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Japanese Investment in Latin America : Unfinished Business.

—— The Case of Mexico, Peru and Brazil ——

Yoshiaki HISAMATSU* and Marco KAMIYA**

Abstract

The authors examine why Japanese Foreign Direct Investment in Latin America, despite a good start in the 1960s and 1970s, never took off in a developmental way as in East Asia. The study examines three countries (Mexico, Peru, and Brazil). Discussions are included on i) the role of geography in determining economic outcomes and regions, ii) the behavior of Japanese investment, and on iii) Akamatsu's Flying Geese Pattern of investment and why Latin America lacked fundamental conditions to foster the success of the "Flying Geese." The paper concludes with directions for future research topics.

I. Japanese Investment : International Trends

In the 1990s, several studies appeared analyzing Japanese investment worldwide and in particular to Latin America. It is both remarkable and ironic that Japanese investment never took off in the developmental fashion as it did in East Asia. Investment was considerable in the early years of the 1960s and 1970s. However, with the exception of Mexico and somehow Brazil, it has remained stagnant since the 1980s. Why did Japanese investment never take root in the region with multiplier effects from clusters of industries and leading countries as in the Akamatsu's Flying Geese way?

The answer to this question has important implications for public policies to attract investment for Latin American governments, and also affects the strategy of

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Japanese companies in the region, already facing future production trends as a result of the emergence of Chinese firms, stronger Western European companies and other new players.

Japanese FDI began to grow at an accelerated pace during the second half of the 1980's. Until that period, production was concentrated in Japan because the cheaper yen made the Japanese archipelago an excellent springboard for exportation to the United States, and Europe.

Japanese investments have been concentrated in developed countries, and in 2003, Japanese FDI was distributed as follows : United States was the most important recipient (29.3%), followed by Western Europe (35.0%), Asia (17.8%), and Latin American and the Caribbean (14.7%) (See Table 1).

Table 1 Regional Distribution of Japanese FDI

Region	2003
TOTAL	100.0
North America[1]	29.6
Western Europe	35.0
Asia	17.8
Latin America and Caribbean	14.7
Caiman Islands, Bahamas, Bermudas, etc.[2]	10.0
Africa, Middle East, Australia, Eastern Europe	2.9

Note : 1/Data on Balance of Payments basis. Mexico's data are included in Latin America and Caribbean. 2/these are investment for financial transactions in "Tax Heavens."
Source : Ministry of Finance Statistics Monthly, various editions[1].

The percentage corresponding to Central and South America includes "tax heavens" such as the Cayman Islands, Bahamas, Virgin Islands, Bermudas, Barbados and Panama, which comprise around 10.0%. Less than 5% of "real" Japanese FDI found its way to Central and South America, a percentage that shows the marginal nature of the region as a target for investment.

The total accumulated investment amount between 1951-2002 shows that the manufacturing sector accounted for 35.4% of FDI flows, and the non-manufacturing sector accounted for 64.5%, with considerable allotments to finances and securities, real estate and services. Concerning the distribution of investments by sectors, more than half of Japanese FDI, 55.7%, is directed to non-manufacturing, which includes services, finances, and raw materials. The manufacturing sector received

35.4%. Japan relies heavily on imported raw material, but the proportion of its investment in raw materials seems relatively small in comparison to the total investment. Nevertheless, Japanese investment is not directly routed to these sectors. The requisite materials are instead obtained through trade or from loans. Consequently, a large portion of Japanese FDI in finances, securities, and commerce represents an indirect investment in raw materials (see Table 2).

Table 2 Distribution of Japan's FDI Flows

Sectors	2002 (%)	1950-2002 (%)
TOTAL	100.0	100.0
Manufacturing	37.6	35.4
Foodstuff	0.4	0.8
Textile	0.2	0.1
Rubber - Leather Products	0.0	0.5
Chemical	19.0	10.0
Oil	2.8	2.8
Glass - Stone Products	0.0	0.2
Metallic Products	0.8	1.2
Machinery	12.4	18.7
Other	2.0	1.1
Nonmanufacturing	62.4	64.5
Construction	0.1	0.1
Real State	1.3	2.4
Commerce and Trade	11.8	13.3
Service	11.3	11.2
Transport - Logistics	0.1	0.2
Communications	7.9	13.0
Finance & Insurance	29.6	19.7
Other	0.3	0.8

Source : Ministry of Finance Statistics Monthly No 620. December 2003

In Latin America, Brazil (for the size of its economy) and Mexico (for its presence in the North American Free Trade Agreement (NAFTA)) have always been the primary destination of Japanese N in the region. Most of the countries have received investments in mining, agriculture and oil sectors.

II. Latin America : Tale of Three Regions

A map of the "Americas" is more graphic than several statistics[2]. Situated directly below Canada and the United States, Latin America appears divided by

Central America and the Caribbean and South America. The Spanish language links Mexico with South America though it is considered part of North America. But geographic features further divide the region. In the Western part of South America, the Andean mountain range splits the continent into two parts, with Andean countries on the left side, and Brazil and Southern cone countries on the right. The jungle in the north-central region of South America poses another geographical division in the region. As a result, Latin America is composed of three distinctive regions: i) Mexico and Central America and the Caribbean. ii) Andean Countries, from Venezuela to Chile, and iii) Brazil and Argentina. Although most Latin American countries share a common language, it is evident that economic and geographic considerations play a greater role than cultural proximities in shaping their relationship.

In his best-selling book, Jarred Diamond[3] includes a map of the "Americas" with an axis crossing the entire continent, indicating that in geographical terms, North and South are almost separate entities. As for South America, geographical features explain why it is so difficult to integrate the continent through land. For example, transporting goods from Sao Paulo to Lima requires a detour down to Argentina, across the Straits of Magellan and a round pass through Chile, before arriving in Lima[4]. Trade must rely mostly on maritime transportation, posing added cost by economics of scale, volume and time. More than 80% of trade is made by sea, except in the cases of Bolivia and Paraguay, which are landlocked.

Current regional free trade agreements and those under negotiation reflect these geographical features. Mercosur comprises Brazil, Argentina, Uruguay and Paraguay; the Andean Group is made of Venezuela, Colombia, Peru, Ecuador and Bolivia; NAFTA is the U.S., Mexico and Canada; and then the Central American Common Market and the Caribbean Community (Caricom). The fact that the Free Trade Area of the Americas (FTAA) has not progressed to achieve its initial deadline for integration in 2005 is the result not only of political issues but also of negotiations driven by geographical issues.

The history of Japanese investment in Latin America began in the late 1960's, when Japan was in a period of rapidly accelerating growth with increased exportations, signaling the need to ensure future sources of raw materials. In 1967, Japan started a policy of liberalization that was completed in 1973, the same year the oil crisis occurred and flexible exchange rate was adopted by world powers. Japan foresaw two major problems. The petroleum crisis reminded Japan that the econ-

omy would be unstable unless it could assure a stable supply of raw materials. The change in the monetary system, on the other hand, indicated the urgency to modify the industrial system from the manufacturing of low value-added products, such as steel, coal and textiles, to move toward the production of higher profit margin goods[5].

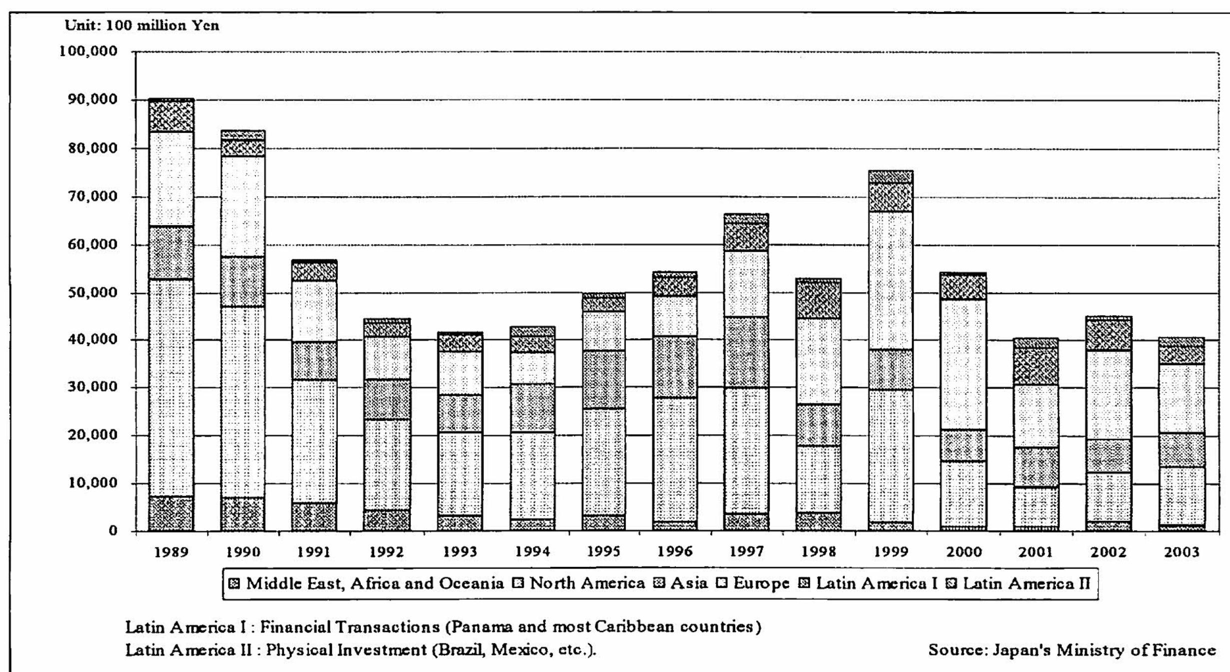
In this context, supported by different indirect mechanisms of the Japanese government (Ministry of Finance and Ministry of Industry), a wave of investments began in Latin America with the entry of Japanese manufacturing companies and Sogo-Shosha (Japanese trading companies)[6], predominantly in the mining sector.

In early 1970s, Japanese companies also went to Latin America to secure market share against protectionist agreements such as the Andean Pact (created in 1969 with Peru, Ecuador, Bolivia, Colombia, and Chile (which withdraw from the pact in 1976) ; Venezuela was included in 1973). Negotiations limited foreign investment and imports of foreign goods manufactured domestically. Peru served as an ideal site for this expansion, as Toyota and Nissan began the production of vehicles, National of Peru (Matsushita) started to produce home appliances, and Ajinomoto produced its famous food seasoning.

The Mexican debt crisis in 1982 interrupted this process and despite considerable Japanese investment worldwide, Latin America was passing through what later became known as “the lost decade”. When Latin America recovered in the 1990s, Japan itself was suffering the collapse of the Bubble Economy and beginning a lost decade of its own which has not yet fully recovered. Graph 1 illustrates the decline of Japanese investment in the 1990s, slightly increasing since 1995 only to fall again since 1999. Latin America figures have been divided by financial and non-financial investments, and in general the region occupies an obviously marginal position in comparison with other regions.

In order to explain the different behavior and characteristics of Japanese investment in Latin America and taking into account geographical differences, this paper analyzes the case of Mexico for North and Central America ; Peru as an Andean region country ; and Brazil as part of the ebullient Eastern zone, which also includes Argentina and Uruguay.

Graph 1. Japanese Investment Trend 1989-2003



i. Japanese investment in Central America : The case of Mexico

Japan's economic relationship with Mexico is characterized by three distinctive elements : market size, natural resource (oil), and proximity with the United States. The history of Japanese foreign direct investment in Mexico illustrates how the Japanese economy has been shaped by those elements.

During the Import-Substitution Industrialization era (1960s-1970s), the relatively large Mexican market attracted foreign direct investment from a number of countries, mainly from the United States. A notable case from Japan was Nissan, the car maker. Nissan established Nissan Mexicana, S.A. in 1961 to produce passenger vehicles. Its production had a high cost structure, but the industry was protected by high tariffs and rigid quantity restrictions from foreign trade.

The oil shocks in 1971 and 1973 and the multiple discoveries of oil fields in 1970s pushed Mexico into the major league of oil producing countries. Since oil in Mexico is considered national property sanctioned in its constitution, its national oil company (PEMEX) controls oil production. So, foreign direct investment in this sector was not permitted. Even though portfolio investment marked the 1970s, bright economic forecasts for natural resources (despite its protected market) brought sizable direct investment into the natural resources sector[7].

The debt crisis in 1982 abruptly halted the brilliant future. With low oil prices and overhanging debt, Mexico suffered economic stagnation in the 1980s. Thus,

Mexico was forced to change its development strategy from long-standing Import Substitution Industrialization to economic liberalization. In 1985 it began to vigorously lower its tariffs and participated in GATT the next year. In the 1980s and early 1990s, the Mexican government also privatized thousands of state-owned companies. Some of them were purchased by foreign capital, but Japan was not on the scene.

It is interesting to observe that the economic crisis and liberalization gave rise to economic opportunities along the border area with the United States. A number of companies started *maquiladora* production near the Mexican border in order to easily export the products to U.S. The *maquiladora* arrangement included tariff exemption (on the condition of reexport), taking advantage of low labor costs in Mexico, and proximity to the U.S. Many manufacturing companies established so-called twin plants (one on the U.S. side and the other on the Mexican side) to take advantage of the arrangement[8]. Japanese companies in the manufacturing sector were not the exception. Matsushita (Panasonic), Pioneer, Sanyo, Sony and others started to produce on the Pacific coast as well as in the Mexican Gulf area. An important feature of this arrangement is that the consumers were located in the U.S., not in Mexico. It influenced organizational reshuffling within Japanese companies. In a typical Japanese company's organizational chart, Mexico used to be identified in its Latin America Division. Even though *maquiladora* production is located in Mexico, its management is more naturally controlled by U.S. divisions because production is integrated into the production system for the U.S. market. Thus, some companies reallocated their Mexico sub-division, integrating it into the North America division.

One puzzling feature of *maquiladora* production is its impact on Japanese statistics of foreign direct investment. Because it is a part of U.S. production, it might be registered in Japanese foreign direct investment as a U.S. investment rather than a Mexican one. Furthermore, if a Japanese company has a U.S. subsidiary engaged in *maquiladora* production with financing from the U.S. financial market, this investment is likely to be recorded as U.S. foreign direct investment. If this factor is sufficiently large, Japanese direct investment data might underestimate the "true" impact of Japanese companies on Mexico regarding local production.

Economic liberalization has culminated in the North American Free Trade Agreement (NAFTA) signed in 1992 and implemented in 1994. In one sense, NAFTA could be depicted as an economy-wide *maquiladora* arrangement for

Mexico because U.S. inputs can be imported to Mexico, assembled in Mexico, and re-exported to the U.S. without tariffs. Therefore, NAFTA's impact on Japanese companies can be seen through the further integration of U.S. and Mexican production sites. Currently Nissan Mexicana is producing models for the U.S. market and importing different models from Nissan's U.S. factories. Thus, a region-wide North American production system is taking shape. Another notable example is found in television set production. Mexico is competing with China for global supremacy, and all the major production sites are found along the border, where all the large Japanese electronics companies are producing for the U.S. market[9].

During the course of phase-by-phase implementation of NAFTA, Japanese companies (especially electronics companies exporting to the U.S.) have found a major problem in importing inputs from Asia. As mentioned above, U.S. inputs are imported tax free to Mexico, but inputs from non-NAFTA countries are not the case in the framework of NAFTA. This is why Japan needed its own free trade agreement with Mexico, which was finally signed in 2004.

In the environment of a free trade agreement, Japanese corporate behavior and foreign direct investment in Mexico will be further influenced by its consideration of North American production systems on one hand, and the competitive advantage of the production site on the other hand. The more the North American market (namely U.S.) consumes, the more production sites in Mexico increase their output. When production sites in Mexico lose their competitive edge (low-cost and high-quality labor and infrastructure), manufacturing companies naturally consider relocation. It will depend on the competitiveness of the southern regions in Mexico and Central American countries whether multinational companies can find suitable manufacturing sites beyond the U.S.-Mexican border. In the textile and apparel sector, many Asian (notably Korean) companies have established production sites in Central America. With the implementation of Central American Free Trade Agreement (CAFTA), Central America might become better integrated into the North American production system with regards to other sectors. Whether this is viable or not remains to be seen, because there are not only economic factors but also political and security concerns in the region.

ii. Investment in the Andean Region : The case of Peru

Peru's relationship with Japan is intertwined with the history of Japanese immigration, which has fostered strong emotional ties between the two nations.

With almost 120,000 Nikkei, Peru's population of Japanese descendants living in Latin America is second only to Brazil, which is home almost a million.

Diplomatic ties were strong during President Alberto Fujimori's tenure. In the early 1990's, Peru was isolated from international finance because the previous president, Alan Garcia, declared a moratorium on payments of external debt. Peru, therefore, was ineligible for loans or assistance from international institutions, including the IMF and the World Bank. Japan supported Peru at the international level and helped to form support groups for Peru at meetings with debtor nations and organizations.

According to the reports of Toyo Keizai[10] and information from Japanese companies in Lima, Japanese businesses in Peru were and are focused on the following areas—Toyota: assembly and import of vehicles; Quimica Sol: industrial dynamite and gunpowder; Honda of Peru: motorcycles; Ajinomoto: monosodium glutamate seasoning; and National Peruana: dry batteries. In addition, it appears that the Compania Minera Santa Rosa, owned by Mitsui Kinzoku and Mitsui Bussan, has been active in developing sources of lead and zinc. The remainder of the businesses deal with trade or services, such as Kawasaki del Peru: shipping; Kintetsu World: transport of fish cargo; Nikko Creative Service: tourism; Nissan Maquinarias: importation and sale of tires; and Mitsui Automotriz: importation of vehicles and components. There are no records of new Japanese companies during the current Toledo administration.

The Japanese manufacturing companies entered Peru between 1965 and 1975, during President Fernando Belaunde's term (1965-68) and Velasco Alvarado (1968-75). It should be noted that the nascent military regime of Velasco did not discourage the opening of new businesses, such as Ajinomoto, Kawasaki de Peru, and other affiliates of Mitsui Bussan. Viewed in hindsight, the economic and political stability of Latin American countries was of greater importance for Japanese private investment than the type of regime.

No new businesses were initiated during the succeeding governments. Only Honda was established during the Morales Bermudez's term (1975-80), but it was an investment agreed upon by schedule. During Belaunde's second term (1980-95) and Alan Garcia (1985-90), no new companies were established.

All companies established during Alberto Fujimori's term (1990-2001) were liaisons or representation offices, although there were some small investments in mining in partnership with other foreign or national firms. In short, however, no

real presence of Japanese investment was present.

Table 3 Total Accumulated Japanese Investment in Peru

Sectors	Accumulated Number of Cases	1951-2002 Amount (In millions of Yens)
Industry	31	12,070
Food	7	4,071
Textiles	5	343
Chemical	6	237
Metals	2	203
Machinery	—	—
Electricity	3	1,256
Transport Equipment	8	5958
Agriculture	1	1
Fishing	19	5,708
Mining	30	173,581
Construction	2	9,471
Commerce	13	7,325
Finance/Insurance	1	1
Other	5	3,671
Subsidiaries	5	1,989
Property	5	479
TOTAL	112	214,247

Note : Registered Investment Flow prepared from official data from the Ministry of Finance of Japan.
Source : Ministry of Finance Statistics Monthly.

In addition to the establishment of manufacturing plants, Japanese investment was very dynamic in natural resources. From the almost US$2 billion accumulated Japanese FDI in Peru, around 80% (US$1.7 billion) went to the mining sector (see Table 3). In this sector the Japanese preferred to either sign long-term contracts or offer loans in order to establish leverage for their positions as purchasers, before directly buying assets. One of the reasons for this policy was to avoid nationalistic reactions which the Japanese had encountered in various countries of Southeast Asia. But as De la Flor [1993] noted, copper was an exception to this preference because signing long-term contracts did not assure delivery of the metal. Because of this situation, they positioned themselves for the purchase of the Katanga mine in 1973 by forming a consortium of Mitsui Mining and Smelting and Nippon Mining; through the 1975 purchase of Santa Lucia (zinc and tin) by the same consortium; and—also in 1975—through the formation of the Corporation of Copper of Michiquillay in order to invest in copper on a grand scale[11]. Unfortunately, it was an objective never realized because of the failure to negotiate an acceptable agreement concerning both the manipulation of foreign capital and the

question of labor policies with the Peruvian government.

In addition, in the oil industry the Japanese government, in coordination with private companies, offered loans at low rates of interest and with very advantageous conditions in order to ensure a stable flow of oil. Three Japanese global trading companies, Mitsui, Marubeni and Mitsubishi, formed JAPECO (Japan-Peru Oil Corporation), to work with Petroperū and Cofide (two public institutions) in order to build the North-Peru oil pipeline. There were, in addition, similar financial arrangements for developing the mines of Cuajone and Huanzala, as well as other projects such as the copper refinery of Cajamarquilla, and the copper operation of Cerro Verde. In the field of telecommunications, NEC directed the work for the construction of Peru's first satellite. NEC then served as the source of equipment for the communication networks with Entel Peru and collaborated with the Peruvian Telephone Company in developing telephone centers.

What stands out about this style of investment is the fact that investments were made in packages where private capital was directly involved and coordinated with governmental agencies, such as the Japanese Eximbank and Japan's Overseas Economic Cooperation Fund (OECF)[12]. Since early 1980s, Japanese development assistance was closely tied to the local needs of Japanese companies, and investments were made in tandem with financing from the Japanese government agency, the private firm, and contractors in an integrated package. Today, Japanese companies are more flexible and acquire products from non-Japanese contractors in order to avoid the complaints and demands of local factories in the host countries.

During the administration of Alberto Fujimori (1990-2001), political and economic cooperation was very active. Peru was a privileged recipient of technical assistance and loans, directly from the Japanese government and through international organizations. However, in comparison to the amount provided by ODA (Official Development Assistance), private investment was small[13].

The government of Japan committed itself to supporting Peru, but although it provided considerable amounts of assistance, it could not convince the private sector to invest because of the following reasons : (i) Instability in Peru, (ii) Recession in Japan, which began at the beginning of 1990s, (iii) The so-called "syndrome of the lost decade" by which senior executives were reluctant to invest in the region ; and (v) the lack of a targeted investment policy. These four elements are explained later in this section.

Japanese companies were badly affected by the economic recession and the end

of the "bubble economy", and most of the senior managers of Japanese companies in Japan in the Latin American departments in the 1990s were junior managers in the region in the 1980s, when several countries including Peru decided to stop payment of the external debt.

In the manufacturing and service sectors, businesses were restructured (see Table 4). Mitsui Bussan and Mitsui del Perú merged to create Tyre Service del Perú ; Mitsui Bussan is joint owner with Toyota Jidosha of Toyota del Peru ; In this same manner Nissan Jidosha and Marubeni joined to create Nissan Maquinarias from the same company that was closed years before. Kintetsu, a railroad company of the Kansai region, which also controlled more than 160 businesses, including one of the largest supermarkets in the country, was also formed in 1995.

The most significant Japanese investment during Fujimori's term was the Cominco/Marubeni-a consortium comprised of businesses from Japan, Canada, and Great Britain aimed at expanding the refinery of Zinc de Cajamarquilla. Marubeni also made another small investment of US$10 million in 1996 in a pulp paper plant of Yukari to supply their Asian market.

In comparison with the previous decade, the 1990s were a fairly good time to invest in Latin America. The so-called "Washington Consensus" advocating liberalization with openness to trade and privatization of public companies was adopted by most of the governments of Latin America. So investment from European countries, mainly Spain, and from the United States, and also within the region was considerable. Japanese companies, despite good prospects and a "Nikkei" president in Peru, were not interested in investment in the country, in both manufacturing plants nor and privatization.

Japanese FDI is also low compared with the amount invested in Chile, a neighboring country of Peru. Until 1998, Japan was fourth among major investors in Chile. That year, Japan invested in the copper mine *La Escondida*, and since then its investments have increased substantially with the cupriferous projects of *La Candelaria*, and with the development of *Los Pelambres*, an enormous project of US$1.3 billion. Although the privatization of public companies started in Chile in 1982, the Japanese were not immediately attracted by the trend and began to invest six years later with the *La Escondida* mine. Distribution by industrial sectors shows that besides interest in copper, large Japanese investments were made in fishing, forest products and agriculture, mainly natural resources that were then exported to the Japanese market.

A historical background provides light to the lower levels of investment during Fujimori's term. In the 1970s, despite good financial conditions for Japanese firms, several projects never progressed. At that time, Japan was interested in establishing a permanent source of copper in Latin America, a role later won by Chile. Also, in the early 1980s, Peru had just decided not to pay Marubeni a debt for the construction of the North-Peruvian oil pipeline ; Again, five years later during the government of Alan Garcia, private Japanese banks were affected by the imposed moratorium on the external debt.

In addition to the above issue, the instability in Peru must be addressed. In the late 1980s terrorist attacks targeted the Bank of Tokyo and Nissan Motors (Bank of Tokyo immediately withdrew from Peru and Nissan closed down its plant several years later). Again, in 1993 three engineers from the Japan International Cooperation Agency (JICA) were assassinated in Huaral, a city north of the capital Lima, and the event caused enormous commotion in the Japanese public. Lastly, when the prospects for Japanese investment seemed to be improving, in December 1996 the residence of the Japanese ambassador in Lima was seized. The incident resulted in a five-month stand-off, which negatively affected several investment plans in the country.

The economic recession in Japan also provided a cause for restraint. With limited room to maneuver, Japanese firms preferred to focus on Asia and Western Europe, and in some Latin American countries such as Mexico (who as a member of the NAFTA agreement was a door to the U.S. market), instead of risking capital in Peru. Japanese FDI was also limited in the 1990s by the "syndrome of the lost decade". Senior managers in companies in Japan in the 1990s, who were junior or middle managers in the 1980s when a debt moratorium also affecting Japanese private banks was imposed by several countries, were afraid of further future instability.

Last but not least, one of the main obstacles to increased Japanese investment was the lack of a targeted promotion policy such as those implemented by East Asian countries. In early 1990s, after Fujimori came to power, the Peruvian economy had stabilized and terrorists had been severely weakened. As a result, foreign investment (non-Japanese) began to increase in amounts which probably made it unnecessary to seek Japanese investment. A closer trade promotion policy with Japan, let alone Asia, was absent, and the regular biannual meetings of Japan-Peru private companies failed to produce any concrete results.

iii. Investment in the Eastern zone : The case of Brazil

Japanese investment in Brazil is shaped by three elements : 1) The fact that it is the largest economy with the biggest market in Latin America ; 2) Its membership with Mercosur, the Common Market of the South with Argentina, Uruguay and Paraguay ; and 3) Its relatively developed industry and several productions clusters.

Brazil is also home of Japanese descendents, more than one million. However, in contrast to Peru, the Nikkei connection is only a marginal element in explaining the economic relations between Japan and Brazil, though it can be said that Brazil attracted Japanese immigrants at the turn of the 20th century and in the 1950s with the hope of become the country of the future. It would not be an understatement to say that Brazil is just too big to be ignored.

Japanese private companies consider Brazil the most promising market in Latin America. The annual study of the Japan Bank for International Cooperation

Table 4 Intentions of Investment of Japanese Companies in Next Three Years (Survey 2004)

Order	Country	Firms
1	China	453
2	Thailand	151
3	India	117
4	Vietnam	110
5	USA	100
6	Russia	49
7	Indonesia	48
8	South Korea	44
9	Taiwan	41
10	Malaysia	28
11	Singapore	17
11	Germany	17
13	Brazil	16
14	Philippines	15
14	France	15
16	Czech Republic	12
17	Australia	11
18	Poland	10
19	Mexico	9
19	United Kingdom	9

Note : Multiple answers permitted. Total surveyed 497 Japanese companies.

Source : JBIC14

(JBIC) on Intention of Investment shows that in the next three years, Brazil and Mexico are important markets for expansion. The list includes 20 countries and is based on nearly 500 Japanese firms surveyed with operations overseas (See Table 4). The data point to two interpretations. The first is that Latin American countries are behind Asia and are even being surpassed by Eastern European countries. On the other hand, Brazil is the leading destination of future investment, a position recently occupied by Mexico. Brazil's economy is considered to be expanding while maquiladoras in Mexico, though still strong, are suffering from competition from Asian countries and China in particular[15].

The importance of Brazil is also highlighted by the existence of the Japan Brazil Economic Partnership Agreement (EPA) supported by Keidanren, the Japanese Economic Federation of Private Firms, which has the objective of deepening economic relations between Japan and Brazil for investment and trade. The last meeting convened in May 2004 included the following list explaining Brazil's importance and potential[16]:

- Important production and sales base in Latin America
- Economic complementarity between both economies
- Operations of Japanese companies in Brazil
- Increased business opportunities

Japan economic relations with Brazil were initially marked by natural resources. In the 1960s and 1970s Japan invested heavily in steel and metals and in agriculture. As was the usual practice of the Japanese government acting as an axis with the private sector, the investments were engineered by economic cooperation. For example the investment in the *Usiminas* Steel Plant (Usinas Siderurgicas de Minas Gerais) and the development of the Cerrado region were undertaken in conjunction with several projects by Japanese private companies.

Still today the main economic cooperation projects are *Usiminas* and *Cerrado*, with the Amazon aluminum refinery, the *Senibra* project for paper pulp development, the Cia. Siderurgica Tubarão, and the *Carajâs* iron mine development.

Japanese investment went to Brazil when both countries were passing through their respective high speed growth cycles. Leon Hollerman, author of an important study on Japanese Investment in Brazil writes, "During the period 1955-1970, Japan's annual average growth rate was 10.2 percent in real terms. In Brazil, in real terms during 1969-1973, growth was more than 11 percent annually"[17]. In the early

1960s, as in the rest of Latin America, Import Substitution policies were firmly in practice in Brazil, and the development strategy implemented by President Juscelino Kubitschek (1956-1961) led the country to reach high rates of growth based on massive public investment, public works and expansion of domestic markets. Kubitschek's motto—"50 years in 5"—summarizes the spirit of this time and helps to explain why Japan felt encouraged to invest in Brazil. This was the first wave of investment when (trading companies) and banks went to Brazil. The second wave started in the late 1960s with massive investment from manufacturing companies including small and medium-sized enterprises, which were struggling in Japan due to the oil shock. The third wave began in the 1980s, with the second oil shock coinciding with the expansion of Japanese overseas investment worldwide.

Japanese investment is geographically concentrated in the state of Sao Paulo and in recent years in the Manaus Free Zone. In both areas Japanese companies engage in commerce, manufacturing and banking, with traditional sectors there and elsewhere for mining, petrol and agriculture.

Since the early 1990s Japanese investment has stagnated. Despite a considerable investment presence from Spain, in banking and telephony firms, (Spanish investment boomed in the 1990s) which revealed the potential of the country, Japanese have maintained a "wait and see" position[18]. Brazil still comprises more than half of Japanese investment in Latin America, with more than US$5 billion of accumulated investment. And in the last two decades Brazil has developed industrial sectors such as aircrafts, IT, banking, and even genetics which, excluding Japan, are attracting considerable overseas investment[19]. For example AES Corporation, a U.S. firm based mainly in Brazil, is the largest electricity company in the world. Other strong firms in the country are Banco Bilbao and Vizcaya, Telefonica for Spain and Portugal Telefonica. Nothing of similar scale is observed for a Japanese firm in Brazil.

According to Keidanren, there are more than 350 Japanese firms operating in Brazil. It is interesting to note that despite the relatively large number, they are mostly independent firms without production networks as in East Asia. Brazil is by far the more advanced industrial country in Latin America, but due to a particular industrial clustering or other reasons which must be researched further, Japanese firms are not networked in a production chain. Mercosur can act as an impetus for Japanese carmakers to increase production and deepen production linkages between Brazil and Argentina. However, discussions on tariffs and pol-

icies have led both countries to protect their markets in order to be the base country for automobile production. Brazil and Argentina are competing with protectionist tariffs and measures which at the end will not encourage production links.

Considering the ebb and flows that characterize the relationship between Japan and Brazil, and the infrastructure and presence of Japanese firms in the country, a deeper relationship can be better developed if Japanese companies decide to do so. The JBIC survey mentioned earlier is an indicator of interest which must not be neglected.

III. Japanese Investment Model Interrupted

Japan's foreign investment has three principal objectives : (1) To guarantee a consistent source of raw materials and use abundant economic factors overseas ; (2) To protect itself against the formation of potential regional agreements that might exclude Japan, especially those in the vehicle and electronic industries ; And more recently (3) To secure diplomatic leverage and presence by "soft power"[20].

Japanese industry began its postwar reconstruction with increased growth in the exportation of manufactured goods, principally to the United States and then to Southeast Asia, all of which added to the accelerated development of the Japanese domestic market. These were all factors that created a demand for a much higher quantity of raw materials. In Latin America, Japanese FDI started in the 1950s and 1960s, primarily in Brazil. The oil crisis in 1972 coincided with the first stages of accelerated growth in Brazil, the so-called "Brazilian Miracle," and Japan's financial interests were redirected toward countries that had oil, thereby accentuating investments in Mexico and Venezuela.

Toward the end of the 1970s, Japanese companies began to invest in the emerging industrialized nations of Asia, Taiwan, Singapore, South Korea, and Hong Kong, where they first implemented a new strategy of transferring the manufacturing of their second-generation products. Furthermore, with the support of ODA, they began to establish a structure of production that embraced all Southeast Asia.

In the 1980s, the accumulation of enormous cash reserves and the existence of an industrial network transformed Japanese companies into a major transnational player. In Latin America, toward the latter part of the 1970s, the concept of "import substitution" as well as a tendency toward strong protectionism remained

in place. But potential problems with foreign debt began to appear on the horizon. At that moment it might have been possible for the Japanese to put together a solid infrastructure for inter-regional production in Latin America. But due to situations, such as recession and an external debt crisis, Japanese business gave priority to other regions. Investment in the United States increased, and the continuing focus on Southeast Asia and East Asia was reinforced.

It is important to note that until 1988, Peru ranked third behind Brazil and Mexico as a Latin American recipient of Japanese FDI. The statistics from the Japanese Ministry of Finance indicate that between 1952 and 1988, Brazil received US$4.8 billion ; Mexico received US$1.5 billion ; and Peru received US$0.6 billion. These numbers include sums that were invested in the financial sector, including the purchase of properties and securities, construction and real estate. Even when the amount invested in the financial sector is disregarded, the three countries retain their same ranking.

Toward the end of 1989, the situation began to change. In addition to Brazil, the prominence of FDI investment in Panama and Chile began to increase. Brazil, of course, continued to maintain its importance because of its relationship with MERCOSUR ; Panama grew in importance as a financial bridge ; and in Chile FDI expanded under the impact of steadily increasing commercial activities with Japan.

What have been the determining factors of Japanese FDI in Latin America? The strategy can be divided into four stages (see Fig.1.). Between 1950 and 1970, given the rapidly accelerating growth of the Japanese economy, an assured source of raw materials was sought. In addition, Japan looked toward the creation of factories in order to obtain a portion of the overseas market, especially in the fields of textiles, vehicles, and basic electronic products, taking advantage of the geographical axis running through Brazil, Mexico, and Peru. Between 1970 and 1980 attempts to ensure a ready and consistent source of raw materials continued as a high priority. Beginning in 1980, the objective was to secure bases for production in a movement toward huge consumer markets such as MERCOSUR, NAFTA, and various regional markets established through bilateral agreements.

Comparing the evolution of Japanese FDI in Latin America with the strategy employed in Asia, a number of variables stand out. Between 1960 and 1970, textile factories and agricultural product processing were established in Southeast Asia. In the ensuing period between 1970 and 1980 factories producing "second genera-

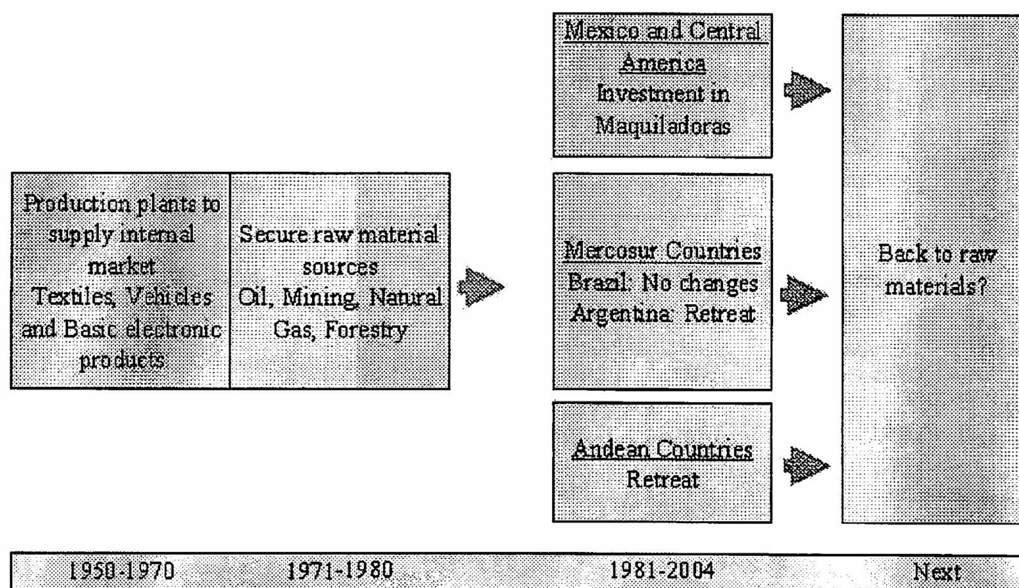


Fig.1. Evolution of Japanese Investment in Latin America[21]

tion" goods were introduced. "Second generation" goods are products which are technologically obsolete and are characterized by low profit margins. For example, black & white TV television sets became second-generation products when color television appeared on the market. Similarly, laser printers displaced earlier ink jet printers.

The establishment of a regional production network in Latin America has not been possible by several factors, including (i) the lack of an integrated transportation and logistics infrastructure, (ii) standardization of trade policies in the region for tariffs as well as non-tariff barriers, (iii) incipient trade exchanges among countries, (iv) lack of cooperation and simultaneous investment promotion policies, and (v) lack of economies of scale due to inequality and limited demand.

These factors have all affected Peru. As a medium size country with a strategic geographical position on the West Coast of South America, it is seemingly well positioned for investment. However, the country has not been able to effectively use its relative closeness to Japan.

In the 1980s, a former Minister of Foreign Affairs of Japan, Saburo Okita, advocated the framework of Flying Geese development in Latin America[22]. With that philosophy the "Okita Foundation" was created in Argentina to be a center for continuous expansion of a co-prosperity sphere in Latin America. The Flying Geese scheme, however, requires a country not only to passively receive investment and assistance, but also to embrace a policy of investment promotion, trade toward

the investment source country, and domestically strong and rapid progression of human resource development in order to support further waves of investment and continuous upgrading.

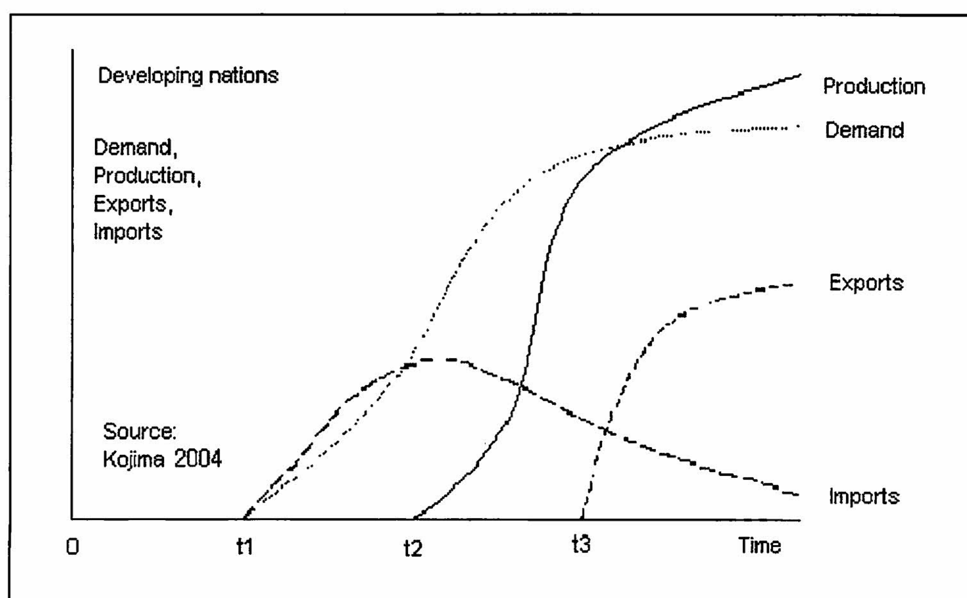


Fig.2. Akamatsu's Pattern of Development

The original Akamatsu scheme is divided into time stages (see Fig.2.), where at t1 : certain goods are imported, at t2 : domestic production starts, and at t3 : domestic production increases and exports increase. This scheme assumes foreign investment and domestic institutional and economic reforms.

In Latin America, the Flying Geese have started at various times but end up stopping because such schemes are unsustainable. See new lines in Figure 3, where "Production" cannot increase because productivity increases are constrained by a lack of human resources and small domestic or regional markets. Thus, exports never take off, or if they do, are inadequate to sustain enough subsequent waves of investment and exports to create a Flying Geese industrial pattern of development.

Latin American countries cannot escape from this "start and stop" trap because human resource development and foreign investment are linked and must increase and improve simultaneously.

Documents produced by Japanese scholars, such as Okita, as well as several reports and country studies have emphasized these points mentioned above. For example, in 1998, the Japan International Cooperation Agency produced its Country Report on Peru. The study was led by Akio Hosono, senior scholar and

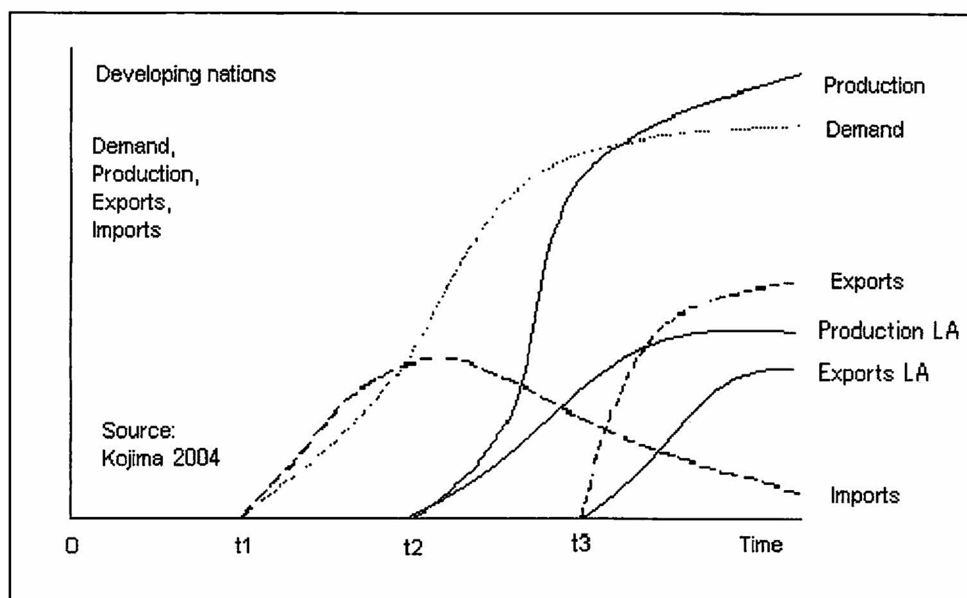


Fig.3. Flying Geese Starts and Stops in Latin America (LA)[23]

Ambassador of Japan in El Salvador as of 2004. The JICA report recommends development with participation and industrial growth. One of the appendixes includes a study by Mitsuhiro Kagami on cluster development, a la Michael Porter[24] style, in which an isolated firm needs a comprehensive framework of related industries and infrastructure to develop as an industrial cluster. Kagami identifies nascent Peruvian clusters and recommends promoting them at a domestic level in Peru, and through rights promotion policies. Not surprisingly, the report repeats previous studies from public organizations in Japan (unpublished studies by JETRO and METI [The Ministry of Industry and Trade formerly MITI]) about increased assistance for education and development of human resources. Hosono dedicates a whole chapter to propose a more participatory agreement in Peru to reduce inequality and promote participation which will lead to greater opportunities in the labor market and in education.

IV. Concluding remarks

This essay illustrates the modalities of Japanese foreign direct investment in Latin America. Three case studies (Mexico, Peru and Brazil) illustrate how Japanese companies have coped with Latin America's economies. We believe that further analysis of why the Flying Geese starts and stops in Latin America is a pressing research topic. This theme is extremely relevant to the region, especially as

foreign investment from China is preparing to enter the region. A comparative evaluation of Japanese foreign direct investment and Chinese foreign direct investment is another promising research theme. We conclude this essay by mentioning future research topics related to the three countries we examined.

We point out that despite foreign competition, an export base is consolidating in the case of Mexico's border region. It remains to be seen whether this will cause a chain reaction toward forming Akamatsu's Flying Geese pattern in other areas such as Mexico's southern states and Central America. The keys to success will likely hinge on labor quality and infrastructure, as well as political and security issues. An important research topic is to elaborate further conditions to develop the Flying Geese pattern in the area.

This essay emphasizes the obstacles faced by countries like Peru in sustaining foreign direct investment. In this Andean region, such sustainability might not occur until more domestic reforms are implemented. Success of those reforms will depend on a specific domestic context, because it is unlikely that a wave of Japanese investment is on the horizon. However, the emphasis on human resource upgrading and a broadening of markets to amplify economies of scale, as well as well-focused investment promotion policies, are extremely important for domestic policy considerations in promoting direct investment from Japan or new investment players in the region like China.

We believe the largest market in the region, Brazil, will receive further direct investment from Japan. Brazil is a large market on its own, able to survive economically without spreading or linking its industries with the rest of Latin America. This is likely to change, however, since a greater number of multinationals are using Brazil as a regional production base. Japanese firms will undoubtedly follow this trend. Judging by its size, Brazil seems to be the ideal candidate to become the Flying Geese player in South America, as Mexico should be in Central America and the Caribbean. However, certain conditions are required. Manufacturing integration in Latin America is affected by geography, which makes physical distances longer. The potential for such integration and the conditions that are likely to spur cross-border investment and industrial linkages are important research topics that must also be translated into to realm of public policy.

Footnotes

1 Also available at [http://www.mof.go.jp/english/e1c008.htm]

2 [http://www.lib.utexas.edu/maps/americas/south_america_ref04.jpg]

3 See Diamond, Jarred (1999) "Guns, Germs, and Steel : The Fates of Human Societies".

4 For an analysis of logistics see Bonifaz, Jose Luis, Fernando Gonzãlez-Vigil and Roberto Urrunaga (2002) Logistics and Markets : Overcoming the challenges of a difficult geography ; in Latin America Competitiveness Report 2002.

5 "In 1973, industries requiring high levels of energy such as iron and steel, non-ferrous metals, chemicals, paper pulp and paper, declined to a point of depression, while the production of automobiles and electronic products soared due to the relatively low use of energy for their production (See Kagami 1995, pp. 128-129).

6 See Kojima and Ozawa (1984)

7 See Whiting (1992) for more detail for foreign investment up to 1980s.

8 See Sklair (1993) for analysis on Maquiladora program up to early 1990s.

9 See Taniura (2000) on detailed analysis on televison set sector in Mexico.

10 See Toyo Keizai, 2004.

11 For a detailed chronology of this first period of Japanese investment with major emphasis on raw materials, see De la Flor, 1993.

12 Both were merged and are now the Japan Bank for International Cooperation (JBIC).

13 For example an opinion column in 1998 in Peru's Gestiõn Newspaper was titled "The Illusion of Japanese Investment" (Bustamante, 1998).

14 JBIC 2004.

15 In the JBIC Survey three Japanese companies indicate plans to transfer production from Mexico to the US and Asia (China and Singapore).

16 Japan-Brazil Partnership Agreement documents can be accessed through the Japan Keidanren Website. [www.keidanren.or.jp]. Japan has other EPAs with Singapore and Mexico. Since EPAs are supported by Keidanren, their existence is the main thermometer of Japanese interest in a foreign country.

17 See Hollerman (1988), Pag.93..

18 See Hosono, Akio. (2000). "Raten Amerika ni Okeru Gaikoku Chokusetsu Toshi". Mimeo. [http://www.rieb.kobe-u.ac.jp/~hosono/gaikoku.PDF]

19 See this graphic example on ECLAC (2000). Page 45.

20 "Soft Power" is an expression coined by Harvard political scientist Joseph S. Nye, Jr., who used it to describe the ways in which the United States gains influence in world geopolitics by means other than military action and strength. This term can also be applied to Japan.

21 Prepared by the authors.

22 See Okita, 1980.

23 Lines for Latin America (LA) are added by the authors.

24 Harvard Business School Professor of management, author of several books and advocate of

cluster development.

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