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Backgrounder

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JAPANESE INVESTMENT IN THE U.S.: CREATING JOBS AND NARROWING THE TRADE DEFICIT

INTRODUCTION

The U.S. trade deficit with Japan reached $49 billion last year, up 34 percent from 1984. So far this year, this bilateral trade deficit is up another 16 percent.

Washington and Tokyo take the deficit seriously. Their joint efforts to reduce it have spurred a 30 percent appreciation of the Japanese yen; and earlier this year the Japanese government initiated an "action program" reducing tariff and nontariff barriers on a wide range of imported goods such as medical equipment, pharmaceutical products, and telecommunication equipment. These moves will help reduce the U.S.-Japan trade deficit in coming months. But more has to be done. One of the best ways to reduce this deficit and simultaneously increase the number of jobs for Americans is to stimulate Japanese investment in the U.S., especially in the manufacturing sector.

Although direct Japanese investment in the U.S. began immediately after World War II, it did not expand very rapidly until 1970. But by last year, cumulative Japanese direct investment was around $17 billion, ranking third after the United Kingdom's $43 billion and the Netherlands' $35 billion.

Today more than 500 Japanese manufacturing companies operate plants in America. These directly employ nearly 100,000 Americans. Another 300,000 American jobs have been created for parts suppliers, transportation companies, distributors and various other "support" firms. In addition, some 4,500 nonmanufacturing Japanese companies and branches--such as trading companies, commercial dealers, banks, and restaurants--create an estimated half a million jobs in the U.S. Such business investments contribute to the U.S. gross national product (GNP), add to both local and federal tax revenue, and stimulate economic and social development in local communities.

Japanese investment in U.S. production, of course, reduces imports from Japan while prompting transfer of new Japanese technology and managerial expertise to the U.S. Over time these contributions will increase U.S. competitiveness in world markets and will improve the overall U.S. trade balance.

Since 1980, most of the new Japanese investment in the U.S. seems concentrated in manufacturing, such as automobiles, semiconductors, television, and steel. This interest in manufacturing stems mainly from efforts by federal, state, and local governments to encourage private Japanese companies to produce goods in the U.S. rather than exporting them from Japan. Local governments offer special grants, tax advantages, and other benefits to potential Japanese investors.

Despite some success in attracting Japanese investment, much more surely would be made were it not for certain legal and political obstacles. For example, the unitary tax system practiced by such states as California creates a negative investment environment, as do attempts by labor unions to organize Japanese subsidiaries. Also, poorly-defined restrictions relating to national security concerns inhibit the acquisition of U.S. firms by foreign companies.

U.S. interests are well served by Japanese direct investment in manufacturing plants, and U.S. policy makers could facilitate such investment in a number of ways. For one thing, the federal government could continue its efforts to abolish state unitary tax systems. For another, Congress could direct the General Accounting Office to assess the benefits of foreign investment in the U.S. in order to supply the background information necessary for a more receptive political environment. Unlike trade protectionist measures, which would damage the Japanese and American economies, Japanese investment in the U.S. would help them both.

GROWTH OF JAPANESE INVESTMENT IN THE UNITED STATES

In recent years, Japanese investment in the U.S. has grown enormously. Only $229 million in 1970, Japanese investments now have reached almost $17 billion. Patterns of Japanese investment also have changed dramatically, shifting from such nonmanufacturing industries as agriculture, fishing, trading companies, restaurants, and banks, to the manufacture of televisions, semiconductors, steel, and automobiles.

A survey conducted by the Japan Economic Institute reveals that in 1970 there were only 12 U.S. manufacturing companies in which Japanese firms held more than 50 percent of the stock. But by 1985, there were nearly 400 such companies, plus more than 500 Japanese-owned plants.[1] Today almost all major Japanese manufacturing companies producing electric machinery, appliances, and transportation (including Hitachi Ltd., Mitsubishi Corp., Sony Corp., and Honda Motor Co. Ltd.), manufacture at least some of their products in the U.S.

FACTORS CONTRIBUTING TO INCREASED JAPANESE INVESTMENT

Several factors explain the sharp rise in Japanese investment.

U.S. Federal and State Encouragement

In 1973, 1978, and 1980, the U.S. Department of Commerce and the American Embassy in Tokyo sponsored a series of "Invest in the USA" seminars in Tokyo and Osaka to induce Japanese businessmen to invest in the U.S. Nearly 600 Japanese company representatives attended these seminars, and the majority now invest in the U.S. In addition, Presidents Jimmy Carter and Ronald Reagan, as well as numerous state governors and union leaders, have encouraged Japanese business leaders to invest in the U.S. rather than export to the American market. More than 20 state governments have trade offices in Japan, and they compete with each other by offering special grants, tax advantages, and other benefits to Japanese firms contemplating investment in the U.S.

As a result of this intense encouragement and competition, Japanese companies have been able to select attractive sites for their U.S. plants. California leads with 140 Japanese plants. Texas ranks second with 38, Georgia with 31, New Jersey with 29, Illinois and Washington with 22 each, North Carolina with 21, Pennsylvania with 20, Ohio and Michigan with 16, Alaska and New York with 15 each, Tennessee with 14, and Indiana with 12. Some 89 Japanese plants are sprinkled among the other states.[2]

Maturing of Japanese Companies

Successful Japanese companies have mastered the technological and managerial know-how to produce cost-competitive goods in the U.S., despite wages that are higher in the U.S. than in Japan. Japanese

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1. Japan Economic Institute (JEI) Report, February 15, 1985.

2. Ibid.

companies conduct extensive studies and detailed preparations, often lasting more than a decade, before investing in American manufacturing plants. This includes study of possible plant locations, the labor market, and local suppliers. The experiences of early Japanese investors, such as Sony Corporation U.S.A. and American Honda Motor Co., Inc., are studied very carefully. Japanese businessmen tend to view any investment as a long-term commitment and regard failure or the closing of a plant as a great embarrassment.

Protectionism in the U.S.

The threat of U.S. protectionist trade legislation probably has accelerated Japanese investment in the U.S. Having faced "domestic content" legislation to mandate significant domestic production of parts for automobiles, which passed the House but not the Senate in 1984, and a 25 percent "import surcharge" bill currently sponsored by Representatives Dan Rostenkowski (D-IL), Richard Gephardt (D-MO), and Senator Lloyd Bentsen (D-TX), Japanese auto makers and businessmen see investing in U.S. production facilities as a means of safeguarding their American market access in case Congress enacts strong protectionist legislation.

BENEFITS OF JAPANESE INVESTMENT

The major benefits of direct Japanese investment in the U.S. include the creation of jobs and community development, the decrease in demands for imported Japanese goods, and the transfer of Japanese technology and managerial know-how.

Jobs and Community Development

Japanese investment contributes to the American GNP and job pool. It has built completely new production facilities, such as the Nissan automobile plant in Smyrna, Tennessee, and the Hitachi color television and video cassette recorder plants in Anaheim, California; it also has acquired existing plants such as the Firestone plant in La Vergna, Tennessee, and the Motorola television plant in Chicago, Illinois; it has participated in joint ventures such as Toyota's cooperation with General Motors; it has invested as a minority shareholder in such ventures as California Steel Industries, Inc. These Japan-affiliated industries directly employ at least 100,000 American workers.[3] Their estimated combined annual payroll exceeds $2 billion.

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3. Ibid.

Employment opportunities are not limited to those directly employed in these plants. The suppliers of parts and transportation, the gasoline stations, grocery stores, schools, and other related services also are stimulated by Japanese investment. Nissan, for example, directly hired 2,000 workers in Smyrna, Tennessee, but this created jobs for 9,000 more.[4] Thus an estimated 300,000 American jobs have been created indirectly by investment in manufacturing plants by Japanese corporations.

In nonmanufacturing sectors, more than 4,500 Japanese companies and branch offices currently are operating in the U.S. These companies hire a large number of Americans. Example: 100,000 Americans work for Japanese car dealerships alone. And these firms create jobs in other industries, such as accounting, law, public relations, and advertising. In turn, these business activities trigger a demand for offices, houses, car rentals, and other goods. Money spent on them, of course, is recycled throughout the community. As such, perhaps more than 500,000 Americans benefit directly or indirectly from the business operations of these Japanese companies.

Direct investments, increased production, higher sales, and increased payrolls contribute to the U.S. GNP, the increase of the tax revenue at both the federal and local government level, and regional development.

Japanese firms even contribute to social stability in communities facing severe dislocation because of collapsing U.S. plants. Bridgestone Tire Company of Japan, for example, bought the Firestone tire plant in La Vergna, Tennessee, which was about to close down. This action saved jobs for 1,200 workers in town, and in effect, the entire community was saved.

Import Substitution

At first, Japanese investments in U.S. manufacturing sectors increase Japan's exports to the U.S. because parts and other equipment must be brought over from Japan. After the plants are established, however, imports from Japan decrease. In 1976, for example, nearly 3,000,000 color TV sets were imported from Japan, while only 500,000 were produced by the U.S. subsidiaries of Japanese companies. Four years later, only 500,000 sets were imported and 3,000,000 sets were produced in the U.S. by the Japanese companies.[5]

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4. JEI Report, December 16, 1983.

5. White Paper on International Trade, Japan External Trade Organization, 1984, p. 30.

Recent expansion of Japanese investment in U.S. automobile plants and high-tech industries also will reduce future imports of these goods. Moreover, products made in the U.S. by Japanese corporations can be competitively exported to Canada, Europe, and Latin America. One Japanese firm, Mitsui & Co. U.S.A., Inc., which imports and exports such products as coal, agricultural goods, and airplanes, reported an export surplus of some $3 billion in 1984--"A figure that would place it among the top five exporting companies in the United States," according to the New York Times.[6]

Transferring Japanese Technology

Many Japanese investments in the U.S., particularly joint ventures with American companies, transfer Japanese technology. Joint ventures between a Japanese auto maker, Toyota, and General Motors, for example, have made the design and production technology for small cars available that has enabled GM to put competitive models of its own on the market.

In addition, Japanese managerial know-how, such as participative management systems, statistical quality control, and factory automation, has convinced U.S. manufacturers that they can make high quality products at competitive costs. Matsushita Electric Industrial Company, for instance, bought ailing Quasar television plants in Chicago from Motorola Company in 1974. Matsushita invested in new equipment and operation techniques; by 1978, the plant's productivity was up more than 25 percent. The Chicago Tribune reported: "According to an independent study cited in a General Accounting Office report last year, the defect rate on Quasar sets fell to 3 to 4 per 100 sets under Matsushita from 50 to 100 per 100 sets under Motorola."[7]

OBSTACLES TO INVESTMENT

In spite of the vast economic benefits for the U.S. from Japanese investment, obstacles remain that discourage further Japanese direct investments in production facilities.

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6. The New York Times, July 1, 1985.

7. The Chicago Tribune, September 17, 1980.

State Unitary Tax Systems[8]

In a state that employs unitary taxation, a foreign firm is taxed not only on its earnings in that state, but everywhere else in the world where it does business. Example: the U.S. subsidiary of a Japanese company, Kyocera International in San Diego, California, which manufactures ceramic packages for integrated circuits and which paid $18 million in U.S. tax and $350,000 in California taxes during 11 years, was charged $21 million additional tax under California's "unitary tax" system. This extra charge was calculated on the basis of earnings by Kyocera's parent company.

In recent years, Oregon, Florida, and other states have attracted foreign investment by abolishing the "unitary tax" system. Even so, and despite the obvious unfairness and adverse effect on businesses and President Reagan's objection to it, California and six other states still employ the unitary tax system. Late November, Reagan announced that he would ask Congress to pass a law that allowed states to tax multinational corporations only on income earned in the United States.

Unclear "National Security" Restrictions

The U.S. restricts foreign investments in certain industries (defense, communications, shipping, nuclear and hydroelectric power, among others) for national security reasons. These restrictions are extremely confusing and ambiguous. Several recent decisions that restricted Japanese investment sparked fears in Japan that an anti-foreign investment mentality, not national security, was the prime motivation behind them. Nippon Steel Corporation, for example, purchased Special Medals Corporation, a subsidiary of Allegheny International Corporation, and was then advised by the U.S. Department of Defense to cancel the deal.

Protectionist and Anti-Foreign Investment Political Environment

Although the governments of Japan and the U.S. view Japanese investment in the U.S. as a hedge against protectionist legislation, most Japanese companies regard it solely as a business venture. Thus, when U.S. trade policies make it unprofitable for them to do business in America, they are unlikely to expand their investment merely "for political reasons." One American subsidiary of Fujitsu Ltd., for example, manufactures computer equipment in California and depends on a supply of low-priced semiconductor chips from Japan. But Washington's recent threat to impose "dumping duties"--i.e.,

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8. Katsuro Sakoh, "The Unitary Tax: Obstacle to Foreign Investment," Asian Studies Center Backgrounder No. 19, December 6, 1984.

protective tariffs--on Japanese semiconductor chips threatens to increase substantially the firm's production costs and decrease its profitability. In response, Fujitsu may curtail production or expansion of its operation in the U.S. Hence, protectionist trade measures not only rob American consumers of free choice in the marketplace, but also discourage foreign investment in the U.S.

As foreign investment activities increase, moreover, some American politicians may be tempted to fan anti-foreign investment hysteria. The New York Times reports that some governors like Richard D. Lamm of Colorado view the trend as "economic colonialism." Says Lamm: "It seems so clear that, when the Japanese are buying our productive resources, it has serious long-term implications....The long-term implication is that our children will be working for the Japanese." Such concerns can be interpreted by the Japanese industrialists as a general trend in the U.S.

CONCLUSION

As Japanese business matured and became increasingly competitive worldwide, Japanese firms naturally sought to produce in the globe's richest marketplace--the United States. In addition, recent increases in the value of the yen relative to the dollar create a much more favorable investment environment in the U.S. for Japanese companies. This then may be the right moment for Washington to encourage expanded Japanese investment by removing obstacles to foreign investment and domestic economic growth. Among other things:

- The Department of Commerce should conduct seminars in Japan on joint ventures.
- The Reagan Administration should continue trying to convince states to abolish their unitary tax systems.
- The U.S. should sharpen and clarify its national security restrictions on foreign investment.
- Congress should direct the General Accounting Office to study the benefits of foreign investments in the U.S.

The U.S. is now trying to reduce its international trade deficit and to create new jobs at home. Its success at doing so may require more efforts at government and private levels to attract long-term capital inflow, such as Japanese manufacturing plant investment. While protectionist trade measures would damage both world and American economies, the expansion of foreign investment in the U.S would help the American and world economies to grow simultaneously.

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