A common evolution? A comparison of United States and Japanese transnational corporations

Dennis J. Encarnation*

The recent surge of Japanese foreign direct investment readily invites comparisons with the earlier expansion of United States transnational corporations. By reexamining various indicators identified in prior research, this article documents the emergence of numerous similarities in both the structure and performance of United States and Japanese transnational corporations, as they evolve along a common path. What important differences remain are then traced to the foreign extension of Japanese industrial organization. So resistant is that organization to change, in fact, that United States transnational corporations in Japan have been forced to deviate markedly from an evolutionary path that has served them well elsewhere in the world. Resultant asymmetries in market access go on to exacerbate persistent differences in the economic performance of United States and Japanese transnational corporations.

The surge of Japanese foreign direct investment (FDI) during the 1980s readily invites comparisons with the earlier expansion of United States transnational corporations (TNCs) around the world. Specifically, compared to the well-established United States TNCs, do Japanese TNCs continue to operate differently overseas? Or have the newly-emerged Japanese TNCs rapidly evolved along an otherwise common path already well-charted by United States TNCs?

Such a common evolution, many (principally Western) observers contend, should be expected when TNCs confront similar economic and political environments. (For a review of this literature, see Encarnation, forthcoming.) As evidence, these observers document the common evolution followed by United States and then European TNCs. The Japanese TNCs, by this logic, are the most recent followers. And whatever deviations persist in

* Associate Professor, Graduate School of Business Administration, Harvard University, Boston, Massachusetts.

their foreign organization and economic performance can be discounted as mere vintage effects, vestigial remnants reflecting an earlier stage in a TNCs's evolution.

By contrast, the sheer persistence of these operational and structural differences has prompted a competing (principally Japanese) school of thought, whose adherents adamantly contend that Japanese TNCs are truly unique (Kojima, 1978, 1990, and others cited below). As evidence, these proponents also examine similar economic and political environments, beginning in East Asia, where they document the simultaneous implementation of different foreign operations by United States and Japanese TNCs. Sharp variation in foreign ownership, trading propensities, market orientation, sectoral distribution and industrial organization figure among the several indicators cited in support of Japanese uniqueness.

Comparing many of these same indicators today, this article documents the recent emergence of several similarities in both the structure and performance of United States and Japanese TNCs, as they evolve along a common path. What important differences remain are then traced to the foreign extension of Japanese industrial organization. So resilient is that organization to change, in fact, that United States TNCs in Japan have been forced to deviate markedly from an evolutionary path that has served them well elsewhere in the world. Resultant asymmetries in market access go on to exacerbate persistent differences in the economic performance of United States and Japanese TNCs.

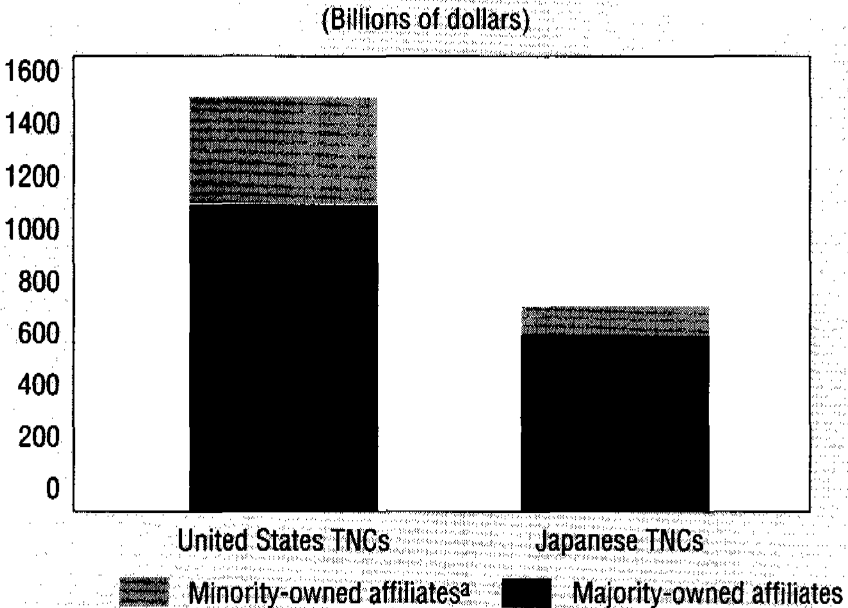
Of course, one's ability to measure both persistent differences and emerging similarities is greatly hampered by the simple fact that the modern TNC defies easy explanation. This conclusion arises naturally from the list of diverse institutions that scholars have already identified as functional TNCs. For purposes of discussion in the pages that follow, such TNCs are equated with FDI, and familiar definitions provided by the United States Department of Commerce and Japan's Ministry of International Trade and Industry (MITI) are used to identify FDI inflows and outflows (Thomsen, 1990). Generally speaking, TNCs engage in extractive, manufacturing and service operations (including trading) by holding the minimum proportion of shareholdings (by today's standards, roughly 10 per cent) deemed necessary to exercise some degree of managerial control over their investments abroad. In the end, that control varies with the overall level of foreign ownership, which in turn shapes an interrelated series of strategic trade-offs concerning foreign production and international trade.

Majority- versus minority-owned affiliates

Transnational corporations, regardless of their national origins, create and sustain competitive advantage through the skillful management of tangible and intangible assets in technology, marketing and organization (Caves, 1982). Such assets are specific to each individual firm, and are best exploited when that firm owns a majority of the equity shareholdings in its foreign affiliates (i.e., when that affiliate is a "subsidiary"). Compared to minority shareholdings, majority equity positions grant parent firms a higher degree of managerial control over the foreign use of their firm-specific assets. Such managerial control, in turn, helps to reduce the high costs that plague more arm's-length transactions between foreign suppliers of firm-specific assets and unaffiliated buyers overseas (Williamson, 1973). Instead of using such arm's-length transactions, these foreign suppliers transfer their tangible and intangible assets internally, directly to their majority-owned affiliates abroad. Later, reverse transfers also take place, as foreign affiliates begin to ship goods and services back to their parent firms (as well as to other related affiliates overseas). In the end, this circular flow enhances the total pool of technological, marketing and organizational assets available to both the parent firm and its affiliates.

Since the Second World War, United States TNCs have consistently preferred to invest in majority-owned affiliates, rather than in minority-owned affiliates. Indeed, as early as 1957, United States TNCs reported to the United States Department of Commerce (in its first post-war census of the foreign operations of United States companies) that they owned upwards of three quarters of the equity invested in their foreign affiliates (United States, Department of Commerce, 1960). For the United States, this strong preference for majority shareholdings remained phenomenally stable over the next three decades (United States, Department of Commerce, 1981), even as fresh outflows of FDI reached their post-war high (during the late 1960s and early 1970s) and subsequently fell off, to be replaced by reinvested earnings in existing affiliates (Lipsey, 1988; Goldsbrough, 1986). As a result of these investments, majority-owned affiliates contributed an ever-increasing share of total foreign sales recorded abroad by United States TNCs, reaching three quarters by 1966, in the Commerce Department's first benchmark survey of United States FDI (United States, Department of Commerce, 1975, pp. 167, 197), and climbing to four fifths by 1990, in the country's most recent annual survey (figure 1). What little remained was dispersed across equal-share partnerships and minority-owned affiliates. Thus, for United States TNCs, majority ownership of foreign affiliates remains a prominent characteristic of their investment strategies.

Figure I. World-wide foreign sales by United States and Japanese transnational corporations, 1990



Sources: United States, Department of Commerce, 1992a, tables II.E.3 and III.E.3; Japan, Ministry of International Trade and Industry, 1992a, p. 12.

[a] Includes equal-partnership joint ventures.

Similarly, according to figure 1, majority ownership has also become central to the investment strategies of Japanese TNCs. In fact, by 1990 (again, the most recent year for which data are available), Japanese TNCs reported to Japan's MITI that majority-owned affiliates contributed over 85 per cent of their foreign sales. That share — roughly comparable to sales reported by the majority-owned affiliates of United States TNCs — may possibly be of a more recent origin. Indeed, a long-standing consensus among Japanese scholars (all reporting data gathered during the mid-1970s) argues that Japanese investors have been more likely than United States investors to establish minority-owned and equal-share joint ventures abroad, occasionally with multiple Japanese partners (Wakasugi, 1989; Komiya, 1988; Sekiguchi, 1979; Ozawa, 1979; Kojima, 1978; Yoshino, 1976; Tsurumi, 1976; Sekiguchi and Matsuba, 1974).

These earlier findings, however, may well represent a simple artifact of the specific indicator that scholars examined: the actual number of joint ventures and majority-owned affiliates established by Japanese TNCs. Such a measure may overestimate the relative importance of small investments in a large number of minority-owned and equal-partnership joint ventures. By this measure, in fact, United States TNCs during 1977 (the same year examined in many of the earlier Japanese studies) proved as likely to establish minority-owned affiliates (11,900) as they did to invest in majority-owned affiliates (11,800) (United States, Department of Commerce, 1981, p. 20). In any event, by 1990, Japanese TNCs had made their ownership preference unambiguous, even by this measure, which showed that majority Japanese-owned affiliates accounted for nearly seven out of every ten Japanese affiliates established world-wide (Japan, MITI, 1992a, p. 11). It therefore seems accurate to claim that, during the late 1970s and throughout the 1980s, any earlier differences in patterns of ownership that distinguished United States from Japanese subsidiaries abroad had surely withered away.

Yet, no similar convergence of ownership patterns in favour of subsidiaries is apparent in bilateral investment flows between Japan and the United States. While in the United States, majority Japanese-owned affiliates also generated nearly the same proportion of sales (over 85 per cent) that they recorded world-wide (Japan, MITI, 1992a, p. 66), in Japan, majority-owned United States affiliates did not generate a comparable global share of foreign sales. To the contrary, as late as 1990, these majority-owned affiliates still generated less than two fifths of the sales recorded by all United States affiliates in Japan (United States, Department of Commerce, 1992a, tables II.E.3 and III.E.3). The remainder, accounting for the bulk of sales in Japan, still came during 1990 from minority United States-owned affiliates, even though the relative position of these firms had actually declined over the previous decade.

With such a great preponderance of minority foreign-owned affiliates, in fact, Japan actually has much more in common with developing India, where the dislodging of TNCs long represented a national strategy (Encarnation, 1989), than with industrialized countries (United States, Department of Commerce, 1992a, tables II.E.3, III.E.3). For in no other *advanced* economy do majority-owned affiliates continue to occupy such a lowly position as they do in Japan. Moreover, in Germany, as well as in Canada, the United Kingdom and France — each with an economy of a size of less than one half of Japan's — majority United States affiliates recorded

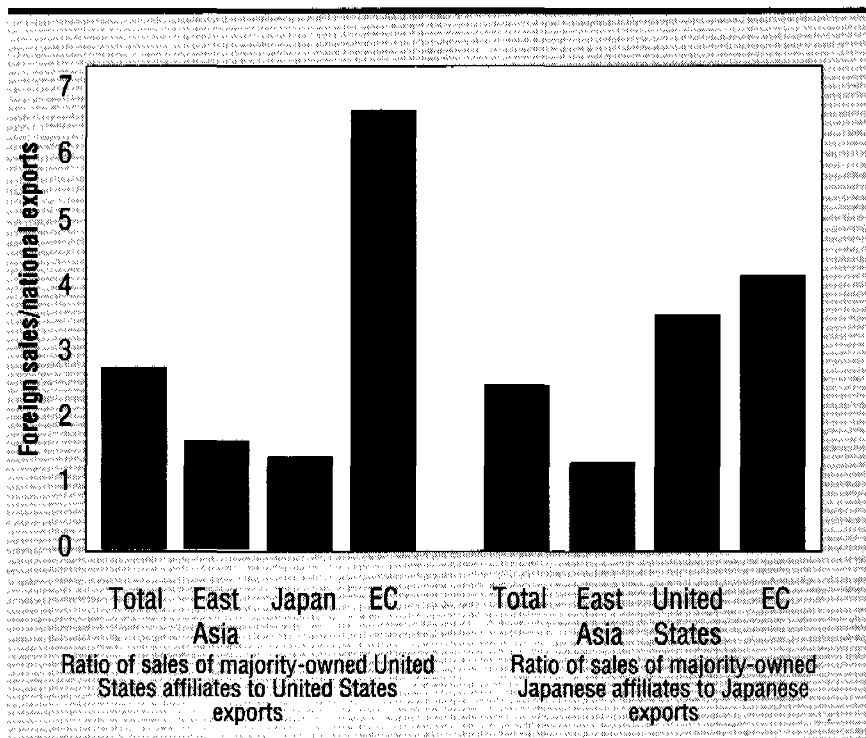
larger dollar sales than they did in Japan (United States, Department of Commerce, 1992a, table III.E.3). In sum, the lower incidence of majority-owned affiliates in Japan worked to deny United States TNCs the same access that they — and Japanese firms — otherwise enjoyed elsewhere in the world.

Foreign sales versus international trade

After securing majority ownership and managerial control, TNCs typically use their foreign affiliates to sell in foreign markets far more than they, and other exporters back home, ship to these same markets. In general, foreign sales come from three sources: the host-country market of the foreign affiliate; the home-country market of that affiliate's parent firm; and third-country markets that are typically in close geographic proximity to the host country. To generate these sales, as will be shown later, TNCs may decide to invest directly in offshore production in foreign markets protected by both public and private barriers, ranging from import restrictions to local competition; or, conversely, they may decide to exploit foreign factors of production by exporting from their foreign affiliates to open markets both back home and in third countries. Thus, each source of foreign sales by TNCs suggests a different FDI strategy.

For United States firms, at least, the predominance of foreign sales over international trade is *not new*, although some analysts have only discovered it recently. For example, Susan Strange (1991, p. 242) asserted that, in the "evolution of international business . . . the mid-1980s were a milestone as the volume of international production for the *first time* exceeded the volume of international trade" (italics added for emphasis). To the contrary, at least for the United States: as early as 1957, United States (largely majority-owned) affiliates abroad reported foreign sales with twice the value of United States exports (United States, Department of Commerce, 1960, p. 110; 1957, pp. 2, 8). A decade later, by 1966, the foreign sales of the majority-owned affiliates had risen to represent three times the value of all United States exports (United States, Department of Commerce, 1975, p. 198; 1967, pp. 3, 12). Subsequently, that three-to-one ratio of foreign sales to international trade has remained largely unaltered. In fact, during 1990, United States TNCs continued to sell nearly three times as much abroad through their majority-owned affiliates than the United States exported to the world (figure 2) — further testimony to the fact that United States FDI continues to carry international competition well beyond cross-border trade.

Figure 2. The ratio of foreign sales by majority-owned affiliates to national exports, United States versus Japan, 1990



Sources: United States, Department of Commerce, 1992a, table III.E.3; 1992d, p. 11; Japan, Ministry of International Trade and Industry, 1992a, pp. 78-89; International Monetary Fund, 1992, pp. 240-242.

Similarly, Japanese TNCs have also come to generate more of their sales abroad through FDI rather than through international trade. But, for these TNCs, such an evolution is of very recent origin, reflecting their prolonged status as traders rather than investors. In fact, as late as 1977, Japanese affiliates reported total foreign sales ($85 billion) to be roughly equivalent to Japanese exports world-wide (Japan, MITI, 1979, p. 54; IMF, 1980, p. 243). But, by 1990, following a decade of rapid growth in Japanese FDI, Japanese foreign affiliates (most of which were majority-owned) reported foreign sales two and one half times larger than all Japanese exports world-wide (figure 2). Thus, Japanese firms have come to pursue the same FDI strategies that have proved so successful for United States TNCs.

For TNCs from both the United States and Japan, however, the relative mix of foreign sales, generated either by FDI or international trade, varies widely

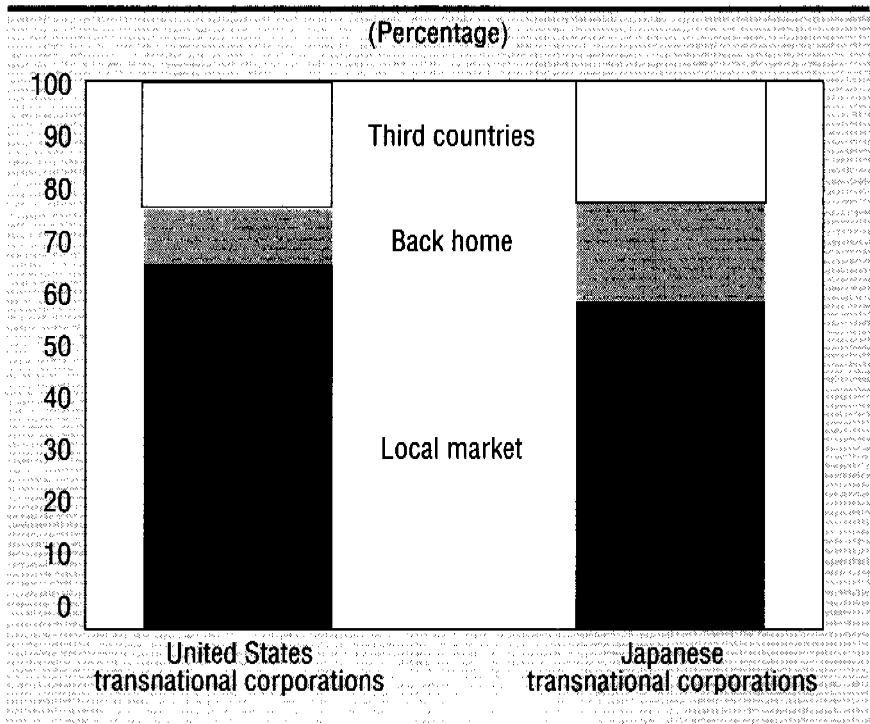
across regions (figure 2). As a general rule, FDI has become the principal means for both United States and Japanese TNCs to secure access in the advanced markets of industrialized countries — except, it seems, when United States firms seek to enter Japan. There, majority United States-owned affiliates suffered from roughly the same limited market access afforded to United States-based exporters — and that one-to-one ratio has remained quite stable over time, dating back at least to the mid-1960s (United States, Department of Commerce, 1975, p. 198; 1967, pp. 3, 12). Indeed, by this measure, Japan actually has less in common with the more advanced markets of the United States or Europe than with the newly industrializing and developing economies of East Asia.

Specifically, in Japan, several factors account for such limited market access (Encarnation, 1992; Encarnation and Mason, 1990). Import protection and capital controls first limit overall FDI inflows and then concentrate those inflows in minority foreign-owned affiliates. This legacy changed little with trade and capital liberalization: as United States FDI outflows worldwide began to taper off, Japanese industrial organization replaced the policies of the Government of Japan as the principal barrier to market access in Japan. Consequently, the same FDI and related trade strategies implemented successfully by United States and Japanese firms across a range of industrialized countries continued to elude United States TNCs in Japan.

Local versus export markets

For both United States and Japanese TNCs, the local market hosting their FDI has typically consumed most of their foreign sales (figure 3). What has changed over time, however, is the relative importance of the host-country market. As early as 1957 and continuing for at least another decade, United States TNCs reported that local markets in host countries accounted for three quarters of all foreign sales generated by United States subsidiaries (United States, Department of Commerce, 1975, p. 197; 1960, p. 110). However, beginning by the late 1970s and continuing through the 1980s, the contribution of host markets to the world-wide revenues of these United States affiliates gradually declined (United States, Department of Commerce, 1981, p. 318); by 1990, that contribution reached two thirds of total foreign sales (figure 3). Japanese subsidiaries evidenced a similar reduction between the early 1970s — when local markets also contributed three quarters of total foreign sales (Japan, MITI, 1973, pp. 86-87) — and the early 1990s, when that sales share dropped to three fifths (figure 3). While moving at different paces, then, both United States and Japanese TNCs again evolved in a common direction, by pursuing similar global strategies.

Figure 3. Destination of sales by United States and Japanese majority-owned affiliates abroad, 1990



Sources: United States, Department of Commerce, 1992a, table III.F.2; Japan, Ministry of International Trade and Industry, 1992a, pp. 88-89.

With this relative decline in local sales by United States and Japanese affiliates came a corresponding increase in shipments either back home or to third countries. World-wide, both United States and Japanese affiliates during 1990 sold just over 20 per cent of their total foreign sales in third countries (figure 3), typically in close geographic proximity to their host countries. Smaller still were shipments back home, although these have been growing rapidly: over the post-war period, exports back to the home market have either doubled (for the United States) or tripled (for Japan) their relative contribution to total sales by foreign affiliates (United States, Department of Commerce, 1960, p. 110; 1975, p. 197; 1981, p. 318; 1992a, table III.F.2; Japan, MITI, 1973, pp. 86-87; 1992a, pp. 88-89). By 1990, therefore, exports back home accounted for anywhere between one tenth (for the United States) and one sixth (for Japan) of total foreign sales by TNCs based in these two countries (figure 3). While regional differences in

these general patterns do persist, the clear fact remains that United States and Japanese TNCs typically have adopted common strategies.

Yet such a simple conclusion actually contradicts the popular argument advanced by at least one important school of Japanese scholars, who have long argued that Japanese TNCs pursue investment strategies that are far more trade enhancing than those favoured by United States TNCs (e.g., Kojima, 1978, 1990). For relevant data, those scholars often turn to East Asia, the only region where both United States and Japanese TNCs can claim long histories of FDI. In that region, at least during the 1980s, the combined exports (back home and to third countries) of United States and Japanese TNCs were roughly identical, while both totals continued to match local sales (Japan, MITI, 1992a, pp. 80-81; United States, Department of Commerce, 1992a, table III.F.2). And even when operating in each other's home market, where local sales become far more important, United States and Japanese firms adopt similar export strategies: affiliates owned by United States firms in Japan and by the Japanese firms in the United States export small and roughly identical proportions (one tenth) of their total sales (Japan, MITI, 1992a, pp. 80-81; United States, Department of Commerce, 1992a, table III.F.2). What emerges is a general proposition: when confronted with common political and economic environments (e.g., as in East Asia), or with the escalating demands of burgeoning local markets (e.g., as in the United States and Japan), United States and Japanese TNCs respond in strikingly similar fashion.

Despite such similarities, however, the FDI patterns of TNCs based in these two countries still exhibit three important differences, each with major implications for bilateral competition. First, from the United States, Japanese affiliates (especially the affiliates of Japanese trading companies) export mostly agricultural products and raw materials back home, principally to their parent firms (United States, Department of Commerce, 1992c, tables E-3, G-2), while from Japan, United States subsidiaries export manufactured goods both back home and to third countries, typically elsewhere in East Asia (United States, Department of Commerce, 1992a, tables III.F.2-III.F.7). Such differences in the composition of trade become significant in the present environment, since commodities presumably respond more readily to exchange-rate changes than do differentiated manufactured goods.

Second, unlike Japanese TNCs, which invest almost exclusively in majority-owned affiliates, United States TNCs rely more heavily on their minority-owned affiliates for exports from Japan. Indeed, these affiliates

export back to the United States three times more than do United States majority-owned affiliates in Japan (United States, Department of Commerce, 1992a, tables II.H.5 and II.H.22). These differences in market orientation also suggest the separate origins of majority-owned affiliates and minority affiliates in Japan; majority-owned affiliates serve the local market almost exclusively, while minority-owned affiliates often serve as offshore sources of Japanese supplies for United States TNCs. Third, when all of the bilateral trade is finally tallied, Japanese affiliates in the United States export more back home — two times more in 1990 — than do all United States affiliates in Japan (United States, Department of Commerce, 1992a, table II.H.22; 1992c, table G-2). Such trade amounts to just over one tenth of Japan's burgeoning exports to the United States, but it contributes nearly one half of United States smaller exports to Japan (United States, Department of Commerce, 1992d, pp. 11, 15). This export contribution makes Japanese-owned affiliates the largest United States-based exporters to Japan, and it effectively guarantees Japanese TNCs uncontested control over bilateral trade.

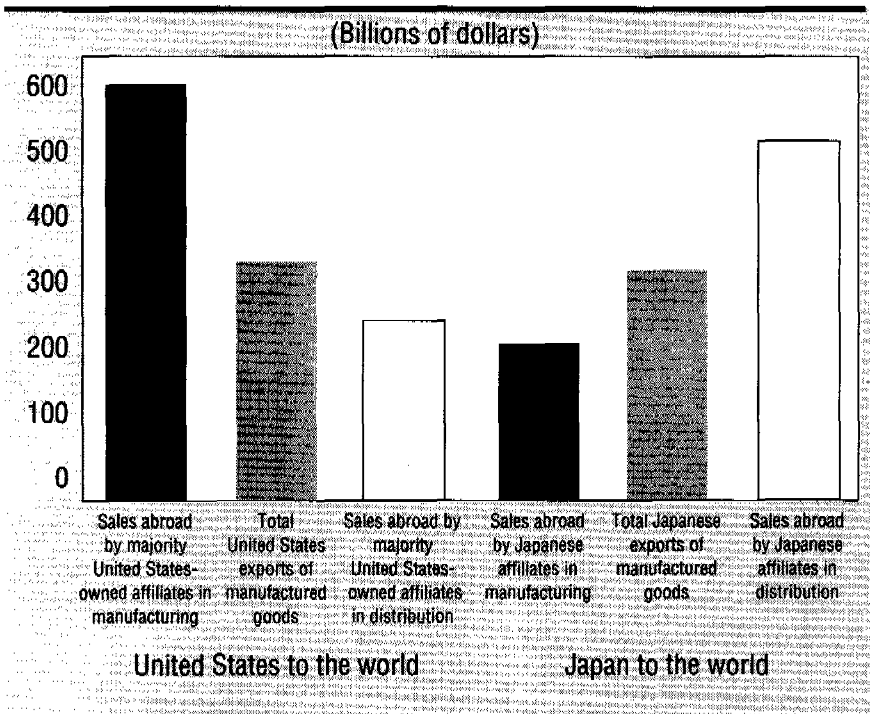
Offshore production versus overseas distribution

To generate their foreign sales, TNCs often invest in affiliates that produce offshore many of the goods and services that are then supplied to markets abroad and back home. As a practical matter, pressures to increase such offshore production greatly increase when *any* of four conditions arise: when national Governments severely constrain, or credibly threaten to limit, imports (Reuber, 1973; Guisinger, 1985); when global competitors derive significant advantage from their location (Porter, 1990); when indigenous buyers demand closer relations with their suppliers (Porter, 1980); and when foreign exporters fear the increased risks of exchange rate fluctuations (Julius, 1990). Thus, each source of foreign sales by TNCs reflects a different FDI and related trade strategy.

United States corporations have been quick to respond to such pressures for offshore production: at least as early as 1957, and continuing beyond the next three decades, those majority-owned United States affiliates engaged in overseas manufacturing reported foreign sales to be double the value of United States manufactured exports (figure 4; United States, Department of Commerce, 1960, p. 10; 1973, p. 14; 1975, p. 199; 1981, p. 318). United States firms concentrated most of this foreign production across industrialized countries, but not in Japan, which invites comparisons with developing

economies. In these economies, as in Japan, international trade continued to exceed foreign production: as recently as 1990, majority United States-owned manufacturing affiliates in developing countries recorded foreign sales roughly three quarters the value of United States manufactured exports to these countries (United States, Department of Commerce, 1992a, table III.E.3; 1992d). In Japan, and across most less developed economies, United States TNCs failed to implement a strategy of offshore production that has served them well in other, industrialized countries.

Figure 4. Foreign production, national exports and foreign distribution: United States versus Japan, 1990



Sources: United States, Department of Commerce, 1992a, table III.E.3; 1992d, p. 28; Japan, Ministry of International Trade and Industry, 1992a, pp. 88-89; International Monetary Fund, 1992, p. 240.

By comparison, Japanese manufacturers in their world-wide investments more closely paralleled those United States TNCs producing locally

in developing, rather than industrialized, countries. Like the United States, those Japanese affiliates principally engaged, during 1990, in foreign manufacturing recorded foreign sales world-wide less than the value of all Japanese manufactured exports (figure 4). Even when we add to those local sales the assembly operations of Japanese affiliates engaged principally in overseas distribution, the total value of Japanese production world-wide still barely equals total Japanese exports of manufactured goods. For Japanese firms, however, this low ratio of foreign production to international trade actually represented a significant *increase* in offshore manufacturing. Indeed, just over a decade earlier (in 1977), Japanese manufacturers had reported exports from home four times larger than the world-wide production recorded by Japanese affiliates abroad (Japan, MITI, 1979, p. 54; IMF, 1980, p. 242). Subsequently, during the 1980s, Japanese TNCs made a much greater effort to increase foreign production in their principal export markets. Yet, even after such growth, these Japanese affiliates still have much in common with United States TNCs operating in Japan and in a wide range of developing countries, but not in other industrialized countries. In other words, for Japanese firms, offshore production competed almost evenly with international trade as a source of foreign sales.

Far more central to the FDI strategies of Japanese TNCs has been the establishment of foreign affiliates engaged in overseas distribution (figure 4). These affiliates often establish dedicated sales and service networks for Japanese manufactured exports (Encarnation, 1986, pp. 120, 126; Yamawaki, 1991). During 1990, Japanese exporters shipped over two fifths of their world-wide exports to Japanese affiliates abroad (Japan, MITI, 1992a, pp. 104-105; IMF 1992, p. 240). By contrast, that same year, United States affiliates engaged principally in foreign manufacturing bought roughly 15 per cent of all United States exports, twice the global share sold through United States marketing affiliates (United States, Department of Commerce, 1992a, table III.H.5; 1992d). These United States affiliates — in manufacturing, not marketing — actually serve as more important final markets and intermediary channels for United States exports.

Only in Japan do United States TNCs significantly deviate from this norm by aggressively investing in affiliates engaged principally in distribution. In this way, United States TNCs seek to overcome a variety of entry barriers, including local control over distribution channels (Lawrence, 1991). Through their marketing affiliates, United States TNCs during 1990 sold roughly one tenth of all United States exports to Japan, twice the trade

contribution of those United States affiliates manufacturing in Japan (United States, Department of Commerce, 1992a, table III.H.5; 1992d, p. 11). By comparison, the establishment of wholesaling affiliates in Japan by United States TNCs represents a significant adaptation to the characteristics of Japanese industrial organization, just as the Japanese establishment of wholesaling affiliates abroad represents a significant extension of that organization into foreign markets.

In addition to downstream marketing of home-country exports, wholesaling affiliates also increase foreign sales by serving as upstream sources of overseas supplies. Specifically, these affiliates often serve as purchasing agents, both for their parents back home and for affiliates in third countries. Of particular significance to United States TNCs have been those United States wholesaling affiliates that supply neighbouring third-country markets. Otherwise, for United States TNCs, wholesaling affiliates have proved to be of little value as purchasing agents for shipments back home, supplying less than 2 per cent of all United States imports during 1990 (United States, Department of Commerce, 1992a, table II.H.22; 1992d). However, for the Japanese, wholesaling affiliates represent much more important sources of shipments back home. These Japanese affiliates reported to MITI during 1990 that they had supplied nearly one half of all Japanese imports worldwide (Japan, MITI, 1992a, pp. 78-79, 88-89; IMF, 1992, p. 240). These imports consisted largely of agricultural products, metals and other raw materials, all of which remained in short supply in Japan. Hence, in marked contrast to United States TNCs, Japanese (especially trading) companies invested far more aggressively in wholesaling affiliates in order to insure the security of imported supplies.

Intra-company shipments versus arm's-length trade

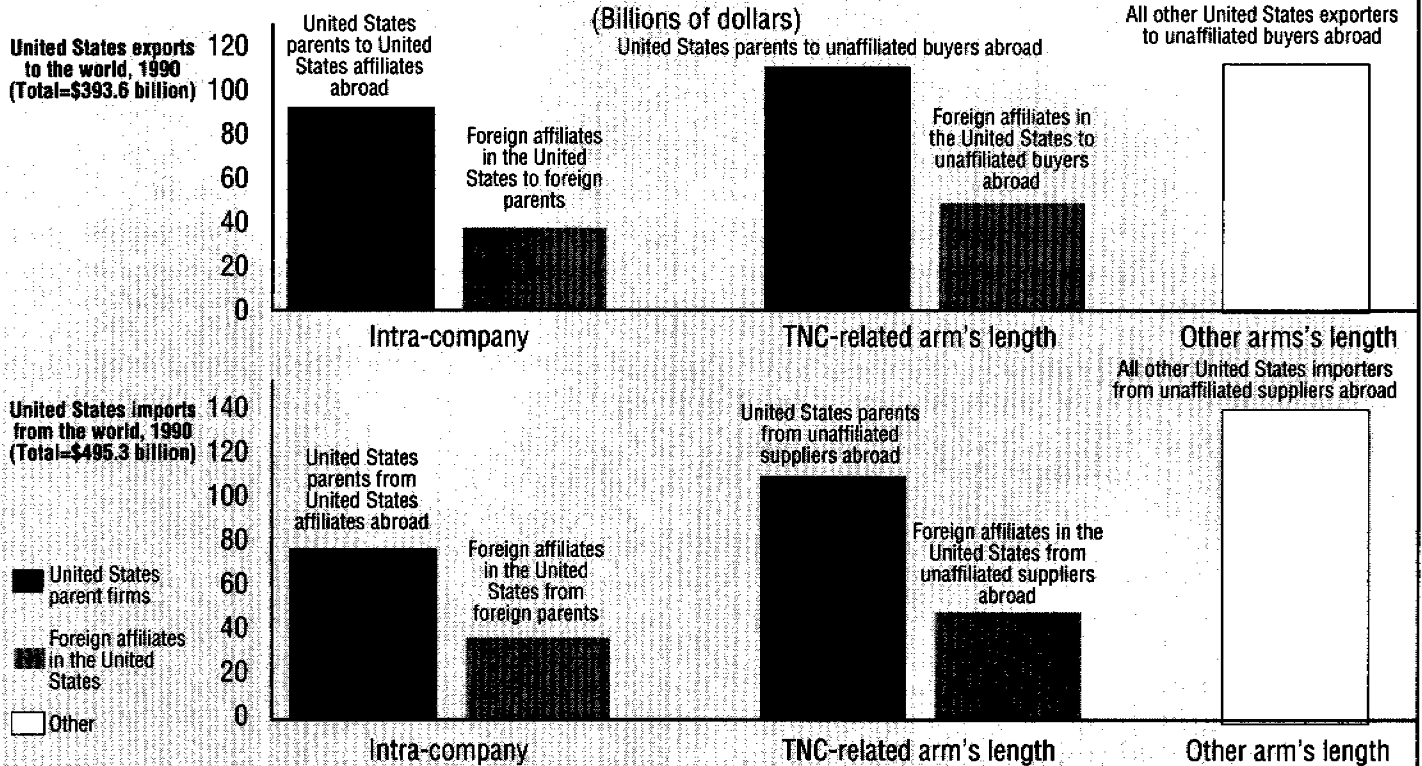
Today, much of the trade conducted by United States and Japanese TNCs is shipped intra-company, among and between parents and their affiliates, a fact only recently recognized by academic scholars (Encarnation, 1992; TCMD, 1992; UNCTC, 1991; Sleuwaegen and Yamawaki, 1990; Julius, 1990). Such trade has important implications not only for these corporations, but also for national economies. For corporate parents, intra-company trade ensures greater control over both upstream supplies and downstream markets than do more arm's-length transactions among unaffiliated buyers and suppliers. Intra-company trade also substantially lowers the high costs that these arm's-length transactions normally would impose on those cross-border exchanges of the technological, marketing and organizational

assets necessary to compete successfully through foreign production and overseas distribution. Thus, relationships resulting from equity ownership and managerial control — rather than only those transactions based principally on relative prices — can be expected to determine patterns of intra-company trade. By this same logic, intra-company trade may prove far less responsive to short-term swings in foreign exchange rates, thereby blunting national policies designed to alter currency movements. Such an impact on national policy can be sizable, because intra-company trade has now grown to dominate international trade among industrialized countries.

To illustrate, consider the global trade of the United States. During 1990 (the most recent year for which data are available, summarized in figure 5), intra-company shipments contributed over two fifths of total United States imports, and roughly one third of total exports world-wide. To those exports, shipments from United States parent firms to their majority-owned affiliates world-wide contributed much more than did shipments from foreign majority-owned affiliates in the United States back to their foreign parent firms. Conversely, these foreign parent firms contributed much more to United States imports through shipments to their majority-owned affiliates in the United States than did United States TNCs engaged in comparable intra-company trade. In addition, United States parent firms proved to be the greatest source of arm's-length trade involving both unaffiliated buyers and unaffiliated suppliers abroad. This has left all other United States-owned enterprises to ship, through arm's-length trade, less than one quarter of United States trade (i.e., both exports and imports) world-wide. In short, United States and foreign TNCs, together, dominate United States trade.

By contrast, in Japan, foreign TNCs exercise a far more limited influence on that country's trade, which is singularly dominated by Japanese TNCs. Such dominance is especially pronounced in shipments of Japanese exports: over two fifths are shipped intra-company, by Japanese TNCs to their foreign (principally majority-owned) affiliates. Those parent firms ship another two fifths of Japan's exports to other foreign buyers (figure 6). Many, perhaps one half, of those additional foreign buyers are actually other Japanese affiliates abroad (Japan, MITI, 1992a, p. 104; 1991, p. 236), which themselves may be affiliated with their Japanese suppliers through vertical *keiretsu* relationships (Graham and Gittelman, forthcoming; Lawrence, 1991). By comparison, foreign TNCs contribute negligibly to Japanese exports.

Figure 5. United States trade with the world: intra-company versus arm's-length shipments, 1990



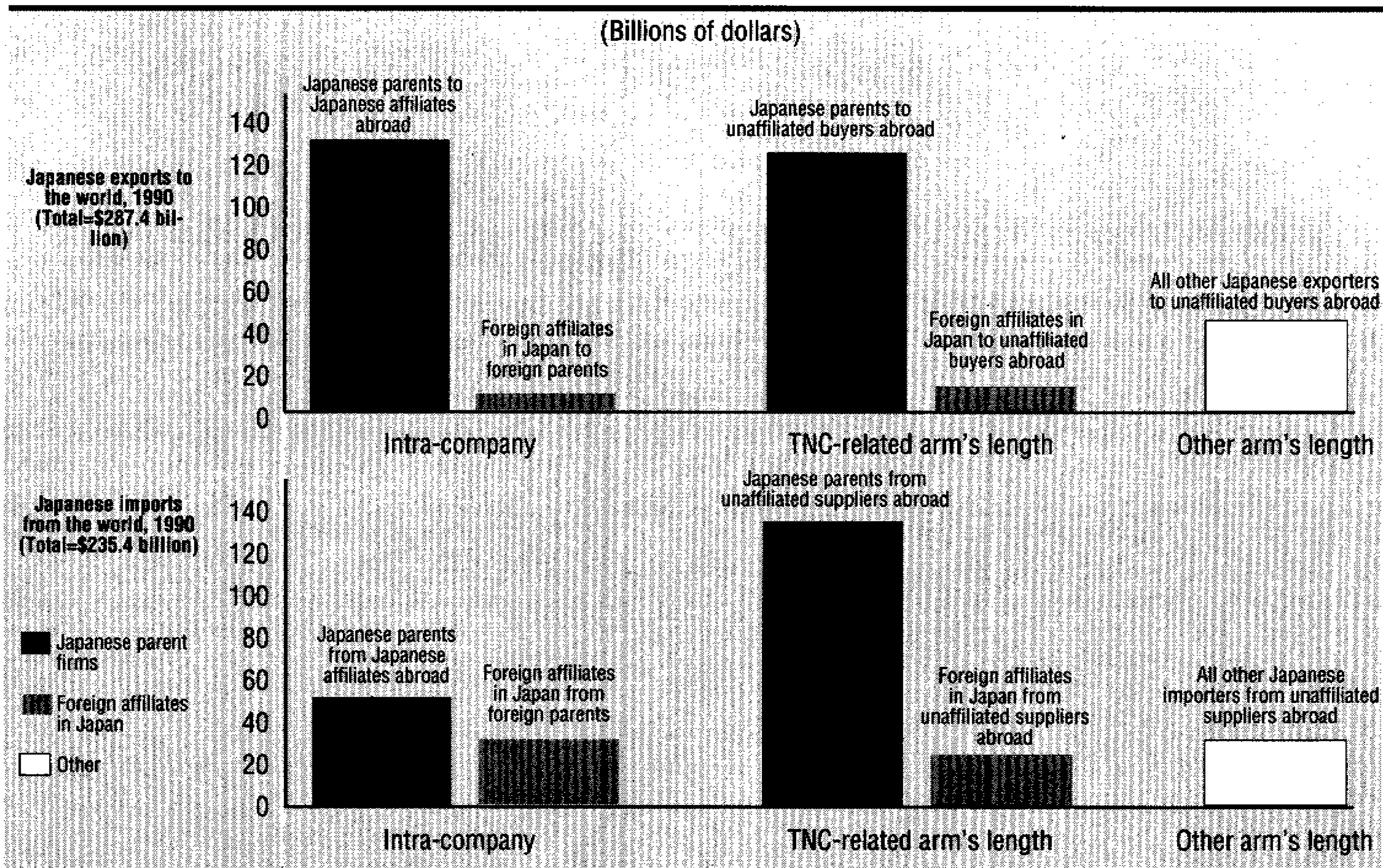
Sources: United States, Department of Commerce, 1992a, table III.H.1; 1992c, table G-2; 1992d, p. 11.

While the actual contribution of foreign TNCs to Japanese imports is slightly larger, it still pales in comparison to the continued dominance exercised by Japanese TNCs. In fact, with unrivaled control over distribution channels in the Japanese market, Japanese TNCs account for roughly three quarters of all Japanese imports (figure 6). Once more, much of that trade (roughly one fifth of all Japanese imports) is shipped intra-company, from Japanese affiliates around the world back to their parent firms. These parent firms, then, receive the remainder of their shipments (over one half of all Japanese imports) from other foreign suppliers, many of which are other Japanese affiliates abroad (Japan, MITI, 1992a, p. 88; 1991, p. 229). Again, a large number of those Japanese affiliates are linked to their Japanese buyers through vertical *keiretsu* relationships. For Japanese firms, therefore, FDI has created the principal channels for two-way trade flows, granting Japanese TNCs unrivaled control over their country's trade.

In Japan, the concentration of limited FDI in minority-owned affiliates greatly constrains the impact of foreign TNCs on that country's trade. For only with majority ownership do TNCs exercise sufficient managerial control to dictate their affiliates' decisions to import supplies from their parents. Such control, however, does not exist in minority affiliates, which typically represent poor markets for national exports, even in those host countries (like Japan) where the sales of these affiliates are relatively large. By contrast, minority-owned affiliates do represent more important sources of supply. For example, during 1990, United States exports to minority United States affiliates world-wide remained negligible, accounting for only 6 per cent of all United States exports to United States affiliates abroad, even though minority-owned affiliates contributed just under 20 per cent of all sales by United States TNC and over 13 per cent of all United States imports (United States, Department of Commerce, 1992a: tables II.E.3, II.H.5, II.H.22, III.E.3, III.H.2; 1992d).

By this logic, then, the higher incidence of United States minority-owned affiliates in Japan has effectively denied to United States TNCs the same access for United States exports that they have enjoyed in other industrialized countries. That is, since Japan has long hosted a disproportionately large share of minority-owned affiliates, and because these affiliates generally refrain from purchasing United States exports (while contributing more to United States imports), United States TNCs in Japan have contributed a relatively small share of this bilateral trade. By contrast, for Japan, the higher incidence of majority-owned affiliates in the United States has actually granted to Japanese exports far greater access to the United States market

Figure 6. Japanese trade with the world: intra-company versus arm's-length shipments, 1990[a]



Sources: Japan, Ministry of International Trade and Industry, 1992a, pp. 47-48, 88, 104; 1992b, pp. 77, 111; 1991, pp. 229, 236; International Monetary Fund,

than the United States TNCs, through their limited investments in minority-owned affiliates, have been able to secure in Japan. As a result, Japanese sales in the United States continue to grow, just as United States sales in Japan continue to lag far behind.

A common evolution? Answers and policy implications

In the end, then, we observe several emerging similarities, as well as a few persistent differences, in the ongoing evolution of United States and Japanese TNCs. Beginning with the similarities, both United States and Japanese TNCs have concentrated most of their FDI in majority-owned affiliates. These affiliates have become the principal means for United States and Japanese TNCs to secure market access abroad. In fact, through their majority-owned affiliates, they record far more foreign sales than do all exporters based in the United States or Japan. Most of these foreign sales come either from the host-country market, or from geographically proximate markets; by contrast, far more limited sales are generated from a subsidiary's shipments back to its parent's home market, or from widely dispersed third-country markets. To supply such local and regional markets, United States and Japanese TNCs increasingly rely on offshore production and not just on imported goods sold through proprietary distribution channels abroad. These distribution channels, plus the import requirements of offshore production, all illustrate that FDI need not displace trade, but may instead complement that trade, by increasing its value, while also altering its composition and direction. In sum, many of the foreign operations evidenced first by United States TNCs immediately after the Second World War have, in the past decade, been extended to Japanese TNCs.

While the historical evolution of Japanese TNCs has generally begun to parallel this United States model, important differences do remain. For example, in marked contrast to United States TNCs, Japanese firms still sell abroad far more manufactured goods through international trade than they do through offshore production. Indeed, even after the rapid expansion of such production over the past decade, by the early 1990s, Japanese manufacturing (including assembly) around the world still lagged by four decades comparable manufacturing by well ensconced United States TNCs. Rather than rely on offshore production, Japanese TNCs generate most of their foreign sales from substantial investments in local distribution. Initially, much of these investments came from Japanese general trading companies (*sogo shosha*), but today the trading arms of Japanese manufacturers also figure

prominently. Together, these Japanese investments in offshore commerce remain much larger than those recorded by United States TNCs. After investing in proprietary distribution channels, Japanese TNCs go on to exercise, through intra-company trade between parent firms and affiliates, unrivaled control over both Japanese exports and Japanese imports.

Seeking to understand why Japanese TNCs continue to operate differently, many observers argue that such persistent differences reflect "vintage effects"; in other words, that the newcomer Japanese TNCs are still at a much earlier stage in their transnational evolution than are the longer established TNCs from the United States (for a summary of these views, see Encarnation and Mason, forthcoming). For sure, as was shown above, vintage effects have seriously confounded earlier analyses of Japanese TNCs, leading whole schools of thought to conclude that the evolution of Japanese TNCs was unique when compared specifically with United States firms. This earlier research reported, for example, that Japanese TNCs preferred minority-owned affiliates to majority shareholdings, and that Japanese FDI enhanced trade far more than did comparable United States investments. Even if accurate at the time reported (itself a questionable assumption), these earlier differences between Japanese and United States TNCs had, by the early 1990s, withered away. And, by the same logic, additional progress along a common evolutionary path should also diminish other more persistent vintage effects.

Alternatively, however, the withering away of such vintage effects may actually exacerbate some of the remaining differences between Japanese TNCs and their United States counterparts. Looking first at the strong relationship between FDI and international trade, the high incidence of intra-company trade between parent firms and their foreign affiliates needs to be considered. While such trade is common to both United States and Japanese TNCs, the latter make far better use of this and related linkages to control their country's trade with the rest of the world. For example, United States TNCs contribute roughly one half of all United States exports, split roughly equally between intra-company shipments to their foreign affiliates and more arm's-length shipments to unaffiliated buyers abroad. By comparison, Japanese TNCs contribute about four fifths of all Japanese exports, again split roughly equally between intra-company shipments and other transactions, many of which (at least for Japanese firms) involve foreign affiliates abroad that are affiliated with Japanese TNCs through *keiretsu* relationships.

Similarly, through either a combination of intra-company shipments, *keiretsu* relationships and more arm's-length trade, the parent firms of Japanese TNCs account for three quarters of all Japanese imports. By contrast, two fifths of all United States imports are channeled through intra-company and more arm's-length shipments to the parent firms of United States TNCs. Moreover, for these United States TNCs, their sizable control over United States exports and imports has remained quite stable in recent years. But for Japanese TNCs, their even greater control over Japanese trade seems likely to grow along with increased Japanese FDI. In short, the growth of intra-company trade and related *keiretsu* relationships suggests that persistent differences between Japanese TNCs and their United States counterparts may actually be exacerbated as Japanese FDI proliferates and matures.

In addition to vintage effects, a second explanation of persistent differences in the structure and performance of Japanese affiliates abroad, compared to the operations of United States TNCs, focuses on the wide variation in market access enjoyed by foreign investors. Specifically, in Japan, this means that United States FDI remains limited and is concentrated in minority-owned affiliates. What few subsidiaries do exist generate just about the same paltry level of Japanese sales as that generated by United States-based exporters. By contrast, Japanese TNCs operating in the United States have come to pursue many of the same FDI strategies denied in Japan to United States TNCs, but actively implemented by both United States and Japanese firms elsewhere in the world.

Among the many explanations of these persistent asymmetries in market access, corresponding differences in Japan's industrial structure and Government policy remain important (Encarnation, 1992). Redressing these asymmetries will thus figure prominently in Japan's bilateral relations, not only with the the United States, but also with the European Community (Encarnation and Mason, forthcoming). Elsewhere in the world, in developing countries that principally host Japanese TNCs, persistent asymmetries in market access also have important policy implications: only by attracting export-oriented Japanese FDI can many of the host countries ever hope to increase their national exports to Japan. In the end, then, both Government policy makers and business managers around the world must recognize that FDI has carried economic rivalries well beyond international trade. ■

References

Caves, Richard E. (1982). *Multinational Enterprise and Economic Analysis.* Cambridge, Massachusetts: Cambridge University Press.

Encarnation, Dennis J. (forthcoming, 1993). Transforming trade and investment: American, European, and Japanese multinationals across the Triad. In *Does Ownership Matter? Japanese Multinationals in Europe*, Mark Mason and Dennis J. Encarnation, eds. London: Oxford University Press.

_______ (1992). *Rivals Beyond Trade: America Versus Japan in Global Competition.* Ithaca, New York: Cornell University Press.

_______ (1989). *Dislodging Multinationals: India's Strategy in Comparative Perspective.* Ithaca, New York: Cornell University Press.

_______ (1986). Cross-investment. In *America Versus Japan*, Thomas K. McCraw, ed. Boston, Massachusetts: Harvard Business School Press, pp. 117-149.

_______ and Mark Mason (forthcoming, 1993). Does ownership matter? Answers and implications for both Europe and America. In *Does Ownership Matter? Japanese Multinationals in Europe*, Mark Mason and Dennis J. Encarnation, eds. London: Oxford University Press.

_______ and Mark Mason (1990). Neither MITI nor America: The political economy of capital liberalization in Japan. *International Organization*, 44 (Winter), pp. 29-54.

Goldsbrough, David J. (1986). Investment trends and prospects: The link with bank lending. In *Investing in Development: New Roles for Private Capital?* Theodore H. Moran, ed. Washington, D.C.: Overseas Development Council, pp. 173-186.

Graham, Edward M. and Michelle Gittelman (forthcoming, 1993). Affiliates of Japanese firms in the European Community: performance and structure. In Mark Mason and Dennis J.Encarnation, eds., *Does Ownership Matter? Japanese Multinationals in Europe.* London: Oxford University Press.

Guisinger, Stephen E. *et al.* (1985). *Investment Incentives and Performance Requirements: Patterns of International Trade, Production and Investment.* New York: Praeger Publishers.

International Monetary Fund (1992). *International Trade Statistics Yearbook.* Washington, D.C.: International Monetary Fund.

_______ (1980). *International Trade Statistics Yearbook.* Washington, D.C.: International Monetary Fund.

Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division (1992a). *The 21st Survey of the Overseas Business Activities of Japanese Enterprises* [*Dai nijuichi-kai wagakuni kigyo no kaigai jigyo katsudo*]. Tokyo: Ministry of Finance Printing Bureau.

_______ (1992b). *The 25th Survey of Business Trends of Foreign Enterprises in Japan* [*Dai nijugo-kai gaishikei kigyo no doko*]. Tokyo: Ministry of Finance Printing Bureau.

_______ (1991). *The Fourth Comprehensive Survey of Foreign Investment Statistics* [*Dai yon-kai kaigai toshi tokei soran*]. Tokyo: Ministry of Finance Printing Bureau.

_______ (1979). *The 8th Survey of the Overseas Business Activities of Japanese Enterprises* [*Dai hachi-kai wagakuni kigyo no kaigai jigyo katsudo*]. Tokyo: Ministry of International Trade and Industry.

_______ (1973). *Overseas Business Activities of Japanese Enterprises: Current Situation and Problems* [*Wagakuni kigyo no kaigai jigyo katsudo: sono genjo to mondaiten*]. Tokyo: Ministry of International Trade and Industry.

Julius, DeAnne (1990). *Global Companies and Public Policy: The Growing Challenge of Foreign Direct Investment*. London: Royal Institute of International Studies.

Kojima, Kiyoshi (1990). Japanese direct investment abroad. Tokyo: Monograph Series 1, Social Science Research Institute, International Christian University.

_______ (1978). *Direct Foreign Investment: A Japanese Model of Multinational Business Operations*. London: Croom Helm.

_______ (1986). Japanese-style direct foreign investment. *Japanese Economic Studies*, 14, 3 (Spring), pp. 52-82.

Komiya, Ryutaro (1988). *The Contemporary Japanese Economy* [*Gendai nihon keizai*]. Tokyo: University of Tokyo Press.

Lawrence, Robert Z. (1991). Efficient or exclusionist? The import behavior of Japanese corporate groups. Washington, D.C.: The Brookings Panel on Economic Activity.

Lipsey, Robert E. (1988). Changing patterns of international investment in and by the United States. In *The United States in the World Economy*, Martin Feldstein, ed. Chicago, Illinois: University of Chicago Press for the National Bureau of Economic Research, pp. 475-545.

Ozawa, Terutomo (1979). *Multinationalism, Japanese style: The Political Economy of Outward Dependency*. Princeton, New Jersey: Princeton University Press.

Porter, Michael E. (1990). *The Competitive Advantage of Nations.* New York: The Free Press.

_______ (1980). *Competitive Strategy: Techniques for Analyzing Industries and Competitors.* New York: The Free Press.

Reuber, Grant L. *et al.* (1973). *Foreign Private Investment in Development.* Oxford: Oxford University Press for the Organisation of Economic Co-operation and Development.

Sekiguchi, Sueo (1979). *New Developments in Foreign Investment* [*Kaigai toshi no shintenkai*] Tokyo: Nihon Keizai Shinbun-sha.

_______ and Mitsuji Matsuba (1974). *Japan's Direct Investment* [*Nihon no chokusetsu toshi*]. Tokyo: Nihon Keizai Shinbun-sha.

Sleuwaegen, Leo and Yamawaki Hideki (1990). Foreign direct investment and intra-firm trade: evidence from Japan. Rotterdam: Discussion Paper No. 9002/G, Institute for Economic Research, Erasmus University.

Strange, Susan (1991). The name of the game. In *Sea-changes: American Foreign Policy in a World Transformed,* Nicholas X. Rizopoulos, ed. New York: Council on Foreign Relations Press, pp. 238-273.

Thomsen, Stephen (1990). Appendix: FDI data sources and uses. In *Global Companies and Public Policy: the Growing Challenge of Foreign Direct Investment,* DeAnne Julius, ed. London: Royal Institute of International Studies, pp. 109-122.

Tsurumi, Yoshihara (1976). *The Japanese Are Coming: A Multinational Spread of Japanese Firms.* Cambridge, Massachusetts: Ballinger.

United Nations Centre on Transnational Corporations (1991). *World Investment Report 1991: The Triad in Foreign Direct Investment.* Sales No. E.91.II.A.12.

United Nations, Transnational Corporations and Management Division (1992). *World Investment Report 1992: Transnational Corporations as Engines of Growth.* Sales No. E.92.II.A.19.

United States, Department of Commerce, Bureau of Economic Analysis (1992a). *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1990 Estimates.* Washington, D.C.: United States Government Printing Office.

_______ (1992b). *U.S. Direct Investment Abroad: 1989 Benchmark Survey, Final Results.* Washington, D.C.: United States Government Printing Office.

_______ (1992c). *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 1990 estimates.* Washington, D.C.: United States Government Printing Office.

_______ (1990). *Foreign Direct Investment in the United States: 1987 Benchmark Survey, Final Results.* Washington, D.C.: United States Government Printing Office.

_______ (1981). *U.S. Direct Investment Abroad, 1977.* Washington, D.C.: United States Government Printing Office.

_______ (1976a). *Foreign Direct Investment in the United States, Volume 2, Report of the Secretary of Commerce, Benchmark Survey*, 1974. Washington, D.C.: United States Government Printing Office.

_______ (1975). *U.S. Direct Investment Abroad, 1966: Final Data.* Washington, D.C.: United States Government Printing Office.

United States, Department of Commerce, Bureau of International Commerce (1973). International economic indicators. *Overseas Business Reports*, 73, 1 (January), pp. 1-14.

_______ (1967). United States trade with major world areas, 1965 and 1966. *Overseas Business Reports*, 67, 21 (May), pp. 3-12.

_______ (1957). United States trade with major world areas, 1955 and 1956. *Overseas Business Reports*, 57, 19 (May), pp. 2-8.

United States, Department of Commerce, International Trade Administration (1992d). *U.S. foreign trade highlights: 1991.* Washington, D.C.: United States Government Printing Office.

_______ (1976b). *U.S. foreign trade highlights: 1975.* Washington, D.C.: United States Government Printing Office.

United States, Department of Commerce, Office of Business Economics (1960). *U.S. Business Investments in Foreign Countries: A Supplement to the Survey of Current Business.* Washington, D.C.: United States Government Printing Office.

Wakasugi, Ryuhei (1989). *International Trade, Direct Investment, and Japanese Industrial Organization* [*Boueki Chokusetsu toshi to nihon no sangyo soshiki*]. Tokyo: Toyo Keizai Shimposha.

Williamson, Oliver E. (1973). Markets and hierarchies: Some elementary considerations. *American Economic Review*, 63 (May), pp. 316-325.

Yamawaki, Hiroyuki (1991). Exports and direct investment in distribution: Evidence on Japanese firms in the United States. Berlin: Discussion Paper FS 111, Wissenschaftszentrum.

Yoshino, Michael (1976). *Japan's Multinational Enterprises.* Cambridge: Harvard University Press.