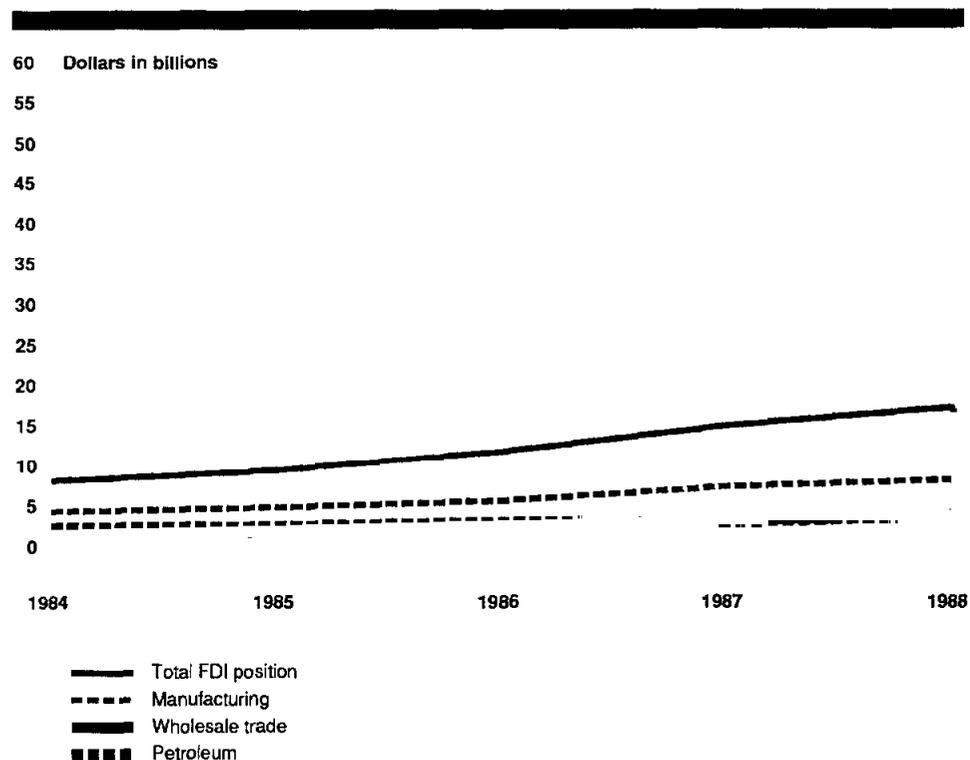
## Foreign Direct Investment Position

Between 1984 and 1988, the Japanese FDI position in the United States more than tripled, from \$16 billion to \$53.4 billion. The top three sectors, in order, continued to be wholesale trade, manufacturing, and real estate, although there were some significant changes in shares (see fig. I.3).

<sup>1</sup>For a more complete discussion of FDI data, see Foreign Investment, Federal Data Collection on Foreign Investment in the United States (GAO/NSIAD-90-25BR, Oct. 3, 1989)

Appendix I  
 The Extent of Japanese Investment in the  
 United States and U.S. Investment in Japan

**Figure I.4: U.S. FDI Position in Japan (Top Three Industries)** (Based on Balance of Payments Statistics)



Source: Bureau of Economic Analysis, Commerce Department

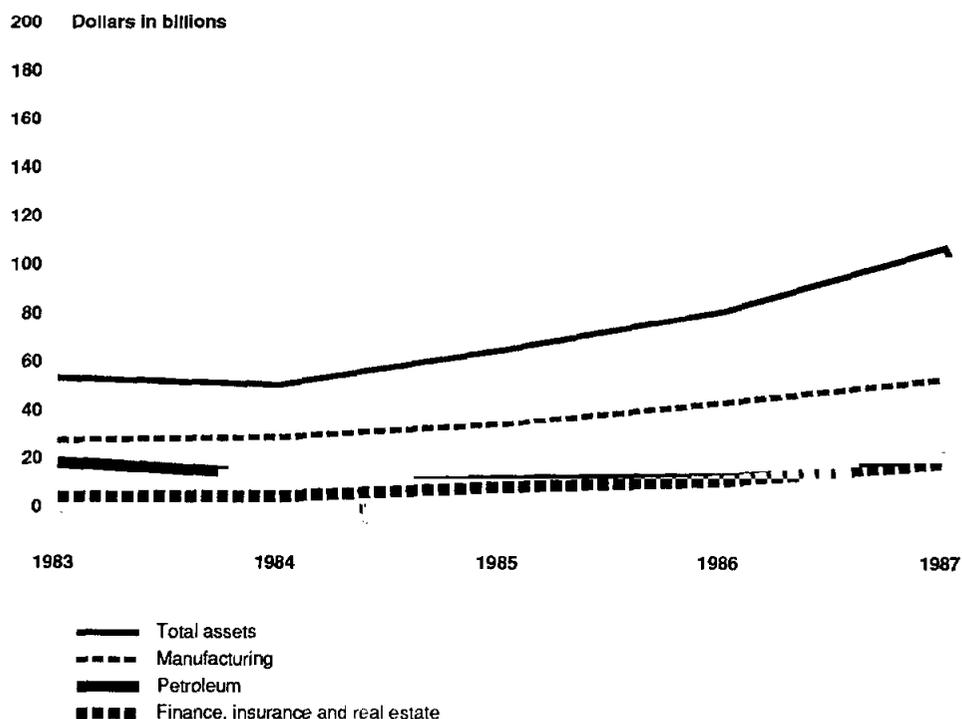
## Assets of Affiliates

Assets of Japanese affiliates in the United States increased fivefold, from \$38.9 billion in 1983 to \$195.8 billion in 1987,<sup>2</sup> the most recent year for which these data are available. The sectors with the largest asset value, according to this measure, were finance (except banking), wholesale trade, and manufacturing. In 1983, finance (except banking), accounted for 6.9 percent of all Japanese affiliates' assets in the United States; this sector grew to 60.7 percent in 1987. Wholesale trade accounted for 64.3 percent in 1983 and 23.2 percent in 1987, while manufacturing accounted for 16.5 percent in 1983 and 7.5 percent in 1987. The large increase in the finance (except banking) category was due in part to Japanese acquisitions of minority interests in a few U.S. finance companies with very large assets.

<sup>2</sup>Based on preliminary data.

Appendix I  
 The Extent of Japanese Investment in the  
 United States and U.S. Investment in Japan

Figure I.6: Total Assets of U.S. Affiliates  
 in Japan (Top Three Industries)



Source: Bureau of Economic Analysis, Commerce Department

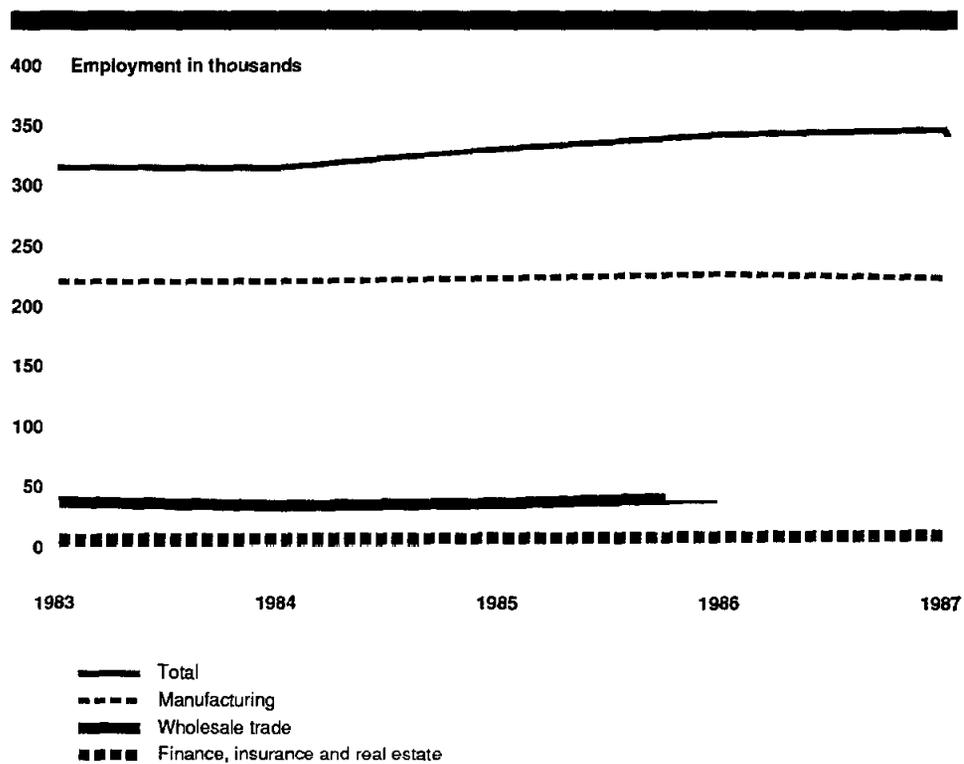
Employment by Affiliates

Employment by Japanese affiliates in the United States increased by 73 percent, to 284,600, between 1983 and 1987. At the same time, employment by U.S. affiliates in Japan increased by 10 percent, to 345,500.

The top three industries, by Japanese affiliates' employment, were wholesale trade, manufacturing, and finance (except banking) (see fig. I.7). The share of wholesale trade dropped from 44.8 percent in 1983 to 38.1 percent in 1987; manufacturing dropped from 32.2 percent to 28.7 percent in 1987, while finance (except banking) increased from 1.5 percent to 15.4 percent

Appendix I  
 The Extent of Japanese Investment in the  
 United States and U.S. Investment in Japan

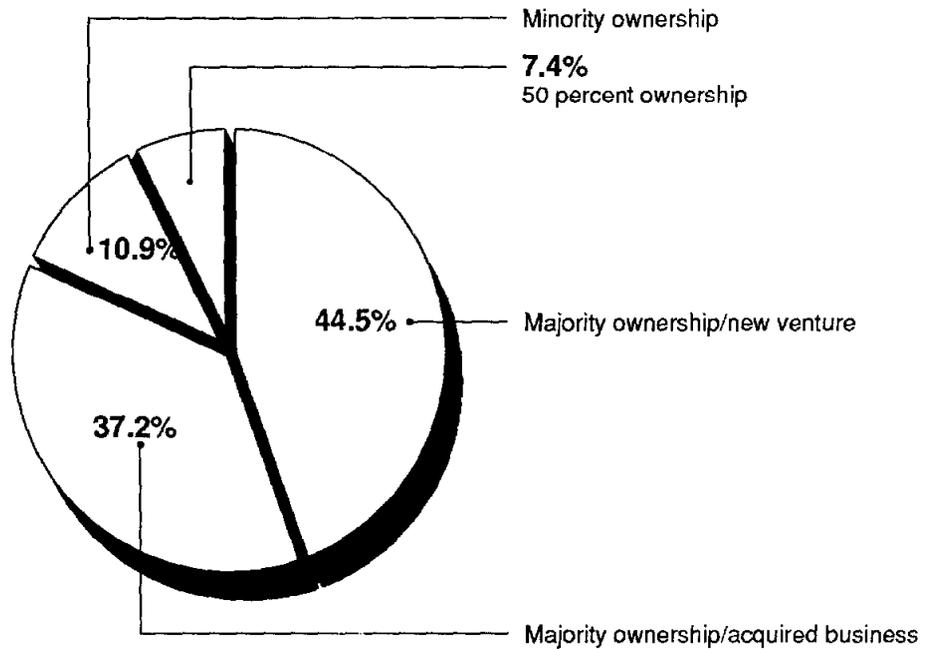
Figure I.8: Total Employment by U.S. Affiliates in Japan (Top Three Industries)



Source: Bureau of Economic Analysis, Commerce Department

**Appendix II**  
**Forms of Japanese Investments in the**  
**United States**

**Figure II.1: Forms of Japanese Foreign Direct Investment in U.S. Manufacturing (1980-1989)**



Source: Japan Economic Institute data.

investment in the United States is in sales activities and how much is in production activities.

Commerce data show that in 1987, businesses in wholesale trade accounted for 78.5 percent of total sales by Japanese affiliates, while those classified as goods producers made 12.7 percent of sales. Service industries accounted for the remaining 8.8 percent of sales.

**Table II.1: Sales by Industry - Nonbank U.S. Affiliates With Ultimate Beneficial Owners in Japan, 1987**

Dollars in millions		
	Sales	Percent of total
Wholesale trade	\$141,448	78.5
Other	38,678	21.5
of which: goods	22,855	12.7
services	15,823	8.8
All industries	180,126	100.0

Note: Goods consists of the following industries: manufacturing, including petroleum and coal products manufacturing, retail trade, agriculture, forestry, and fishing, and mining.

Source: Bureau of Economic Analysis, Commerce Department.

1. National security: arms; gunpowder; atomic energy; aircraft; and space development;
2. Maintenance of public order and protection of safety of the general public: narcotic manufacturing; vaccine manufacturing; and security guard services; and
3. Protection of domestic industries: agriculture; forestry and fisheries; petroleum refining and marketing; leather and leather product manufacturing; and mining.

Before 1980, according to this State Department study, foreign investment in these areas was prohibited. Investment is now allowed, but investment and ownership may be limited under the present law. U.S. investment has taken place in these sectors (particularly in the petroleum industry), but, according to the State Department report, the criteria for defining and controlling these sectors remain unclear because they are not made public.

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# Barriers to U.S. Investment in Japan

Informal barriers are generally considered to be the main reason U.S. investors have difficulties investing in Japan. Japanese business culture and practices entail significant differences from those in the United States and, therefore, result in informal barriers for foreign investors. These informal barriers include a business environment in which Japanese companies are rarely sold; there are virtually no hostile takeovers; and cross-shareholding among allied companies leaves a low percentage of companies' common stock available for sale on the stock market. In addition, Japan's long-term supplier relationships, close ties between government and industry, and complex distribution system are considered imposing barriers, particularly to start-up investments.

Inadequate protection for companies' patents, trademarks, and industry secrets due to ineffective registration and legal protection are regarded as an investment barrier and can also alter the types of foreign investments that go into Japan. And, the slowness of the registration process (with some issuances of patents taking 10 years or longer after filing) and the availability of the application to the public create disincentives to invest.

A 1989 Treasury Department study listing formal investment restrictions in the Group of Seven<sup>1</sup> countries concluded that Japan has liberalized its investment climate by changing or relaxing its legal and regulatory requirements. This study also noted that informal barriers still exist, and these can be potentially formidable. These informal barriers to investment (noted earlier) were discussed during the recent U.S.-Japan talks on trade and investment.<sup>2</sup>

Although Japan has liberalized its investment climate, certain formal restrictions remain on foreign direct investment. Similar to other countries, including the United States, Japan limits foreign direct investment in particular industries. According to a 1988 State Department report, Investment Climate Statement for Japan, these industries include the following:

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<sup>1</sup>The Group of Seven includes the United States, Canada, the United Kingdom, France, Germany, Italy, and Japan.

<sup>2</sup>Our critique of this Treasury study emphasized the significance of informal practices as barriers to U.S. investment. See Foreign Investment: Critique of Treasury Report on Major Industrial Country Restrictions (GAO/NSIAD-89-234, Sept. 21, 1989)

<sup>3</sup>These were the recent Structural Impediments Initiatives negotiations.

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# Forms of Japanese Investments in the United States

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There has been concern over the form that Japanese FDI in the United States may take. One aspect of this concern is that foreign interests may gain control over a large value of assets through minority ownership in a joint venture. A second aspect is the extent to which such investments are in the form of sales activities, which may primarily sell imported goods, as opposed to production facilities, which provide employment and add to domestic production.

Available data indicate that about 82 percent of Japanese FDI in U.S. manufacturing, between 1980 and 1989, was through majority ownership. Commerce data show that 78 percent of the 1987 sales of Japanese affiliates in the United States were made by businesses classified as wholesale trade. The classification, however, is based on the dominant activity of the business, and many of these businesses may have significant production activities.

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## Joint Ventures

It is difficult to determine the number of Japanese investments in the United States that are joint ventures. According to a Commerce Department official, the problem is mainly one of definition. For example, a joint venture can be a business agreement that specifies 50-percent ownership for both parties or a 90/10-percent division. Furthermore, there may be agreements whereby one partner provides capital or technology but is not involved in managerial decisions.

Because of this definitional problem, we divided the types of Japanese investment in U.S. manufacturing into four broad categories: minority ownership, 50-percent ownership, majority ownership in a new venture, and majority ownership in an acquired business.

Figure II.1 shows that 81.7 percent of all Japanese investments in U.S. manufacturing between 1980 and 1989 was through majority ownership of either a new or an acquired business; 10.9 percent was through minority ownership; and 7.4 percent was through a 50-percent ownership.

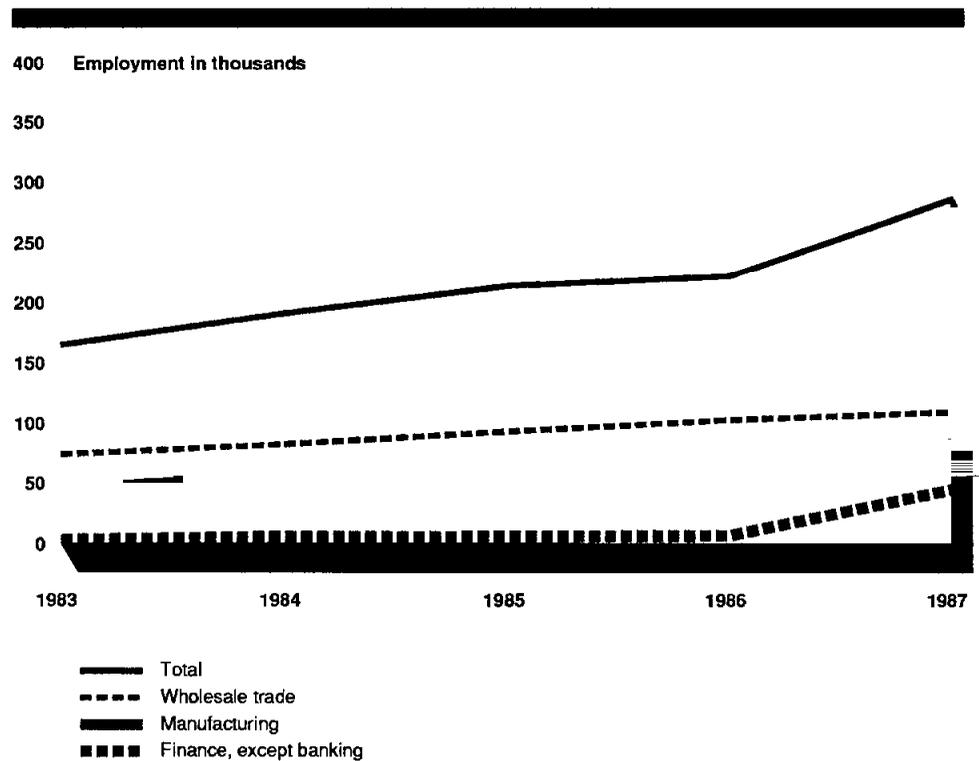
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## Investments in Sales Subsidiaries and Production Facilities

Many Japanese affiliates in the United States perform both sales and production operations. An affiliate, for example, may have 60 percent of its sales in wholesale trade and 40 percent in manufacturing. In such cases, Commerce Department investment statistics would classify the entire amount of direct investment as "wholesale trade," the dominant activity. It is, therefore, difficult to determine how much Japanese

Appendix I  
 The Extent of Japanese Investment in the  
 United States and U.S. Investment in Japan

**Figure I.7: Total Employment by Japanese Affiliates in the United States (Top Three Industries)**



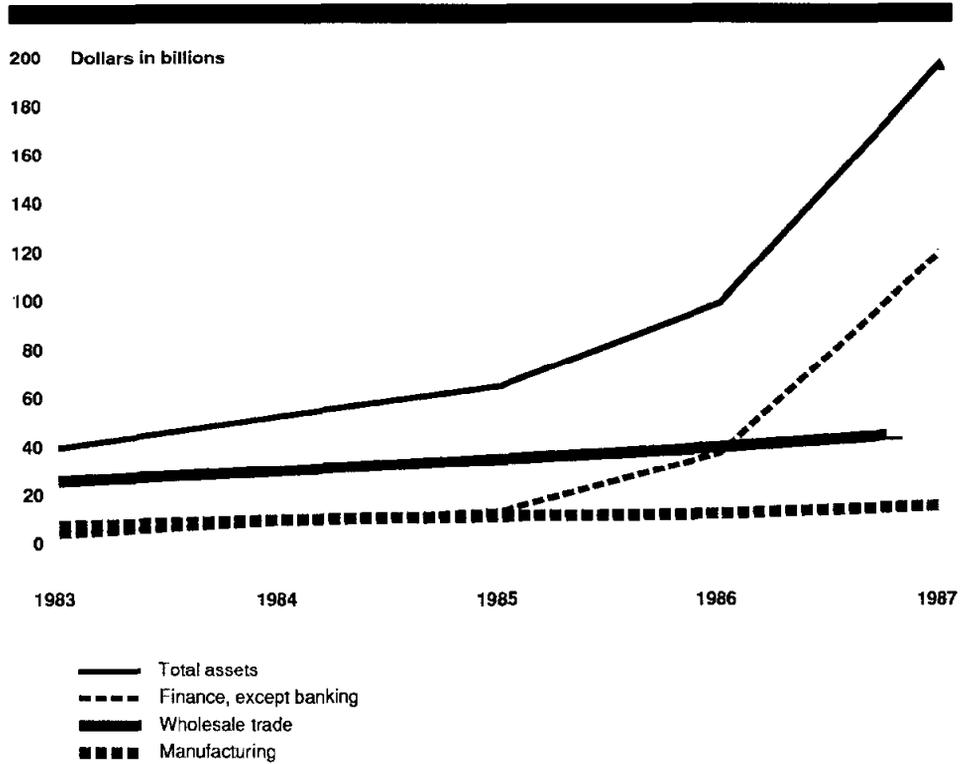
Source: Bureau of Economic Analysis, Commerce Department

The top three industries, measured by employment by U.S. affiliates in Japan, were manufacturing, wholesale trade, and finance, insurance, and real estate (see fig. I.8). The share for manufacturing dropped slightly, from 69.9 percent in 1983 to 64.4 percent in 1987, while wholesale trade and finance, insurance, and real estate each increased about 1 percent.<sup>3</sup>

<sup>3</sup>According to a Commerce Department official, statistics used to determine the amount of employment include U.S. affiliates that have minority ownership in Japanese companies.

Appendix I  
 The Extent of Japanese Investment in the  
 United States and U.S. Investment in Japan

Figure I.5: Total Assets of Japanese  
 Affiliates in the United States (Top Three  
 Industries)

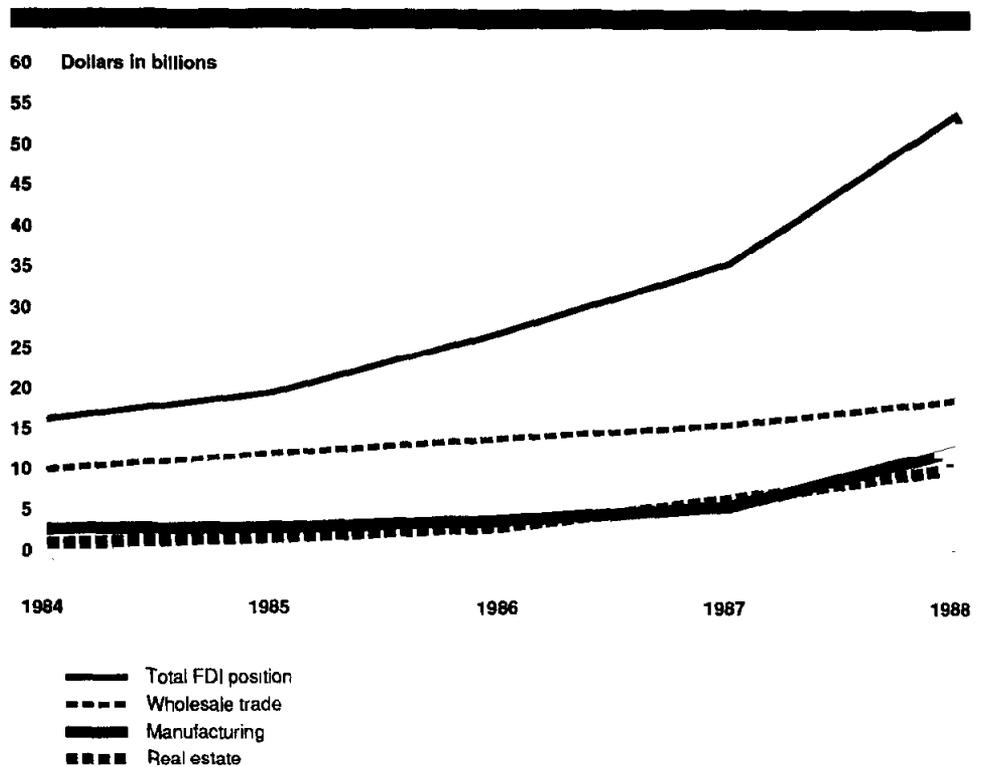


Source: Bureau of Economic Analysis, Commerce Department

Between 1983 and 1987, total assets of U.S. affiliates in Japan doubled, from \$52.5 billion to \$106 billion, and were mostly in the manufacturing, petroleum, and finance, insurance, and real estate sectors in Japan. Figure I.6 shows that the share of total assets in manufacturing was 50.7 percent in 1983 and 49.7 percent in 1987. The share of petroleum declined from 33.1 percent in 1983 to 18.8 percent in 1987, while the share of finance, insurance, and real estate increased from 6.3 percent in 1983 to 16.3 percent in 1987.

**Appendix I**  
**The Extent of Japanese Investment in the**  
**United States and U.S. Investment in Japan**

**Figure I.3: Japanese FDI Position in the United States (Top Three Industries)**  
 (Based on Balance of Payments Statistics)

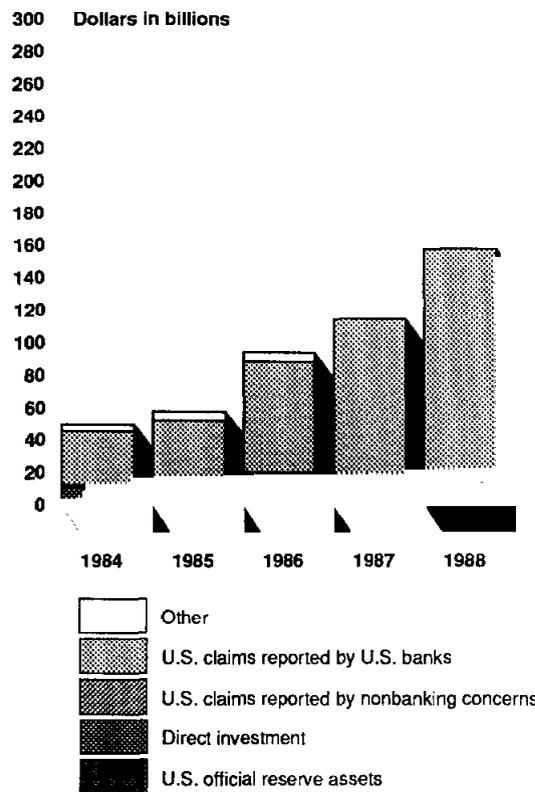


Source: Bureau of Economic Analysis, Commerce Department.

The U.S. FDI position in Japan more than doubled, from \$7.9 billion to \$16.9 billion, between 1984 and 1988. Figure I.4 shows that the largest sectors for U.S. investors in Japan are manufacturing, wholesale trade, and petroleum. Manufacturing, as a percentage of U.S. foreign direct investment in Japan, decreased from 51.9 percent in 1984 to 46.7 percent in 1988. Wholesale trade grew from a 15.2 percent share in 1984 to a 20.7 percent share in 1988. Petroleum investments dropped from a 26.6 percent share in 1984 to a 20.7 percent share in 1988.

Appendix I  
 The Extent of Japanese Investment in the  
 United States and U.S. Investment in Japan

**Figure I.2: U.S. Investment Position in Japan** (Based on Balance of Payments Statistics)



Note "Other" includes bonds, corporate stocks, and U.S. government assets (other than official reserve assets)

Source: Bureau of Economic Analysis, Commerce Department

investment abroad that went into Japan grew from 6.4 percent in 1984 to 11.6 percent in 1988

**Table I.2: Japanese Foreign Direct Investment** (Measured in Yearly Flows)

	Dollars in millions		
	Total	In the United States	Percent in the United States
1984	\$10,155	\$3,360	33.1
1985	12,217	5,395	44.2
1986	22,320	10,165	45.5
1987	33,364	14,704	44.1
1988	47,022	21,701	46.2

Source: Japan Economic Institute, based on Japan Ministry of Finance data

# The Extent of Japanese Investment in the United States and U.S. Investment in Japan

The U.S. net investment position with Japan has changed dramatically since 1980, as shown in table I.1. In 1980, U.S. investment in Japan was \$37.4 billion, while Japanese investment in the United States was \$35.3 billion. By 1988, U.S. investment in Japan had more than quadrupled—to \$156.3 billion—while Japanese investment in the United States had increased eightfold—to \$284.8 billion—leaving the U.S. with a negative net investment position of \$128.5 billion.

**Table I.1: U.S. Net Investment Position With Japan, Based on Balance of Payments Statistics**

Dollars in billions

	Japanese investment in the United States	U.S. investment in Japan	Net U.S. investment position with Japan
1980	\$35.3	\$37.4	\$2.1
1981	44.7	43.0	-1.7
1982	43.4	44.8	1.4
1983	50.1	48.4	-1.7
1984	67.6	48.3	-19.3
1985	101.1	56.1	-45.0
1986	156.2	91.9	-64.3
1987	197.7	113.4	-84.3
1988	284.8	156.3	-128.5

Source: Japan Economic Institute; based on Commerce Department statistics.

## Types of Japanese Investments in the United States

All types of Japanese investments in the United States increased during the period 1984-1988. However, there were major changes in the shares of the types of investment (see fig. I.1). The direct investment share of Japanese investment in the United States declined from 23.7 percent in 1984 to 18.7 percent in 1988. Japanese investments in U.S. Treasury securities also declined, from 58.6 percent in 1984 to 32 percent in 1988. The share of Japanese investment placed in U.S. corporate stocks and bonds, however, increased from 6.2 percent to 17.2 percent during the same period. Japan's "other" investments, consisting mainly of Japanese financial assets deposited with American banks, grew from an 11.5 percent share in 1984 to 32.1 percent in 1988.

## Types of U.S. Investment in Japan

The types of U.S. investment in Japan also changed between 1984 and 1988. U.S. claims against Japan reported by U.S. banks accounted for \$32.9 billion in 1984 and by 1988 had increased to \$135.5 billion (68.1 percent and 86.7 percent of total investment, respectively). During

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# Contents

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Letter		1
Appendix I		6
The Extent of Japanese Investment in the United States and U.S. Investment in Japan	Types of Japanese Investments in the United States	6
	Types of U.S. Investment in Japan	6
	Direct Investment	7
	Sectors of Investment	9
Appendix II		16
Forms of Japanese Investments in the United States	Joint Ventures	16
	Investments in Sales Subsidiaries and Production Facilities	16
Appendix III		18
Barriers to U.S. Investment in Japan		
Appendix IV		20
Major Contributors to This Fact Sheet	National Security and International Affairs Division, Washington, D.C.	20
Tables		
	Table I.1: U.S. Net Investment Position With Japan, Based on Balance of Payments Statistics	6
	Table I.2: Japanese Foreign Direct Investment	8
	Table I.3: U.S. Foreign Direct Investment	9
	Table II.1: Sales by Industry - Nonbank U.S. Affiliates With Ultimate Beneficial Owners in Japan, 1987	17
Figures		
	Figure I.1: Japanese Investment Position in the United States	7
	Figure I.2: U.S. Investment Position in Japan	8
	Figure I.3: Japanese FDI Position in the United States	10
	Figure I.4: U.S. FDI Position in Japan	11

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provides a discussion of such informal barriers and a listing of the principal industries where formal barriers exist.

In developing this fact sheet, we compiled data from the Departments of Commerce, State, and the Treasury, the U.S. Trade Representative, and the Japan Economic Institute. We performed our work between November 1989 and March 1990. As you requested, we did not obtain official agency comments on this report. Unless you publicly announce its contents earlier, no further distribution of this report will be made until 30 days from its issue date. At that time, we will send copies to other interested congressional committees and to the cognizant executive agencies. We will also provide copies to others upon request. Major contributors to this fact sheet are listed in appendix IV. If you have any questions, I can be reached on (202) 275-4812.

Sincerely yours,



Allan I. Mendelowitz, Director  
Trade, Energy, and Finance Issues

