

### **Chapter 3 Development of overseas business activities of Japanese enterprises**

In light of the analysis in Chapters 1 and 2, Chapter 3 focuses the developments of overseas business activities of Japanese enterprises and presents the analysis of the current activities and the overview of future developments while comparing Germany and South Korea.

First, Section 1 reviews overseas business activities of Japanese enterprises from a variety of angles, thereby showing the spread of the base of overseas business activities, and also shows the potential of the contribution of the activities to the domestic economy while making clear the current concerns over the hollowing-out of Japanese industries and the future challenges involved.

Next, Section 2 defines the international position of overseas business activities of Japan through a macro-basis comparison with major countries, and overviews Germany's and South Korea's initiatives to expand overseas business activities. Based on these, we will look at reference points to follow.

Section 3 overviews the current situation of and problems involved in Japan's outward foreign direct investments regarding service trade and service industry from the viewpoint of international comparison with Germany and South Korea, etc. Then, we will overview, by using example cases, the characteristics of overseas business activities primarily in emerging economies of Japan's service industry that has been vitalized in recent years. In addition, we will show the impact of overseas business activity developments of the service industry on domestic economy while analyzing the synergies that may work on the competitive edge of other industries, such as the manufacturing industry.

Section 4 refers to the concept of initiatives toward strengthening domestic locational competitiveness required for eliminating concerns over hollowing-out and ensuring sustainable growth.

#### **Section 1 Current situation of overseas business activities of Japanese enterprises and the problems involved**

First, this section presents the spread of the base of overseas business developments by overviewing overseas business activities of Japanese enterprises in terms of industry, corporate scale, geographical scope, functions, and means of business expansion.

Next, we will analyze the hollowing-out of domestic industries facing first-growing concerns caused by the historical appreciation of the yen and anxieties about electricity supply. In addition, in this section we will see a reduction in production, investments, and employment as an element behind the hollowing-out, and confirm the moves of domestic manufacturers and enterprises that developed overseas business.

We will make an international comparison of the hollowing-out in particular between Germany, South Korea and the U.S. in order to understand in more details the problems Japan faces. Germany and South Korea hold a relatively large share of employees in the manufacturing sector among advanced countries, and remain countries strong in manufacturing. The U.S. has proceeded with changes in its industrial structure ahead of other advanced countries and the percentage of manufacturing industry remains at a low level. Through comparison with these countries, we will clarify current concerns over the hollowing-out of Japanese industries and future problems involved.

Finally, we will show the importance of overseas activities for Japan by analyzing and examining what kind of impact the expansion of such overseas business activities will cause on the domestic economy through the productivity and the employment of domestic enterprises and other factors.

## **1. Expansion of the base of Japanese overseas business activities**

To begin with, we will compile the current situation of overseas business activities (exports/imports and outward foreign direct investments) of Japanese enterprises with a threshold of the “spread of the base.” First, we will show the spread of the corporate scale on the basis of the export/import ratio of SMEs and mid-sized enterprises and the change of the ratio, and next show the spread of outward foreign direct investments from the perspective of industry, corporate scale, geographical scope, and functions.

### **(1) Expansion of the base of exporting/importing company**

First, we will confirm the characteristics of Japanese exporting<sup>1</sup>enterprises. According to the Ministry of Economy, Trade and Industry “Basic Survey of Japanese Business Structure and Activities<sup>2</sup>,” the number of exporting companies is about 6,000 and is on the increase. Nearly 70% of exporting companies are manufacturers and those of slightly more than 20% are wholesalers, while other industries remain at about 5% in total (Table 3-1-1-1).

Exports per company in both manufacturing and wholesale industries have been almost comparable at more than 10 billion yen. Exports of both industries increased until 2007 but decreased in FY2008 due to the world economic crisis. Latest exports per wholesaler outnumber those of manufacturers. Worthy of note is that the number of exporting companies did not decrease even in the declining phase of exports from FY2008 to FY2009. Despite a harsh environment, a shrink in the base of exporting companies had not been observed before FY2009.

Next, looking at the share of exports and imports by corporate scale, as for the manufacturing industry, the share of large enterprises with more than 1,000 employees is much higher in both exports and imports but is slightly lowering. In particular, the share of exports and imports of enterprises with less than 999 employees did not decline even in the phase of a decrease of trade seen in FY2008 and FY2009 but rather imports increased. It follows that exporting and importing activities of mid-sized enterprises and SMEs remain firm (Figure 3-1-1-2).

In contrast, when comparing with the manufacturing industry, the ratio of wholesalers with 1,000 or more employees is lower than manufacturers, and conversely enterprises with 499 or less show a high share. For both exports and imports, the share of enterprises with 999 or less employees increased until the middle of 2000s but recently the share of enterprises having 1,000 or more employees is recovering (Figure 3-1-1-3).

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1 Exports here are limited to exports of goods and no service exports are included.

2 This survey targets enterprises with 50 or more employees and the capitalization or capital contribution of 30 million yen or greater, which are included in mining, manufacturing industries, wholesale/retail sector or other certain service industry.

Table 3-1-1-1

Number of exporting enterprises and export amount (100 million yen) by industry

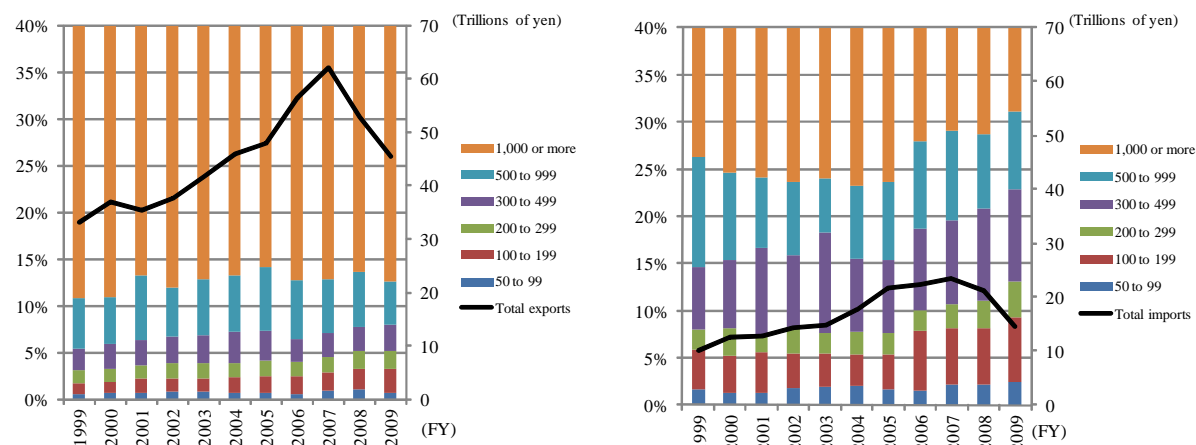
	FY2005		FY2006		FY2007		FY2008		FY2009	
	Export companies	Exports per company	Export companies	Exports per company	Export companies	Exports per company	Export companies	Exports per company	Export companies	Exports per company
Total	5,867	113	5,821	128	6,047	137	6,089	116	6,117	103
Manufacturing	4,172 (71%)	115	4,132 (71%)	136	4,314 (71%)	144	4,346 (71%)	122	4,380 (72%)	104
Wholesale	1,429 (24%)	121	1,422 (24%)	127	1,415 (23%)	134	1,412 (23%)	115	1,408 (23%)	123
Retail	103 (2%)	6	106 (2%)	8	121 (2%)	9	103 (2%)	10	126 (2%)	7
Information and communications	82 (1%)	72	69 (1%)	9	78 (1%)	129	93 (2%)	90	71 (1%)	8
Services	79 (1%)	52	91 (2%)	9	118 (2%)	53	134 (2%)	38	130 (2%)	20
Mining, etc.	2 (0%)	x	1 (0%)	x	1 (0%)	x	1 (0%)	x	2 (0%)	x

Note: "x" means that figures are kept secret in the table because secrets of applicants may be revealed. "Services" in the table includes "services (excluding "miscellaneous services"), scientific research, professional and technical services," "goods rental and leasing," and "eating and drinking services" etc. Exports per company in "Services" in the table are only for reference because some figures are kept secret.

Source: *Basic Survey of Japanese Business Structure and Activities* (Ministry of Economy, Trade and Industry).

Figure 3-1-1-2

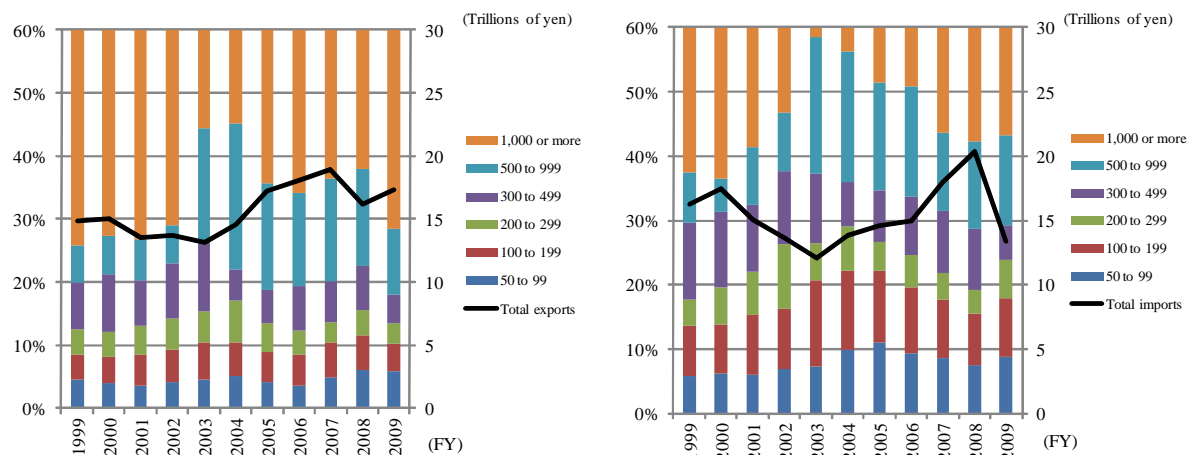
Share of export and import amount by scale of employees (manufacturers) (left: export amount, right: import amount)



Source: *Basic Survey of Japanese Business Structure and Activities* (Ministry of Economy, Trade and Industry).

Figure 3-1-1-3

Trade by scale of employees (manufacturers) (left: export amount, right: import amount)

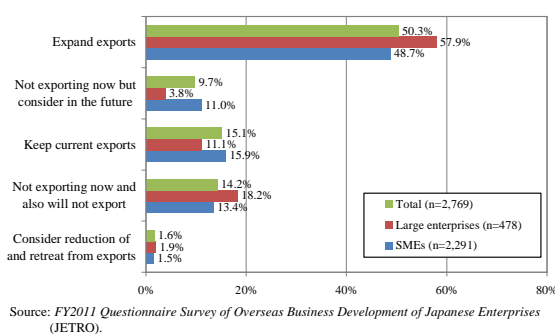


Source: *Basic Survey of Japanese Business Structure and Activities* (Ministry of Economy, Trade and Industry).

According to the findings of JETRO's questionnaire survey (FY2011)<sup>3</sup>, for the future, 50.3% of all enterprises responded "expand exports," and when combined these replies with those of "not exporting now but consider in the future," 60% of enterprises show an active attitude about exports. Among others, 11% of SMEs<sup>4</sup> answered "not exporting now but consider in the future" in response to the questionnaire. Thus, exports are expected to expand, including SMEs (Figure 3-1-1-4).

Figure 3-1-1-4

Policy for exports (for about coming three years) (all industries)



## (2) Expansion of the base of outward foreign direct investments by Japanese enterprises

Next, we will confirm outward foreign direct investments by Japanese enterprises by industry, corporate scale, geographical scope, and function of entry in the market.

### (A) Spread of types of industries

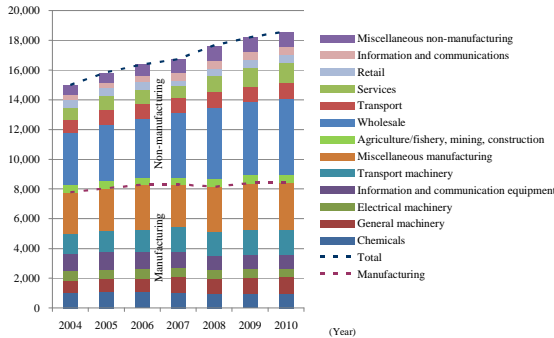
The Ministry of Economy, Trade and Industry "Basic Survey of Overseas Business Structure and

<sup>3</sup> *FY2011 Questionnaire Survey of Overseas Business Development of Japanese Enterprises* (JETRO)

<sup>4</sup> The definition of SMEs is based on the Small and Medium-sized Enterprise Basic Act.

Activities<sup>5</sup>” shows that overseas subsidiaries were increasing consistently from the period from FY2004 to FY2010 and in terms of the business structure of subsidiaries, non-manufacturers marked significant growth. In 2007, subsidiaries of non-manufacturers outnumbered those of manufacturers and thereafter the gap between them widens (Figure 3-1-1-5).

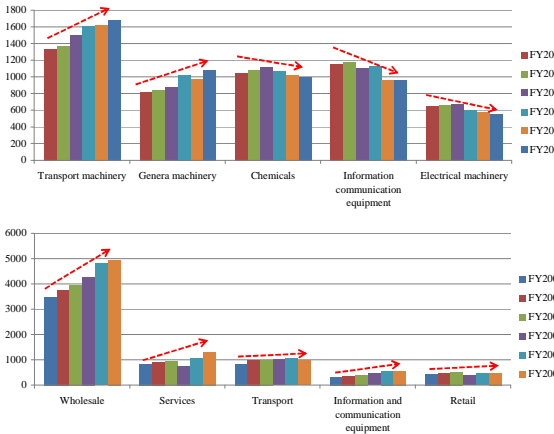
Figure 3-1-1-5  
Number of overseas subsidiaries



Note: "Overseas subsidiaries" refers to those with total investment ratio on the Japanese side of 10% or more, etc..  
Source: Basic Survey of Overseas Business Activities (Ministry of Economy, Trade and Industry).

Looking at the breakdown of manufacturing industry, overseas subsidiaries dealing with transport machinery and general machinery increased from FY2004 to FY2010 while those dealing with chemicals, information communications equipment, and electrical machinery decreased. This shows that the number of overseas subsidiaries belonging to manufacturing industry experienced sluggish growth as a whole (Figure 3-1-1-6).

Figure 3-1-1-6  
Number of overseas subsidiaries by industry (above: manufacturers, below: non-manufacturers)



Source: Basic Survey of Overseas Business and Activities (Ministry of Economy, Trade and Industry).

In non-manufacturing industry, an increase in wholesalers’ overseas subsidiaries contributed

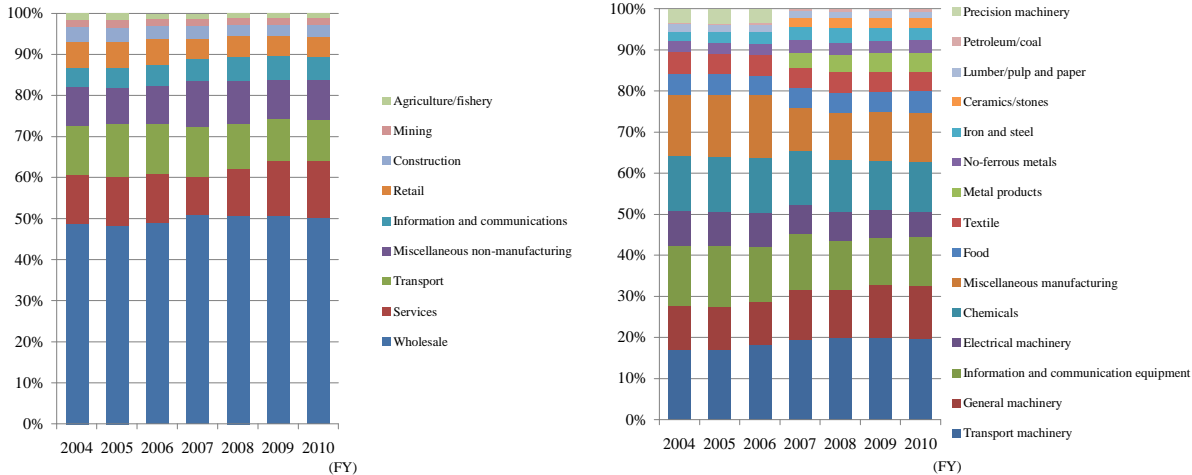
5 This survey targets Japanese enterprises (excluding the finance, insurance and real estate industries) that hold overseas subsidiaries as of the end of March every year.

significantly to the increase of the number as a whole. As for other industries, the service and information communications industries increased overseas subsidiaries while overseas subsidiaries of the transport industry and retailers remained almost flat. In terms of the industry-by-industry share to the number of overseas subsidiaries belonging to non-manufacturing sector, the number of wholesalers saw a further increase between FY2004 to FY2010 and that of the service industry has also been expanding since FY2007 (Figure 3-1-1-7).

The factor behind increasing overseas subsidiaries particularly in the non-manufacturing sector could be an increase in the importance of seizing overseas markets. According to findings<sup>6</sup> of the survey on determinants of outward foreign direct investments, enterprises that replied “able to secure a good quality and cheap labor force in the country where we operate” decreased from FY2004 to FY2010 while enterprises that answered “large local demand for products or future demand is expected” and “large local demand for products or future demand is expected in three neighboring countries of the country where we operate” are increasing. Thus, the shift of the primary purpose of outward foreign direct investments could be reflected in the industrial composition of the direct investments (Figure 3-1-1-8, Figure 3-1-1-9).

Figure 3-1-1-7

Breakdown of the number of overseas subsidiaries by industry (left: manufacturers, right: non-manufacturers)



Note: “General machinery” includes general-purpose machinery, “production machinery,” and “business-oriented machinery.” In FY2007, the scope of “general machinery” and “miscellaneous manufacturing” was changed. Namely, the classification of “precision machinery” was abolished and “precision machinery” was included in the business-oriented machinery and “miscellaneous manufacturing.” In addition, “metal products” and “ceramics/stones” were excluded from “miscellaneous manufacturing” and calculated individually.

Source: *Basic Survey of Overseas Business and Activities* (Ministry of Economy, Trade and Industry).

6 *Basic Survey of Overseas Business Structure and Activities* (Ministry of Economy, Trade and Industry), this item covers headquarters of enterprises that undertook new or additional investments in overseas subsidiaries in the year of survey.

Figure 3-1-1-8  
Factors to determine investments (manufacturers)

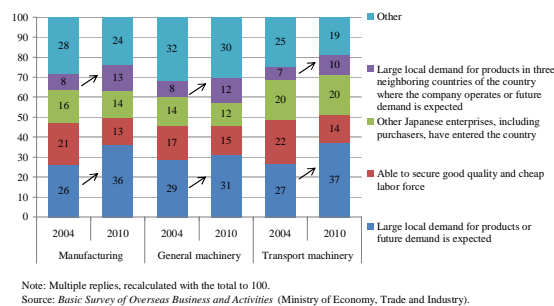
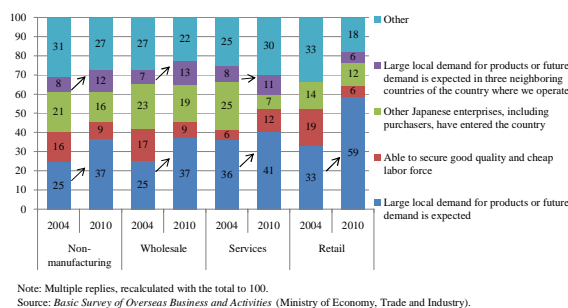


Figure 3-1-1-9  
Factors to determine investments (non-manufacturers)

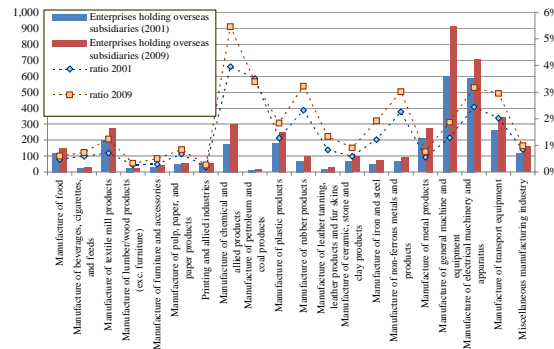


For more details on outward foreign direct investments by manufacturing industry, the trend that the number of enterprises holding overseas subsidiaries is large in the machinery-related industry remained unchanged, but it is found that, during FY2001 and FY2009, enterprises holding overseas subsidiaries increased in most industries, including other industries<sup>7</sup>. In addition, the ratio of enterprises that held overseas subsidiaries to total number of enterprises for each industry also increased. Thus we can confirm that overseas business activities of Japanese enterprises are growing (Figure 3-1-1-10).

<sup>7</sup> The 2009 Economic Census for Business Frame is the same as the Establishment and Enterprise Census in terms of the subject of survey but different in survey methods for the use of administrative records, such as commercial/corporate registration and the introduction of headquarters, etc. blanket survey, etc. Because of this, all of the differences from the Establishment and Enterprise Census until 2006 do not indicate an increase or a decrease.

Figure 3-1-1-10

Number/ratio of Japanese enterprises holding overseas subsidiaries by industry



Note: Manufacture of textile mill products for 2001 shows the total of "manufacture of textile mill products" and "apparel/miscellaneous fabricated textile products." Manufacture of general machine and equipment for 2001 shows the total of "manufacture of general machine and equipment," "manufacture of precision instruments" and "manufacture of ordnance and accessories," and for 2009 the total of "manufacture of general-purpose machinery," "manufacture of production machinery," and "manufacture of business oriented machinery." Manufacture of electrical machinery and apparatus for 2009 shows the total of "manufacture of electronic parts, devices, and electronic circuits," "manufacture of electric machinery and apparatus," and "manufacture of information and communication electronics equipment."

Source: 2001 Establishment and Enterprise Census and 2009 Economic Census for Business Frame (Ministry of Internal Affairs and Communications).

## (B) Spread of corporate scale

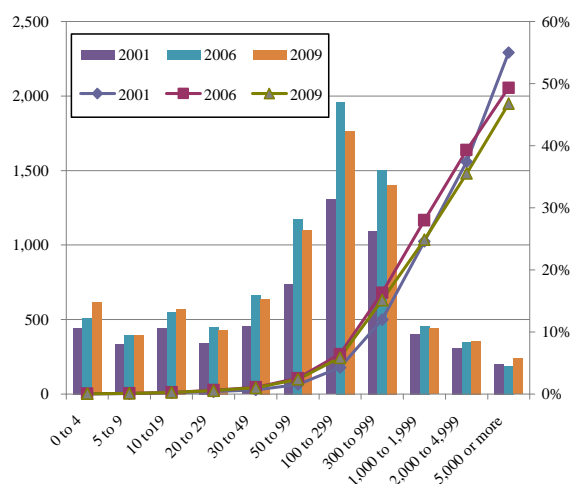
Next, we will confirm the trend of outward foreign direct investments by corporate scale. It is found that the larger the corporate scale is, the higher the ratio of holding overseas subsidiaries becomes while, on a numerical basis, about half of such enterprises are mid-sized enterprises with 50 to 999 employees. Further, enterprises with such scale stand out particularly during 2001 to 2006 in terms of both the number and ratio of enterprises holding overseas subsidiaries. This trend backs up the spread of overseas business development. In addition, a decrease is seen in 2009 and the decrease may be resulted from a special move under the world economic crisis but the number and the ratio<sup>8</sup> are greater than the level as of 2001 (Figure 3-1-1-11).

8 The 2009 Economic Census for Business Frame is the same as the Establishment and Enterprise Census in terms of the subject of survey but different in survey methods for the use of administrative records, such as commercial/corporate registration and the introduction of head office, etc. blanket survey, etc. Because of this, all of the differences from the Establishment and Enterprise Census until 2006 will not indicate an increase or a decrease.



Figure 3-1-1-11

Number/ratio of Japanese enterprises holding overseas subsidiaries by scale of employees (all industries)



Note: Left vertical axis (bar chart) shows the ratio of the number of enterprises holding overseas subsidiaries to the total number of enterprises by scale.  
 Source: 2001 Establishment and Enterprise Census and 2006 Establishment and Enterprise Census and 2009 Economic Census for Business Frame (Ministry of Internal Affairs and Communications).

By manufacturer and wholesaler/retailer, such general trend is common to both manufacturers and wholesalers/retailers but more than 80% of manufacturing enterprises with 5,000 or more employees have overseas subsidiaries while for wholesalers/retailers the share of even such large enterprises having overseas subsidiaries remain at only 20% to 30% (Figure 3-1-1-12).

Thus, although SMEs' overseas business activities have been brisk, the share of overseas subsidiary-holding enterprises of all SMEs remains low. According the questionnaire survey (FY2010)<sup>9</sup> by the Organization for Small & Medium Enterprises and Regional Innovation, Japan, in response to a question about a reason that SMEs have not developed overseas business, manufacturing enterprises replied "could not secure adequate human resources in Japan" (37%) account for the highest percentage followed by the reply "could not make a decision due to inadequate prediction" (33%). For wholesalers, major reasons include the replies "could not undertake overseas business activities because of coping with domestic matters" (43%) and "could not make a decision due to inadequate prediction" (43%). These replies suggest that a shortage of human resources and risk avoidance consciousness together with insufficient information constitute a barrier to SEMs' overseas business development (Figure 3-1-1-13).

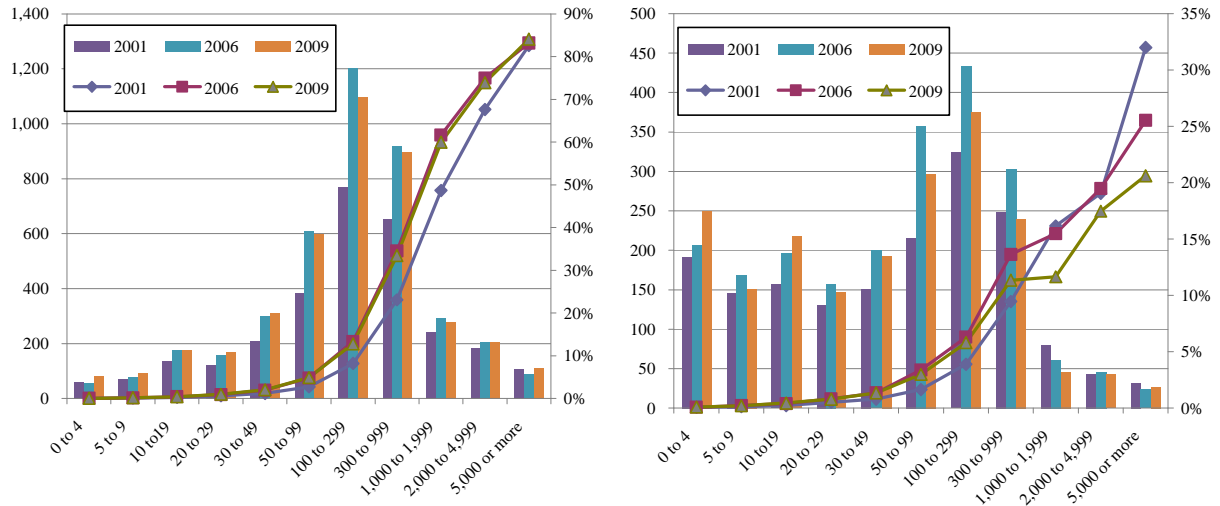
Results of the same questionnaire survey indicate that the supporting institution<sup>10</sup> that is most used by SMEs is JETRO by far the highest rate among institutions assisting SMEs' internationalization, followed by chambers of commerce and industry/societies of commerce and industry (Figure 3-1-1-14).

9 Survey on SME Overseas Business Activities (FY2010) (Organization for Small & Medium Enterprises and Regional Innovation, Japan)

10 This question is asked about other institutions than Organization for Small & Medium Enterprises and Regional Innovation, Japan.

Figure 3-1-12

Number of enterprises holding overseas subsidiaries by scale (left: manufacturers, right: wholesalers/retailers)

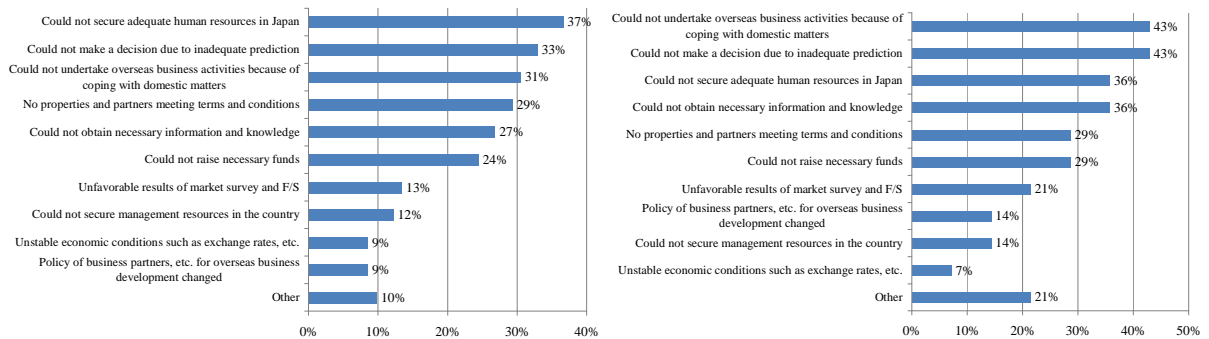


Note: Left vertical axis (bar chart) shows the ratio of the number of enterprises holding overseas subsidiaries to the total number of enterprises by scale; 2011 “Wholesaler/retailer” includes “eating and dining places.”

Source: 2001 Establishment and Enterprise Census and 2006 Establishment and Enterprise Census and 2009 Economic Census for Business Frame (Ministry of Internal Affairs and Communications).

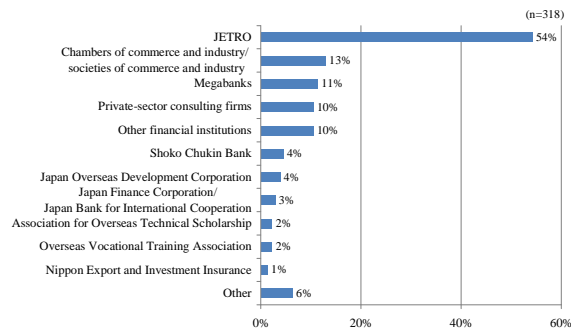
Figure 3-1-13

Reasons for abandoning overseas expansion (left: manufacturers, right: wholesalers)



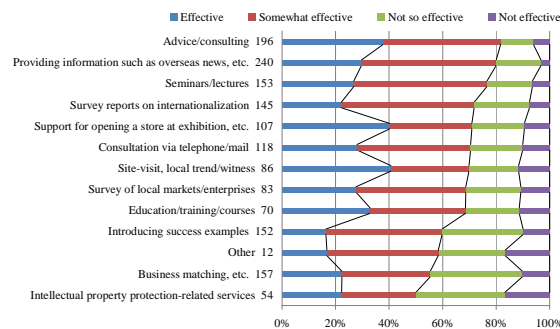
Source: Survey on SME Overseas Business Activities (FY2010) (Organization for Small & Medium Enterprises and Regional Innovation, JAPAN).

Figure 3-1-1-14  
Supporting institutions used most



Source: Survey on SME Overseas Business Activities (FY2010) (Organization for Small & Medium Enterprises and Regional Innovation, JAPAN).

Figure 3-1-1-15  
Effects of support by JETRO



Source: Survey on SME Overseas Business Activities (FY2010) (Organization for Small & Medium Enterprises and Regional Innovation, JAPAN).

The most effective support in JETRO's support programs was "advice/consulting" which was appreciated by 81.7% of SMEs combined by "effective" (37.8%) and "somewhat effective" (43.9%). The next higher percentage of the effective support was "providing information such as overseas news, etc." which was answered from 80.0% of SMEs combined by "effective" (29.6%) and "somewhat effective" (50.4%). Thus, efforts made by supporting institutions centering on JETRO could have helped promote SMEs' overseas business activities. In a bid to further activate SMEs' overseas business activities, a policy for further strengthening support for human resources development and provision of information and consulting could be taken (Figure 3-1-1-15).

### (C) Spread of countries/regions with overseas subsidiaries

Third, in terms of the number of overseas subsidiaries by country/region, that of both manufacturers and non-manufacturers account for around 60% of the total in China, North America, and Europe. China's share increased from 28.6% to 36.6% for manufacturers and 18.5% to 24.4% for non-manufacturers during FY2004 and FY2010, with the share of Europe and the U.S. decreased gradually (Figure 3-1-1-16).

Other Asian economies (India, Vietnam, etc.) saw significant growth with a 10.5% increase for

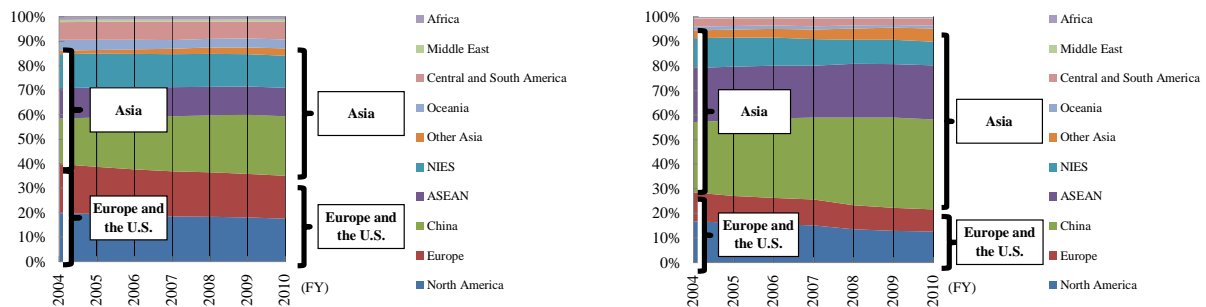
manufacturers and a 20.0% increase for non-manufacturers on an annual average basis during FY2004 and FY2010 though the percentage to the total remained low (Figures 3-1-1-17).

Non-manufacturing industry marked an increase in the number of overseas subsidiaries in all regions during FY2004 and FY2010. It follows that the base of business is spreading. The growth rates for the same period for non-manufacturers are also higher than those for manufacturers in all regions excluding Africa.

In the trend as a whole, it is found that overseas subsidiaries are shifting from advanced countries where they have developed to emerging economies.

Figure 3-1-1-16

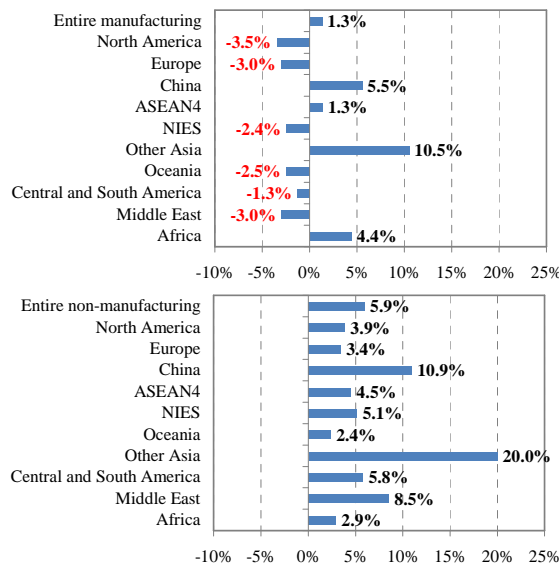
Number of overseas subsidiaries by region (left: manufacturers, right: non-manufacturers)



Source: Basic Survey of Overseas Business and Activities (Ministry of Economy, Trade and Industry).

Figure 3-1-1-17

Annual average growth rate of the number of overseas subsidiaries by country/region (FY2004 to FY2010) (above: manufacturers, below: non-manufacturers)

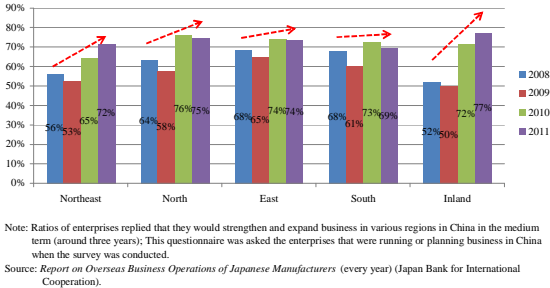


Source: Basic Survey of Overseas Business and Activities (Ministry of Economy, Trade and Industry).

As a result of the above, it seems that overseas subsidiaries are concentrated in China, but they are

developing in the broad area within China. According to the survey<sup>11</sup> conducted by the Japan Bank for International Cooperation, FY2008 survey shows that the high percentage of enterprises that replied they would strengthen and expand business in the regions of China in the medium term (around three years), with emphasis on coastal areas, namely Northeast China with 56%, North China with 64%, East China with 68%, South China with 68%, and the inland region with 52%, while in the FY2011 survey, respondents placed more emphasis on coastal areas than the FY2008 survey, namely Northeast China with 72%, North China with 75%, East China with 74%, South China with 69%, and the inland region with 77% but the percentage of enterprises that replied they would strengthen and expand the business in the inland region is highest among all regions. It follows that business development in China is beginning to spread regionally (Figure 3-1-1-18).

Figure 3-1-1-18  
Business strengthening areas in China



**(D) Spread of overseas subsidiaries’ functions**

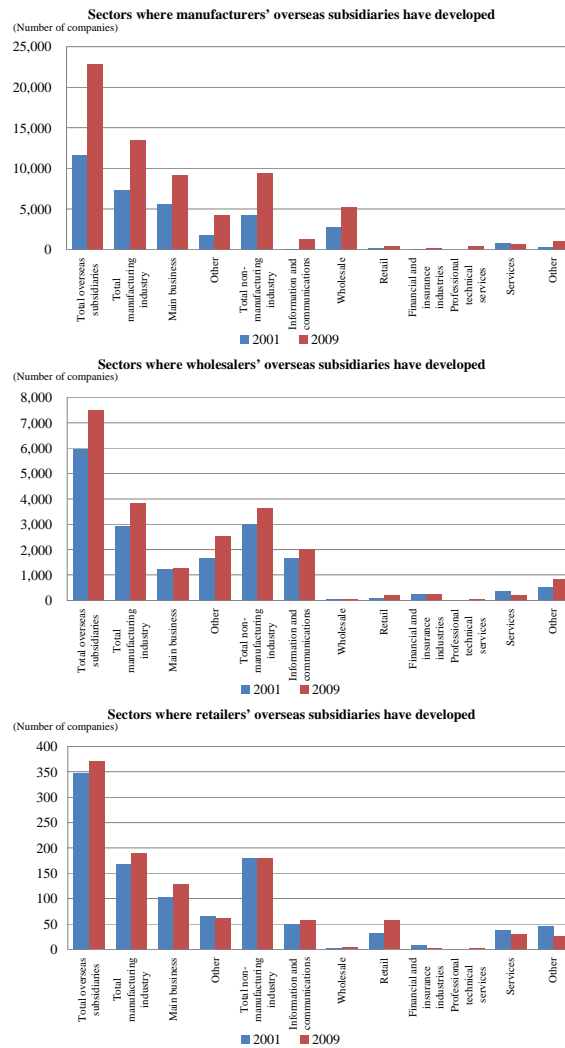
Finally, we will confirm the current situation of the spread of overseas subsidiaries’ functions. In the manufacturing sector, subsidiaries that assume functions of not only a manufacturing division but also a non-manufacturing division, such as wholesales, services, etc., are on the increase. As stated earlier, the focus in the purpose of outward foreign direct investments is shifted from a cost reduction to the capture of local markets. Thus, it is considered that sales related functions have been strengthening even among manufacturers (Figure 3-1-1-19).

In addition, the diversification of forms of entering the manufacturing sector is observed such as moves that even wholesalers and retailers are increasing their manufacturing subsidiaries.

11 Report on Overseas Business Operations of Japanese Manufacturers (every year) (Japan Bank for International Cooperation)

Figure 3-1-1-19

Composition of industries for overseas subsidiaries/affiliates



Note: A subsidiary/affiliate refers to the company with the ratio of voting rights of 20% or more held.  
Source: *Basic Survey of Overseas Business and Activities* (Ministry of Economy, Trade and Industry).

As stated above, we discussed the current situation of Japanese enterprises' overseas activities from the viewpoint of the spread of business base. Envisioned typical overseas business activities of Japanese enterprises could be that large-scale manufacturing enterprises develop supply chains primarily in East Asia and sell products in large markets centering on Europe and the U.S. markets. Such overseas business activities still remaining important were also referred to in Chapter 2. Japanese enterprises' overseas business activities are spreading more to industry sectors such as the non-manufacturing industry, etc. that have been referred to as "domestic demand-led industry," including mid-sized enterprises and SEMs, and also growing geographically and functionally. In other words, the option of developing overseas business is becoming not only for a handful of enterprises but for "everyone."

### (3) Development of overseas business activities ---- Increasing external M&As and future challenges ----

Next, we will examine the expansion of the external M&A (mergers & acquisitions) as a means of overseas business development. On a numerical basis, external M&As<sup>12</sup> by Japanese enterprises in 2011 was the largest level at 457 in and after 1996 and on a value basis, the third largest amount of about 6.3 trillion yen (Figure 3-1-1-20). The factors behind this were the two consecutive years of increase in acquisitions<sup>13</sup> and capital participations<sup>14</sup> (Figure 3-1-1-21). In particular, by type of the external M&A, acquisitions in 2011 topped 200 for the first time with 213 M&As (year-on-year increase of 37%), the largest since 1996. The background of this increase in acquisitions could be Japanese enterprises' money to spare, needs for speedy business development, lingering appreciation of the yen, and other factors.

Figure 3-1-1-20

Number of Japan's external M&As and amount

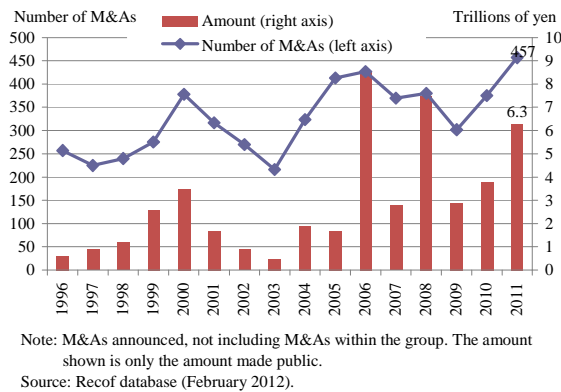
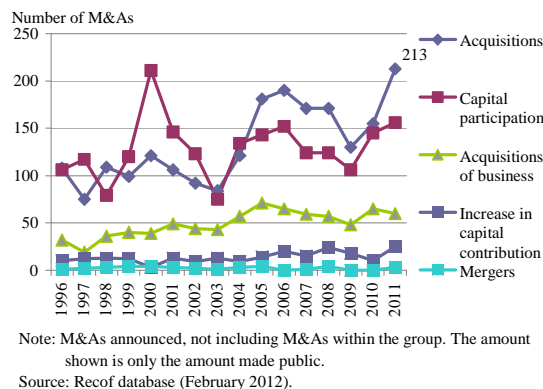


Figure 3-1-1-21

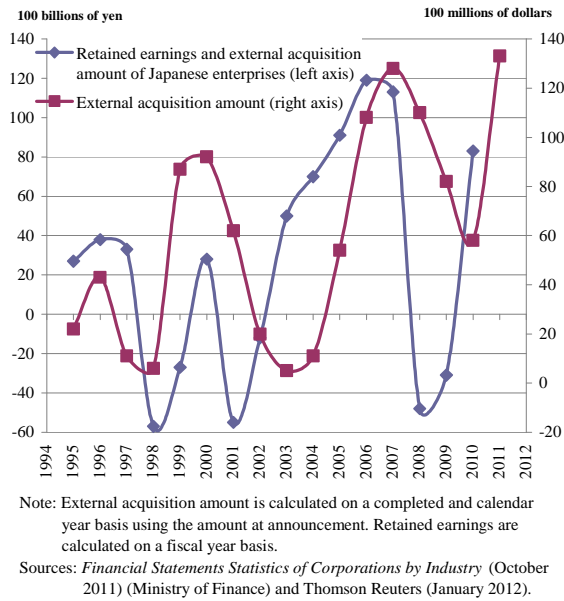
Number of Japan's external M&As by type



- 12 The external M&A in this paragraph refers to cases where, in a foreign country, an enterprise undertakes takeovers, capital participation, acquisitions of business, increase in capital contribution, and mergers, and is comparable with the a “green field” type direct investment as a type of external direct investment.
- 13 The acquisition here refers to an acquisition of more than 50% shares.
- 14 The capital participation here refers to an initial acquisition of 50% or fewer shares.

For retained earnings and external acquisitions of Japanese enterprises, changes of retained earnings are about one to two years ahead of the amount of external acquisitions. This could be resulted from aggressive external acquisitions in 2011 backed by abundant financial resources of Japanese enterprises (Figure 3-1-1-22).

Figure 3-1-1-22  
Retained earnings and external acquisition amount of Japanese enterprises



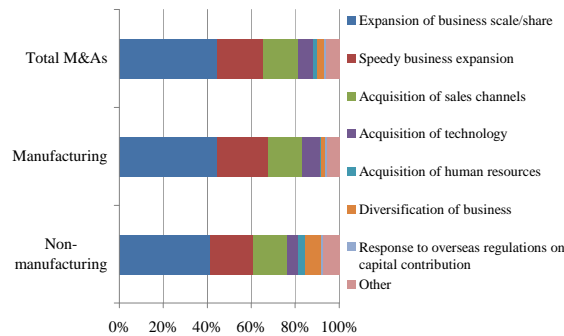
As for major purposes of Japanese enterprises’ external M&As<sup>15</sup>, many Japanese enterprises pursue “speedy business expansion” and “acquisition of sales channels” following “expansion of business scale/share.” This may involve a high possibility that Japanese enterprises intended to, through an external acquisition, become a parent company of foreign enterprises that had established sales channels in overseas markets, thereby securing markets as soon as possible (Figure 3-1-1-23, Table 3-1-1-24). In addition, other purposes include “acquisition of technology,” “acquisition of human resources,” “diversification of business”, etc. Particularly in the non-manufacturing sector, the percentage of non-manufacturers that chose “acquisition of human resources” and “diversification of business” is higher than that of manufacturers.

15 Replies of Japanese enterprises to “major purposes of external M&A” contained in the *Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises* (2012) (Mitsubishi UFJ Research and Consulting)



Figure 3-1-1-23

Major purposes of external M&As



Source: *Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises* (2012) (Mitsubishi UFJ Research and Consulting).

Particularly in 2011, Japanese enterprises may be more likely to have been active in external acquisitions in an effort to develop overseas business out of fears caused by the earthquake and the higher yen coupled with the need of risk diversification.

Next, looking at the number of Japanese enterprises' external acquisitions by region, the number in 2011 increased in the regions other than Middle East and Africa and particularly grew in Asia and Oceania (Figure 3-1-1-25). Acquisitions that increased in Asia and Oceania in 2007 as well were led by those undertaken in Indonesia, China, etc. but in 2011 acquisitions centered on Australia, India, etc. Specifically, in Australia, acquisitions were undertaken in a wide range of areas, such as those of energy and forestry related enterprises by trading companies, those of banks and investment companies by financial institutions, those of system related enterprises by communications service companies, and those of pharmaceutical and packing related companies by medical equipment manufacturers. Furthermore, in India, acquisitions, whereby entries were achieved in first growing automobile related markets, including automotive parts, refining, and painting related markets, stood out. In addition, marine related and distribution related enterprises acquired transport related enterprises.

Table 3-1-1-24

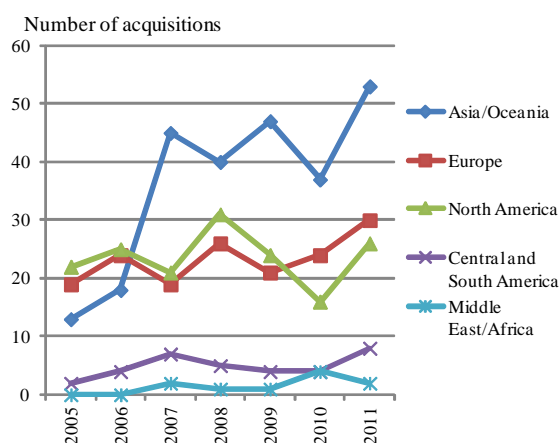
Example of external M&As

Industry	Purposes of external M&As	Example of external M&A
Food	Expansion of business scale/share, acquisition of sales channels	Company A intended to be a leading company in the area of food and health, and set a target of an increase in the ratio of overseas sales and profit in the long-term management goals. In line with the target, the company has been acquiring enterprises successively in Australia since 2007.
Drugs and Medicines	Acquisition of sales channels, speedy business expansion	With the aim of acquiring speedy sales channels, company B acquired company O that holds more than 10 plants worldwide and networks (permit and license procedure systems related to sale of drugs and sales channels) with hospitals/doctors in emerging economies.
Game-related services	Expansion of business scale/share, acquisition of sales channels, acquisition of technology	For the purpose of capturing nearly 100 million users, and games, company C acquired company P that develops platform business in Europe the U.S., and China.
Electrical machinery manufacturing	Speedy business expansion	Company D has been undertaking acquisitions but recently there are many positive views on overseas business development within the company. In particular in case a speedy response is required, the company begins to undertake M&As depending on shopping lists.
Automobile-related manufacturing	Diversification of business	Company E whose main business was to manufacture automobile-related equipment promotes M&As as a means of pushing diversification of business in the relevant fields, including medical fields, and chemical-related areas, for example by acquiring a European medical-related equipment manufacturer.

Source: Hearings with enterprises (2011).

Figure 3-1-1-25

Number of external acquisitions by Japanese enterprises by region

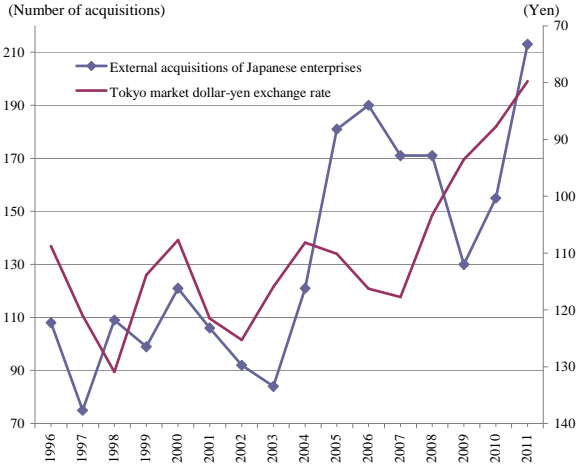


Note: Completed basis.  
Source: Thomson Reuters (January 2012).

Furthermore, a higher yen trend has taken hold in recent years and particularly 2011 was a year of a historical higher yen. Because of this, M&As attracted attention to take advantage of the higher yen.

Plotting dollar-yen rates and the number of external acquisitions for a long term often shows a certain linkage (Figure 3-1-1-26). On the other hand, a certain period of time could be required before the actual implementation of M&As considering the level and fluctuation of exchange rates (Figure 2-4-3-4). Because of this, regarding the increase of external acquisitions in 2011, the appreciation of the yen seen in 2011 and the prolonged higher yen trend in and after 2008 may have also pushed external acquisitions of Japanese enterprises.

Figure 3-1-1-26  
 Number of external acquisitions by Japanese enterprises and exchange rate

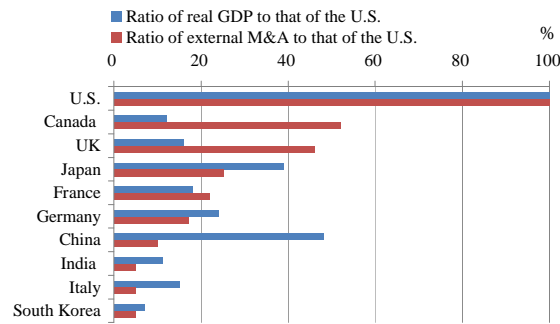


Note: The number of acquisitions does not include those announced and M&As within the group.  
 The exchange rate refers to a Tokyo market dollar-yen spot rate (as of 17:00/monthly average).  
 Source: Recof database (February 2012) and BOJ database (April 2012).

In addition, external M&As could experience a stable increase but involve many future challenges. First, when comparing the real GDP of major countries and the number of external M&As, Japan's real GDP accounts for about 40% of that of the U.S. but the number of M&As remains at around one-fourth of the U.S. (Figure 3-1-1-27). External M&As are carried out actively in Canada, the UK, and France compared with their real GDP scales. In contrast, it is found that the number of Japan's external M&As is small, relative to the scale of its real GDP. Therefore Japanese enterprises may lag behind among major advanced countries in terms of a speedy overseas business development and the securing of markets/human resources, as well as the realignment of industries and structural changes.

Figure 3-1-1-27

Ratio of real GDP and the number of external M&As of major countries in 2011 to those of the U.S.

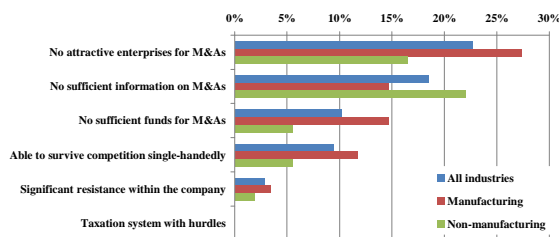


Notes: M&A and external M&A are calculated by the number of completed basis. Hong Kong is not included in China.  
Source: WEO database (April 2012) (IMF) and Thomson Reuters (March 2012).

Looking at reasons for Japanese enterprises' reluctance to external M&As, the survey<sup>16</sup> conducted this February shows that “no attractive enterprises for M&As” took the top spot and “no sufficient information on M&As” came next as the reasons that they do not undertake external M&As (Figure 3-1-1-28). In this survey, nearly 70% of enterprises replied “securing of information on markets and enterprises” as an item required to promote external M&As in the future. Thus, external M&A-conscious information provision on overseas markets and enterprises may be raised as policy issue (Figure 3-1-1-29). Also, as an item required to promote external M&As, many respondents replied “securing of expert human resources.” For example, it may become important to use human resources with extensive experience in external M&As, such as retired corporate workers, etc.

Figure 3-1-1-28

Reasons that no external M&As are undertaken

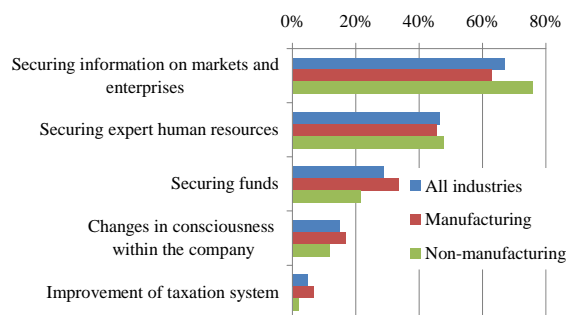


Note: In addition to the reasons in the figure, “other” reasons account for one-third of the total and are not shown in the figure.  
Source: Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises (2012) (Mitsubishi UFJ Research and Consulting).

16 Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises (2012) (Mitsubishi UFJ Research and Consulting)

Figure 3-1-1-29

Items necessary to promote external M&As



Source: *Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises* (2012) (Mitsubishi UFJ Research and Consulting).

Thus, external M&As are considered as attractive means for Japanese enterprises to facilitate the securing of markets and human resources while regarded as a difficult way due to their insufficient information and inexperience. For effective use of external M&As in overseas business development, it may be of importance to overcome challenges of the securing of information, the development of human resources, etc. through trial and error of enterprises and policy assistance.

**2. Current situation of so-called “hollowing out” and assessment**

From here, we will analyze fast growing hollowing-out of domestic industries reflecting the historical yen’s appreciation and uneasiness over the electricity supply caused by the earthquake. First, we will see a decrease in production, investments and jobs as a factor of hollowing-out, and analyze trends in domestic manufacturers and overseas operating enterprises.

To understand problems Japan faces in more details, we will make international comparison of Germany, South Korea, and the U.S., Germany and South Korea show a relatively high percentage of manufacturing workers among advanced countries and are strong in manufacturing even now. The U.S. has changed its industrial structure ahead of other advanced countries and the percentage of manufacturing is low. Through the comparison with these countries, we will clarify the current situation of concerns over the hollowing-out of Japanese enterprises and future challenges involved.

**(1) Current situation of Japan and assessment**

In this Chapter, we will, as the definition of the hollowing-out, use “refers to a situation where production, investments, employment, etc. in Japan decrease due to an increase in overseas direct investments” contained in the White Paper of 1986, and overview whether domestic investments, etc. have decreased following an increase in outward foreign direct investments while comparing the current situation of domestic investments, domestic employment, domestic production, etc. in Japan with those of Germany, South Korea and the U.S..

**(A) Overseas local production ratio**

Overseas production ratios are on a rising trend and concerns over a rapid rise in the ratios have

been growing reflecting the sharp yen's appreciation in 2011. According to the Cabinet Office's *Questionnaires on Corporate Behavior*, Japanese manufacturers' overseas production ratios are rising and marked an increase rate of 18.4% in 2011, the highest on record. Comparison with the ratios for the current fiscal year forecast five years ago indicates that overseas production is proceeding almost at a rate higher than the forecast (Figure 3-1-2-1).

Overseas production ratios are found to be prone to rise particularly during the appreciation of the yen but on the other hand, overseas production ratios also tend to be raised for the purpose of tapping into local markets. Thus, it should be noted that, for recent years, the movement of overseas production ratios is significantly affected by trends, etc. in overseas markets mainly in emerging economies among others.

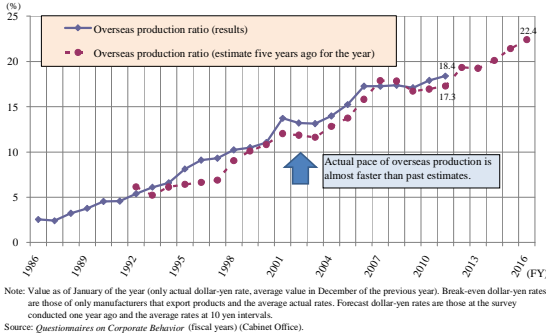
**(B) Current situation of domestic investments, employment, and production in Japan**

**(a) Domestic and external investments**

First, we will compare country-by-country trends in domestic and external investments to examine whether domestic investments have decreased along with the expansion of outward foreign direct investments<sup>17</sup>.

Looking at the relation between domestic investments and outward foreign direct investments in Japan, domestic investments amounted to 140 to 150 trillion yen in the early 1990s while the current amount fell to less than 100 trillion yen. In contrast, outward foreign direct investments stood at 1 to 4 trillion yen during the mid-1990s and 2005 but turned upward and expanded to slightly below 10 trillion yen in 2011 after a temporary drop following the failure of Lehman Brothers. It follows that domestic investments have stalling while overseas investments have been on the rise (Figure 3-1-2-2).

Figure 3-1-2-1  
Results and forecast of overseas local production ratio of Japanese manufacturers



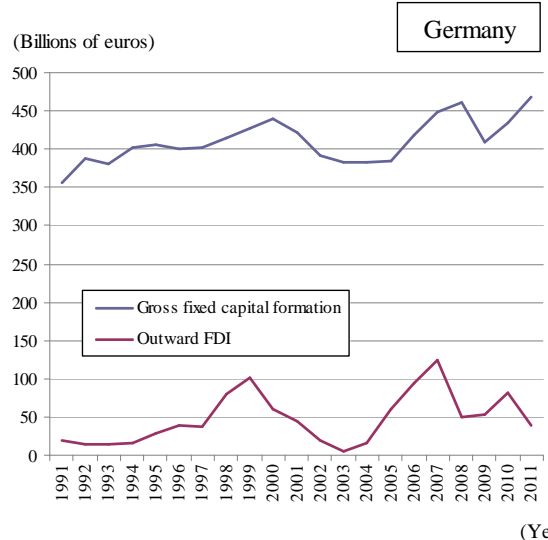
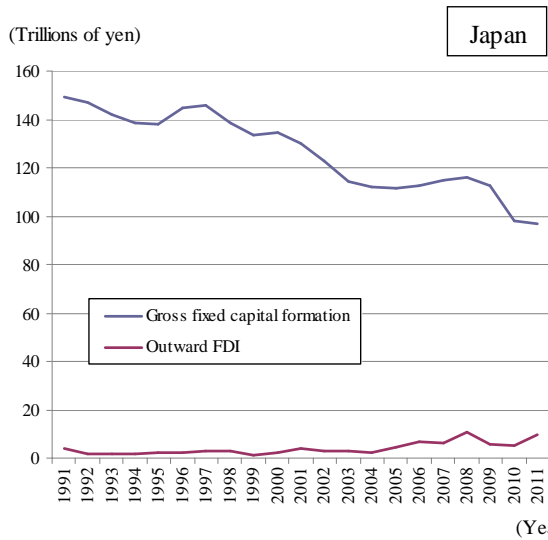
When overlapping the trend of Japanese manufacturers' domestic investments and overseas capital spending and nominal GDP of emerging economies, advanced countries and Japan, domestic capital investments were increasing at a pace close to the movement of the GDP of emerging economies. On the other hand, domestic investments were far exceeding Japan's GDP until 2007 but thereafter

17 Note that nominal value is used here and no real value after the adjustment of price increase rate is used.

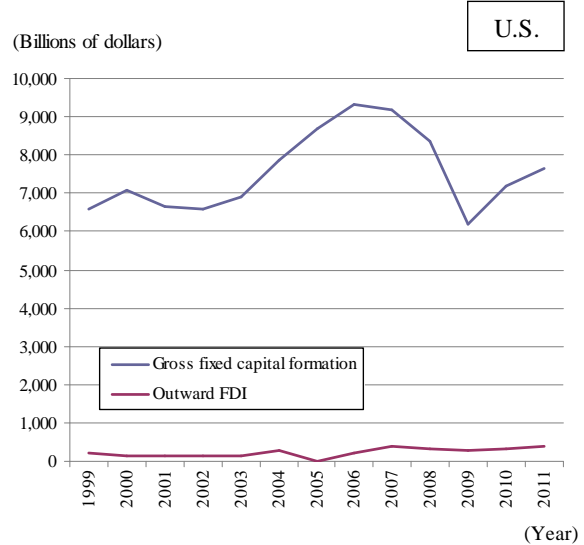
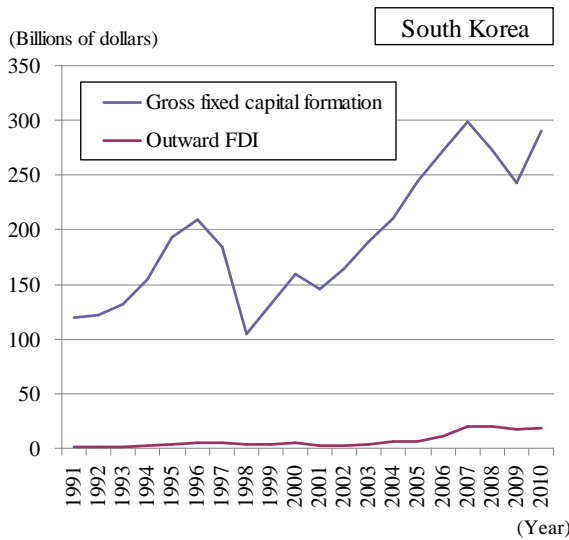
decreased and delayed in recovery recently as well (Figure 3-1-2-3).

Figure 3-1-2-2

Domestic investments and outward foreign direct investments



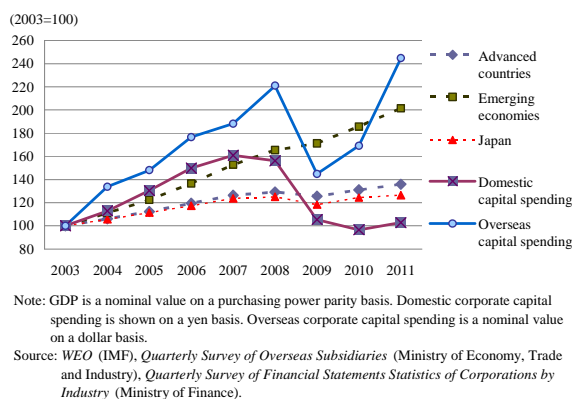
Source: (Left) *Balance of Payments Statistics* (Bank of Japan/Ministry of Finance), *National Accounts of Japan* (Cabinet Office).  
(Right) CEIC database, *Balance of Payments* (IMF).



Source: (Left) CEIC database (Bank of Korea), *Balance of Payments* (IME).  
(Right) CEIC database (U.S. Department of Commerce), *Balance of Payments* (IMF).

Figure 3-1-2-3

Domestic and external capital spending of Japanese manufacturers, and GDP



Meanwhile, Germany faced a period of sluggish domestic investments in the early 1990s and early 2000s but since 2005 both domestic investments and external investments are increasing, excluding a certain period after the failure of Lehman Brothers (Figure 3-1-2-2).

South Korea experienced a period of a sharp decline in domestic investments when the Asian currency crisis occurred in 1998 but after that both domestic investments and external investments are growing. Among others, outward foreign direct investments are soaring in recent years (Figure 3-1-2-2).

The U.S. saw a significant fall in domestic investments in 2009 due to the impact of the global economic crisis, but looking at the trend since the end of the 1990s, both domestic investments and external investments show an increasing trend (Figure 3-1-2-2).

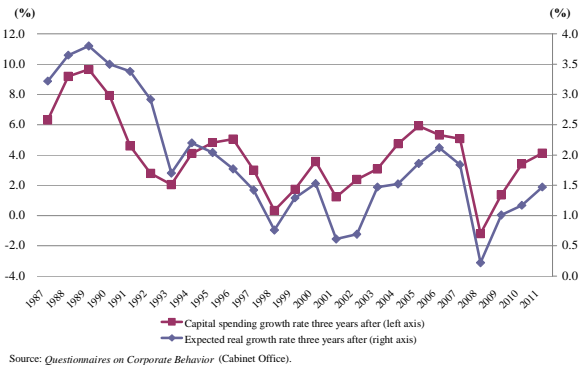
Thus, in Germany, etc., both domestic investments and external direct investments are increasing. Therefore there is not always a trade-off relation between both investments. In Japan as well, it must be possible to expand both investments.

As discussed above, it follows that major countries show an increase trend in both outward foreign direct investments and domestic investments but in Japan alone, outward foreign direct investments increased while domestic investments decreased. The decline in domestic investments is caused by the growing outward foreign direct investments. Namely, as to whether a hollowing-out has occurred, domestic investments are also affected by expected growth rates and the trend of domestic production/exports, etc. The Cabinet Office's *Questionnaires on Corporate Behavior* (2012) makes clear that the growth rate of capital spending after three years is linked to the forecast value of the real economic growth rate after three years to a certain degree (Figure 3-1-2-4). Therefore, a link of "an increase in outward foreign direct investments leads to sluggish domestic investments" is not adopted immediately. (Further, if outward foreign direct investments entail an export inducement effect, domestic investments could also be increased). Rather the questionnaires indicate that the expansion of both domestic and external investments is possible.



Figure 3-1-2-4

Relation between capital spending growth rate and real economic growth rate in the next three years forecast by Japanese enterprises



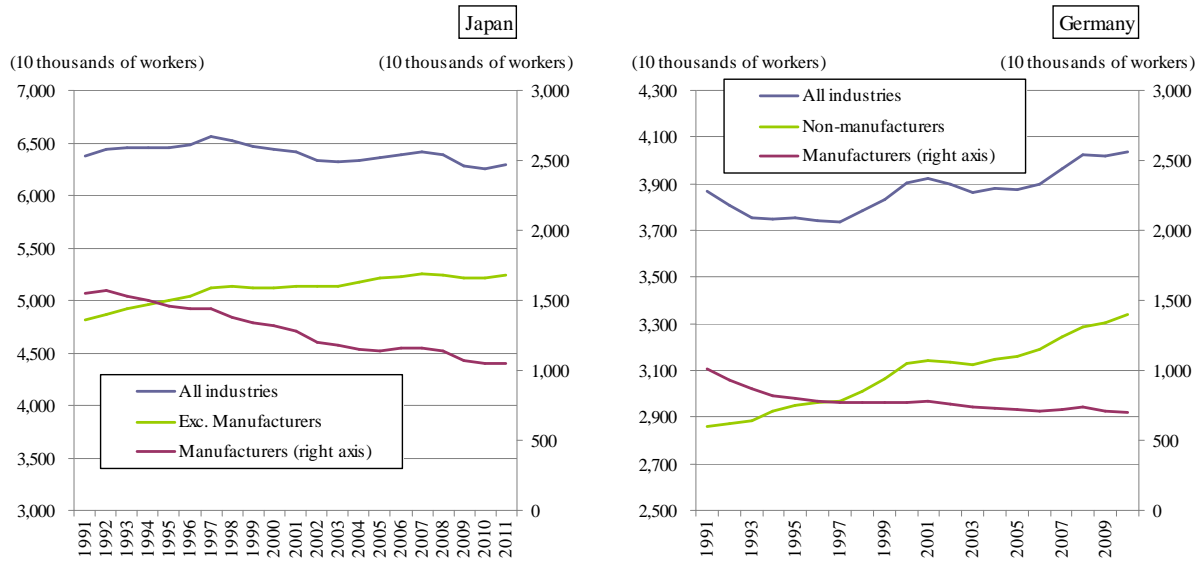
**(b) Number of domestic workers**

Then, we will compare trends in the number of domestic workers by country to examine whether the number of domestic workers has decreased along with the expansion of outward foreign direct investments.

To begin with, we look at the number of workers in Japan. The number of manufacturing workers was on a declining trend excluding the period of increase during 2005 to 2007 and in particular in 2009, saw a marked decline due to the failure of Lehman Brothers. In contrast, the number of non-manufacturing workers is increasing but now the increase has not made up for the decreased number of manufacturing workers, resulting in the number of workers decreasing in all industries (Figure 3-1-2-5). Further, the number of workers was on a downward trend until 2012 in part due to the earthquake, etc. (but increasing somewhat since 2012 partly due to reconstruction demand, etc.).

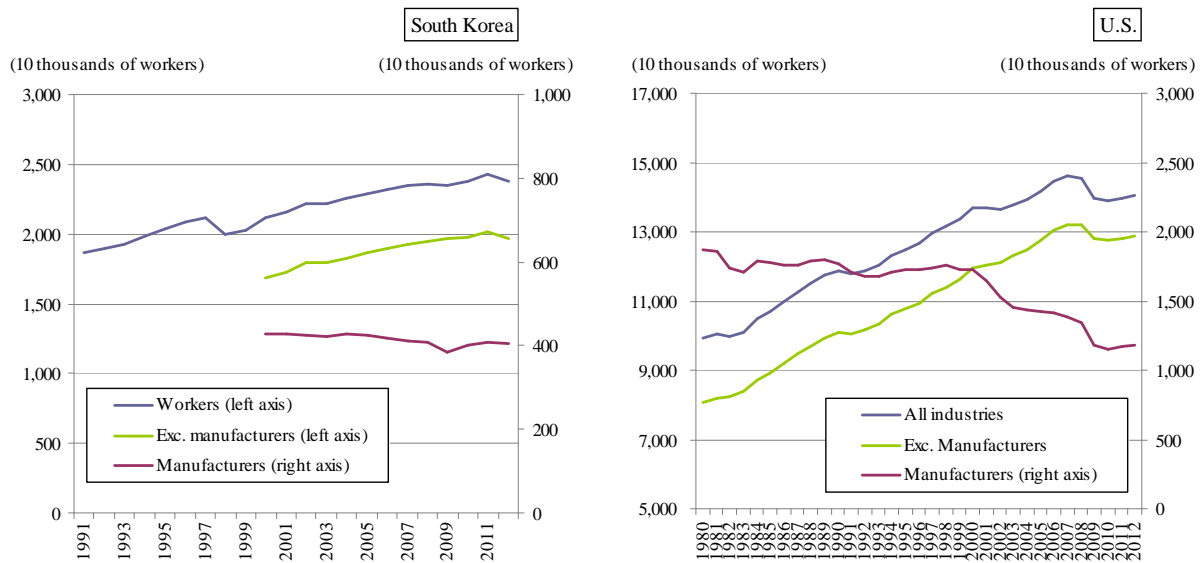
In Germany, manufacturing workers are decreasing but non-manufacturing workers are increasing, resulting in an increase of workers in all industries (Figure 3-1-2-5). In South Korea as with Germany, the number of workers is continuing an upward trend in all industries as decreased manufacturing workers are made up for by those in non-manufacturing sector (but decreasing since 2012) (Figure 3-1-2-5). In the U.S. as well, the number of manufacturing workers has been on an underlying downward trend but workers in all industries are increasing as a decreased number of manufacturing workers are covered by increased number of non-manufacturing workers (but the number decreased when Lehman Brothers failed, and now remains at the same level) (Figure 3-1-2-5).

Figure 3-1-2-5  
Number of workers by industry



Note: Data is discontinuous around 2002 due to the revision of the Japan Standard Industry Classification. The 2011 data of Japan is subject to complementary estimates regarding the results for Iwate, Miyagi and Fukushima prefectures and based on the estimates, calculated as reference value.

Source: *Labor Force Survey* (Ministry of Internal Affairs and Communications).



Source: CEIC database.

Thus, in Japan, the decreased number of manufacturing workers has not been made up for by an increase in non-manufacturing workers and the number of workers is decreasing as a whole. This trend may be one of the phenomena that evoke “concerns over hollowing-out.”

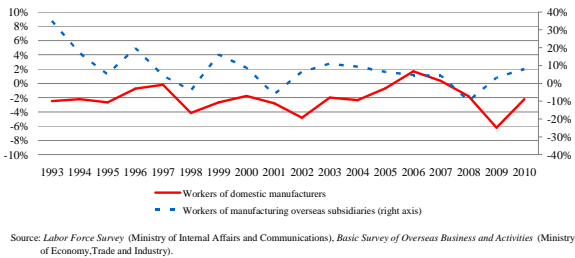
Has this decline in the number of workers that occurred in Japan resulted from increased outward foreign direct investments?

The tone of people feeling concern about the hollowing-out is that if outward foreign direct investments push overseas production, domestic employment would decline accordingly. So we will compare the growth rate (year-on-year change) of workers of manufacturing overseas subsidiaries and the growth rate (year-on-year change) of workers of domestic manufacturers. The growth rate of the

number of workers of manufacturing overseas subsidiaries tends to move almost into positive territory while the growth rate of domestic workers tends to move into negative territory. Both, however, do not always move in a trade-off relationship every year. This is because the number of domestic workers is affected not only by overseas subsidiaries but also various domestic factors (Figure 3-1-2-6).

The number of domestic workers in a country could be affected significantly by (i) change in the labor force population, (ii) change in domestic production depending on demand fluctuations at home and abroad, (iii) efforts to improve productivity, and (iv) the shift of industrial structure (here, refers to employment absorption capacity of the non-manufacturing industry such as service industry, etc. in place of the manufacturing industry). Then, we will examine respective relationships.

Figure 3-1-2-6  
 Number of domestic workers and employees of overseas subsidiaries in Japanese manufacturers



First, it is found the number of domestic workers is linked to the movement of labor force population in the long run and both are in negative territory recently (Figure 3-1-2-7). However, in the recessionary phases of 1993 to 1995, 1998 to 1999, 2001 to 2002, and 2008 to 2009, Japan faced unemployment and a gap between the number of domestic workers and labor force population (The number of domestic workers declined more).

Coupled with demand fluctuations caused by domestic cyclical economic factors in Japan, external demand also has a certain impact on domestic production and employment centering on the manufacturing industry among others (Figure 3-1-2-8).

Figure 3-1-2-7  
 Relation between the number of Japan’s domestic workers and workforce population growth rate

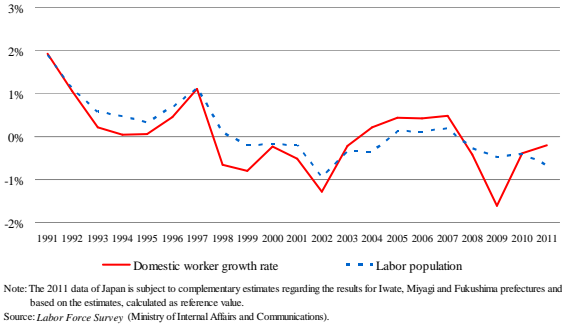


Figure 3-1-2-8

Relation between the growth rate of the number of domestic workers of Japanese manufacturers, and the growth rate of export and production output (nominal)

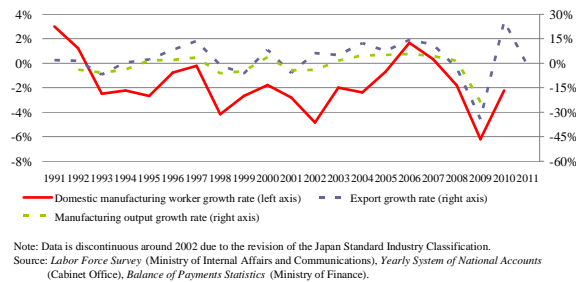
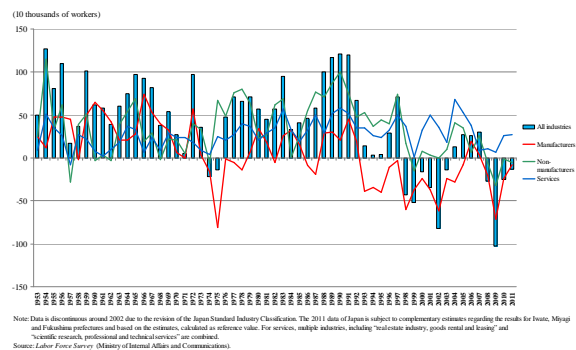


Figure 3-1-2-9 (1)

Year-on-year change of the number of domestic workers in Japan



Further, any improvement of productivity causes a decline in labor demand and a gap between domestic production and employment.

Finally, the growth of employment in the service sector has been larger than that of employment of the manufacturing sector since 1981, showing that the shift of the industrial structure in employment is progressing over the long term. It is suggested, however, that the employment absorption capacity of the service industry in recent years has weakened compared with that seen in the 1990s and 2000s (Figure 3-1-2-9 (1)). Any significant decline in future job opportunities in the manufacturing industry may lead to an increase of uncertainty over employment if the declined employment is not made up for by the increase of jobs in the service sector, etc.

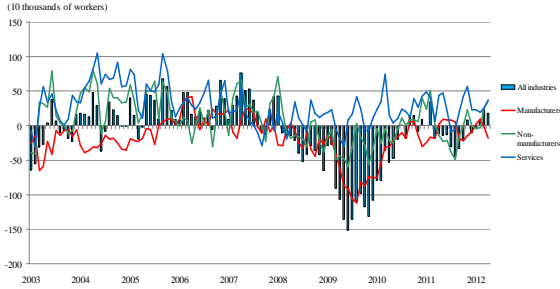
Summarizing the above, the number of domestic workers has leveled off recently, but basically it can be said that the leveling-off is significantly affected by domestic factors (labor force population, domestic production and improvement of productivity depending on fluctuations in domestic and external demand, as well as the employment absorption capacity of service industry, etc.).

The recent number of workers, however, marked the postwar largest drop in 2009 due to the failure of Lehman Brothers, and since then domestic employment has been on a declining trend reflecting the impact of the great earthquake in March 2011. Moreover, in 2012 as well the recovery of exports is delayed due to a sharp rise in the yen and fears over a slowdown in the global economy, and incentives to the recovery of employment mainly by manufacturers may be dampened (Figure 3-1-2-9 (2)). If overseas expansion of manufacturers is accelerated in the future in such a situation where there is an

uncertainty over future in Japan, domestic jobs of manufacturers will decrease further and an increase in employment in the service industry, etc. may not make up for the job decrease, leading to concerns over mounting uncertainty in employment.

Figure 3-1-2-9 (2)

Year-on-year change of the number of domestic workers in Japan in recent years



Note: Data is discontinuous around 2002 due to the revision of the Japan Standard Industry Classification. The 2011 data of Japan is subject to complementary estimates regarding the results for Iwate, Miyagi and Fukushima prefectures and based on the estimates, calculated as reference value. For services, multiple industries, including "real estate industry, goods rental and leasing" and "scientific research, professional and technical services" are combined.  
Source: Labor Force Survey (Ministry of Internal Affairs and Communications).

**(c) Domestic production**

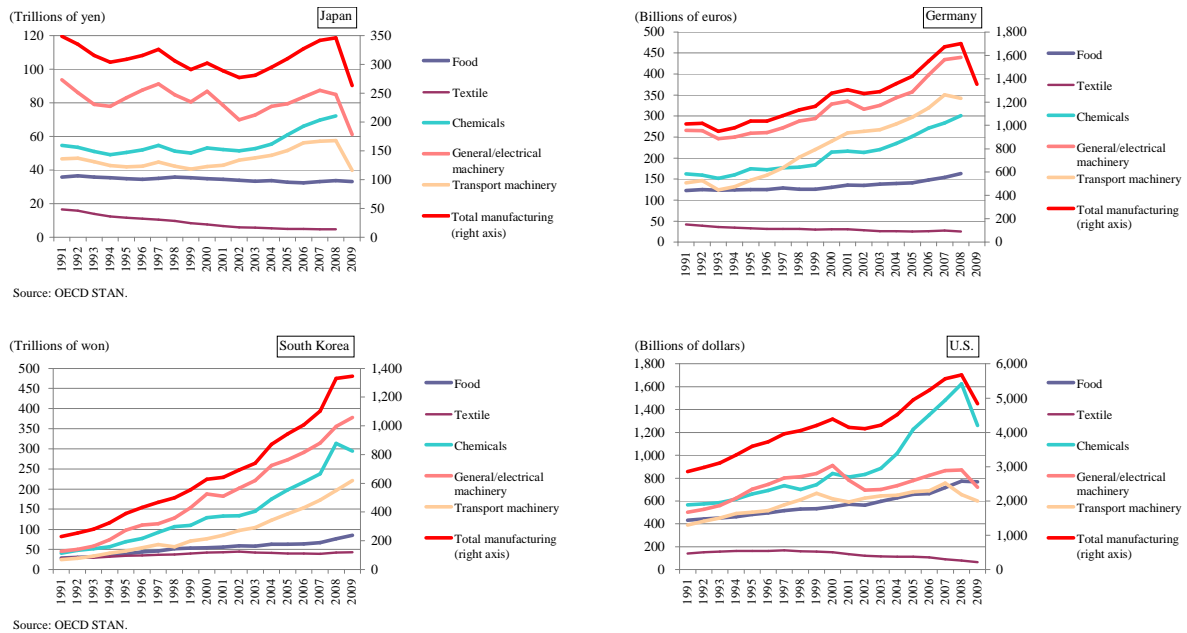
Next, we will discuss whether the domestic production of manufacturers decreases with the increase of outward foreign direct investments. To this end, we will look at the trend of domestic production volume by country.

First, Japan is characterized by a continued upward trend in production of general/electrical machinery. Transportation machinery had been expanding until 2008 but fell significantly in 2009 due to the impact of the global economic crisis. Chemical products have been performing well in recent years (Figure 3-1-2-10).

In contrast, Germany faced sluggish domestic production in the early 2000s when concerns over the hollowing-out might be spread and is characterized by, after that, basically a rising trend in production volume of general/electrical machinery, transport machinery, and chemical products (Figure 3-1-2-10). South Korea has basically been on an expansionary trend in all of the above major industries, excluding textiles (Figure 3-1-2-11). The U.S. saw a slump in the entire manufacturing sector in 2000 and 2002, but in recent years, transport machinery and general machinery have recorded flat growth, while chemicals, food, etc. have also been steady, resulting in a steady increase in the entire manufacturing industry during 2003 and 2008 (but decreased in 2009) (Figure 3-1-2-10).

Figure 3-1-2-10

Production output (nominal) of manufacturers by industry

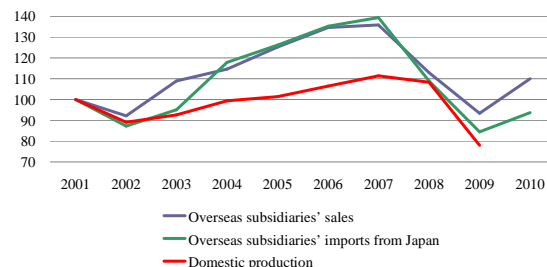


We will examine whether increased manufacturers' outward foreign direct investments caused a negative impact on their domestic production value.

Taking general/electrical machinery as an example, it seems that the domestic production value in the industry tended to be unchanged or decreased for a long term of 1991 to 2009. However, for the period from 2002 to 2007 when the sales of overseas subsidiaries of general/electrical machinery manufacturers expanded significantly, domestic production also continued to rise (Figure 3-1-2-11). It suggests that imports from Japan (exports to the country) induced by increased local sales, and other factors may have expanded domestic production (Figure 3-1-2-11).

Figure 3-1-2-11

Relation between overseas subsidiaries' sales of general/electrical machinery and the procurement amount of import from Japan and domestic production output (nominal)



Note: The above shows changes using indices with 2001 as 100.  
 Source: Basic Survey of Overseas Business and Activities (Ministry of Economy, Trade and Industry) and OECD STAN.

Generally, if domestic production has an alternative relation with overseas production, domestic production could decrease in line with the expansion of overseas production. On the other hand, there

may be domestic production like domestic production of key items that have a complementary relationship with overseas production. Because of this, domestic production does not always have a trade-off relation with overseas production.

The recent decline in domestic production in the manufacturing industry may have been caused mainly by an external shock such as the global economic crisis, the great earthquake, etc. so the decline may remain a short-term phenomenon. Even if existing industries have shrunk due to the expansion of overseas production, this may be positive for the economy as a whole if new industries expand domestically.

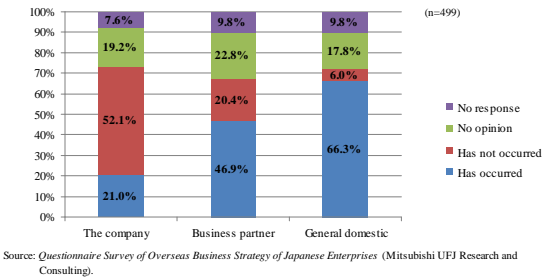
However, if the domestic business environment continues worsening for a medium and long term, it cannot be denied that the expansion of overseas production may be accelerated and domestic production likely to be decreasing, but adequate attention should be paid.

**(C) Corporate awareness and impact of overseas business development**

We will first discuss what kind of awareness of “hollowing-out” enterprises have and what kind of domestic negative impact of hollowing-out enterprise estimate. In addition, we will examine enterprises’ estimate of a domestic positive impact associated with the progress of overseas business development and also examine enterprises’ thought about domestic functions they should strengthen. Further, we will also discuss how structural changes have occurred in domestic manufacturing workers in such a situation.

First, we will examine corporate awareness of “hollowing-out.” According to the *Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises* (2012) asking (i) the company, (ii) business partner enterprises and (iii) general domestic enterprises about whether domestic hollowing-out has occurred, “just below 70% of “general domestic” enterprises and just below 50% of “business partner” enterprises replied that hollowing-out “has occurred” (Figure 3-1-2-12). In contrast, as for “the company,” the percentage of enterprises that relied hollowing-out “has not occurred” (just over 50%) were more than twice the percentage of enterprises that replied hollowing-out “has occurred” (just over 20%).

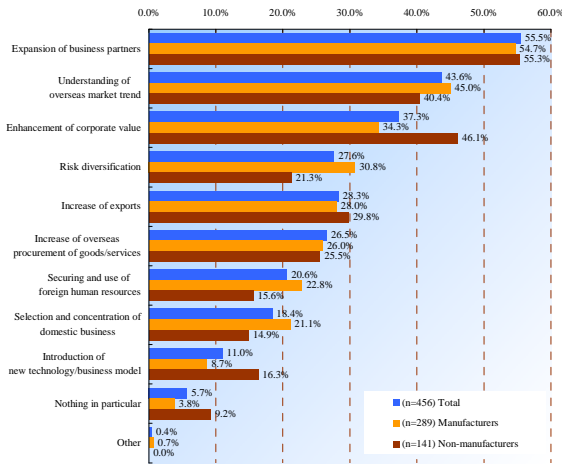
Figure 3-1-2-12  
Whether or not the hollowing-out has occurred



In response to the question about the element expected to contract in the future due to the impact of

overseas development<sup>18</sup> in connection with concerns over domestic hollowing-out, manufacturers that replied to the question with the order of higher percentage being the “number of employees (manufacturing)” (43%), “manufacturing function (general-purpose products)” (42%), “number of business partners (customers)” (27%), “number of employees (administrative)” (24%), “number of business partners (suppliers)” (23%). On the other hand, the percentage was relatively low for “research function (basic and applied),” “headquarters function” and “human resources development function,” fundamental technology.” It should be noted that “manufacturing function (mother plant)” (14%) and “development function” (5%) account for a certain percentage even though their percentages are relatively low, which may lead to a weakening of the base of domestic industries in Japan (Figure 3-1-2-13).

Figure 3-1-2-13  
Elements subject to contraction in the future by overseas expansion



Source: Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises (Mitsubishi UFI Research and Consulting).

Further, we will look at whether a hollowing-out poses a threat of outflow of technology or knowhow, etc. In response to the question about whether any technology or knowhow, etc. have been lost in Japan with the progress of overseas development, the majority of respondents replied “nothing in particular” (just over 70%), while some respondents answered “has lost some advanced technology/knowhow, etc. alone” (about 6%), “has lost considerable simple technology/knowhow, etc. alone” (about 4%), and “has lost some, including advanced technology/knowhow, etc.” (about 3%) (Figure 3-1-2-14).

In addition, in response to the question about advantages and effects excluding those for business performance/employment as a positive impact of overseas business activities on domestic economy, manufacturers replied “expansion of business partners” and “understanding of overseas market trend” (just over 50%), “enhancement of corporate value” (just over 40%), “risk diversification” (40%). In contrast, non-manufacturers answered “expansion of business partners” (just over 50%) and “understanding of overseas market trend” (40%), high percentages as with manufacturers. But

18 “Overseas development” in this questionnaire survey refers to exports, overseas direct investments, and business alliances.

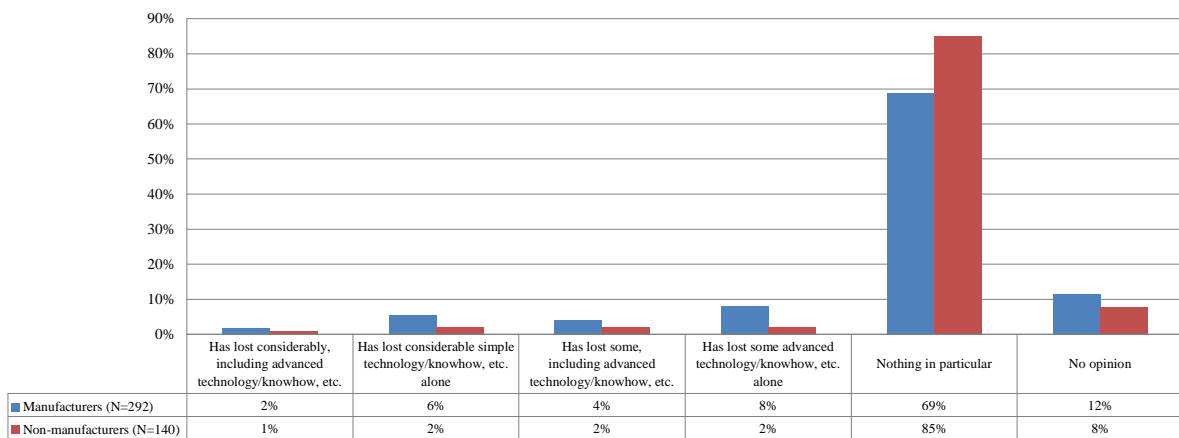


“enhancement of corporate value” (just under 50%), and “expansion of exports” (just under 30%) showed a relatively high percentage compared with manufacturers (Figure 3-1-2-15).

In addition, in response to the question about “functions to be expanded in Japan,” manufacturers answered with a particularly high percentage “development” (just under 50%), “human resources development/training of Japanese staff” (just over 40%), “research (application)” (just under 40%), “planning/marketing” (just under 40%), and “research (basic)” (just under 30%). Non-manufacturers replied with a particularly high percentage of “human resources development/training of Japanese staff” (just over 50%), “planning/marketing” (40%), and “sales” (just under 40%) (Figure 3-1-2-16).

Figure 3-1-2-14

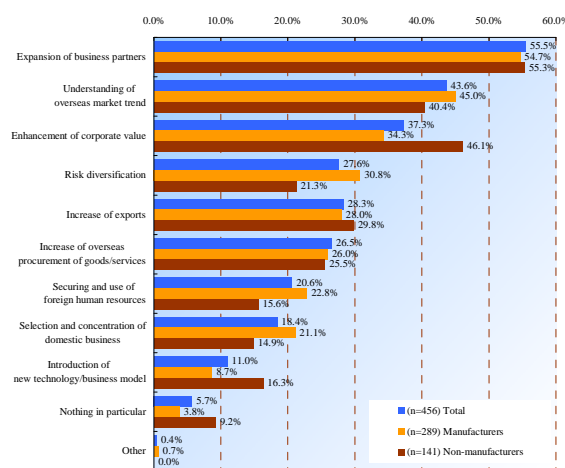
Knowhow that has been lost in Japan due to overseas expansion



Source: Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises (Mitsubishi UFJ Research and Consulting).

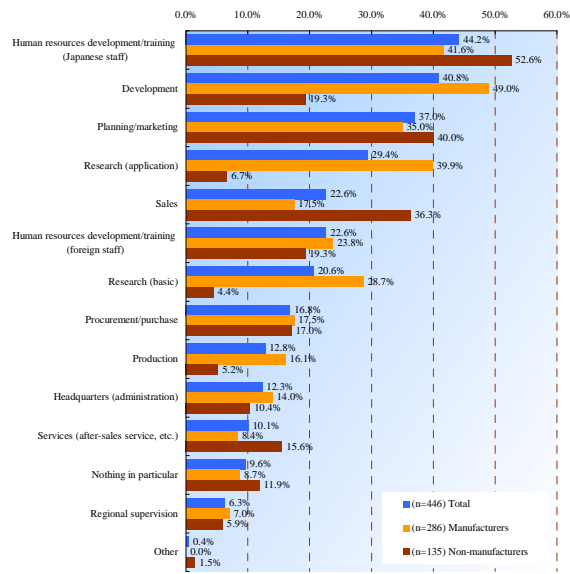
Figure 3-1-2-15

Advantages/effects, excluding those for business performance/employment, derived from the impact of overseas business activities on domestic activities (all industries)



Source: Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises (Mitsubishi UFJ Research and Consulting).

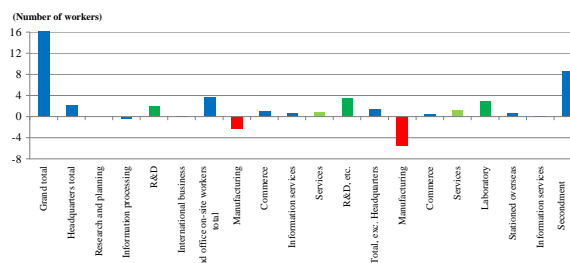
Figure 3-1-2-16  
 Functions to be expanded in Japan (all industries)



Source: Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises (Mitsubishi UFI Research and Consulting).

Finally, we will show the significant change of the structure in employment, etc. in domestic manufacturing industries over the past 10 years. In terms of the employment of manufacturers by business organization, employment in the “manufacturing” division decreased throughout 2000s while that in “R&D,” “services,” and “international business,” etc. was on an upward trend. Amid a gathering momentum of business activities overseas, it is found that, in the manufacturing industry as well, a shift of domestic employment from “manufacturing” to “R&D” and “services,” etc. is becoming important, showing that changes of domestic functions and elements with the progress of overseas development have an impact on the contents of employment (Figure 3-1-2-17).

Figure 3-1-2-17  
 Number of employees (per enterprise) by business organization in the manufacturing sector (2001 to 2009)

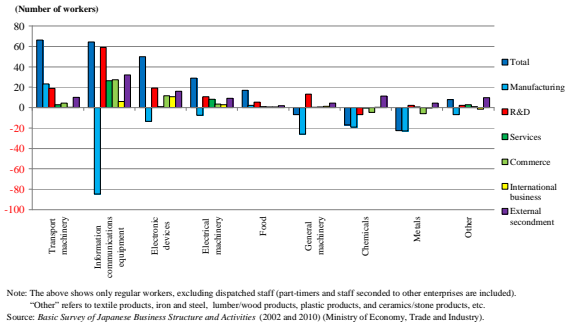


Note: The above shows only regular workers, excluding dispatched staff (part-timers and staff seconded to other enterprises are included).  
 Source: Basic Survey of Japanese Business Structure and Activities (2002 and 2010) (Ministry of Economy, Trade and Industry).

Next, looking at the details of changes by industry, “manufacturing” decreased in all industries excluding transport machinery and food. Information communications equipment, electronic devices, and electrical machinery are characterized in that an increase of the total number of employees is

achieved through the covering of a decrease of “manufacturing” by an increase of “R&D” and “services.” This suggests that, if the employees in the “manufacturing” division decrease in the future due to overseas business development, it is crucial to make changes in the employment structure of domestic manufacturing industries through the strengthening of functions of “R&A” and “services,” etc. (Figure 3-1-2-18).

Figure 3-1-2-18  
 Number of regular employees (per enterprise) by industry in the manufacturing sector (2001 to 2009)



Note: The above shows only regular workers, excluding dispatched staff (part-timers and staff seconded to other enterprises are included).  
 \*Other\* refers to textile products, iron and steel, lumber/wood products, plastic products, and ceramics/stone products, etc.  
 Source: Basic Survey of Japanese Business Structure and Activities (2002 and 2010) (Ministry of Economy, Trade and Industry).

**(2) Discussions in major countries**

The following shows the overview of the transition of discussions on the hollowing-out in Germany, South Korea and the U.S., and preceding studies on the hollowing-out by country.

**Column 10 Impact of outward foreign direct investments on domestic employment**

In the definitions referred to in this section, the “hollowing-out” is a phenomenon where domestic production/employment, etc. decrease due to the expansion of outward foreign direct investments. If this makes sense, there could be an alternative relation between outward foreign direct investments and domestic production.

However, whether such investments and production are alternative or complementary may depend on the nature of individual outward foreign direct investments. For example, if direct investments are intended to be made for the international division of production, these investments may induce exports of intermediary goods from Japan (see Chapter 2) and therefore the direct investment and domestic production may be complementary. In contrast, if the products that were produced in the country and exported are produced locally, both may turn out to be alternative. In addition, if the development of overseas new markets is intended, there is a possibility that such development has no impact on domestic employment, or the scale of domestic employment also expand through the increase of sales worldwide. Because of this, what kind of impact outward foreign direct investments will have on domestic employment is an empirical issue.

So far, some achievements of empirical analysis for Japanese manufacturers have been announced. First, Yamashita and Fukao (2010) found a relationship where a 10% increase in employment of overseas subsidiaries leads to a 0.2% increase in domestic employment on the basis of individual data from 1991 to 2002, and pointed to a possibility that policies involving excessive concerns over the hollowing-out would rather have negative impact on domestic employment. Hijen et al. (2007)

concluded using individual data from 1995 to 2002 that new outward foreign investments would cause a positive impact on domestic production and employment, and increase the effect of expanding employment year by year, reaching 6.9% in the third year. In addition, Ando and Kimura (2011), using the data from 1998 to 2006, came to the conclusion that enterprises that invested in East Asia would increase the tendency to boost employment and strengthen exports and imports, with the tendency being strengthened more in the latter half of the analysis period.

Direct investments may also have an impact on the composition of domestic employment. Obashi et al. (2010) pointed out, on the basis of individual data from 1992 to 2005, that direct investments in advanced countries would help increase the employment of a non-manufacturing division in the enterprise while having little impact on employment of the manufacturing division, and direct investments in developing economies (regarded as the labor division between manufacturing processes) would exert little impact on the volume of domestic employment but cause a shift to workers with more sophisticated techniques.

Thus, there are many empirical researches pointing out a positive effect of the impact of outward foreign direct investments on domestic employment. Notwithstanding this, in case production transfer to overseas makes rapid progress and no smooth shift to new industries, etc. are achieved, a possibility that a negative effect may be larger than a positive effect cannot be ruled out. It is considered crucial to enhance the domestic business environment and reinforce functions of labor markets so as to ensure that new growth opportunities created by overseas business development may constitute an advantage contributing to domestic economy.

#### **(A) Germany**

Discussions on Germany's locational competitive edge have become vibrant since 1990s. After the end of the Cold War in 1990, which divided Europe and Germany, the European Community was developed to the European Union in 1992, creating an opportunity for intra-European markets to become united and grow larger. These circumstances led to expectations of an increase in investments in Germany backed by the growth of trade within the European region and rather, the spread of concerns over avoidance of investments in Germany where costs are high and an increase of investments in other European countries, creating the term "Germany as a location site (Standort Deutschland)" with locational competitiveness being the subject of discussions<sup>19</sup>.

Germany was expected to grow on the back of the unification of East and West Germany and deepening European integration but actually the integration of East and West Germany was a burden on the German economy and the German economy stagnated in 1990s. Germany was ridiculed and even called "a patient in Europe."

Germany's manufacturers underwent a gradual decline in their competitiveness due to the mark's appreciation and wage rise since the end of 1970s. In 1990s, exports did not increase as expected and continued flat (Figure 3-1-2-19). The unemployment rate remained high and the rate in Germany as a whole rose to 12% in 2005. In particular, the jobless rate in former East Germany declined after the

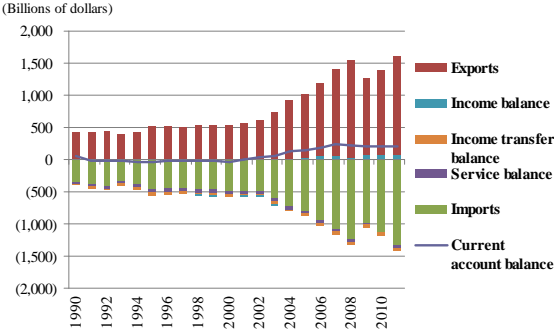
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19 *Introduction to Contemporary German Economy* p. 279 (Smyser (1992))

unification but continued rising since 1995 and hovered around 18% in 2000.

Figure 3-1-2-19

Germany’s current account balance



Source: CEIC database (Bundesbank).

Under these circumstances, the German economy suffered continued low growth after the unification due to slowing growth in exports and the Germany’s economic growth marked the lowest level among G7 nations in the 2000s. German’s real GDP growth rate in the early 2000s was average 0.6% (average during 2001 and 2005), far behind other major European nations, the UK (2.5%) and France (1.6%), and ranked the bottom among G7 nations.

Amid the continued stagnation in the German economy, the eastward expansion of the European Union was decided in December 2002. The entry in the EU of 10 Central and East European states in May 2004 caused widespread concerns over a possibility of enterprises’ outflow from Germany to Central and Eastern Europe for cheap labor and activated discussions on Germany’s locational competitiveness.

Throughout the 2000s, the German government took measures to strengthen the German locational competitive edge including measures for (1) improvement of trade environment, (2) cost reductions in domestic projects, and (3) support for creating high-added value (see Chapter 1 Section 3). Looking at the German economy by demand item, exports stood out throughout the 2000s and the German economy was revived particularly from the mid-2000s led by exports (Figure 3-1-2-20).

As a result, the nation’s economic growth rate that was the lowest in the early 2000s ranked first on the contrary among G7 countries in the late 2000s (Figure 3-1-2-21).

In the process of the economic growth achieved in the late 2000s, two problems (1) deterioration in employment environment and (2) decline in competitiveness of export industry were corrected and concerns over the hollowing-out were swept away.

Figure 3-1-2-20

Germany's real GDP growth rate (by demand item)

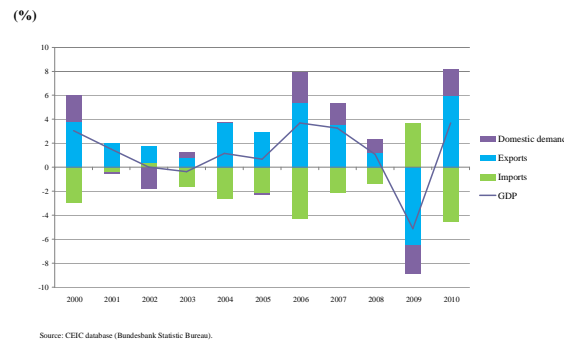
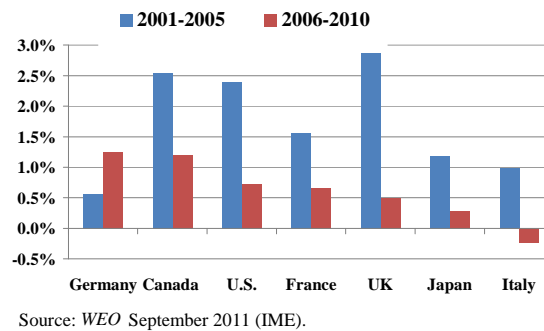


Figure 3-1-2-21

Real GDP growth rate of G7 countries (average of 2001 to 2005 and average of 2006 to 2010)



**(B) South Korea**

South Korea's potential growth rate remains high and overseas business development has proceeded in recent 10 years or so. Therefore, it seems that the hollowing-out problem has yet to come to the surface (Figure 3-1-2-22). In the past, however, against the backdrop of South Korea's domestic wage increases and the inflow of low-cost Chinese products, South Korean enterprises accelerated expansion in China, thereby exhausting regional economies. These experiences made South Korea face concerns about the outflow of enterprises to China, South Korea's neighbor. Here, we will refer to the example of South Korean textile industry that was first affected by the outflow of enterprises to China.

The South Korean textile industry was a key industry from the late 1970s to early 1980s, accounting for around 15% of total production, and also an export industry accounting for 40% of total exports (Figure 3-1-2-23). However, wages rose from the mid-1980s backed by the brisk South Korean economy and mounting labor movement. As a result, a wage gap with developing economies such as China, etc. widened<sup>20</sup>, and the textile industry that was characterized by low-wage labor faced

20 According to the analysis of Kim Jun Hyo, an expert researcher of the textile industry at the Industry Promotion Agency, average personnel costs per hour were one dollar and 77 cents in 1987, or about one-seventh of the wages of textile industry in Europe and the U.S. and about three to nine times those in developing economies such as China, but rose to three dollars and 60 cents in 1991. As a result, the

hardship. Under these circumstances, clothing, apparel companies and small and medium textile firms in South Korea made inroads into overseas markets to pursue production activities in China and Indonesia, leading to the acceleration of hollowing-out in South Korea.

Figure 3-1-2-22  
South Korea’s potential growth rate

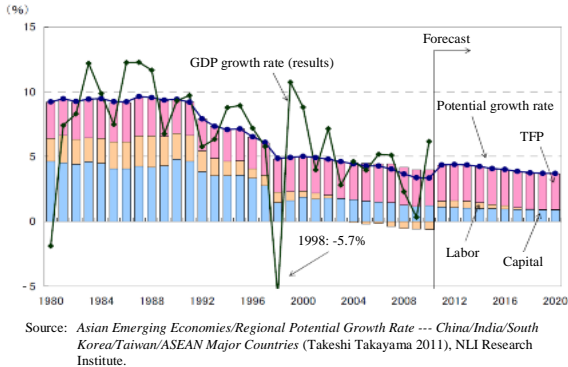


Figure 3-1-2-23  
South Korea’s textile industry in the 1980s and 1990s

	1980	1985	1990	1995	1998
<b>Production (billions of won)</b>					
Manufacturing		26,737	70,925	159,448	181,085
Textile		4,157	7,751	15,887	15,988
Ratio		15.5%	10.9%	10.0%	8.8%
<b>Employment (1,000 workers)</b>					
Manufacturing		2,438	3,020	2,952	2,698
Textile		628	605	502	413
Ratio		25.8%	20.0%	17.0%	15.3%
<b>Exports (100 millions of dollars)</b>					
Manufacturing	175	302	650	1,251	1,323
Textile	50	70	147	184	165
Ratio	28.6%	23.1%	22.6%	14.7%	12.5%

Source: Realignment of South Korean Textile Industry and Shift to Life/Fashion Industry.

In particular, it was said that, in the Daegu area that highly depends on the textile industry, corporate failures were routine and the collapse of the regional economy was seen as problematic<sup>21</sup>. As a result, the production output of the textile industry in 1998 remained at 8.8% of the total output of the textile industry and exports were 12.5% of the total, declining to half the level recorded in the 1980s. In addition, the number of workers in the textile industry that was 650,000 in 1988 decreased to 500,000 four years later in 1991. Thus, 150,000 employees corresponding to 23% left the textile industry.

Such waves of hollowing-out threaten to rush to even capital, technology-intensive industries, such as the chemical, metal/machinery industries as well as the automobile and electricity/electronic industries, from labor-intensive industries, such as the textile industry (Iwao 2010).

In addition to the outflow of enterprises to China, etc., there will be risks of a full-scale hollowing-out in South Korea, such risks as a rise of emerging economies such as China, further increase of wages, exchange rate fluctuations, etc. In response, the South Korean government is

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gap narrowed to one-fifth the average wages in Europe and the U.S. while the gap widened to 4 to 13 times those in developing economies.  
21 *Current World Textile Industry 1994* (Life Manufacturing Bureau, Ministry of International Trade and Industry)

implementing some measures through efforts to enhance environment and sophisticate industries. Specific and detailed measures are shown in Section 4.

### **(C) The U.S.**

In the U.S., the “hollowing-out” generated a lot of discussions in the mid-1980s. While imports from Asia and Mexico surged and outward foreign direct investments by U.S. enterprises grew, there were concerns about a reduction in employment opportunities caused by a shift of production base to overseas<sup>22</sup>. In the 1980s, the dollar was hovering at a high level and the U.S. manufacturing industry continued to wane also after the Plaza Accord in 1985, but while a shift to the service industry accelerated in the U.S. economy, employment was absorbed and workers in all industries increased. As a result, in the manufacturing sector, advanced technology-oriented industries, such as the aircraft and biotechnology industries, achieved growth. Because of this, concerns over hollowing-out waned.

But after then, in the service industry as well, operations of IT areas, etc. began to be outsourced to overseas countries where personnel costs were low. Outsourcing of the service industry to overseas has been a serious political agenda since it was cited in the presidential race in 2004. After the failure of Lehman Brothers in 2008, the unemployment rate rose to a historically high level and the decline in manufacturing industry is gaining attention anew as a serious political agenda. In addition, recently the cutting-edge functions of R&D divisions, etc. are facing concern over overseas outflow. In January 2012, Harvard Business School released a report “*Prosperity at Risk: Findings of Harvard Business School’s Survey on U.S. Competitiveness*,” warning against declining U.S. competitiveness. A total of 42% of graduates of the business school, who were engaged in corporate management, replied to a questionnaire that advanced functions, including R&D, might also be transferred overseas in the future. In respect of the future competitiveness of the U.S., the answer of “behind advanced countries” remained at 21%, but 66% answered “behind emerging economies.”<sup>23</sup> Factors behind these answers could be inefficient regulations in the U.S. and a rapid emergence of emerging economies.

On the other hand, discussions on the revival of the manufacturing industry have been brisk since last year. Factors behind this could be that China’s personnel costs are soaring, the U.S. has domestic markets where population will grow in the long term, which is a rare case in advanced countries, and a reduction in electricity costs is expected due to the development of shale gas. Therefore, manufacturers at home and abroad are increasing investments recently (Figure 3-1-2-24). In May 2011, the Boston Consulting Group (BCG), a U.S. consulting firm, released the report “*Made in America, Again*” forecasting a possibility of a return of manufacturers to the U.S. The analysis in the report shows that, reflecting a surge in personnel expenses in China<sup>24</sup>, seven industries, such as transport machinery and metal-processed products, will reach a turning point in 2015, where cost advantages in the production of products in China that are shipped to the U.S. are lost<sup>25</sup>. As a result,

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22 *White Paper on International Economy and Trade 2002* (Ministry of Economy, Trade and Industry (2002))

23 *Prosperity at Risk : Findings of Harvard Business School’s Survey on U.S. Competitiveness* (Michael E. Porter and Jan W. Rivkin (2012))

24 For personnel costs in China, refer to Chapter 1 Section 4 Chinese Economy.

25 *Made in America, Again* (2012), *U.S. Manufacturing Nears the Tipping Point* (Boston Consulting



the report forecasts that in those seven industries, 10 to 30% production of products for the U.S. market produced in China will return to the U.S., thereby creating 2 to 3 million jobs in the U.S. and lowering the jobless rate by 1.5 to 2.0%<sup>26</sup>.

Figure 3-1-2-24  
Examples of new plant construction in the U.S.

Enterprises	Business
Caterpillar	Transferred a part of production from Japan
Toyota Motor	Transferred production of "Corolla" from Japan
Ford Motor	Transferred a part of parts production from China and Mexico
Dow Chemical	Constructed the world-largest scale ethylene plant
Mori Seiki	Constructed a first overseas plant
General Electric	Transferred production of home appliances from China

Source: Prepared by the Ministry of Economy, Trade and Industry via various news coverage.

Amid the mounting expectations of a return to the U.S., President Obama positions support for manufacturers as a key issue to improve the employment situation. In the U.S., full-scale efforts to sweep away concerns over the hollowing-out are now under way.

**3. Overseas business activities and domestic economy**

From here, we will analyze the impact of overseas business development on the domestic economy, particularly showing the impact of overseas business activities by comparing domestic employment, domestic capital spending, domestic average wages, productivity, etc. for enterprises developed overseas and those not developed overseas. In addition, we will compile implications based on the earlier discussions and those discussions to be developed in and after the following section.

**(1) Mutual relation between domestic business and overseas business**

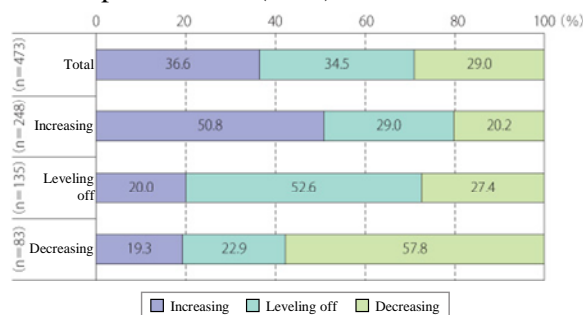
The impact caused by overseas business activities on the country varies depending on whether domestic business and overseas business are complementary or alternative and whether either propensity is strong is an empirical issue (see column 10). According to the relation between overseas and domestic business performance (sales) in response to the "Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises" (2012), nearly 50% of enterprises that increase overseas sales also increase domestic sales, and around 60% of enterprises with a decrease in overseas sales also see a decrease in domestic sales. It follows that overseas sales and domestic sale is likely to move in the same direction, rather than a trade-off relation (Figure 3-1-3-1). This is consistent with the view that the relation between domestic business and overseas business is not alternative but complementary.

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Group (2011))  
 26 According to the U.S. Department of Commerce ([http://www.bea.gov/iTable/index\\_MNC.cfm](http://www.bea.gov/iTable/index_MNC.cfm)), the percentage of U.S. enterprises developing business in China to sales continues at a low level, declining to 7% as of 2009. In contrast, sales for China remain at a high of 77%. Because of this, if there are no advantages in terms of costs for reimports to the U.S. from China, many U.S. enterprises may not always return to the U.S. and rather continue developing their business in China to sell products in China

Figure 3-1-3-1

Relation in overseas and domestic performance (sales)



Note: Left axis and left axis show “overseas sales” and “domestic sales” in coming three years, respectively.

Source: *Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises* (Mitsubishi UFJ Research and Consulting).

In addition, the Development Bank of Japan “*Survey on Planned Capital Spending for the Year*” shows that the strengthening of overseas supply capacity in the medium term will not lead to a contraction in the domestic capacity. This is consistent with the above results<sup>27</sup>.

## (2) Domestic employment after starting exports/outward foreign direct investments

The “*Basic Survey of Japanese Business Structure and Activities*”-based comparison of changes over the years for enterprises that started exports in 2001 and those that have not started exports (all industries) shows that in 2004 and 2005, the employment growth rates of enterprises that started exports were higher than those of enterprises not started exports, but in 2008 the employment by export-started enterprises declined significantly. Looking at enterprises that started outward foreign direct investments in a similar way, no marked differences are found in the trend.

The above does not necessarily mean that export-started enterprises and direct investment-started enterprises are increasing domestic employment more but not also mean that they are reducing employment. Export-started enterprises in particular may have been affected significantly by the global financial crisis around 2008. Therefore it should be noted that assessment must include the period of recovery after then<sup>28</sup> (Figure 3-1-3-2).

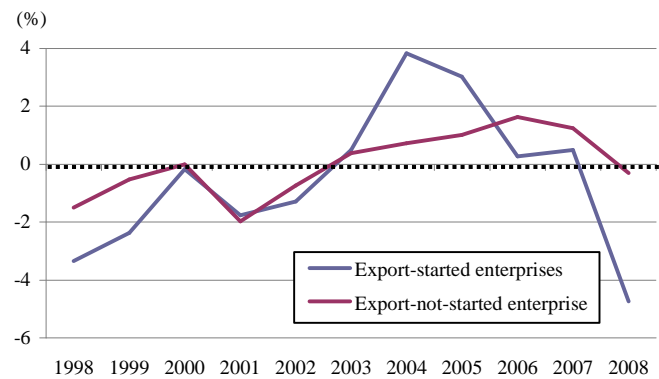
27 Summary of the findings of *Survey on Planned Capital Spending for FY2010, FY2011 and FY2012* (Jul.2011) (Development Bank of Japan)

28 For the trend by industry, see Section 3.

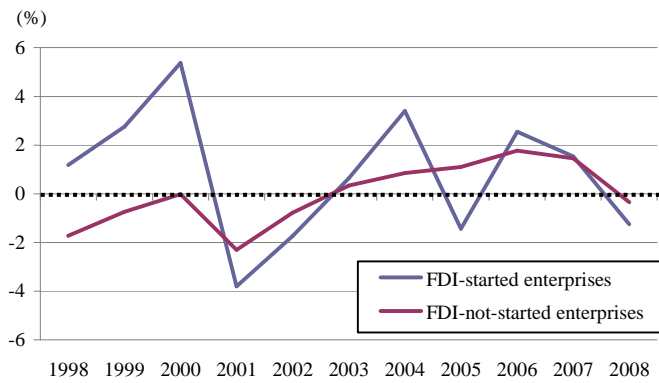
Figure 3-1-3-2

Domestic employment growth rate (year-on-year change) (all industries)

(a) Export-started enterprises and not-started enterprises



(b) Outward foreign direct investment-started enterprises and not-started enterprises

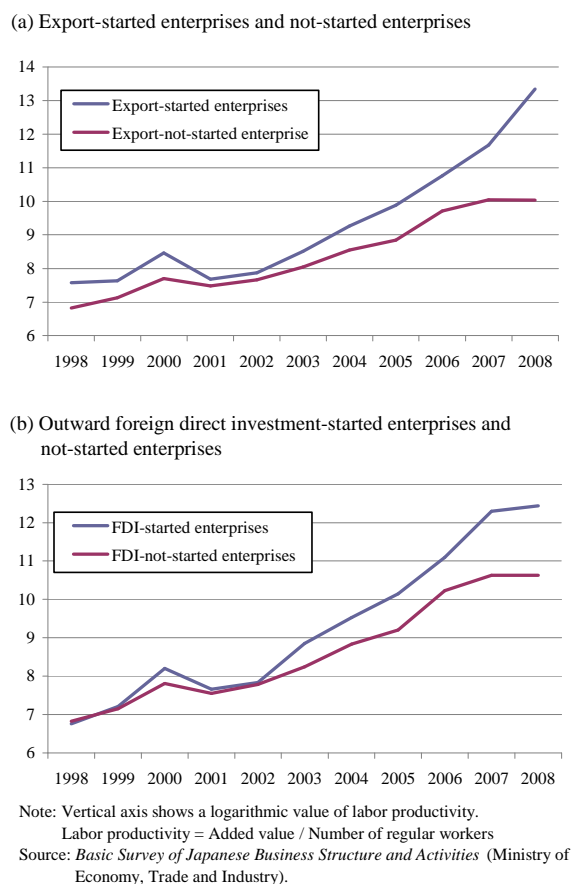


Source: *Basic Survey of Japanese Business Structure and Activities* (Ministry of Economy, Trade and Industry).

**(3) Domestic productivity after starting exports/outward foreign direct investments**

Similarly, the comparison of the productivity of enterprises that started exports in 2001 and those that did not start exports shows that the growth of the productivity of export-started enterprises was higher than that of enterprises that had not started exports, and shows the same also for direct investment-started enterprises (Figure 3-1-3-3).

Figure 3-1-3-3  
Productivity (all industries)



#### (4) Relations between overseas production ratio and domestic employment, and between domestic capital spending and domestic average salaries

Next, we will confirm on the basis of overseas production ratio whether there is a change in a forecast for a change in the number of domestic workers, domestic capital spending, and domestic average salaries three years later. According to the “*Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises*” (2012), the percentage of enterprises with overseas production that replied, the number of workers, domestic capital spending and domestic average salaries would tend to increase in the coming three years was higher than the percentage of enterprises without any overseas production. In addition, the survey also shows that while the percentage of enterprises with lower overseas production ratios was higher, the percentage of enterprises replied that those would tend to decrease in the coming years in line with an increase in overseas production would tend to be higher<sup>29</sup>. Further, when comparing the number of employees and the average salary level, the percentage of enterprises with overseas production that replied that domestic employment would increase and

29 This suggests that there is a possibility of a difference in domestic implications caused by the overseas business development between the cases where enterprises that are engaged only in domestic business start a new overseas business and the cases where enterprises that have been engaged in overseas business will further promote the business. To make clear this matter, analysis on the basis of chronological data is required.

domestic employment would decrease was higher than that of enterprises with domestic production alone while, in case of average salaries, the percentage of enterprises with overseas production that were expected to increase average salaries was far higher than the percentage of enterprises with domestic production alone, the percentage of enterprises that were expected to decrease average salaries did not change so much. Thus, these replies suggest that overseas business development may change the quality and composition of domestic employment (Figure 3-1-2-16 and Figure 3-1-2-17 referred to earlier).

Figure 3-1-3-4

Estimates of the number of domestic employees, domestic capital spending and domestic average salary by overseas production ratio (manufacturers)



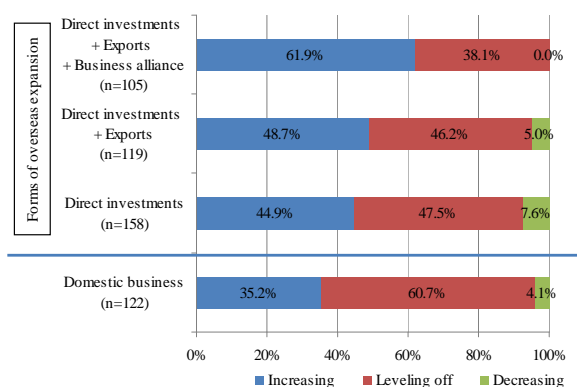
Source: Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises (Mitsubishi UFJ Research and Consulting).

### (5) Relation between the form of overseas production and productivity

Next, comparing the productivity by form of overseas expansion, the percentage of enterprises (44.9%) with “only direct investment” was higher than that of enterprises (35.2%) with “only domestic business” in respect to an increasing trend in terms of productivity. In addition, enterprises (48.7%) with “direct investments + exports” and those (61.7%) with “direct investments + exports + business alliance” showed a higher percentage of an “increasing trend” in terms of productivity. Thus this suggests that when various overseas development functions are added, productivity will become more an “increasing trend” (Figure 3-1-3-5).

Figure 3-1-3-5

Productivity by type of overseas expansion



Note: Left axis and right axis show the trend in “forms of overseas expansion” and “productivity,” in the coming three years, respectively.  
 Source: *Questionnaire Survey of Overseas Business Strategy of Japanese Enterprises* (Mitsubishi UFJ Research and Consulting).

### Column 11 Overseas business activities and innovation

Regarding the impact of overseas business activities on the inside of the country, what is important from the view point of long-term economic growth is an impact on innovation and productivity. In this regard, active empirical research on the basis of corporate data has been carried out in recent years.

First, for the impact of outward foreign direct investments on domestic productivity, the effects may vary according to types as with the case of employment. Matsuura et al. (2008) concluded that investments for the labor division between manufacturing processes in the electrical machinery manufacturing industry would improve the productivity in the intermediary goods division remaining within the country and in contrast, in case of the transfer of product activities without accompanying the labor division between manufacturing processes, such effects are not observed.

The possibility that exports may encourage a productivity improvement and innovation is intuitively affirmed easily with the acquisition of new information from overseas and the economies of scale, etc. through business expansion. It is the general consensus, however, that the productivity of exporting companies is higher than that of non-exporting companies, but a causal relationship whether productivity is improved by exports and whether enterprises with high productivity conduct exports was not clear. Recent research on the effects of the trade liberalization in Argentine and the U.S.-Canada free trade agreements revealed that exports induced innovation, leading to a productivity

improvement combined with such two factors (Bustos (2011), Lileeva and Trefler (2010)).

Not only exports and outward foreign direct investments but also imports and inward foreign direct investments may be important to enhance domestic productivity in that these trades and investments may become a channel to cause a technical spillover effect. Empirical research so far showed effects on the productivity improvement by use of imported intermediary goods and by a cut in tariff on imported intermediary goods and effects on the increase of the introduction of new products (innovation). This research also revealed, for inward foreign direct investments as well, the effects through channels that varies according to the type and positioning of inward foreign direct investments, such as productivity improvement of domestic enterprises supplying to foreign enterprises located in the country and contrarily the productivity improvement of domestic enterprises to be supplied by foreign enterprises located in the country, as well as productivity improvement and innovation stemming from a spillover of the knowhow of foreign enterprises located in the country to domestic enterprises in the same industry. In addition, intensifying competitiveness caused by imports and inward foreign direct investments may also become a strong incentive to the enhancement of domestic productivity.

Thus, such accumulated empirical analysis has been providing an understanding that overseas business activities as well as trade investment activities, including imports and inward investments, may bring the effect of encouraging domestic productivity and innovation via a variety of channels.

## **Column 12 Relationship between trade balance and current account balance**

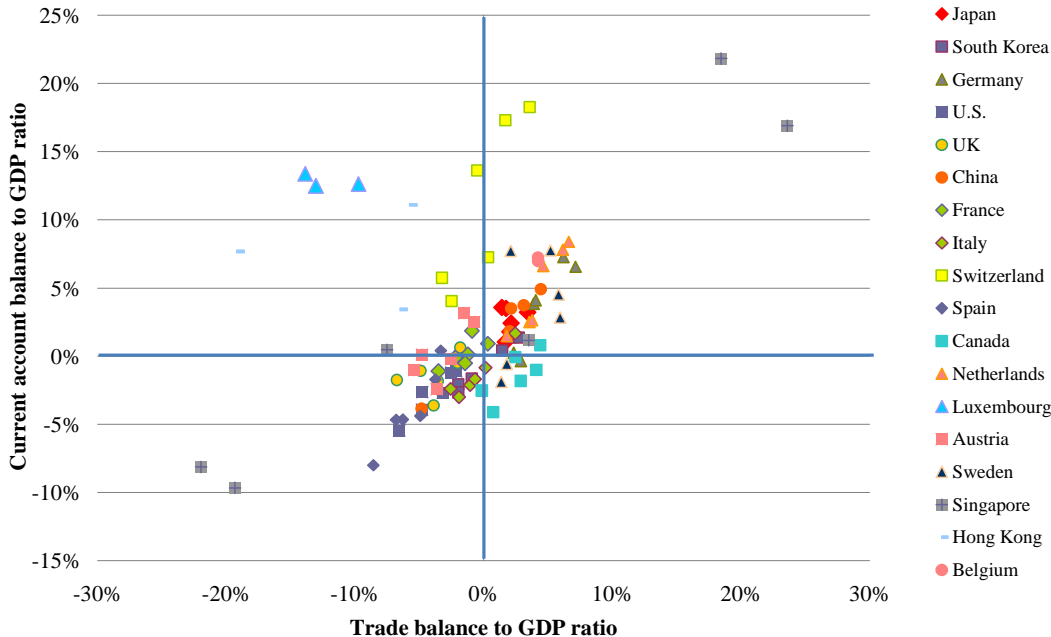
Japan suffered a trade deficit on a customs clearance basis in calendar year 2011 for the first time in 31 years (the largest-ever trade deficit on a calendar year basis was recorded in 1980). In addition, a record deficit was registered in FY2011 for the first time in three years. Private think tanks, etc. forecast that if trade deficit is increasing reflecting sluggish exports, and there is a continuous expansion in imports and other factors, the current account balance may also fall into a deficit in the near future. So, we will examine whether there was a country in the past where the current account surplus was kept by a surplus in income balance, etc., even if the trade balance continued showing a deficit.

We will examine the relation between trade balance-GDP ratios and current account balance-GDP ratios for the period from 1985 to 2010 regarding 16 countries centering on advanced countries. In all of plotting, “trade deficit and current account deficit” (the U.S., the UK, etc.) accounts for 39% of the total and “trade surplus and current account surplus” (Japan, Germany, China, etc.) accounts for 37% of the total. Those two relations represent the majority of answers.

On the other hand, “trade deficit and current account surplus” (Luxembourg, Austria, etc.) accounts for only 16% of the total and “trade surplus and current account deficit” (Canada, etc.) remains at only 8% of the total (Column Figure 12-1).

Column Figure 12-1

Ratio of trade balance to GDP and ratio of current account balance to GDP



Note: The above is plotted every five years from 1985 to 2010 but Luxembourg is from 2000 to 2010 due to data restrictions.  
 Source: *International Comparison Statistics* (Institute for International Trade and Investment).

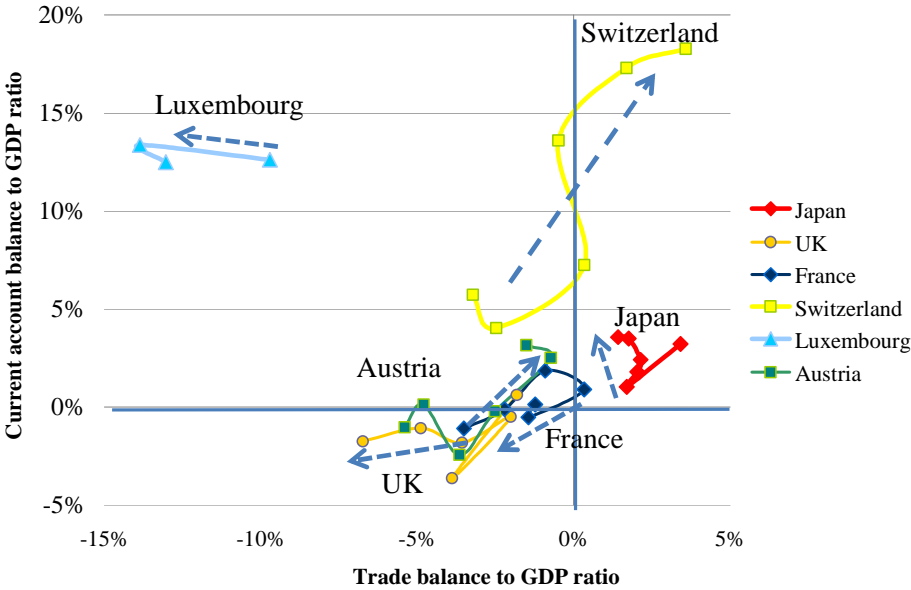
Next, countries that showed “trade deficit and current account surplus” in and after 1985 include Switzerland, Luxembourg, Austria, France, the UK, Spain, Singapore, etc. But countries that maintained current account surplus in 2010 are only Luxembourg, Austria, Switzerland, and Singapore. Luxembourg and Austria make up for their trade deficit with their financial service surplus (Hong Kong, which is not a country, also falls under this case). Meanwhile, Switzerland completely shifted from trade deficit to trade surplus and maintained surpluses in income balance and service balance, leading to a rising trend in the current account surplus-GDP ratio. Singapore was also a country with trade and service deficits but thereafter turned into trade and service balance surpluses, making up for income balance deficits (Column Figure 12-2).

Looking at France and the UK, France fell into a current account deficit in five years and the UK in three years after posting a trade deficit. (The U.S. also returned to a trade deficit after marking a trade surplus in early 1980s but turned into a current account deficit only in one year). The factor behind this is that trade deficits increased in a faster pace even though surpluses were kept in income balance and service balance



Column Figure 12-2

Case of “trade balance deficit and current balance surplus”



Note: The above is plotted every five years from 1985 to 2010 but only Luxembourg is from 2000 to 2010 due to data restrictions.  
 Source: *International Comparison Statistics* (Institute for International Trade and Investment).

Consequently, it is rare that trade deficits continued to be covered by other surpluses, and in some cases current account fell into a deficit about one to five years after trade deficit was registered. It is currently uncertain whether Japan will be able to continue making up for its trade deficits by an increase in income balance, but to maintain its current account surplus, an option should be to maintain and increase income balance surpluses and also turn the trade balance into a surplus again as with the example of Switzerland. To this end, now that imports are forecast to increase due to surging prices of resources, it is crucial to proactively seek to boost exports as well.

**(5) Implications on the basis of earlier discussions and discussions in and after the following section**

As stated above, the current situation of overseas business activities of Japanese enterprises has been discussed. Japan’s overseas production ratios are in an upward trend on the back of the yen’s appreciation, etc., and its outward foreign direct investments have been increasing in recent years.

In contrast, domestic investments, the number of domestic workers, and domestic production output remain flat. Many of enterprises recognize concerns over hollowing-out particularly for business partner enterprises and domestic general enterprises, and forecast that if overseas developments proceed in the future, manufacturing functions of general-purpose goods and the number of manufacturing-related workers, etc. will be reduced in Japan.

On the other hand, however, as discussed above, when considering the findings of questionnaire surveys and previous studies, it is impossible to say that employment and domestic investments of enterprises producing overseas have been decreasing more than those of enterprises not producing

overseas.

Some cases are also found where enterprises producing more overseas lead to sales and profit increases and boost employment and domestic investments in the country as well by taking the opportunity of growing new business and exports. Even though a rise in the overseas production ratio may constitute one of the factors to reduce domestic employment and investments, such a reduction is not determined only by domestic employment and investments but may be affected also by the growth expectation for and export trend in the domestic business. As discussed, in Germany and South Korea, both domestic and external expansions may be compatible with each other as is their entire economies.

In addition, as observed in Section 2, the overseas presence of Japanese enterprises has definitely been fast growing recently but has not always remained at a high level in terms of volume compared with other advanced countries. Also the purposes of overseas expansion are shifting from production to market acquisition. Thus, the acceleration of overseas development does not always contract the domestic business at the same time. This may on a case-by-case basis depend on the future forecast for the developments of the enterprise and industry, as well as scale, business partners, and domestic business.

In other words, it is not always true to assess Japan's current situation by a link of "acceleration of overseas business activities leads to sluggish domestic economy." Overseas business activities and economic revitalization do not always constitute a trade-off but should be viewed as having individual economic significance and effects. In addition, it should fully be considered that sluggishness in the domestic economy may be caused by domestic structural factors (population decrease, high business costs, incomplete improvements in business environment, delays in changes in the industrial structure, etc.) rather than by a shift of enterprises to overseas.

However, in the current situation after the failure of Lehman Brothers and the great earthquake, enterprises whose sales declined significantly and which faced a delayed recovery thereafter are no longer unusual. Furthermore, the continuing sharp appreciation of the yen and a rise in electricity charges, coupled with the worsening export environment, may have deteriorated the domestic business environment to a great extent. As a result, an "overseas business activities for growth strategy" that will sophisticate domestic functions while ensuring the growth both at home and abroad may have changed significantly to "overseas business activities to survive" that will cause domestic functions to contract and shift business bases to overseas significantly. Due consideration should be given since the development of overseas business activities under these circumstances may cause an enormous negative impact to the domestic business environment.

So, the following Section 2 refers to the current situation of overseas business activities of Japanese enterprises and the problems involved, and the impact, etc. on the domestic economy. In addition, Section 3 shows discussions on the potential of the overseas business of the service industry that could be required to be revitalized among others due to restrictions now in place in domestic markets. Then, based on these discussions, in the concluding section (Section 4), we will compile challenges and measures involved while considering examples of the German and South Korean governments, and enterprises, etc. concerning discussions required to revitalize domestic economy.