

Section 2 Relationship between Japanese companies and East Asia

The features of the trade structure, the growth of trade of intermediate goods in East Asia and expanded exports from China and ASEAN countries, which we have discussed so far, have a close relationship with overseas deployment of Japanese manufacturing companies. This section studies the trends in Japan's direct investments and provides an overview of changes in economic activities of overseas affiliates of Japanese companies (in terms of sales, material procurement and money transferred to Japan).

In particular, we analyze economic activities of Japanese overseas affiliates, focusing on: (i) whether Japanese companies have changed their ways of generating income; (ii) if there has been any shift of production bases within Asia; and (iii) if there were any changes in the system of division of labor between Japan and overseas.

1 . Outward direct investments

(1) On a flow basis

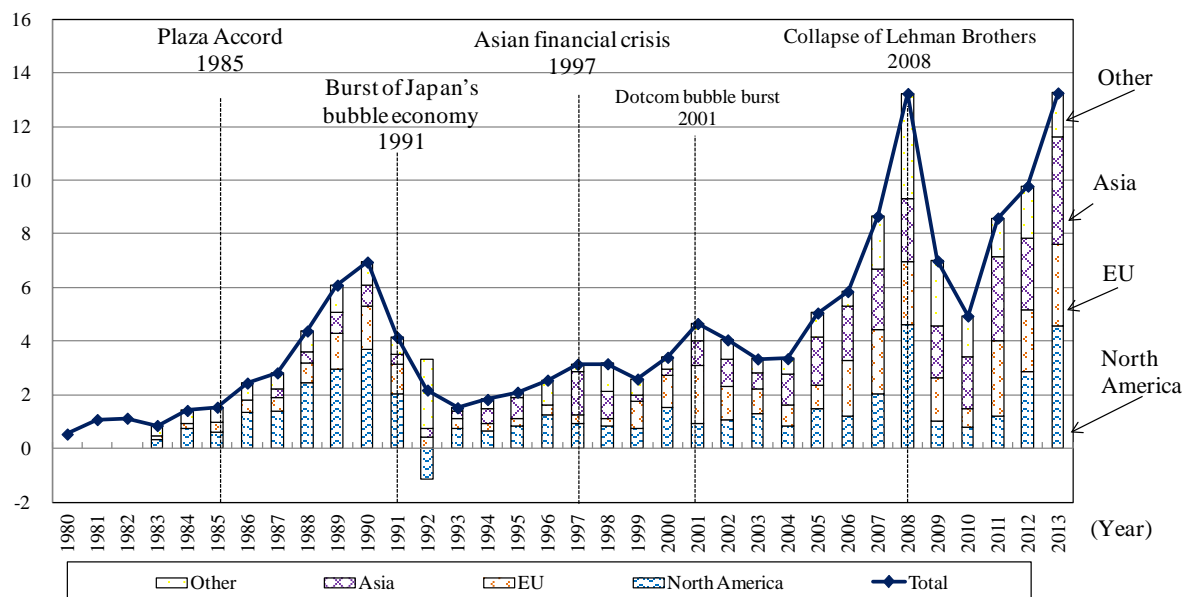
A look at the changes in Japan's long-term direct investments shows that they increased significantly in the late 1980s amid the strengthening trend of the yen after the signing of the Plaza Accord. In the late 1980s, direct investments to the United States centered on non-manufacturing industries, including real property, accounted for a large portion of Japan's direct investments. However, the volume of such investments dramatically dropped after the burst of the economic bubble, and investments in Asia centered on the manufacturing industry started to grow instead. Although Japan's investments in Asia temporarily shrank at the time of the Asian currency crisis, they increased again in the 2000s (Figure II-3-2-1).

The composition of industries differ significantly between the investments in Asia and that in the U.S.²³⁹ As for the United States, investments in non-manufacturing industries, including services, finance and insurance, wholesale and retail industries, and recently, telecommunication, account for comparatively large portions (Figure II-3-2-2). On the other hand, in investments in Asia, the manufacturing industries such as electric machinery, transportation equipment, general machinery, chemicals, iron/non-ferrous metals comprise a large portion, and overseas expansion of production bases of Japanese companies are resulting in the rise of exports of intermediate goods from Japan (Figure II-3-2-3). Recently, investments in non-manufacturing industries are growing in both North America and Asia.

²³⁹ As statistical data of direct investments by industrial sector in terms of international balance of payments were first available concerning 2005 onward, here we have used the other data series for direct investments up to 2004. Note, however, that the statistical data are based on the notification of the total amount of investments at the time of agreement (not actual disbursement) and do not include withdrawal of investments. Thus, the statistics before 2004 and those from 2005 onward are not technically consecutive.

Figure II-3-2-1 Trends in Japan's direct investments

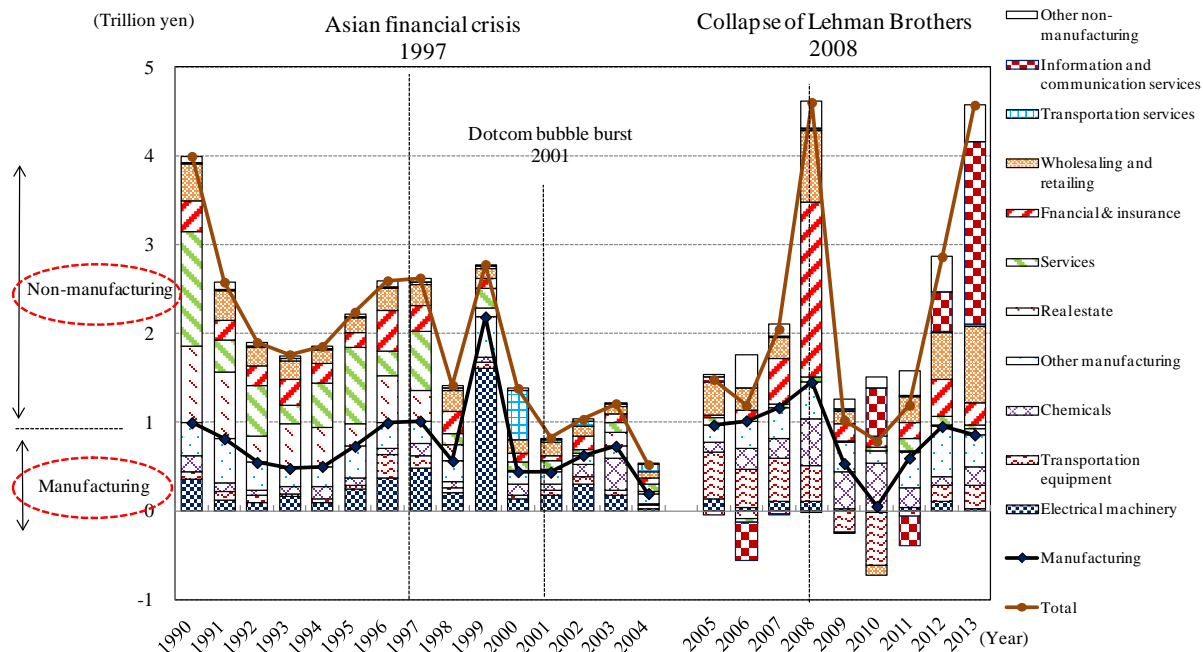
(Trillion yen)



Notes: Changes were made to the statistics for international balance of payments in 1996. Thus, the statistics before 1996 and those from 1996 onward are not technically consecutive. The region classifications were also different. As there was no such classification as "Asia" from 1987 to 1995, we used the total from Southeast Asia and China. Statistical data for Asia for the years before 1986 was not available. Data for North America from 1983 to 1995 shows values for the U.S. only. The data for the EU shows the values for the member states of the EU (or EC) at that point.

Source: Websites of the Policy Research Institute, Ministry of Finance, Bank of Japan.

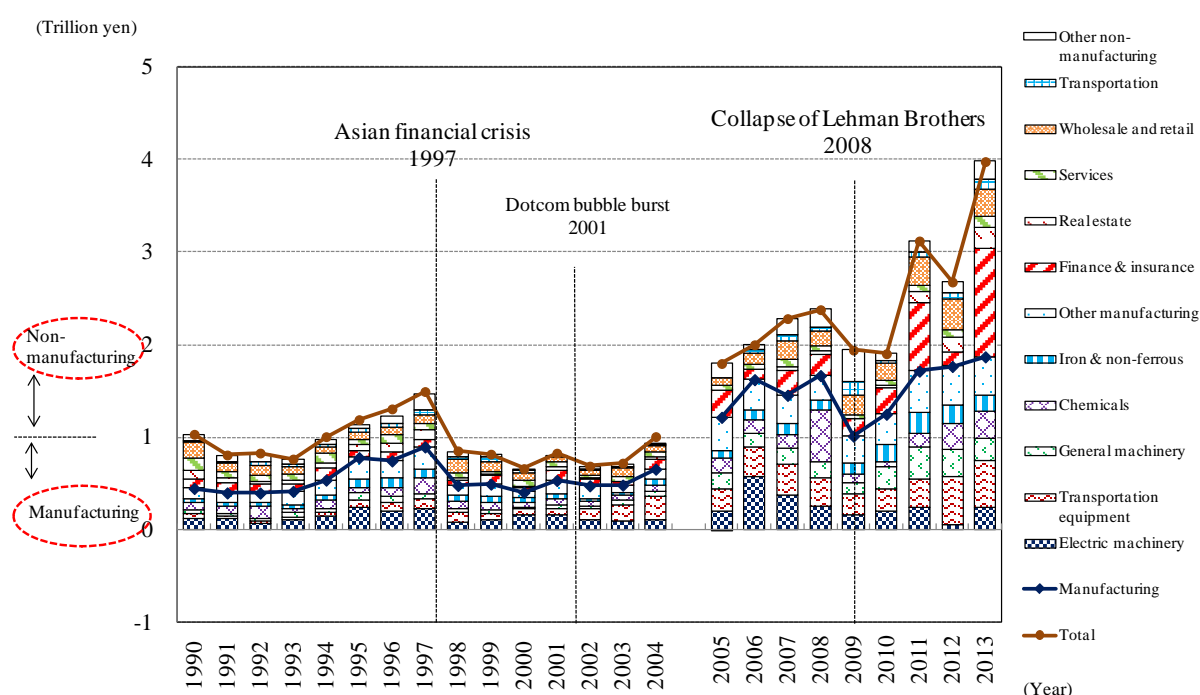
Figure II-3-2-2 Trends in Japan's direct investments by industry (North America)



Notes: Direct investments for the years before 2004 are reported and notified values, and those for 2005 onward are on a basis of international balance of payments (net). Thus, the statistics before 2004 and those from 2005 onward are not technically consecutive. The classifications of industries were also different. Until 2004, there was no such industry classification as "communication industry."

Source: Websites of Ministry of Finance and Bank of Japan.

Figure II-3-2-3 Trends in Japan's direct investments by industry (Asia)



(2) On a stock basis

Next, while Japan's direct investments differ significantly from year to year on a flow basis, they have been stable on a stock basis. Although the growth of Japan's direct investments temporarily slowed down after the collapse of Lehman Brothers, it is generally on an increasing trend (Figure II-3-2-4). By region, North America's share in Japan's direct investments used to be large but it has been decreasing since the beginning of the 2000s (Figure II-3-2-5). In contrast, Asia's share has been growing since the 2000s, despite the downturn caused by the currency crisis in 1997, reaching an equal level with North America in recent years. The EU still maintains a share of more than 20%. The total of investments in North America, Asia and the EU accounts for approximately 80% of all direct investments by Japan.

By industry, although Japan's direct investments have been growing both in manufacturing and non-manufacturing industries since 2005, the growth rate is larger in the non-manufacturing industries. In recent years, investments in finance and insurance, wholesale and retail, mining, and communications are especially growing (Figure II-3-2-6).²⁴⁰

Investments are expanding mainly in the manufacturing industry in Asia, in contrast to North America where investments in non-manufacturing industries, such as finance and insurance and wholesale and retail, are growing (Figure II-3-2-7).

Amid the expansion of direct investments in Asia, the growth of ASEAN's share is moderately growing while China is increasing its share at a faster pace (Figure II-3-2-8). Among ASEAN countries, Thailand and Indonesia both saw their share drop significantly at the time of the Asian financial crisis,

²⁴⁰ Direct investments by industry on a stock basis have been published since 2005.

but investments in Thailand rapidly recovered after that, expanding to an equal level with investments in Singapore. In addition, Indonesia's share has been slowly increasing after the collapse of Lehman Brothers, while Viet Nam's share is also growing.

Figure II-3-2-4 Trends in Japan's direct investments on a stock basis

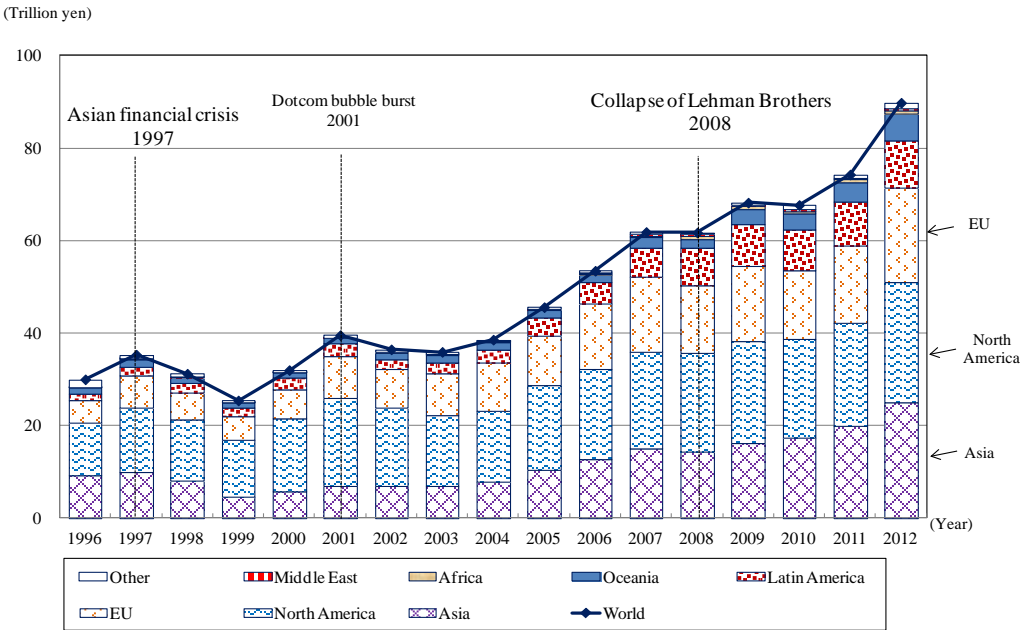


Figure II-3-2-5 Trends in Japan's direct investments on a stock basis by regional share

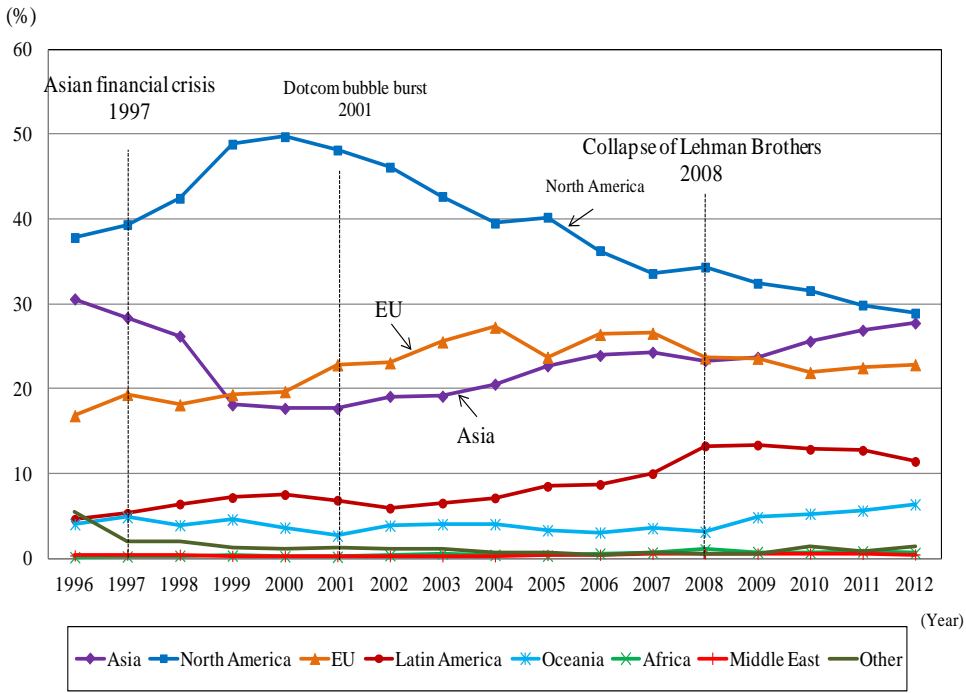
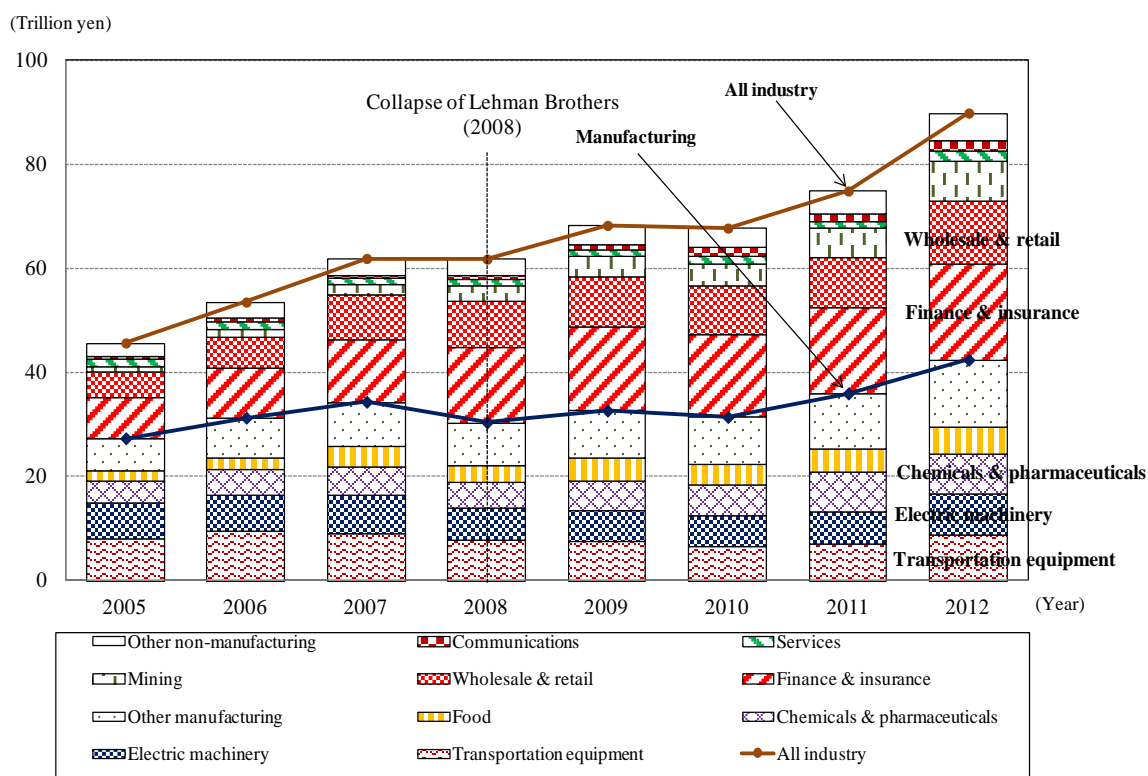
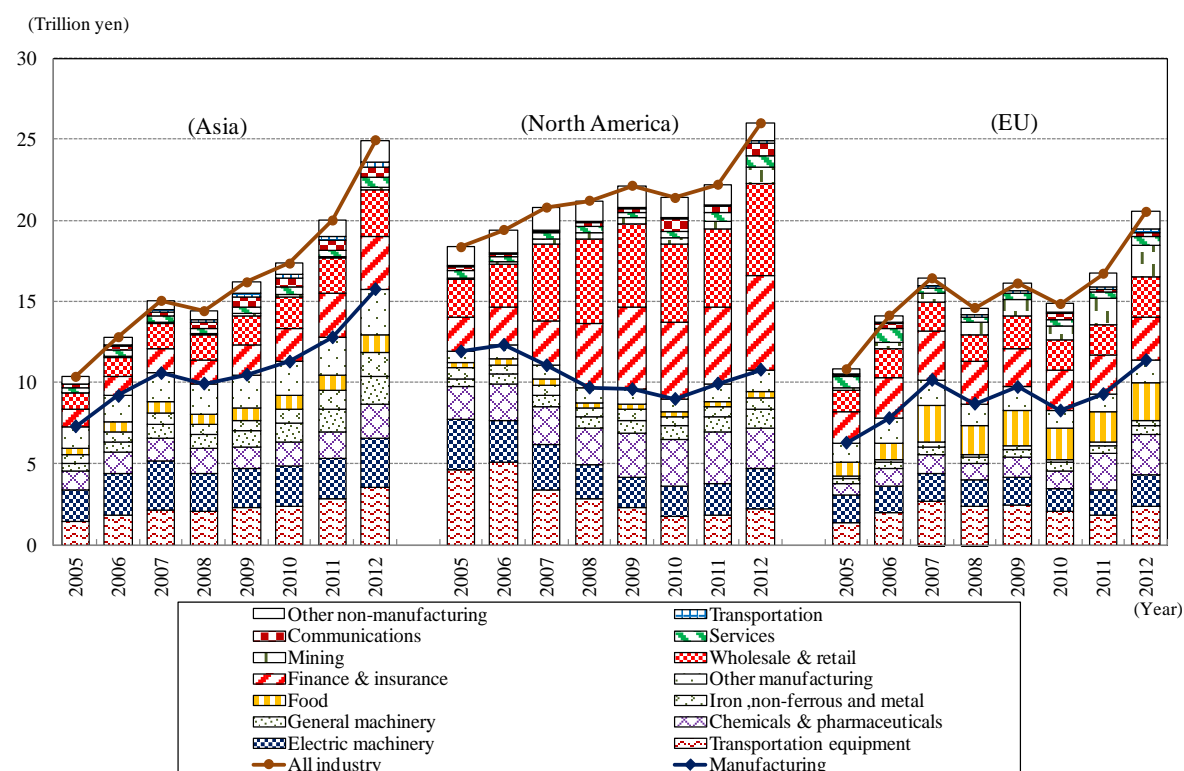


Figure II-3-2-6 Trends in Japan's direct investments on a stock basis by industry



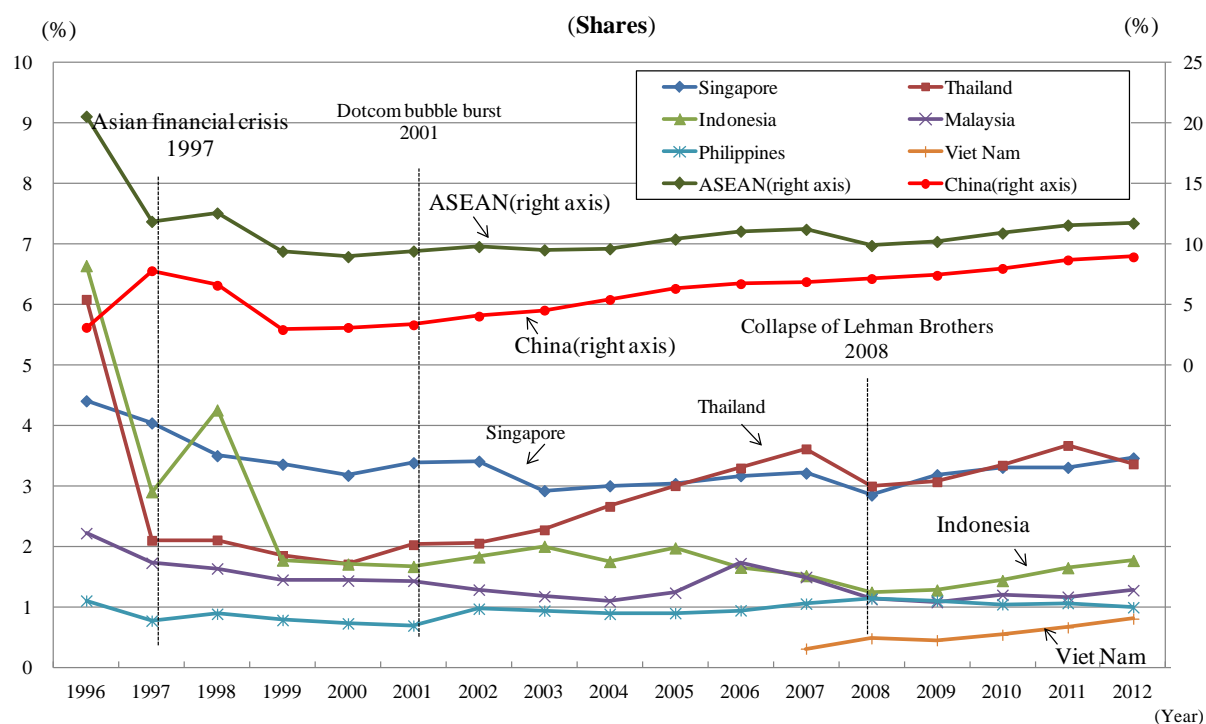
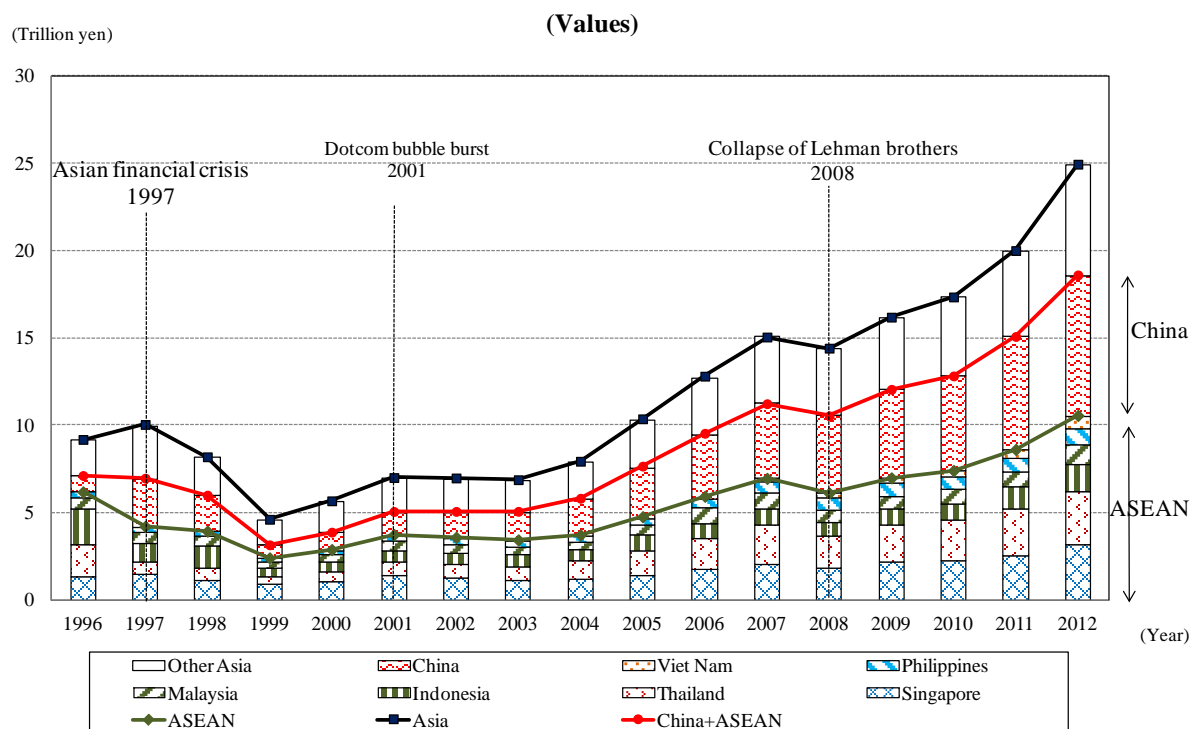
Source: Website of Bank of Japan

Figure II-3-2-7 Trends in Japan's direct investments by region and industry



Source: Website of Bank of Japan

Figure II-3-2-8 Trends in Japan's direct investments by country and region (Asia)



(3) Influence on exports from Japan

Against such trends in direct investments described above, Japan's exports –especially those bound for East Asia– have grown since the signing of the Plaza Accord (Figure II-3-2-9). In Japan's exports to

East Asia, exports of intermediate goods such as parts and components, especially for electric machinery, are expanding in line with the overseas expansion of Japanese manufacturing companies, suggesting ongoing international division of production in the East Asian region (Figure II-3-2-10). Meanwhile, the growth in exports to the United States is moderate as most of Japan's direct investments in the United States are made in non-manufacturing industries, which do not necessarily involve exports of materials. In exports of consumption goods, transportation equipment has come to account for a large portion.

Figure II-3-2-9 Trends in Japan's export value by export destination

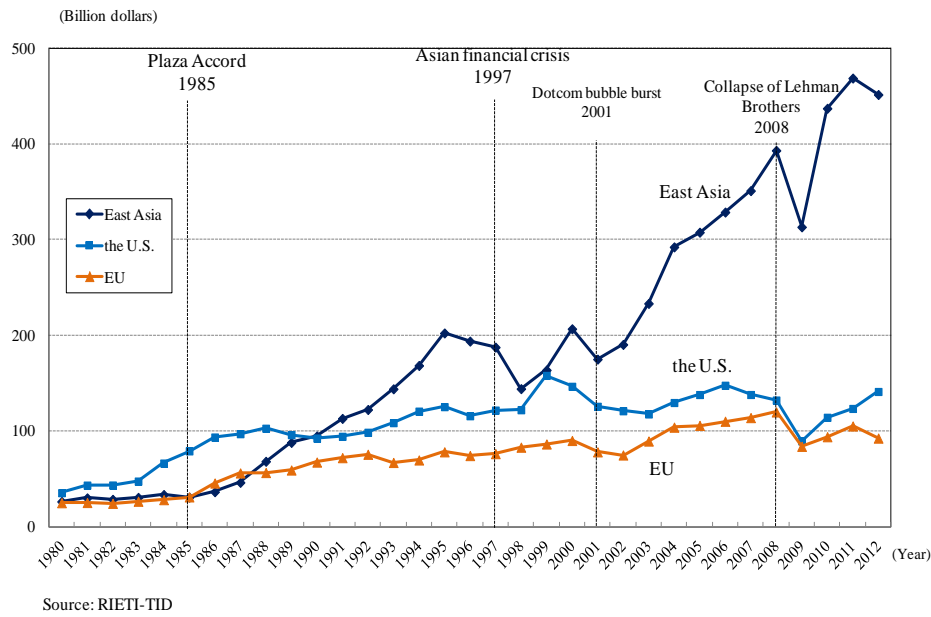
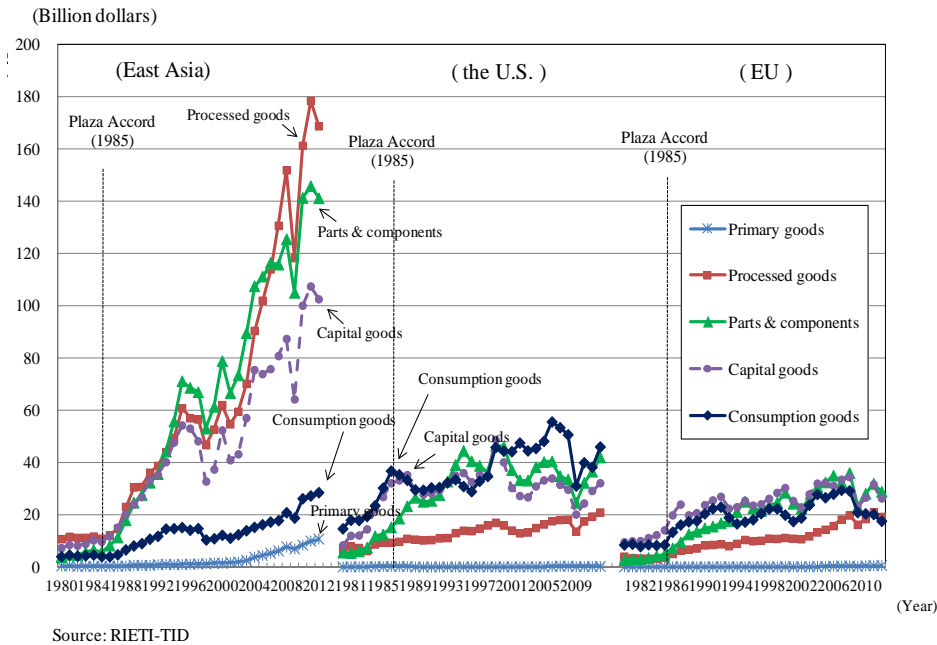


Figure II-3-2-10 Trends in Japan's export value by export destination and goods



2 . Activities of overseas affiliates of Japanese companies

There have been some changes in the way Japanese companies generate income in line with their business expansion overseas. In terms of trade, in addition to exports to North America, etc., exports of intermediate goods have greatly increased for international division of production in East Asia. In terms of transactions other than trade, there is growth in production activities of overseas affiliates as well as in accompanying dividends and royalty income. Let us take a look at this situation through statistics on Japanese overseas affiliates.

First, we study the overseas expansion of Japanese companies (number of overseas affiliates and sales volumes), and then focus on how they generate profits (material procurement from Japan and payment of dividends and royalties to Japan). Finally, we will discuss how the system of division of labor between Japan and overseas has changed.

(1) Number of Japanese overseas affiliates and their sales volume

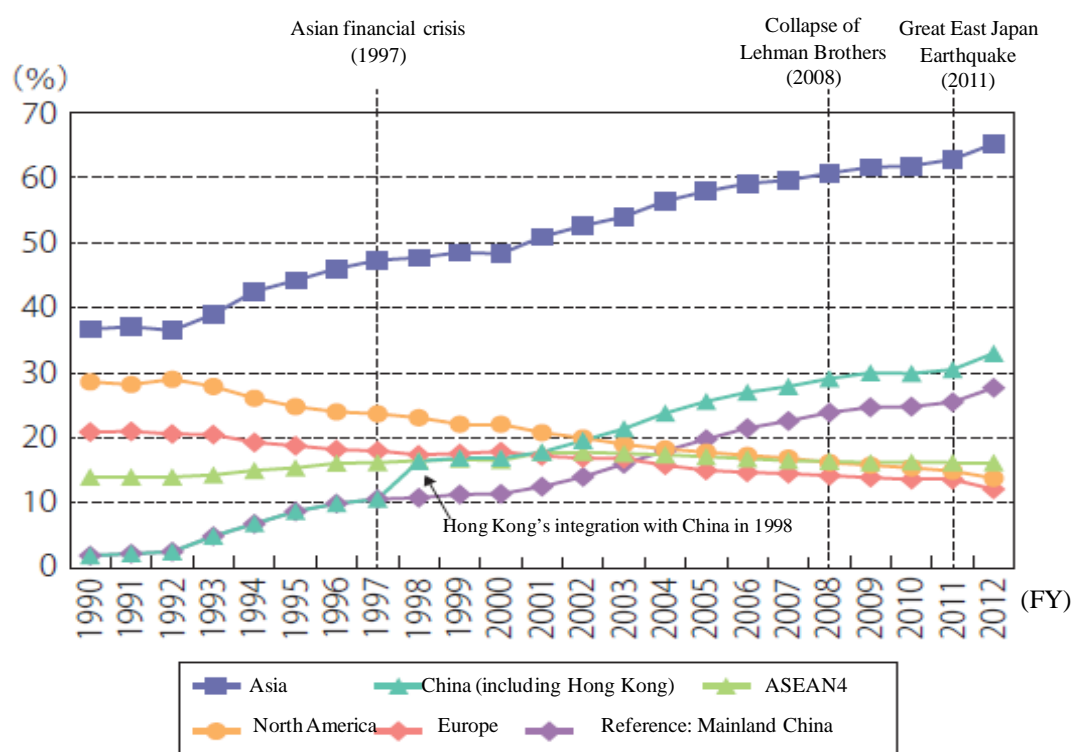
First, we study where Japanese companies are mainly expanding and operating their production activities. The number of Japanese overseas affiliates has been generally increasing. Looking by main region, Asia's share has been growing in line with the expansion of Japanese manufacturing industry in the region. Among the Asian countries, expansion in China is notable (Figure II-3-2-11).

Looking at the overseas expansion status of Japanese companies as of the end of FY2012, the number of Japanese overseas affiliates reached 23,351, of which 65.2% are located in Asia. Within the Asian region, China (including Hong Kong; the same applies hereinafter) and the ASEAN region make up 33.0% and 23.2%, respectively, of the total number of Japanese overseas affiliates, outpacing the shares of North America (13.8%) and Europe (12.1%). In the manufacturing industry, 76.4% is concentrated in Asia, which is mainly comprised of China (39.7%) and the ASEAN region (27.7%) (Table II-3-2-12).

Japanese overseas affiliates experienced a fall in sales due to the effect of the collapse of Lehman Brothers, but sales are generally trending upward (Figure II-3-2-13). By region, the growth in Asia is outstanding. Since FY2006, the sales deriving from Japanese overseas affiliates in Asia, where the expansion of the manufacturing industry is notable, is exceeding the sales of those located in North America. Although sales deriving from Japanese overseas affiliates as a whole have been lower than those before the collapse of Lehman Brothers, sales of the overseas affiliates in Asia are outperforming pre-Lehman Brothers collapse sales.

When we focus on Asia and look at the changes in sales, domestic sales are growing in addition to sales in Japan and Europe (Figure II-3-2-14). Looking at the change in the sales structure, the proportion of domestic sales is increasing (Figure II-3-2-15).

Figure II-3-2-11 Trends in the number of Japanese overseas affiliates (shares by main region)



Note: 1. North America refers to the U.S. and Canada. ASEAN4 refers to Indonesia, Malaysia, the Philippines, and Thailand. Values for China for 1998 onward include those for Hong Kong.

2. The values for FY2012 are preliminary values.

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

Table II-3-2-12 Number of Japanese overseas affiliates (as of the end of FY2012)

																(Companies; %)	
	World	North America	Latin America	Asia	China	Reference: Mainland China	ASEAN10	ASEAN6						India	Europe	Middle East Oceania Africa	
								Thailand	Singapore	Indonesia	Malaysia	Viet Nam	Philippines				
Total	23,351 (100.0)	3,216 (13.8)	1,205 (5.2)	15,234 (65.2)	7,700 (33.0)	6,479 (27.7)	5,410 (23.2)	1,807 (7.7)	974 (4.2)	787 (3.4)	714 (3.1)	610 (2.6)	468 (2.0)	410 (1.8)	2,834 (12.1)	862 (3.7)	
Manufacturing industries	10,425 (100.0)	1,152 (11.1)	292 (2.8)	7,962 (76.4)	4,142 (39.7)	3,879 (37.2)	2,887 (27.7)	1,071 (10.3)	217 (2.1)	516 (4.9)	403 (3.9)	402 (3.9)	259 (2.5)	197 (1.9)	851 (8.2)	168 (1.6)	
Food	508	80	20	344	193	185	123	51	13	20	11	23	5	5	44	20	
Chemicals	1,213	162	35	837	342	328	319	104	50	66	52	28	17	27	154	25	
Metal products	528	43	5	456	249	226	173	64	18	29	20	25	15	5	17	7	
Production machinery	674	77	7	536	291	286	168	81	15	25	14	21	12	11	50	4	
Electrical machinery	667	63	13	535	326	306	153	72	16	15	12	23	15	13	48	8	
Information and communications equipment	1,095	78	20	905	469	397	332	72	34	36	89	42	57	5	87	5	
Transportation equipment	1,950	316	107	1,310	534	530	588	278	7	132	42	69	55	83	183	34	
Other manufacturing industries	3,790	333	85	3,039	1,738	1,621	1,031	349	64	193	163	171	83	48	268	65	
Non-manufacturing industries	12,926 (100.0)	2,064 (16.0)	913 (7.1)	7,272 (56.3)	3,558 (27.5)	2,600 (20.1)	2,523 (19.5)	736 (5.7)	757 (5.9)	271 (2.1)	311 (2.4)	208 (1.6)	209 (1.6)	213 (1.6)	1,983 (15.3)	694 (5.4)	

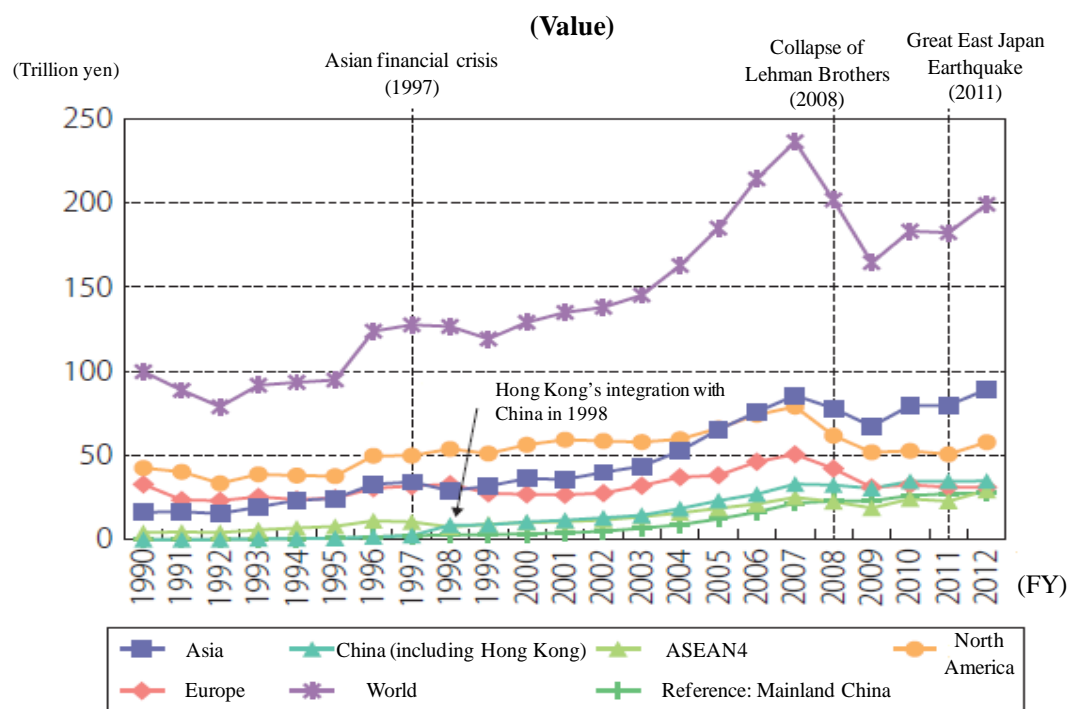
Note: 1. We tabulated the number of companies that responded that they were "operating" at the time of the survey.

2. As of the end of FY2012

3. North America refers to the U.S. and Canada. Values for China include those for Hong Kong.

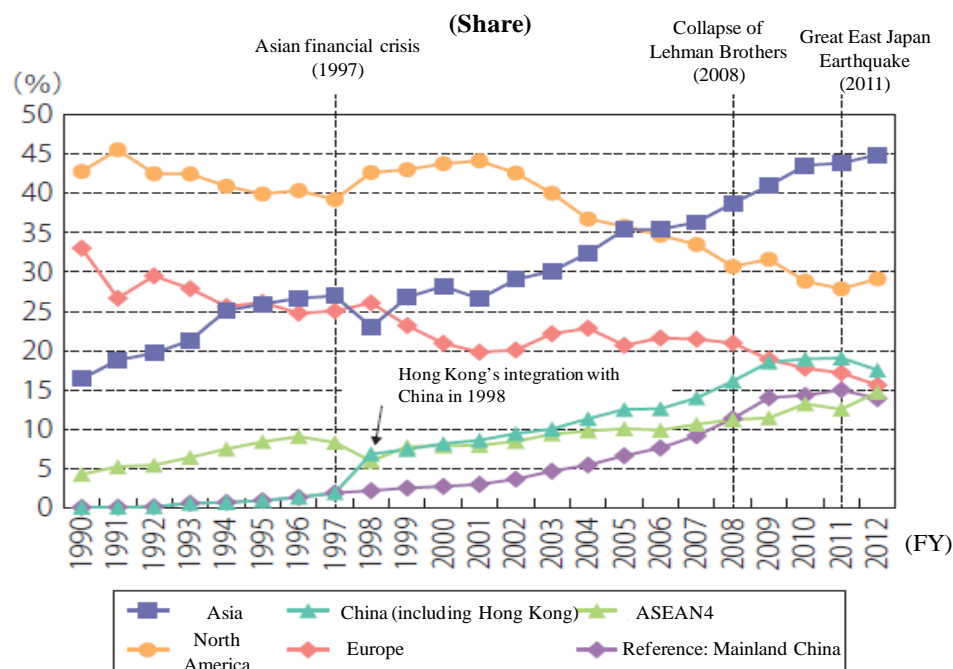
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-13 Trends in sales of Japanese overseas affiliates (by main region)



Note: 1. North America refers to the U.S. and Canada. ASEAN4 refers to Indonesia, Malaysia, the Philippines, and Thailand. Values for China for 1998 onward include those for Hong Kong.
2. The values for FY2012 are preliminary values.

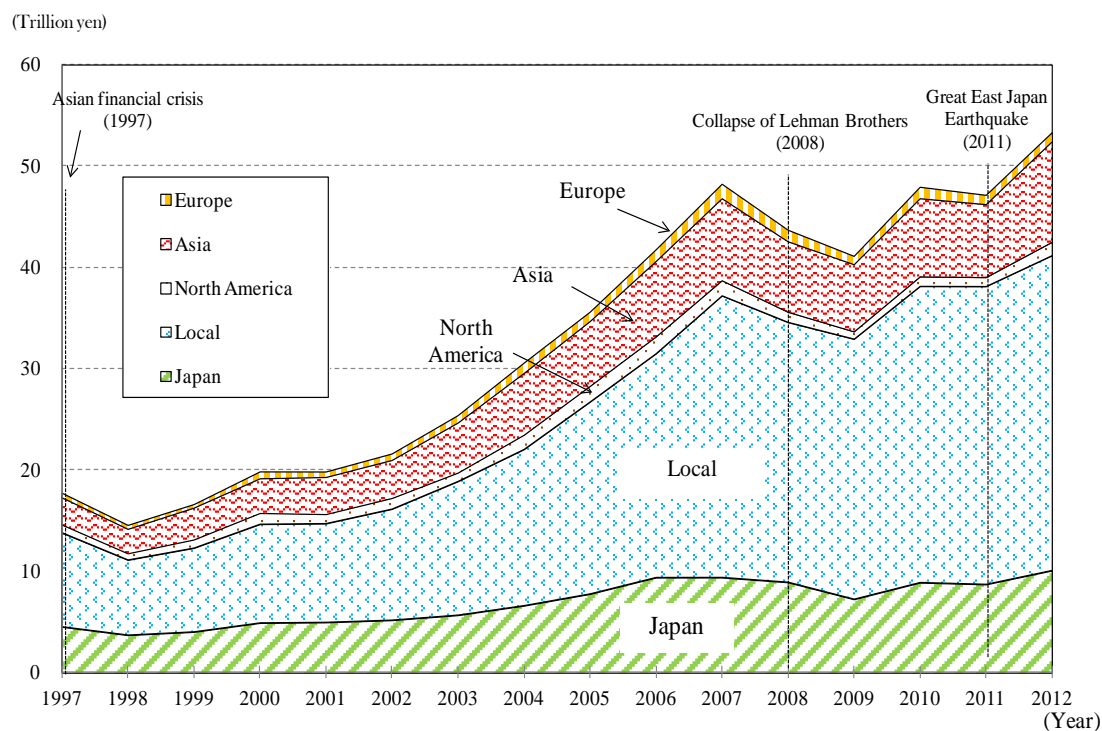
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).



Note: 1. North America refers to the U.S. and Canada. ASEAN4 refers to Indonesia, Malaysia, the Philippines, and Thailand. Values for China for 1998 onward include those for Hong Kong.
2. The values for FY2012 are preliminary values.

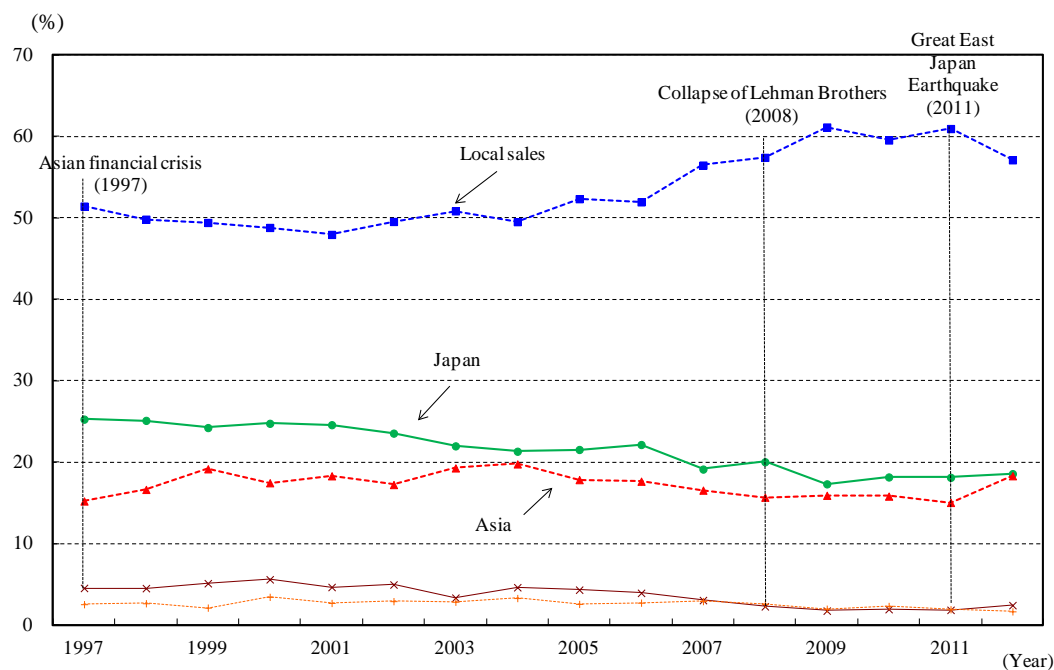
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-14 Trends in sales of Japanese overseas affiliates in the manufacturing industry in Asia



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

Figure II-3-2-15 Trends in shares by region in sales of Japanese overseas affiliates in the manufacturing industry in Asia



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

(2) How Japanese companies generate income

In line with the overseas expansion of Japanese companies through direct investments, their ways of generating income and the influence on international balance of payments have changed. Changes are happening such that, for example: Japanese overseas affiliates' material procurement, including key parts and components, from Japan is reflected in Japan's trade balance; sales of Japanese overseas affiliates affect the primary income balance; and patent royalties are included in the services balance.

(A) Material procurement

Japanese manufacturing companies set up overseas affiliates mainly in Asia amid a strengthening yen after the signing of the Plaza Accord, and have been conducting their production activities since then. Materials necessary for production, including key parts and components, are procured not only from parent companies and other Japanese sources, but also domestically in the country of production and from third countries. These flows of procurement among production bases are the background to the trade of intermediate goods, including parts and components, in the East Asian region as discussed above.

First, Japanese overseas affiliates' material procurement from Japan (manufacturing industry) is on a decreasing trend in North America and Europe, while it is growing in Asia (Figure II-3-2-16).²⁴¹

Below, we focus particularly on Asia and study the current status and recent trends in procurement activities by Japanese overseas affiliates. As the production value of Japanese overseas affiliates in Asia grew, there was an increase in the value of their procurement of materials from Japan, including key parts and components (in recent years, there was some decrease in the value of procurement due to the impact of the collapse of Lehman Brothers and the Great East Japan Earthquake) (Figure II-3-2-17).²⁴² On the other hand, a look at the composition of sources of procurement reveals that domestic procurement is increasing while procurement from Japan is moderately decreasing (Figure II-3-2-18).

The composition of the source of procurement in terms of region considerably differs from industry to industry. In the electric machinery industry, procurement from third countries in the Asian region account for a certain portion, in addition to domestic procurement and procurement from Japan, whereas in the transportation equipment industry the proportion of domestic procurement is high (Figure II-3-2-19). Such characteristics specific to each industry are considered as being attributable to the differences in the level of standardization concerning parts and components, need for adjustment in production process, transportation costs and the level of technology.

As we have discussed already, the ratio of domestic procurement is growing in terms of procurement

²⁴¹ Analysis of non-manufacturing industry has been omitted here. This is because the volume of material procurement is low in non-manufacturing industry, in the first place, as well as the fact that approximately 90% of the procurement in the industry is conducted by the wholesale industry (which is considered as being the trading activity of a trading company) and is likely to overlap with material procurement of the manufacturing industry.

²⁴² We use the Survey of Overseas Business Activities by the Ministry of Economy, Trade and Industry for the analysis of the activities of Japanese overseas affiliates. Here, statistics of "Asia" means the tabulation data for the whole Asian region excluding the Middle East and Oceania. In addition, North America refers to the two countries, Canada and the United States, and ASEAN-4 refers to the four countries: Indonesia, Malaysia, the Philippines and Thailand.

by Japanese overseas affiliates; however, approximately one-third of domestic procurement is that from local Japanese companies (Figure II-3-2-20). If we count the procurement from Japan (import) and procurement from local Japanese companies together, it would account for approximately 47% of total procurement (Figure II-3-2-21).²⁴³

Figure II-3-2-22 shows the procurement of Japanese overseas affiliates in Asia by industry in terms of "broadly-defined procurement from Japan," by which we mean the total of imports from Japan and procurement from local Japanese companies.²⁴⁴ The horizontal axis shows the share of procurement from Japan, the vertical axis the share of procurement from local Japanese companies; the size of circles shows the value of procurement. In this chart, the closer the circle sits to the upper right corner, the higher the ratio of broadly-defined procurement from Japan. If the ratio of local Japanese procurement is greater than the ratio of procurement from Japan, the circle would be positioned in the upper left side of the 45-degree line.

In the transportation equipment industry, although the ratio of procurement from Japan is decreasing, the ratio of the broadly-defined procurement from Japan, which includes procurement from local Japanese companies, reaches 49% –nearly half– of the total procurement value. Other industries that procure materials from Japan and local Japanese companies in almost equal volumes are electric machinery and business oriented machinery industries, whose circles sit near the 45-degree line. In the information and communications equipment industry, the ratio of procurement from Japan is comparatively high, and its ratio of broadly-defined procurement from Japan is 56%.

Next, we take a look at their procurement behaviors to see if there is any difference among the countries. When comparing the ratios of Japanese overseas affiliates' procurement from Japan in China and ASEAN-4, there is no significant difference between the two regions; however, the ratio of procurement from local Japanese companies is higher in ASEAN-4 compared to China, while the ratio of procurement from local companies is lower in ASEAN-4 in contrast (Figure II-3-2-23). In addition, the ratio of procurement from local Japanese companies increased in ASEAN-4 in the four years for which data was available.

²⁴³ Procurement from third countries should technically include procurement from Japanese companies located in third countries. However, we cannot distinguish which are procurements from Japanese companies and which are not due to data limitations. Therefore, we did not include procurement from Japanese companies located in third countries in the broadly-defined procurement from Japan.

²⁴⁴ Note that the share of procurement from Japanese local subsidiaries may be overvalued due to double counting in cases where the materials are traded between Japanese local subsidiaries and Japanese local parts and components manufacturers multiple times before final assembly.

Figure II-3-2-16 Value of material procurement from Japan by Japanese overseas affiliates (manufacturing industry)

(Trillion yen)

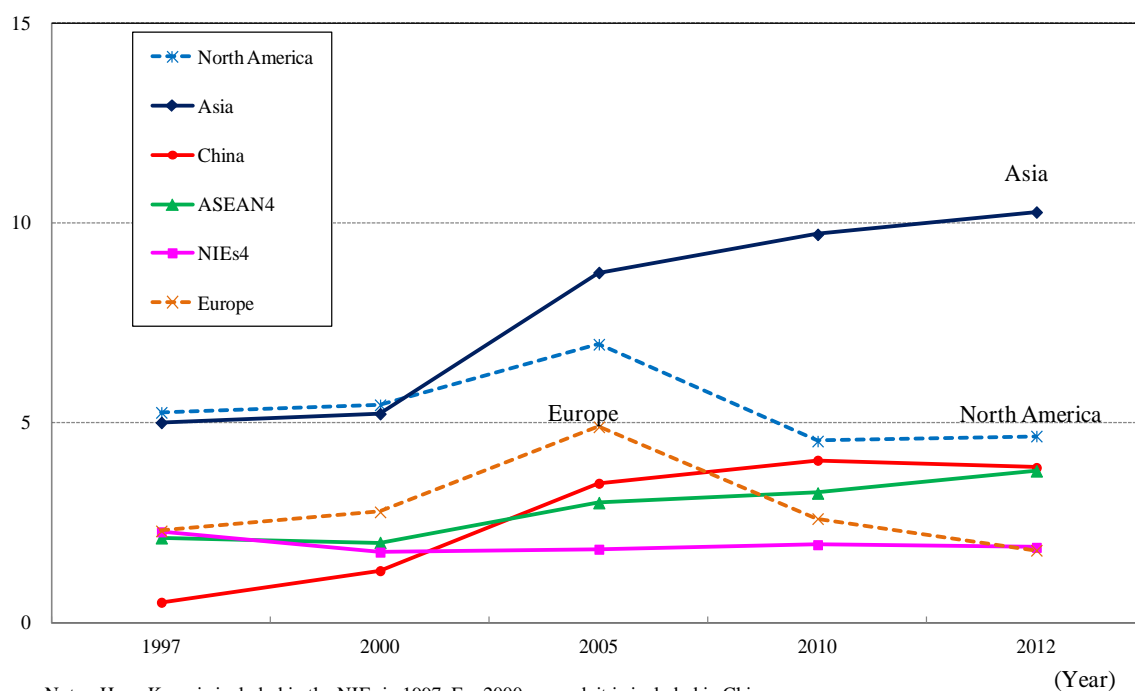


Figure II-3-2-17 Trends in values of procurement by Japanese overseas affiliates in the manufacturing industry in Asia

(Trillion yen)

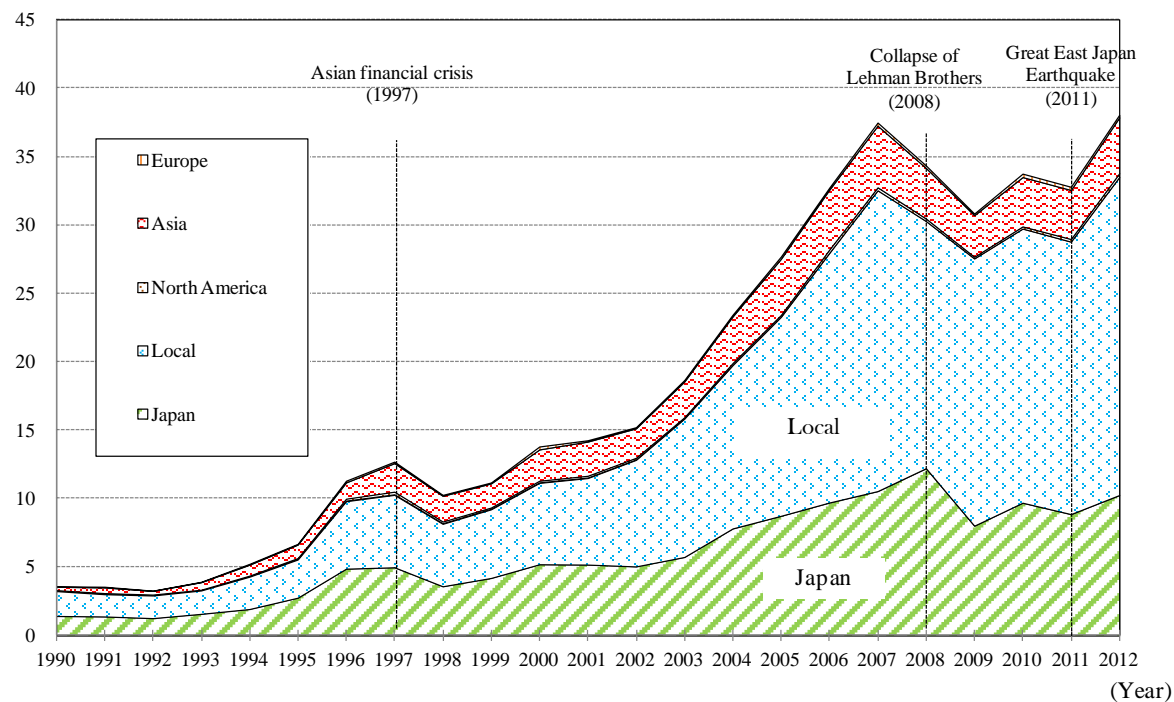
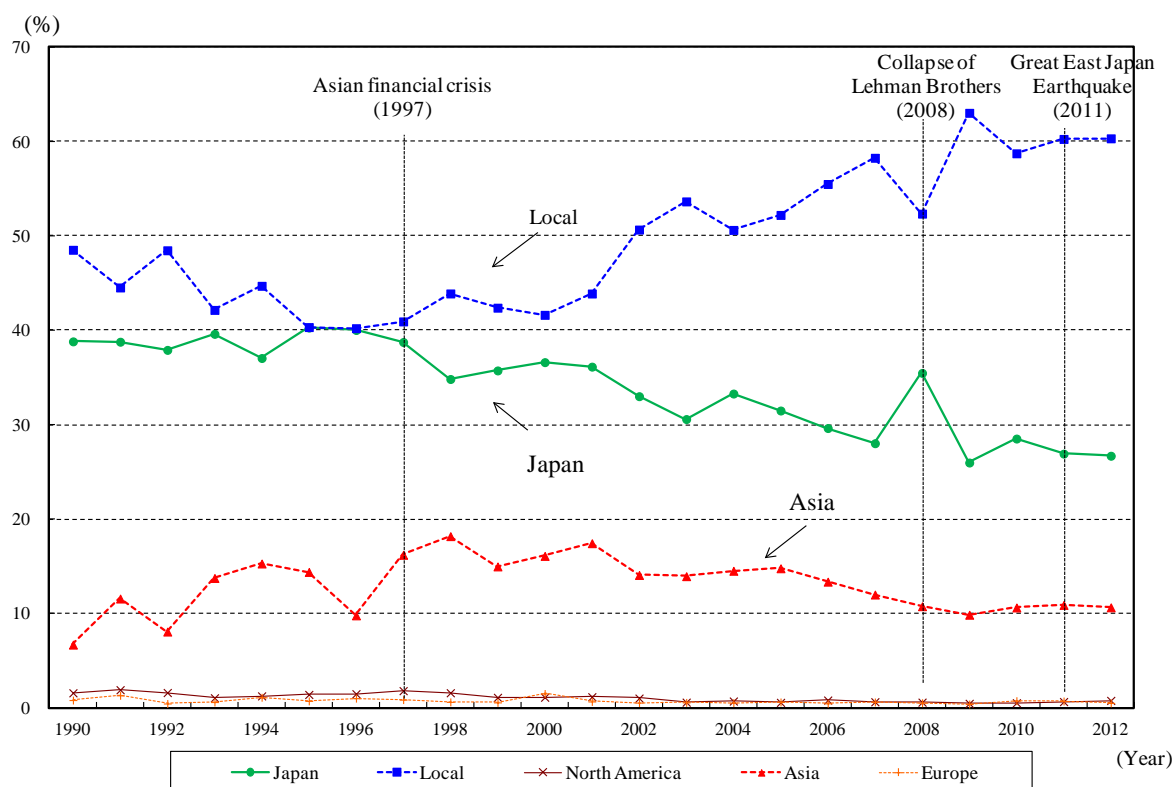
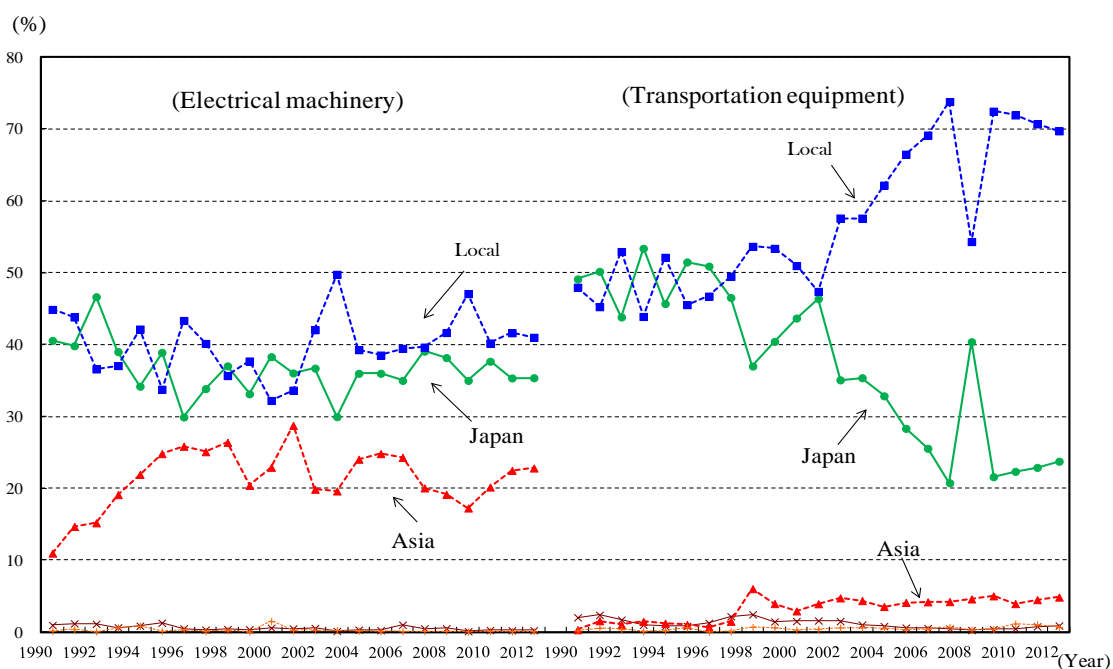


Figure II-3-2-18 Trends in shares of the source of material procurement by Japanese overseas affiliates in the manufacturing industry in Asia



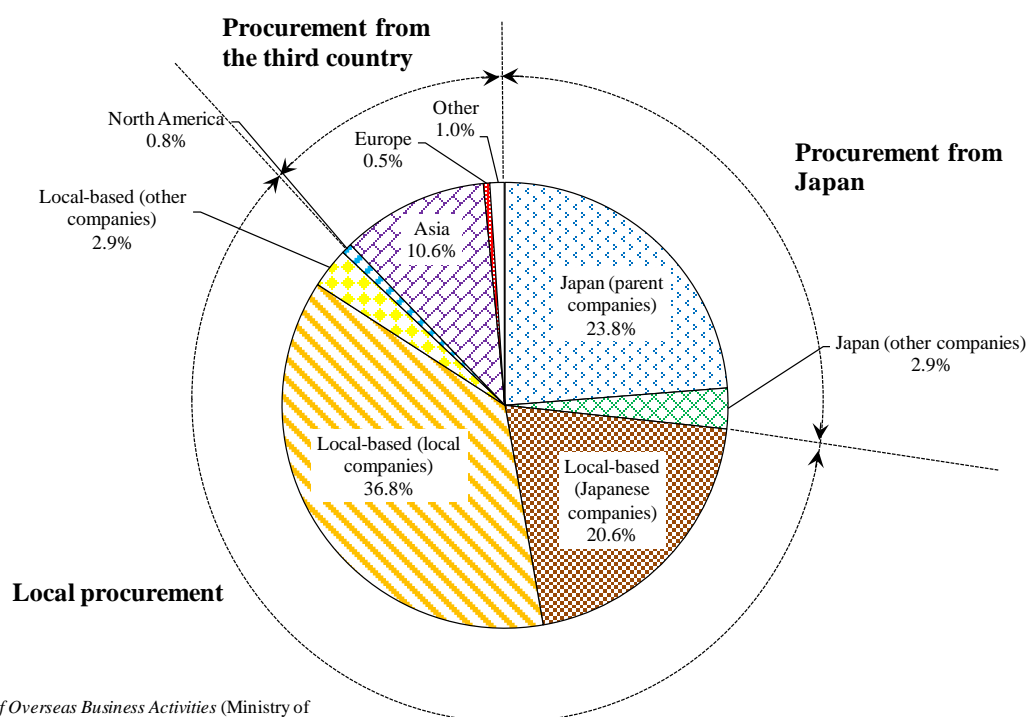
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-19 Trends in share of the source of material procurement for Japanese overseas affiliates in the manufacturing industry in Asia by industry



Notes: There was a change in industry classification in 2001. For the purpose of statistical continuity, we used the total of "electrical machinery" and "information and communications equipment" under the new industry classification system as the value for electrical machinery.
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-20 Shares of the source of material procurement by Japanese overseas affiliates in the manufacturing industry in Asia (2012)



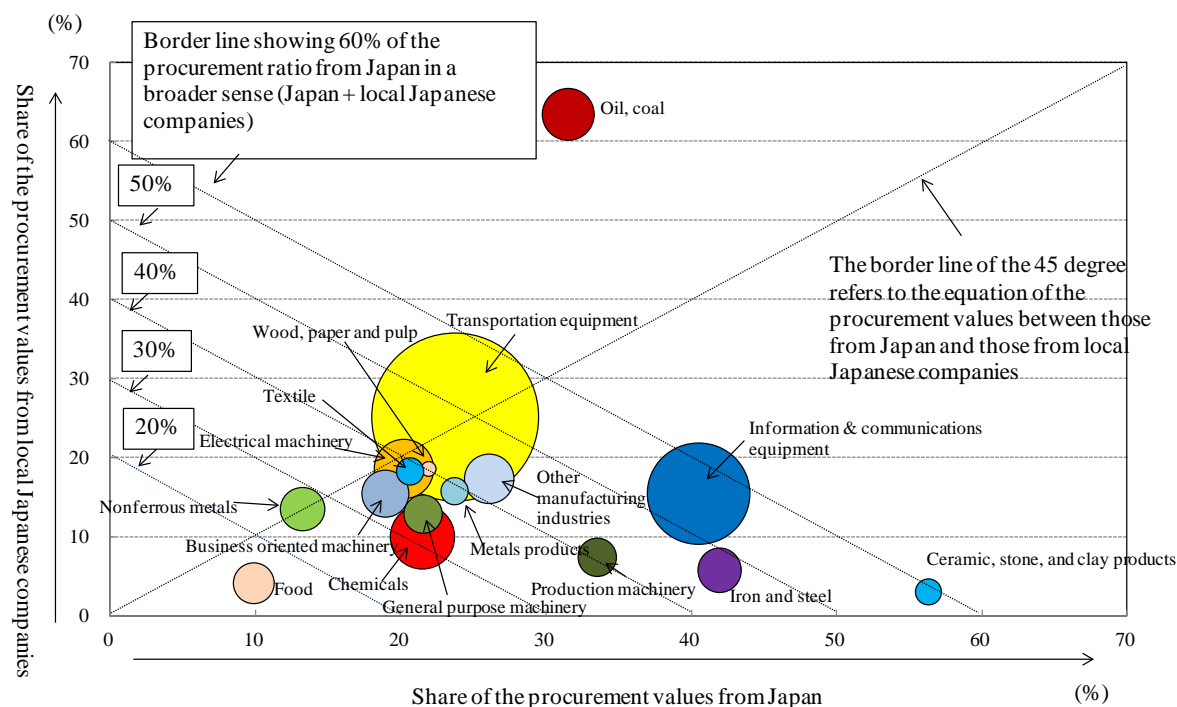
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Table II-3-2-21 Share of the source of material procurement by Japanese overseas affiliates in the manufacturing industry in Asia

	Total	Japan	Local country			Third countries				Japan +local Japanese companies
			Japanese companies	Local companies	Others	Asia	North America	Europe	Others	
2009	100.0	26.6	17.4	42.9	2.1	9.9	0.5	0.4	0.3	43.9
2010	100.0	28.5	17.5	38.9	2.3	10.6	0.5	0.7	0.8	46.0
2011	100.0	26.9	18.1	39.5	2.7	10.9	0.6	0.7	0.5	45.0
2012	100.0	26.7	20.6	36.8	2.9	10.6	0.8	0.5	1.0	47.3

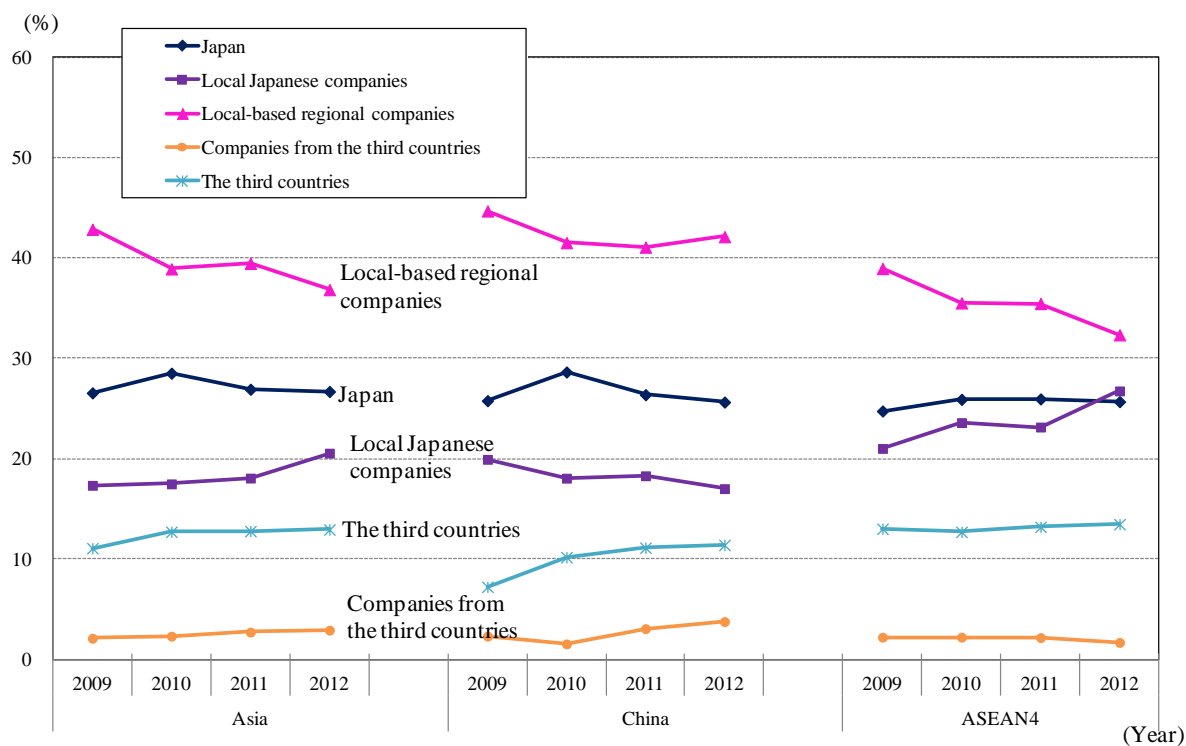
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-22 Material procurement by Japanese overseas affiliates in the manufacturing industry in Asia (2012)



Notes: Shares in the total procurement including those from Japan, the local country, and third countries. The size of the circles shows procurement values.
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-23 Shares of the source of material procurement by Japanese overseas affiliates in the manufacturing industry (China and ASEAN4)



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

(B) Dividends and royalties

Part of the profits gained through the activities of Japanese overseas affiliates is paid as dividends to the investors in Japan. In addition, royalties are also sent to Japan if the overseas affiliates use technologies and brands owned by the parent company. The value of such payments to the investors in Japan is generally growing (Figure II-3-2-24). In the manufacturing industry, the value of payments has increased mainly in Asia, whereas in the non-manufacturing industry payments from North America are growing remarkably.

By industry, the manufacturing industry accounts for a large portion; the following industries, in particular, together represent over half of all payments to the investors in Japan: transportation equipment, chemical, information and communications equipment and electric machinery (Figure II-3-2-25). Among non-manufacturing industries, the wholesale industry accounts for a large share.

Furthermore, a look at a cross chart by region and industry shows that the payments from Asia largely originate from the manufacturing industries, such as the chemical and machinery industries, including transportation equipment, information and communications equipment and electric machinery industries (Figure II-3-2-26). Regarding payments from North America, the value of transportation equipment and chemical industries is high in the manufacturing industry, but the payments from the wholesale industry, which is a non-manufacturing industry, are even greater.

As shown above, the parent companies in Japan receive the largest dividends and royalties from their overseas affiliates in Asia, which dovetails with the fact that Asia's portion is large in terms of primary income balance (return on direct investments) (Figure II-3-2-27).

A comparison of (1) the evolution of the value of material procurement from Japan and (2) remittance to Japanese investors (dividends and royalties) by Japanese overseas affiliates shows that both the value of material procurement and the payments of dividends and royalties are growing in Asia in the manufacturing industry, and the proportion of dividends and royalties to the value of material procurement is rising (Figure II-3-2-28). In North America and Europe, the value of procurement is trending downward, and payments of dividends and royalties remain flat. The proportion of dividends and royalties to the value of procurement is on a rise, as with Asia. Such increases in the proportion of dividends and royalties to the value of procurement are considered as being attributable to the increase in the income of overseas affiliates as well as to the rise in their domestic procurement ratio.

Figure II-3-2-24 Trends in payments to Japanese investors by Japanese overseas affiliates in the manufacturing industry

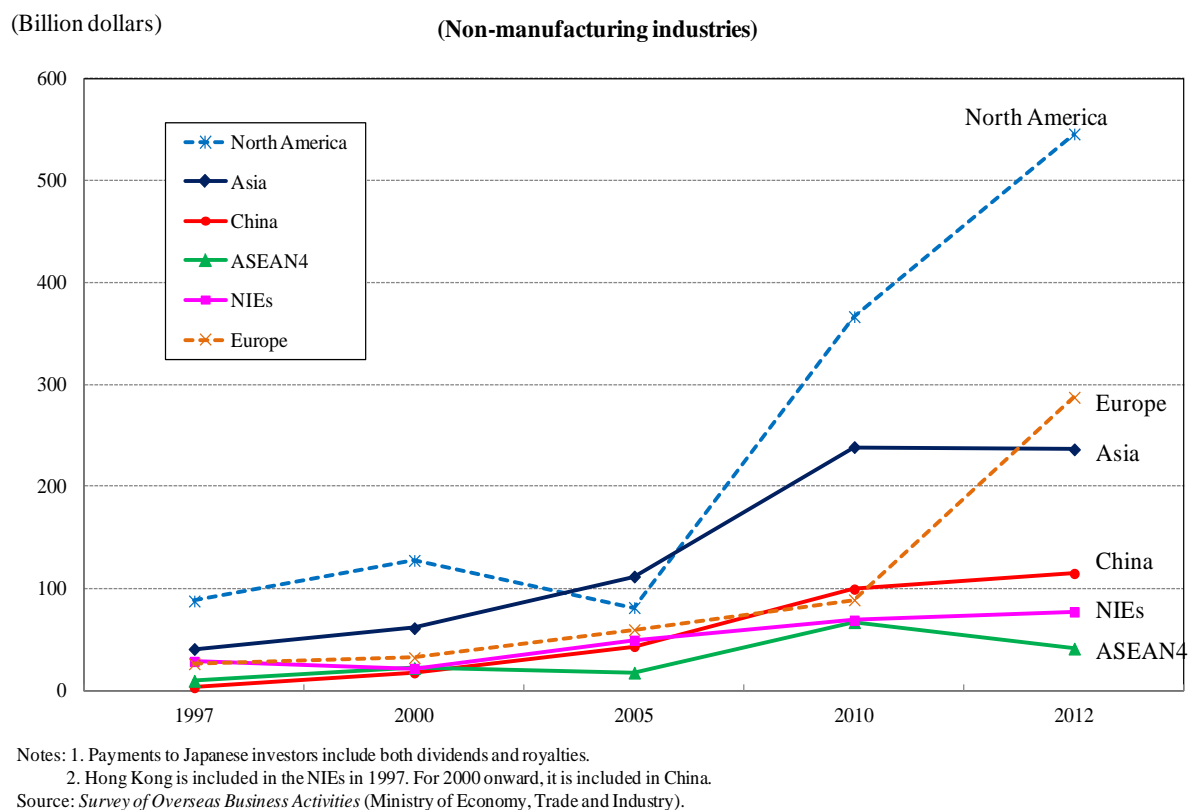
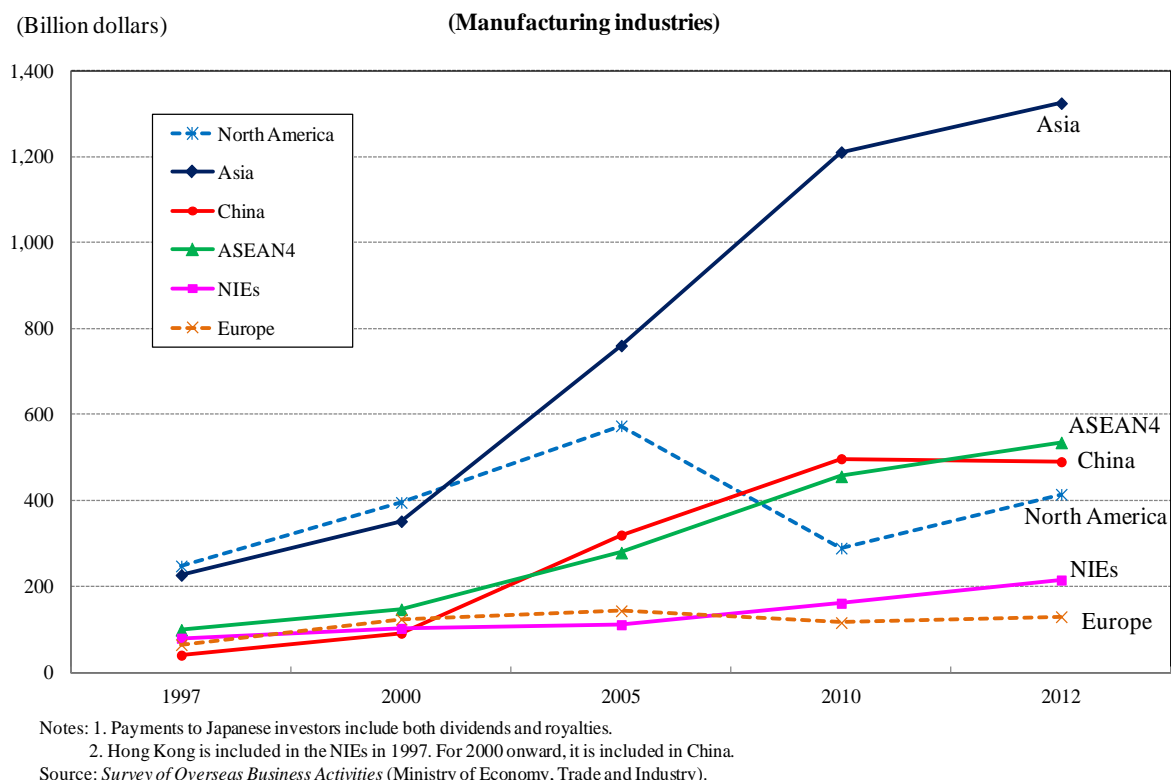


Figure II-3-2-25 Payments to Japanese investors by Japanese overseas affiliates (by industry) (2012)

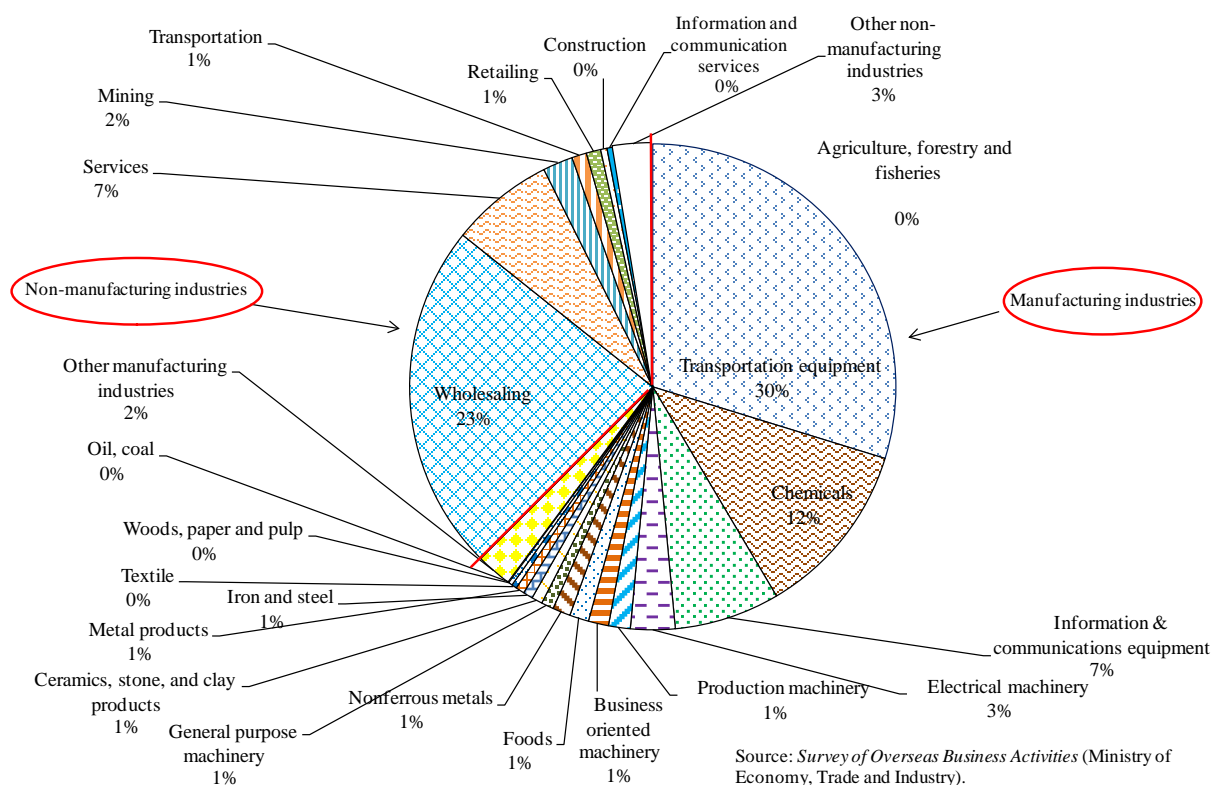
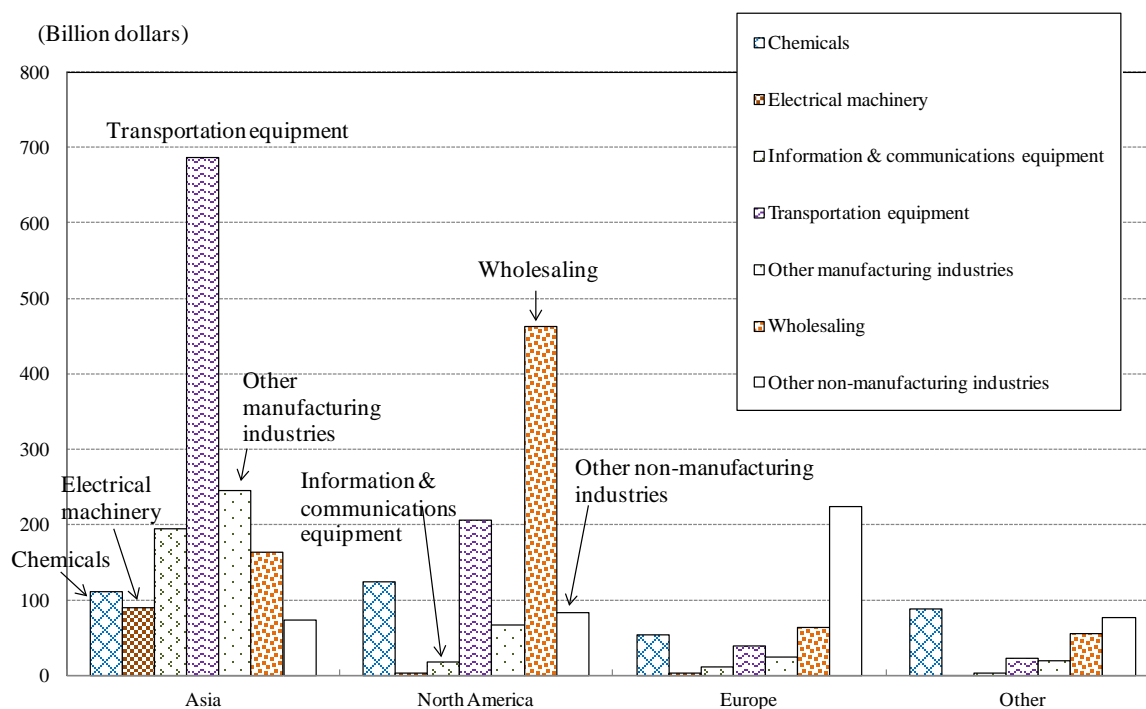
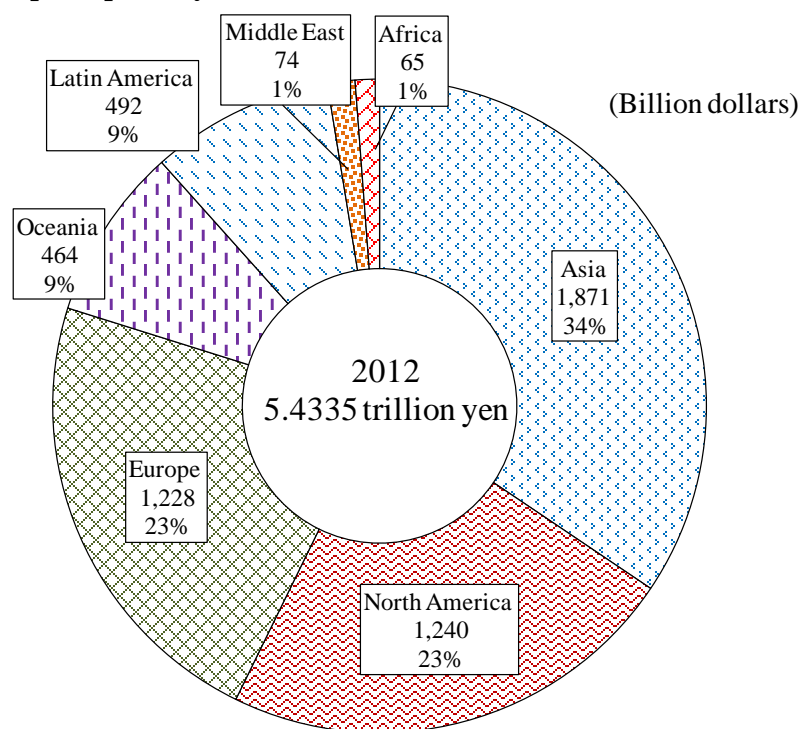


Figure II-3-2-26 Payments to Japanese investors by Japanese overseas affiliates (by region and industry) (2012)



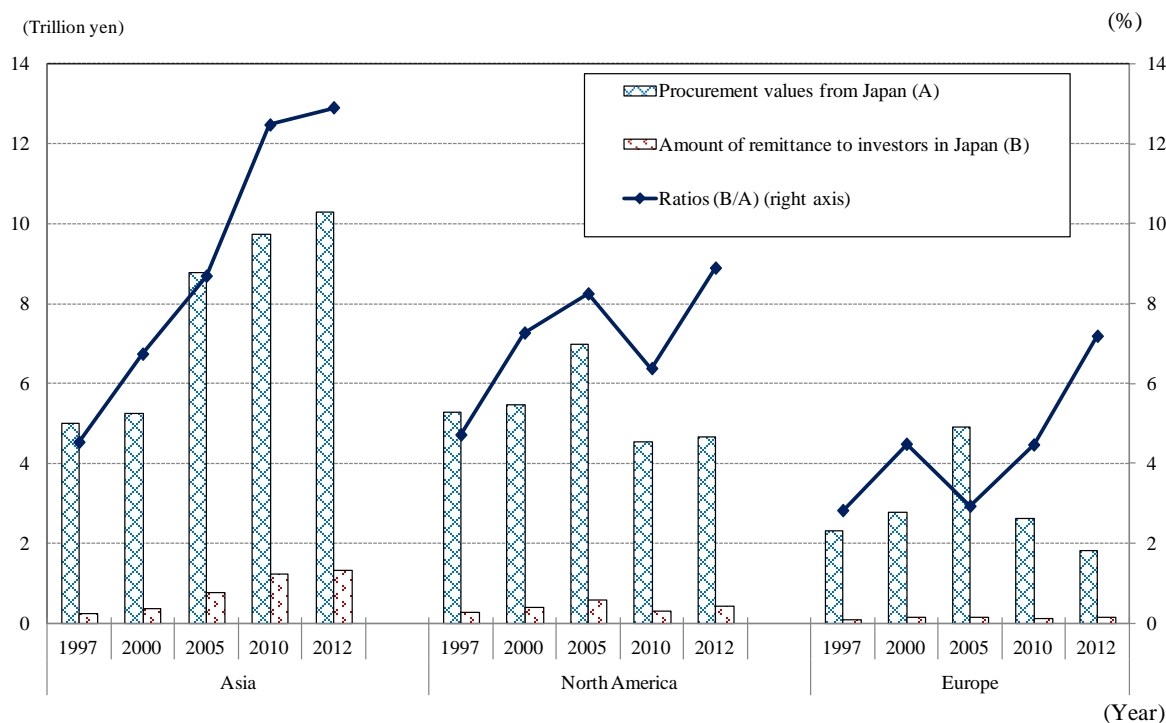
Notes: Payments to Japanese investors include both dividends and royalties.
Source: Survey of Overseas Business Activities (Ministry of Economy, Trade and Industry).

Figure II-3-2-27 Japan's primary income balance (return on direct investments) (2012)



Source: Bank of Japan

Figure II-3-2-28 Japan's income derived from Japanese overseas affiliates (manufacturing industry)



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

(3) Shift of production bases in Asia

Below, we study the changes of production bases in Asia by looking at past sales values deriving

from Japanese overseas affiliates by country.²⁴⁵ In addition to high growth in sales in China, the expansion in ASEAN countries such as Thailand and Indonesia is also striking. Although the values are still small, sales in Viet Nam and India are also growing, showing the expansion of production across the whole of Asia (Figure II-3-2-29). ASEAN's share has become comparatively low, while China's share is showing an outstanding increase (Figure II-3-2-30). However, in recent years, inversion of trends of ASEAN (upward trend) and China (downward trend) has also been observed. Among the ASEAN countries, Singapore's share is decreasing, while Thailand and Indonesia are increasing their shares instead.

A survey on investments by Japanese companies shows that a large portion of them considered China as the most promising investment destination in the early 2000s. Such perception is considered to have led to the expansion of sales of Japanese overseas affiliates in China, as described earlier (Figure II-3-2-31). Among the ASEAN countries, the portion of companies that consider Thailand as a high-potential investment destination stays stable, while the portions for Viet Nam and Indonesia are also increasing. Companies' expectations for investment destination countries are considered to be reflected in the shift of overseas production bases.

Although companies used to consider China as the most promising investment destination on the grounds of low labor costs, recently there has been a decrease in the number of companies that view China that way as more and more companies start to recognize rising labor costs as a problem (the survey also reveals that more and more companies are viewing China as a market rather than a production base). In contrast, in the case of India, Viet Nam and Indonesia, which are all experiencing point growth in survey results, companies pointed out the growth potential of the market as well as the cheap labor force as reasons for their expectations. The results of the survey show that Japanese companies determine the most suitable place for their production bases according to the situation at the time and shift their production activities to such places.²⁴⁶

²⁴⁵ Since statistical data of production value is not available, sales value is used instead.

²⁴⁶ Despite high expectations from companies, the sales value of Japanese overseas affiliates in India is low. Many companies pointed out insufficient infrastructure and other factors as issues, and we predict that investments will grow once these are resolved.

Figure II-3-2-29 Sales of Japanese overseas affiliates in Asia

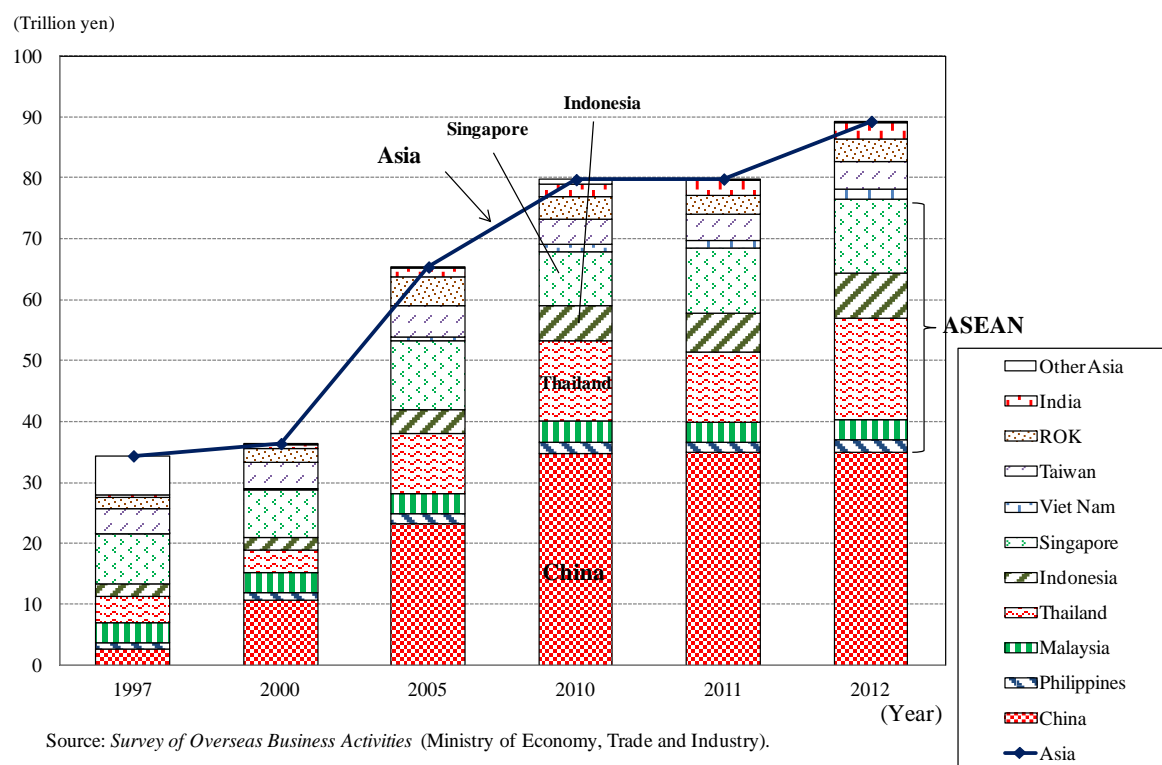
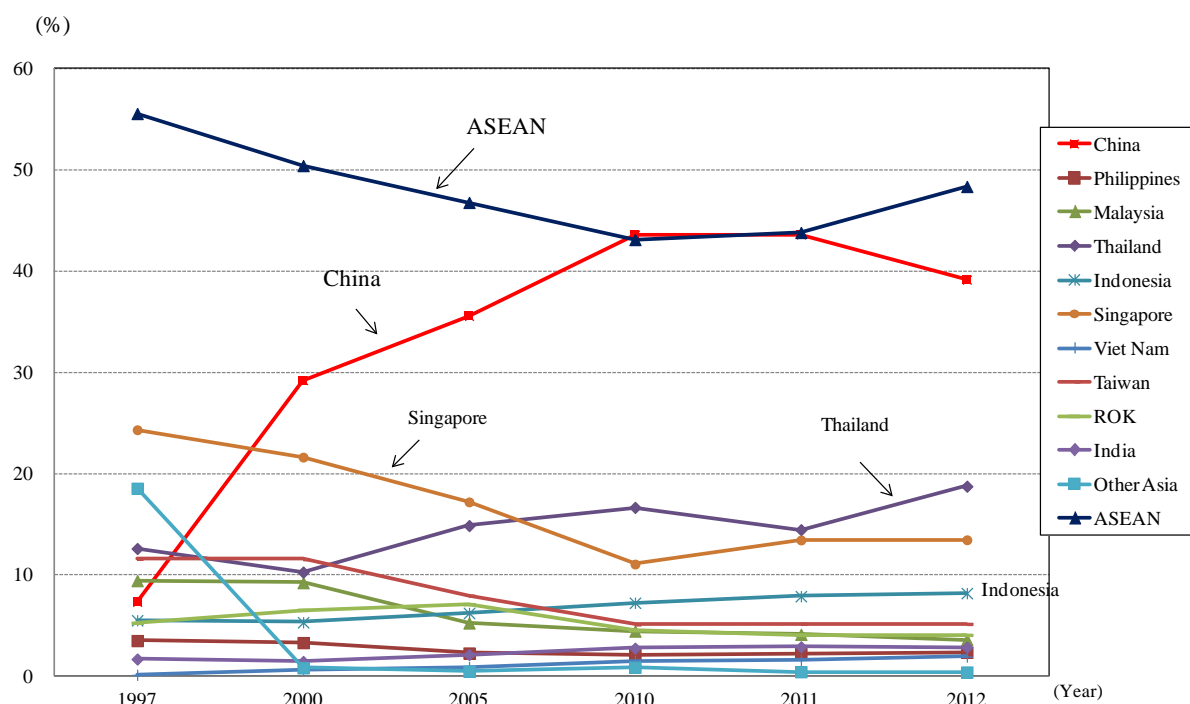
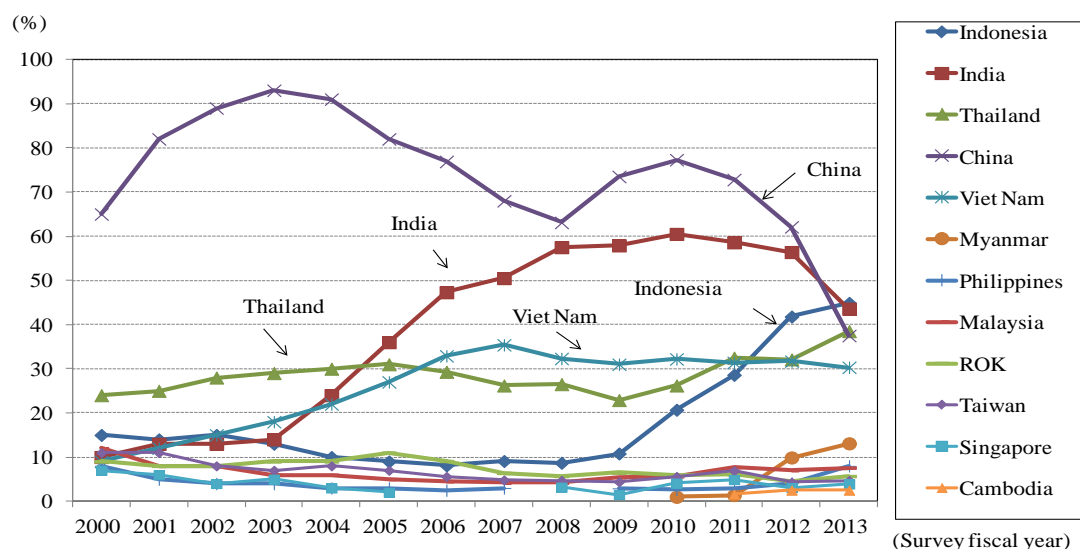


Figure II-3-2-30 Share of the sales of Japanese overseas affiliates in Asia



Notes: Here, the values for ASEAN indicate the total for the six countries: Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam.
Source: Survey of Overseas Business Activities (Ministry of Economy, Trade and Industry).

Figure II-3-2-31 Countries cited by Japanese manufacturers as promising for medium-term business operations



Notes: Countries cited by Japanese manufacturers as promising for mid-term business operations (about three years) based on a questionnaire survey
Source: *Survey Report on Overseas Business Operations Manufacturing Companies* (Japan Bank for International Cooperation)

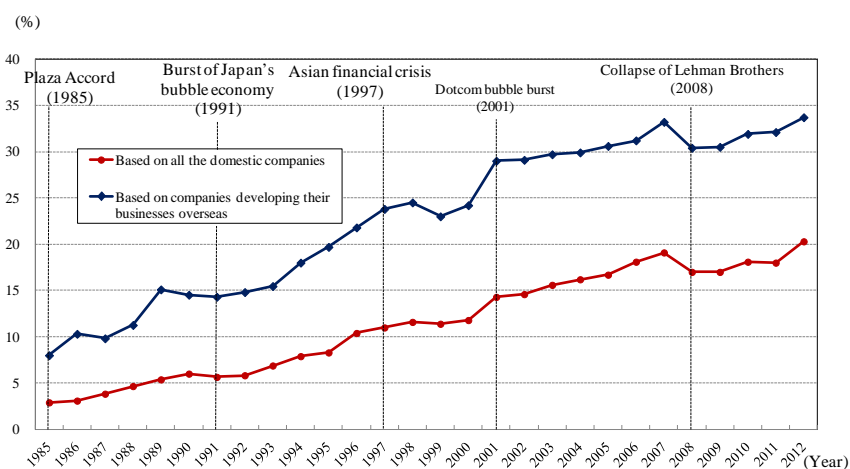
(4) Changes in the system of division of labor between Japan and overseas

As described above, Japanese companies are conducting their economic activities in the most suitable bases centered on East Asia. Below, we consider the changes in the system of division of labor between Japan and overseas.

(A) Overseas production ratio

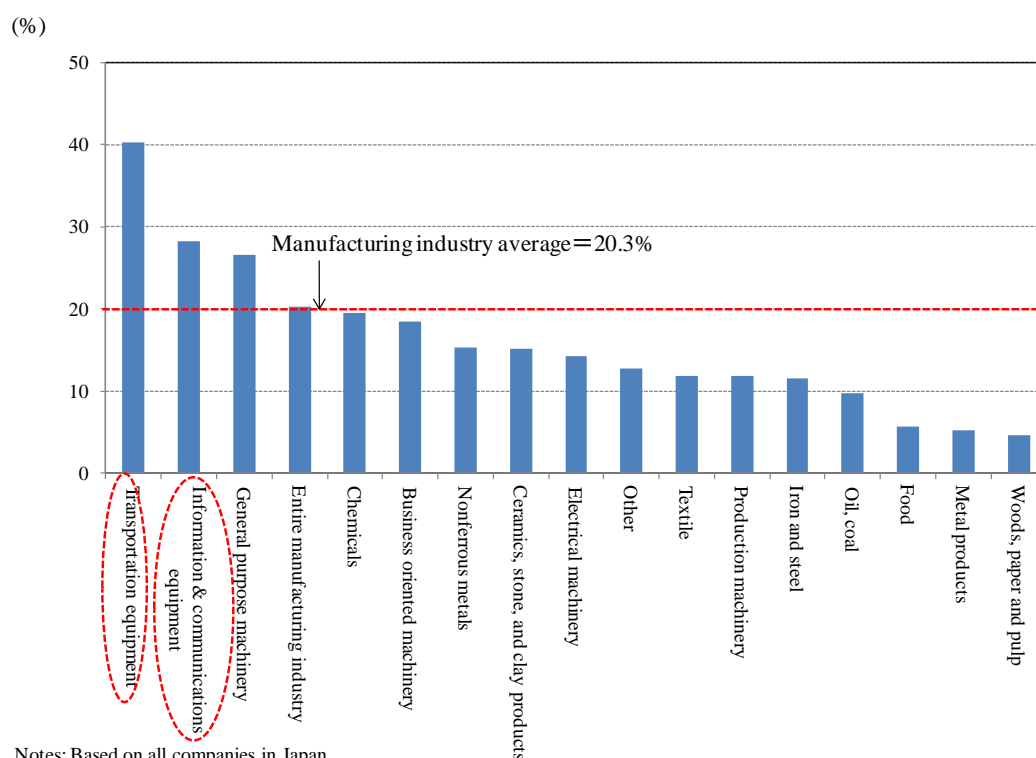
Overseas production activities of Japanese companies are expanding and that ratio is on a rise (Figure II-3-2-32). Especially, the growth of ratio in the transportation equipment and information and communications equipment industries is outstanding (Figure II-3-2-33).

Figure II-3-2-32 Trends in ratio of overseas production (manufacturing industry)



Notes: Ratio of overseas production (based on Japanese companies operating overseas) = Sales by local subsidiaries / (Sales for local subsidiaries + sales for parent companies)
Ratio of overseas production (based on all companies in Japan) = Sales for local subsidiaries / (Sales for local subsidiaries + sales for companies in Japan)
As the announced values for the years from 1985 to 1993 were calculated by a different formula, they have been corrected for the sake of consistency with other years.
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-33 Ratio of overseas production by industry (2012)



Notes: Based on all companies in Japan

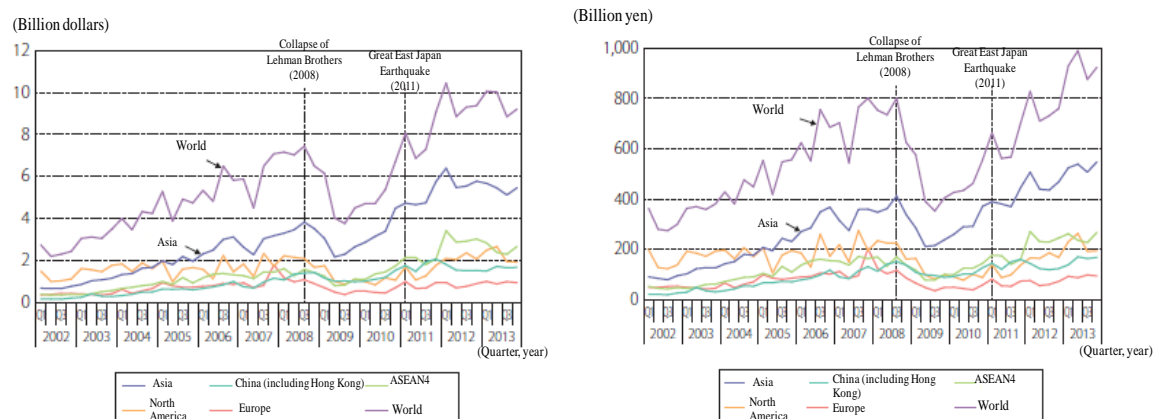
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

(B) Capital investment

While the growth of capital investments is slow in Japan, overseas capital investments are becoming more and more active. Quarterly capital investments made by Japanese overseas affiliates show different trends in dollar terms (decreasing from the previous year) and in yen terms (increasing from the previous year) due to a weakening yen in recent years; however, we can say that the investments have generally increased compared to the value of 2008. Especially, Asia shows a great increase (Figure II-3-2-34). By industry, capital investments in Asia are increasing remarkably in the transportation equipment industry, while in the electric machinery industry there is a marked downward trend (Figure II-3-2-35).

Looking at domestic and overseas capital investments made by Japanese companies, the increase has been slow in domestic capital investments since the collapse of Lehman Brothers, whereas overseas capital investments have been steadily growing (Figure II-3-2-36). As a result, the ratio of overseas capital investment is growing after the collapse of Lehman Brothers.

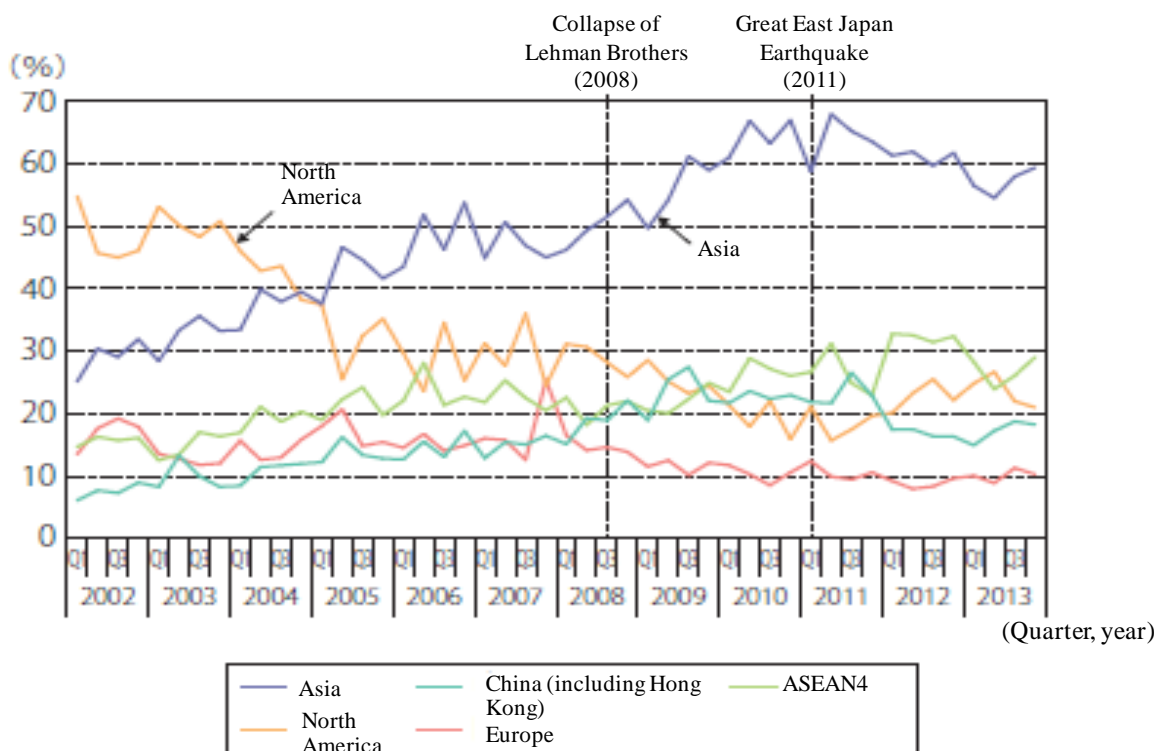
Figure II-3-2-34 Trends in capital investments by Japanese overseas affiliates (by main region)
(left: dollar basis; right: yen basis)



Note: 1. Values of tangible fixed assets (excluding lands) acquired in the current period
2. North America refers to the U.S. and Canada. ASEAN4 refers to Indonesia, Malaysia, Thailand, and the Philippines.
Source: *Quarterly Survey of Overseas Subsidiaries* (Ministry of Economy, Trade and Industry).

Note: 1. Values of tangible fixed assets (excluding lands) acquired in the current period
2. North America refers to the U.S. and Canada. ASEAN4 refers to Indonesia, Malaysia, Thailand, and the Philippines.
Source: *Quarterly Survey of Overseas Subsidiaries* (Ministry of Economy, Trade and Industry).

(Share (for dollar and yen))



Note: 1. Values of tangible fixed assets (excluding lands) acquired in the current period
2. North America refers to the U.S. and Canada. ASEAN4 refers to Indonesia, Malaysia, Thailand, and the Philippines.
Source: *Quarterly Survey of Overseas Subsidiaries* (Ministry of Economy, Trade and Industry).

Figure II-3-2-35 Trends in capital investments by Japanese overseas affiliates in Asia (by main industry)

(left: dollar basis; right: yen basis)

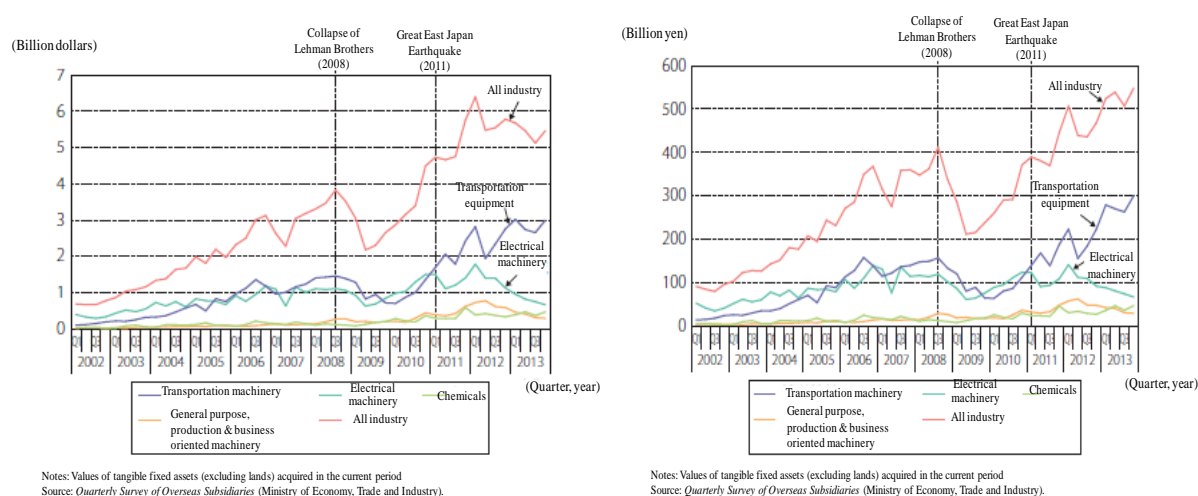
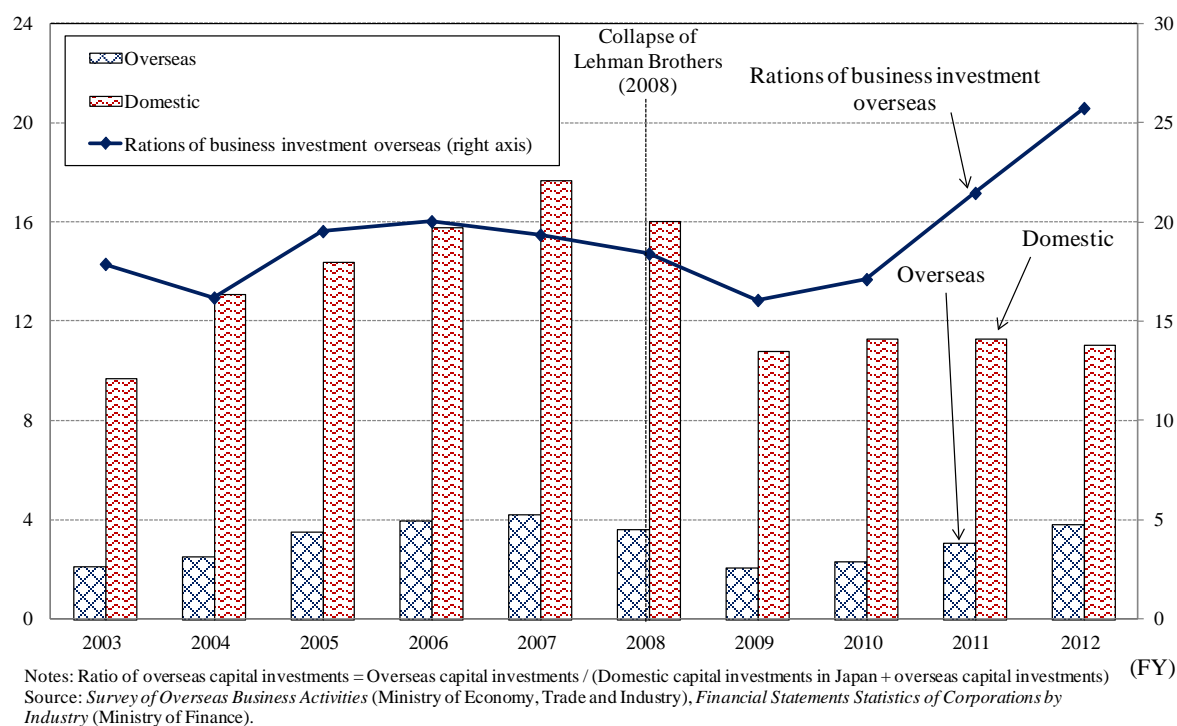


Figure II-3-2-36 Trends in overseas and domestic capital investments by Japanese companies

(Trillion yen)

(%)



(C) Research and development activities

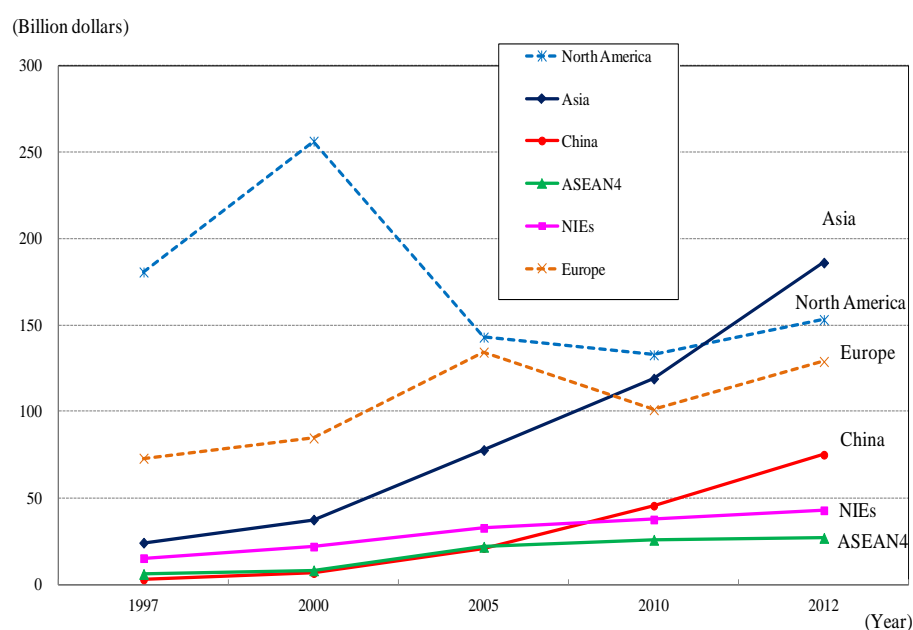
Japanese companies have addressed the development of basic technologies in Japan to produce key parts and components, while also conducting R&D activities overseas to make their products meet the specifications for the local market. A look at the recent R&D expenditures shows that Japanese companies are expanding their R&D activities overseas while also maintaining activities in Japan.

Especially, in the manufacturing industry, R&D expenditures for overseas affiliates located in Asia are notably increasing, with its total amount outpacing that of North America (Figures II-3-2-37 and II-3-2-38). In Asia, R&D activities are vigorous in the machinery industries, including transportation equipment as well as information and communications equipment and electric machinery industries. As for North America, there is a distinctive trend in active R&D activities in the chemical industry as well as transportation equipment and information and communications equipment industries. R&D in the chemical industry is also active in Europe.

Additionally, as we have already seen, Japanese companies are not only entrusting assembly processes to foreign countries, but also expanding their own business overseas and producing parts and components locally, while also expanding procurement from local companies. Such movements have further deepened the relationship between Japan and countries in which Japanese overseas affiliates are located. As described above, Japanese manufacturing companies are proactively conducting activities such as production, capital investments, R&D and material procurement overseas, especially in Asia. Companies select the countries which are most suitable for their overseas operation, while in turn they can also be expected to contribute to the host countries in the form of promoting economic development through production and capital investment activities, as well as providing local spillover in the form of technology and know-how through local R&D activities and material procurement.

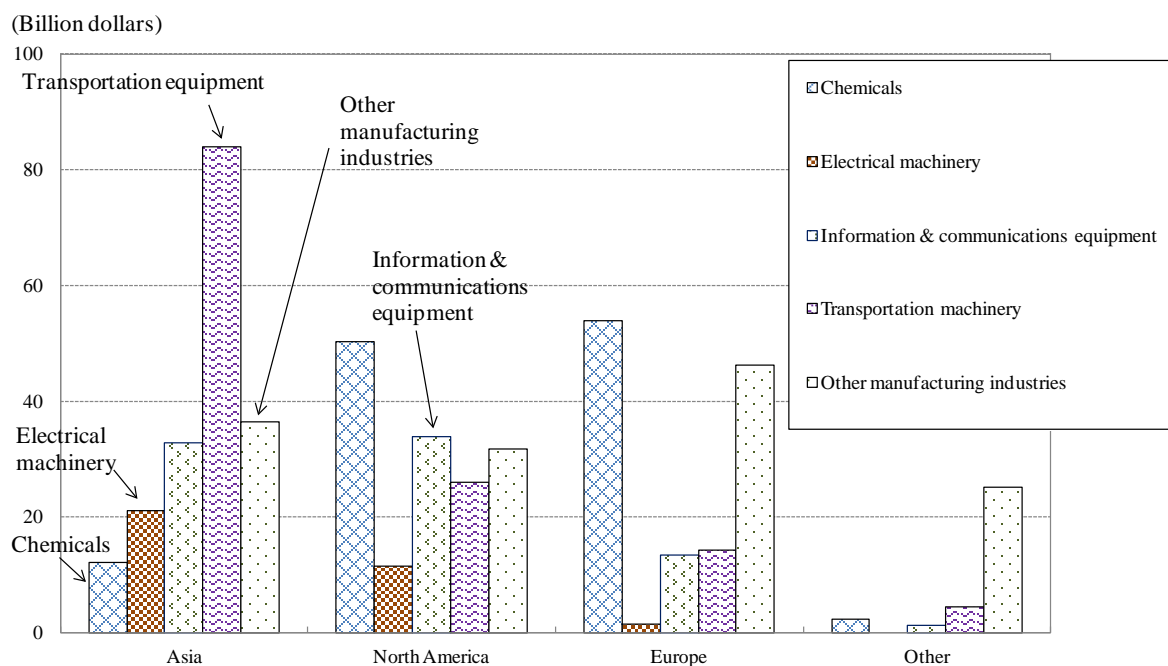
In the next part of this chapter, we analyze how trade and investment has increased in East Asia and how the relationship between Japan and East Asia has deepened. Furthermore, we will discuss how Japan can contribute to the shift to new growth models in emerging countries in Asia.

Figure II-3-2-37 Trends in R&D expenditures by Japanese overseas affiliates (manufacturing industry)



Notes: Hong Kong is included in the NIEs in 1997. For 2000 onward, it is included in China.
Source: *Survey of Overseas Business Activities* (Ministry of Economy, Trade and Industry).

Figure II-3-2-38 R&D expenditures for Japanese overseas affiliates (manufacturing industry)
(by region and industry) (2012)



Note: 1. The European information and communications industry does not publicize R&D expenditures due to its classification as confidential data. Therefore, we could not calculate or indicate the values for non-manufacturing industries.

2. "Other manufacturing industries" refers to manufacturing industries other than the chemical, electric machinery, information and communications equipment, and transportation equipment industries.

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