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JAPANESE FOREIGN DIRECT INVESTMENT IN AFRICA:

PROSPECTS FOR INCREASED FUTURE ACTIVITY *

* The views expressed therein are those of the author and do not necessarily reflect those of the United Nations Economic Commission for Africa

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I. INTRODUCTION

1. African businessmen and government officials may have to resign themselves to the fact that Japanese foreign direct investment (FDI) in Africa may remain stable at its current level or even taper off over the next decade. This is the result of a number of internal and external economic, political, and social factors which can be influenced only marginally from Africa.

2. It is difficult to accept bleak prospects for Japanese involvement in Africa, especially since many African countries have been dedicating time, effort and resources to making their markets more open and attractive to foreign investors. It is also difficult to accept since Africa seems to offer some of the natural resources needed by Japanese manufacturers. As this paper will show however, foreign direct investment is not always demand-driven or solely dependent on the efforts and resources of African nations. In fact, in times of recession or investment capital scarcity FDI decisions are almost exclusive motivated by supply-side factors; i.e. Japanese market perceptions and global market options. What this means for Africa is that no matter how liberalized or open their markets become over the next few years, until the flow of investment Yen strengthens there is, little likelihood that the volume of FDI or degree of interest in Africa will change.

3. In this paper we will consider several factors which seem to inhibit Japanese investment in Africa. In **Section 1** we will explain the history of Japanese intervention on the African continent, and try to ascertain why many multi-national corporations (MNCs) have developed a [perhaps unfounded] apprehension about investing there.

4. In **Section 2** we will discuss how the negative impacts of Japan's historical presence in Africa are compounded further by current economic and financial sector trends, making the investment picture even more grim. By looking at financial trends over the past two years, we will better understand why Japanese investment in Africa is almost completely ***supply-side*** driven, and how this makes Africa's uphill battle to attract investment funds from a shrinking pool of available capital an even steeper climb.

5. Since foreign direct investment is not entirely one-sided, in **Section 3** we will investigate why Africa's [*demand-driven*] efforts to promote Japanese investment have been largely ignored by the "Nihon Ren". 1/ Although we would like to argue that it is only investment capital [Yen] scarcity behind the current investment conservatism, even during times of capital availability Japanese investors still chose other markets over Africa. The current Yen scarcity simply adds to the unlikelihood that Japanese investments will be channeled towards Africa anytime in the near future. Rather, Asia seems to be the destination for a larger and larger portion of Japan's venture capital. We will look at Asia as an investment site, and discuss how a more cohesive Asian market draws investment funds away from Africa.

6. To explain how the Japanese do make their investment decisions, a short case study on China will be presented. By examining the reasons why many Japanese MNCs are deciding

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1/Japanese people.

to invest in China now, and comparing these reasons to the African investment situation, we will better understand the attraction that Asian markets hold for Japanese investors and African markets do not.

7. In the **CONCLUSION** section of this paper, we will explain why, when all of these factors are combined, it looks as if many MNCs will continue to pull back into a tighter investment "comfort zone" whose borders do not extend far outside of the Pacific Rim and other "known" markets. In response, we will discuss how Africa can use its scarce investment promotion funds to take the most advantage of Japanese international foreign direct investment. We will discuss the different kinds of medium-term activities that Africans can pursue while they wait for the Japanese economy to get back on its feet, and how these activities will make their market even more open and attractive to Japanese investors in the long-run.

II. HISTORY OF JAPANESE INTERVENTION IN AFRICA

A. General Trends

8. Japan's initial presence in Africa was stimulated by the Berlin Treaty of 1885 which declared the Congo Basin and East Africa a free trade region. Japanese traders filled the gap left by colonial powers after World War I, increasing exports to the continent from 1.846 million Yen to 7.189 million between 1913 and 1920. 2/ In return for cotton and other raw materials Japanese firms shipped finished products to Africa, mostly through trading companies. Most of the trade was with East Africa, Egypt and South Africa, and at their height trading companies had established offices around the continent in cities like Mombassa, Casablanca, Nairobi, Alexandria and Lagos. Unfortunately World War II completely destroyed Japan's presence in Africa.

9. Since 1945, Japan's level of trade and investment with Sub-Saharan Africa has hovered between 2%-5% or its average volume with other developing regions. However, it has been suggested that even this figure is inflated since over half of the cumulative total between 1951 and 1981 3/ was concentrated in Liberia to take advantage of its liberal flag of convenience, tax and disclosure laws. 4/ Although Japan trades with all African nations, 90% of its trade is limited to only 11 countries. 5/ Of these, South Africa is Japan's most important

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2/William Nester (1991), "Japanese Neomerchantilism Toward Sub-Saharan Africa", <u>Africa Today</u>, 3rd Quarter.

3/$1.267 billion.

4/William Nester (1991), "Japanese Neomerchantilism Toward Sub-Saharan Africa", <u>op.cit.</u>

5/South Africa, Nigeria, Kenya, Ghana, Zambia, Sudan, Liberia, Zimbabwe, Zaire, Mauritania, and Tanzania.

trade and investment partner on the continent and accounts for 45% or $500 million worth of total non-Liberian investments. 6/ The remaining 55% of Japanese investments are concentrated either in manufacturing countries with large domestic consumer markets like Kenya, or in mining ventures where over 63% of venture funds are invested in resource rich countries like Nigeria, Zambia and Zaire. 7/

10. Compared to Africa, Asian 8/ countries draw approximately 20% of Japan's total overseas investments. This percentage is rising as the North American and European markets continue to grapple with recession and trade imbalances with Japan. In contrast to Africa, over half of Japanese ventures in Asia 9/ are in real estate, construction and services. The remaining half is invested in manufacturing ventures which require machine exports from Japan and which provide components for Japanese exports. Later in this paper we will discuss why it is unlikely that these general trends, both in terms of quantity and location, will diverge much from historical figures, and why the movement of investment Yen from western markets in heading to Asia instead of the developing world and Africa.

B. Oil Embargo

11. During the oil embargo in the 1970s, Africa experienced an uncommon surge of interest from the Japanese public and private sectors. As the threat of petroleum shortages swept through Japan, visits from ministry officials to Africa were commissioned in force. Private sector interests were represented by many of Japan's large trading companies, who also entered oil rich countries as quickly as possible. However, it is interesting and ironic to note that the suddenness with which the private sector entered the African market in the 1970s may be the cause for existing negative perception problems which inhibit many Japanese businessmen from considering African markets as investment sites today.

12. In Japan, trading houses play a very important role in the market entry process. By establishing liaison and administrative offices in countries before starting manufacturing and extraction operations, trading companies can help themselves and smaller investors ease into and quickly familiarize themselves in a new working environment. Because of the close working relationships between trading houses and smaller manufacturers, independent investors often enter into new markets two to three years after a trading company has established support offices.

13. However, during the 1970s when the oil embargo was at its most precarious, trading

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6/William Nester (1991), "Japanese Neomerchantilism Toward Sub-Saharan Africa", op.cit.

7/Ibid.; over 63% of Japan's investments in Africa are dedicated to natural resource mining ventures in oil, iron ore, and copper.

8/Oceania, NICs, ASEAN, and the rest of Asia.

9/Particularly in Newly Industrializing Countries (NICs).

companies did not have enough time to establish the local linkages needed to facilitate smooth operations in Africa. Although they had been in operation in Africa since the 1960s, trading companies have not established the networks needed in the relevant countries or industries. 10/ In retrospect, it seems that in their haste to hedge resource exposure by investing in oil rich countries quickly, trading companies lacked the knowledge, intelligence and experience needed to successfully support investments in Africa.

14. Economic downturns in Africa, which could not be weathered because of the uncommonly weak information infrastructure, combined with a quicker than expected recovery to the oil embargo in Japan, both contributed to the island nations's fleeting interest in Africa since the 1980s. Investments that more than doubled in Africa during the 1970s quickly returned to the traditionally low levels experienced during the 1960s. This downturn is ironic in that Japan's lack luster effort to penetrate the African market is partly caused by the private sector's own failure to implement the standard businesses practices that make their ventures successful in other new markets.

15. Because of their experiences during the 1970s, the Tokyo-based managers of many multi-national corporations (MNCs) are left with bad memories of Africa. Twenty years of marginal returns combined with the unfamiliarity and distance of Africa has propagated a negative feeling towards business operations there, which may be based more on history than existing investment possibilities. It would seem that promotional activities could go a long way towards curing the inaccurate and damaging reputation that Africa seems to hold for Japanese investors. However, before investing even more time and resources on investment promotion efforts, it is important to consider that negative perception problems are only the beginning and least severe of several impediments blocking Japanese investment in Africa. Even more harmful and having a strong impact, are national and global financial trends which are forcing Japanese businessmen to choose between investment sites even more critically.

III. SUPPLY-SIDE FACTORS CONTRIBUTING TO INVESTMENT CONSERVATISM

16. In general, Japanese investors have two goals when they enter any foreign country, which are (i) to dominate and saturate a particular consumer market and (ii) to use the resources of the host country for manufacture and eventual export to tertiary markets. Key variables which help investors decide which markets are most attractive include: access to productive resources at competitive prices (including land, labor and natural resources); incentives regarding taxation and equity participation; access to large consumer markets; transportation prices; the political situation; and a variety of other factors which are largely determined by the host country. During times of profitability, investors are willing to consider ventures which may or may not meet all of these demand side considerations. They

10/Japanese trading house activity in Africa throughout the 1960s was concentrated mostly in steel and mining operations, where they took advantage of local production advantages and industrial promotion incentives offered by host country governments.

may also be willing to take on ventures having lower profitability margins or which take longer to yield an acceptable return, in hopes of eventually cultivating potential markets.

17. However, when venture capital is scarce foreign direct investment decisions are based almost entirely on supply-side considerations, or on immediate Japanese needs. This means that when MNCs choose between investment sites, they are much less tolerant of those markets that yield unsure or marginal investment benefits. Markets that they do decide to enter must provide the immediate gains and fill immediate needs.

18. This is interesting when one considers that for the past year, Japan has been weathering an economic storm that is difficult for its traditional trading partners to conceive. In Japan, the global recession has been complicated further by a number of domestic, private sector occurrences which have left many multi-national corporations in precarious financial positions. As a result, corporate officers are forced to make investment decisions to meet and respond to existing problems. Investment trends indicate that many businessmen see the answer to their problems laying in regions other than Africa.

19. International economic occurrences which directly impact the level of Japanese foreign direct investment include the most recent and on-going Yen to Dollar appreciation and market losses due to the global recession. Complicating the corporate financial picture further is past faulty capital investment decision-making compounded by uncommonly poor consumer spending patterns which effect domestic demand in Japan.

A.Scarcity of Japanese Venture Capital

20. One of the most influential factors affecting Africa's ability to attract Japanese FDI is the scarcity or 'shrinking' of the overall pool of available investment capital. The depressed health of the Japanese economy combined with the impacts of the global recession and the current Yen to Dollar appreciation on corporate profitability, all contribute to a 'new investment conservatism' on the part of Japanese multinational corporations. Investment conservatism refers to the hesitance that many corporate executives feel about venturing into unknown or uncertain markets. It is particularly prevalent in Japan, where corporate officers feel the need to locate and cultivate new sources of potential profit and market stability in order to compensate for exchange rate losses felt over the last fiscal year. These losses stem from having to drastically discount profitability assumptions and counterbalance year end income projections that have fallen short of forecasts, as a result of the stronger Yen.

21. Exchange rate changes and Yen appreciation are not new phenomena to Japanese multinational corporations. In 1985 finance ministers from the top five industrial nations met and agreed on a schedule to appreciate the Yen against the U.S. Dollar, from ¥240 to ¥120 by early 1988. 11/ This Yen appreciation or *'Endaka'*, led to substantial Japanese investment overseas and a domestic economic boom in the late 1980s. However, the nature

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11/"Up with the Yen", Far Eastern Economic Review, March 4, 1993.

and impact of the most recent appreciation affects regional FDI flows more than in past years. This is largely because the most recent Yen appreciation has not been as planned or scheduled as that of 1985, and foreign investors have not been prepared for the overseas losses resulting from shifts in the exchange rate 12/.

22. As the Yen continues to appreciate against the Dollar 13/ in the presence of downgraded projections for economic growth, Japanese investors and businessmen are tightening the reigns on spending. These spending cuts come in the form of cost-cutting measures to compensate for lower than expected profits and revenues. One very publicized cut during fiscal year 1993 involved remittances to owners, and the fact that one out of every four Japanese companies decreased or completely abandoned its annual dividend payment, according to a survey of 1,536 listed companies. 14/

23. Other cuts directly impact foreign direct investment. They come in the form of lay-offs, slashing product lines and moving production facilities to locations that offer a mix of incentives that are more attractive, more competitive and more able to fill immediate corporate financial needs. However, the mix of investment incentives that the current investors searches out has less to do with the traditional package of tax holidays and duty exemptions than in the 1980s, and more to do with providing corporate executives with options to minimize the damage resulting from Japanese economic woes over the past year or two. In traditional Japanese style, these options are long-term and center around the prospects for developing investment centers which offer the traditional incentives <u>combined with</u> guaranteed increases in large-scale market access and consumer demand.

24. Because the amount of money available to make foreign investments has decreased, any remaining venture and investment capital must be spent in markets that can make up for the current profitability slack and assure future revenues quickly. As we will discuss later, when faced with tight financial constraints investors are more likely to target markets that are better known and offer more assured returns.

B. Excess Production Capacity and Inventories

25. Spending excesses incurred by many manufacturers during abundant economic times complicate the profitability slump caused by Yen appreciation even further. In the late 1980s

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12/ A recent study by the U.S Trade Commission estimates that with an exchange rate of ¥130 to the Dollar, the production cost of a small passenger car is approximately $7,300, or the same that it would cost an American manufacturer. But, at a rate of ¥106-¥111, the Japanese Manufacturer's costs are 20% higher than his U.S. competitor. (Japan's New Target for Investment is China. Global Finance, June 1993).

13/At a current rate of ¥111.52 to the Dollar. Quoted Reusch International's Selling Rate as of November 16th, 1993.

14/"This Time the Yen's Rise is Really Making Everyone Crazy", <u>Global Finance</u>, October 1993.

the Japanese cost of capital averaged approximately 1%, 15/ which enabled manufacturing corporations to make excessively large capital investments. The strategy for many corporations was to dominate particular sectors or markets by squeezing out competition. However, by 1990 the domestic economy in Japan began to slow and capital spending rose to 1.5 times 16/ gross cash flows on average. Because of the global recession, domestic and overseas consumption figures are down and Japanese manufacturers are faced with a three-tier problem: large excesses in manufacturing capacity 17/; existing inventories that far exceed demand, both in Japan and in existing export markets; and huge equity-related debts resulting from depreciation on plant and equipment. All three of these factors contribute to what is called Japan's 'balance sheet recession'. An indication of the seriousness of this problem is that thus far, the Presidents of over 180 listed corporations have announced their resignations to take responsibility for corporate losses stemming from excessive capital investments.

26. As the recession continues to sting and the United States and Europe look to decrease their trade imbalances, Japanese manufacturers can only expect to partially solve their excess inventory and manufacturing problems through existing export channels. As speculations on how long it will take to work down inventories through exports vary, Japanese MNCs are looking to off-load their existing merchandise and seek out new consumer markets for future products. In short, business owners are compensating for past poor capital investment decision-making by finding new markets to absorb the surplus inventories and production capacity created over the past five to eight years.

27. Capital spending during the 80s has direct repercussions on foreign direct investments decision-making. When demand exceeds supply, manufacturers can be satisfied with marginal consumption figures that yield net profits. However, when carrying expensive inventories and unused production capacity, manufacturers are faced with the immediate problem of finding consumer markets in which to prevent losses from excess holdings.

28. As a result, overseas investment decisions are no longer made simply to seek out a haven for cheap labor and raw materials, for manufacture and export to tertiary markets. The perpetual strategic planners that they are, Japanese manufacturers are looking for ways to satisfy both their immediate need to sell, and the long-term need to cultivate new markets to take up slack resulting from decreased exports to the U.S.A. and Europe, and dwindling domestic consumer demand. However, as mentioned earlier manufacturers are more critical than ever when it comes to evaluating potential sites for their scarce investment Yen. Although the current emphasis is on finding and enriching a future large-scale consumer base, manufacturers are still looking for sites that offer the traditional package of investment

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15/"Japan's Balance Sheet Deflation", Global Finance, July 1992.

16/Ibid.

17/The Mitsubishi Bank Survey recently reported that Japan's domestic automotive production capacity was 2.5 million units greater than actual output in 1992. (Japan's New Target for Investment is China. Global Finance, June 1993).

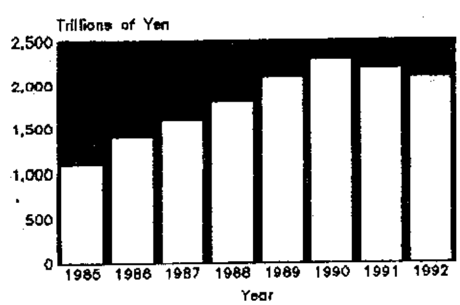
incentives. These increasingly competitive requirements in Japanese investment decision-making are the primary reasons that Africa is at a comparative disadvantage when considered along side her Asian competitors as a recipient of foreign direct investment.

C. Private Sector Debt in Japan and its Effect on Foreign Direct Investment (FDI)

29. An interesting aberration has recently occurred in the Japanese economy [also as a result of the excesses of the 1980s] that adds to the urgency many MNCs feel to find and cultivate new sources of consumer demand. It is a slow-down in domestic consumer spending, resulting from borrowing excesses which have left many Japanese consumers deep in hock and unable to maintain current consumption levels.

30. Through mid-1993, the hope in Japan was that an upturn in domestic consumer spending would stimulate demand, fuel private sector growth and help lift the country out of its current recession. As many economists are realizing however, the needed spending purge seems to have happened a little too early in Japan and the borrowing spree of the 1980s has caused an even greater slow down in domestic economic growth. Many Japanese individual consumers and organizations found themselves exposed by investing in the real estate or other asset-based markets that appreciated greatly in the 1980s, but took a dive again early this decade. Japan's aggregate consumer debt is growing very quickly and continues to do so despite more conservative lending practices on the part of creditors. Consumer credit grew by 130% to ¥63 trillion between 1985 and 1990, while disposable income only rose 27% during the same period. This resulted in a fall in Japanese household net worth by ¥133 trillion since it's peak in 1990. 18/

Net Worth of Japanese Households
The Less Affluent Society



Source: FEER " Deep in Hock" March 1993

31. Although Japanese MNCs only sell a small percentage of manufactured goods in Japan, the impact of domestic consumer spending decreases on foreign direct investment decision-making are very potent. As economic growth slows both in Japan and around the world, and as multi-national corporations experience lower sales in domestic and international markets, they feel the even stronger necessity to find new dynamic markets that can fill both their immediate and future needs.

18/"Deep in Hock", Far Eastern Economic Review, March 1993.

32. Decreases in domestic spending, compounded by manufacturing and inventory excesses confirm that many MNCs will be compelled to locate new markets in order to remain profitable. The domestic economic prognosis bolsters the importance of cutting production and transportation costs and finding, developing and optimizing new overseas markets.

D. Summary

33. The global economic slow-down and the domestic consumer credit crunch are directly impacting investment decision-making on the part of Japanese MNCs. Large international corporations need to compensate for lower than expected profits and higher than needed inventories and production capacity, but don't see their traditional trading partners as outlets for these excesses or expansion. Further, decreases in the domestic consumer market is also likely to contribute to corporate liquidity problems. All of these difficulties point to the fact that existing export markets for Japanese commodities don't offer the demand that is needed to absorb increases in production and growth. As a result, manufacturers are faced with the task of locating and cultivating new sources of consumer demand. These sources, more than in the past, need to offer manufacturers the traditional incentives associated with producing in developing countries (stable infrastructure, tax holidays and low production costs), while also guaranteeing access to a large consumer base. Several markets pose themselves as options to the Japanese and corporate decision-makers are decisively evaluating their options.

IV. DEMAND-SIDE FACTORS AND FOREIGN DIRECT INVESTMENT

34. Many African countries have been working hard to make their markets more enticing to foreign investors. Countries such as Ghana, Kenya, Namibia, South Africa, Tunisia, Uganda, Zambia and Zimbabwe offer particularly attractive incentives.

- Under **Ghana's** investment code of 1985, foreign investors are permitted to hold a 100% equity stake in any venture. Additionally, investors are privy to 100% duty and tax exemptions and are guaranteed free transfer of profits, dividends and other fees in the event of liquidation or sale. Particularly strong sector-specific incentives have also been introduced in mining, tourism and general services. *Ghana's GNP is $400 per year in 1991.*

- **Kenya** is a member of several international investment promotion bodies including the Multi-lateral Investment Guarantee Agency (MIGA) and the International Center for the Settlement of Investment Disputes (ICSID). Under these bodies investors are guaranteed protection against expropriation and repatriation of original capital and profits. In export processing zones, investors benefit from a ten-year tax free period and are exempt from customs duties and exchange controls. *Kenya's GNP was $340 per year in 1991.*

- Except for certain industries, the **Namibian** government allows foreign ventures without any restrictions on local equity participation. Other incentives include Namibia's access to European markets (through the Lomé Convention) and other

African markets through a series of protocols and agreements. *Namibia's GNP was $1,460 per year in 1991.*

- **South Africa** is Japan's largest trading partner and offers several incentives to foreign investors. The largest attraction is a *gross national product of $2,560 per year (1991)*, guaranteeing a large domestic consumer market. Other incentives include a strong exchange rate, tax-fee subsidies for goods produced or manufactured in South Africa and an export marketing tax allowance.

- In **Tunisia**, one of the largest investment incentives is the proximity of the European and Middle Eastern markets. Other foreign investment incentives vary by sector and include repatriation of 100% of profits and eligibility for VAT and consumption tax breaks after an initial investment period. *GNP in Tunisia was $1,500 in 1991.*

- Investment in **Uganda** is protected through their membership in MIGA. Incentives include an existing foreign exchange policy allows which allows for the repatriation of funds and the retention of 100% of export earnings. Fiscal incentives include a corporate tax exemption and freedom from duties for up to six years. *The GNP for Uganda was $280 in 1992.*

- **Zambia** is also a member of MIGA, protecting investors from potential expropriation. Incentives include exemptions from customs duties and sales taxes, a regressive retention of foreign exchange earnings, and customs duties exemption s on equipment and spare parts. There is also a seven year exemption from taxes on dividends and royalties following the establishment of any new venture. New ventures also qualify for a three-year exemption on corporate income tax. *Zambia's GNP for 1990 was $420 per capita.*

- **Zimbabwe** is also a member of MIGA, and is subject to the rules protecting foreign investment. Incentives include 100% profit retention and remittance by entirely foreign-owned corporations. May other incentives exist which heavily favor the export sector, but which do not favor agriculture. *Zimbabwe's GNP per capita for 1991 was $650.*

35. Although these incentives are commendable and attractive in terms of the benefits that they offer to investors, Japanese private sector had steadily kept its distance from Africa. When we ask ourselves why, we should consider that although tax breaks ownership provisions and terms regarding repatriation of profits influence investors when they are trying to decide where to place investment funds, there are several other demand-driven considerations that also take higher precedence for the Japanese. As global markets vie for scarce investment capital and the playing field becomes even more balanced in terms of incentives offered to foreign-owned businesses, Japanese MNCs have the luxury of choosing between markets and selecting those that best fill their particular corporate needs. Some of the most important considerations for Japanese manufacturers today pertain to accessing a consumer base and MNCs' ability to sell in domestic and third country markets. As

investors choose between manufacturing and investment sites they try to ascertain: (i) the absorptive capacity of local markets both in terms of production and consumption, (ii) the proximity of international or third country markets, and (iii) the ease with which manufactured goods can be moved to market. It is for these reasons that national income (wealth) and infrastructure considerations become paramount. National wealth gives MNCs a clear indication of absorptive capacity and infrastructure directly inhibits or facilitates the movement of goods.

36. Following is a discussion on how Japan uses Official Development Assistance (ODA) to improve the infrastructure of sites that it perceives to be beneficial to its investors. We will contrast this with its use of ODA in sites that it perceives to be less attractive, and consider how the provision of different kind of ODA effects regional investment decision-making on the part of the Japanese private sector.

A. Japanese Official Development Assistance (ODA) and Infrastructure Development

37. Japanese Official Development Assistance (ODA) and foreign direct investments have always been closely linked in developing countries. Japanese aid officials sometimes describe ODA as 'seed' money which promotes investments in the third world. This occurs because: (i) a large percentage of Japan's aid remains tied, formally or informally 19/ to the purchase of Japanese goods and services; (ii) in some countries ODA is used in investment-facilitating activities such as infrastructure development; and (iii) Yen loans demonstrate to the private sector that the government has confidence in a recipient country's political and economic stability.

38. Although Japan has stepped up its aid program in Africa in terms of total Yen appropriations, a closer look a the type of aid and its impact on FDI will demonstrate that Japan's existing aid program in Africa is not nearly as effective in attracting foreign investments as ODA initiatives in some Asian countries. This can be seen when taking a closer look at the amount of Japanese ODA provided to African countries in loan versus grant form, coupled with differences in actual development programming in African and Asian countries.

1. Loan and Grant Aid in Africa

39. Since 1980, Japanese aid officials have decreased their emphasis on Yen loans and placed progressively stronger focus on the grant component of ODA in Africa. In 1979, the total amount of Japanese aid in Africa amounted to 183 billion Yen. This was made up of 84% Yen loans and less than 16% in grants. 20/ However, during the period 1980-1988 the cumulative amount of ODA increased to 638.8 billion Yen, of which 59% was allocated

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19/Even though Tokyo maintains that its aid is now largely untied, Japanese firms win a disproportionate number of contracts through informal tying techniques. (Yen for Development; Japanese Foreign Aid and the Politics of Burden-Sharing. S. Islam, 1991.)

20/only 28.8 billion Yen.

for grant-aid and approximately 40% for loans. 21/

40. Although the amount of ODA flowing into Africa has been increasing over the past few years, the kind of ODA that is needed to facilitate FDI has been actually decreasing. This is not the case in Asian countries where investment-facilitating projects have been taking place in force, and don't look to be ending anytime in the near future. In order to understand why Yen loans facilitate investment, we must look at the kinds of activities that take place under loan-based ODA as opposed to grant-based ODA.

41. ODA loans are most closely associated with large infrastructure development projects. Examples of the projects funded by loan-aid in China in 1991 include: dam, plant, port, and highway construction, telecommunications network expansion and hydropower development projects 22/. These projects encourage foreign direct investment in three ways: (i) through the procurement of Japanese goods and services for project implementation 23/ (ii) through the direct benefits gained from better roads, a more stable power supply and more reliable communications; and (iii) through investor perception 24/. The grant component of ODA does not facilitate FDI. It is used more to further the GOJ's political relations than to encourage investments in a particular country or region.

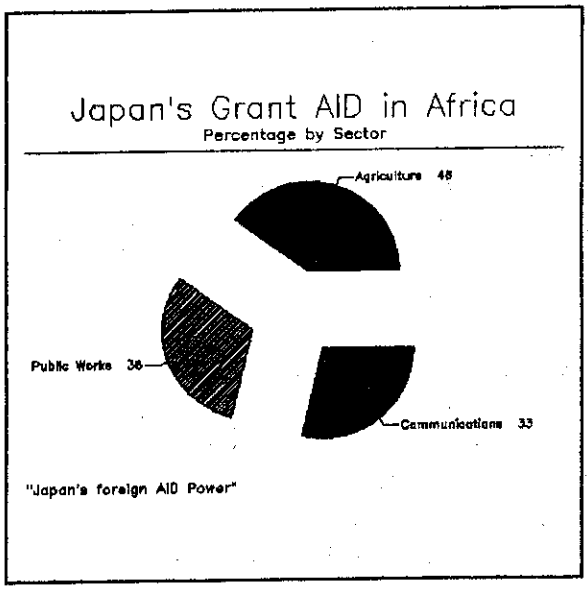
42. Grant-aid demonstrates that Japan is sensitive to emergency and humanitarian assistance needs in Africa and is willing to contribute to the continent's general development. Japanese grant-aid in Africa is targeted primarily towards humanitarian assistance and basic human needs activities, and is specifically concentrated in the areas of public welfare, improved provision of water supply and environmental development, with some investment in communications and transportation. Grant-aid does not respond to investor's needs to build and maintain the infrastructure that is so dearly needed to make large manufacturing initiatives workable in developing countries.

21/Ministry of Foreign Affairs (1992), Japan's ODA: Annual Report, Page 206.

22/Ibid.

23/Although the GOJ has been trying to untie their procurement activities over the past few years, in actuality, the procurement of machinery and other items used in infrastructure development projects is largely tied to Japanese organizations. This exposure allows trading companies and independent manufacturers to become familiar with the African setting and perhaps establish manufacturing ventures in-country.

24/ Since ODA loans have to be repaid to Japan, they demonstrate to the international business community that the Government of Japan (GOJ) has confidence in (i) the recipient country's economic stability and ability to pay back its loans plus interest, and (ii) political permanence and assurances that it will not renig on existing obligations. These factors are important to investors who are looking to make sizable capital investments.



43. Additionally, the percentage of grant-aid provided to Japan's top ODA recipient countries in Africa is lower than those countries receiving less ODA. In other words, the more ODA a recipient country receives the less likely it is to be in grant form. On average, Yen loans represent 60% of all Japanese ODA in the top five recipient countries in Africa, 41% for the second five, and 23% for the third five. The bottom ten countries receive no Yen loans, but only small amounts of grant aid. In general, the African nations that receive grant-aid over loan-aid, are smaller countries with populations of under 10 million 25/, i.e relatively small potential for developing large domestic consumer markets.

44. The distinction between loan and grant-aid is important because Official Development Assistance, and Yen loans in particular, is one of the GOJ's foremost methods of attracting private sector foreign direct investment and facilitating economic cooperation. Humanitarian aid through grant assistance, although an increasingly larger component of Japan's overall aid program in Africa, does not provide the investment appeal that loan aid does. In fact, grant-based assistance may actually discourage foreign direct investment. This is true for three major reasons:

- Since grant-aid is not repaid by recipient countries, by emphasizing grant-aid in Africa the GOJ sends out signals that it does not have confidence in many African countries' ability to pay back loans, and is thus apprehensive about their economic stability.

- Grant-aid is used mostly for projects and activities that do not focus on infrastructure development. By decreasing the ratio of loan to grant aid, the number of investment-facilitating projects taking place in Africa are decreasing.

- Grant-aid is associated more and more with Japan's efforts to untie procurement requirements. By allowing foreign firms to implement grant programs in Africa 26/, one would assume that the GOJ sees Africa as having limited importance

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25/William Nester (1991), "Japanese Neomerchantilism Toward Sub-Saharan Africa", op.cit.

26/S. Islam (1991), Yen for Development: Japanese Foreign Aid and the Politics of Burden

to Japan's business interests. 27/

2. ODA Summary

45. Recent trends in ODA programming indicate that the Japanese Government does not see the potential returns to investing in Africa that it sees for other regions. Although the total amount of ODA flowing into Africa is increasing, it is increasing in the form of grant-funds and is largely in response to the cry from other donor nations for Japan to take a greater role in international development and humanitarian assistance activities.

46. The decreased number of Yen loans in Africa indicates that the GOJ does not see the African market as one that responds to the needs of the Japanese private sector. Compounded by the general untying of grant-based assistance, it seems that the GOJ has, for the immediate future, "written-off" Japanese business interests in all but a few select countries in Africa, and this has real negative impacts on actual FDI and investor interest in African countries. Without public sector prodding and promotion in African countries, Japanese investors are unlikely to venture into uncertain markets.

47. It is ironic that many African nations have been calling for increased ODA in the form of grant funds, perhaps without realizing the impact that this has on attracting Japanese FDI into their countries. When estimating the real impact that increased ODA has on economic growth, analysts must first take into consideration the relative increases in ODA that actually attract foreign direct investments.

48. Although Japan is currently wading through a credit crisis, 28/ it is likely that the private sector will gradually pick up where it left off in 1991 in terms of large foreign direct investment outflows. Today's questions surround where exactly Japan's new investments are headed and why. From 1986-1991, 47% of the $270 billion total flow of Japanese FDI went into the United States and another 21% to Europe. 29/ Although these traditional markets can help the Japanese release their excess and future inventories on the margin, many of Japan's traditional consumer markets have become saturated and don't offer the appeal of new untapped demand. Additionally, many industrialized countries don't offer Japan the

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27/In fact, in May of 1987 Japan decided to introduce untied non-project grant-aid in a package of "Emergency Economic Measures" offered to Africa. This innovation was Japan's first large effort to allow foreign firms to procure goods and services under ODA projects. Through this initiative, Japan provided untied grant-aid in the amount of ¥61.7 billion from 1987-1989. This became the largest single component of grant-aid offered to Sub-Saharan Africa during that time. An additional 600 million Yen was extended under the same provisions for the period 90-92." (Japan's Foreign Aid, pp 264)

28/The cost of capital in Japan has risen to nearly 7%, as opposed to the 1% which financed huge capital investments during the late 1980s.

29/"Japanese Investment in Asia: The Second Wave", The Economist, November 1992.

return on investment (ROI) as quickly as certain underdeveloped regions. 30/

49. Although investors seriously consider infrastructure requirements when searching out new markets, their primary consideration is the market itself. Before thinking about how to get their goods to a particular location, they must first decide if there are people there who want to buy what they make. For this reason, absorptive capacity is important.

B. Absorptive Capacity and How Japan Has Chosen Its Markets in the Past

50. To try to ascertain how important absorptive capacity is to Japanese MNCs when they choose between investment sites, one can take a look at regional investment trends and try to find a correlation between investment flows and economic growth. Although the Japanese foreign direct investment portfolio has always been fairly diverse, it has not always been equitably spread by region. An analysis of current and past investment trends allows one to calculate the amount of foreign direct investment moving into new regions, and based on those regional shifts make assumption about how investment priorities are changing for the Japanese.

51. During the late 1980s, Japan poured investment capital into the Four Tigers of South Asia 31/ and into many big countries in the Association of Southeast Asian Nations (ASEAN). 32/ Much of their investment reasoning laid behind finding cheaper labor and other inputs to feed growing consumer demand in Japan and other countries. However, because of the diminishing corporate investment capital base, Japanese businessmen are faced with choices about where to reduce investments.

52. Over the past two to three years the focus of Japanese investments has shifted regionally in two ways: (i) investments in Europe and North America have been diverted to Asia in order to focus resources on tapping larger, more profitable and rapidly expanding markets; and (ii) investment targets within Asia have shifted to those economies that offer the greatest potential for future growth, both in terms of manufacturing capacity and consumer demand.

53. Beginning in 1991, Japan's cumulative foreign direct investments began to decline dramatically, falling 38.4% in fiscal year 1991 to $41.6 billion and down another 14% in the

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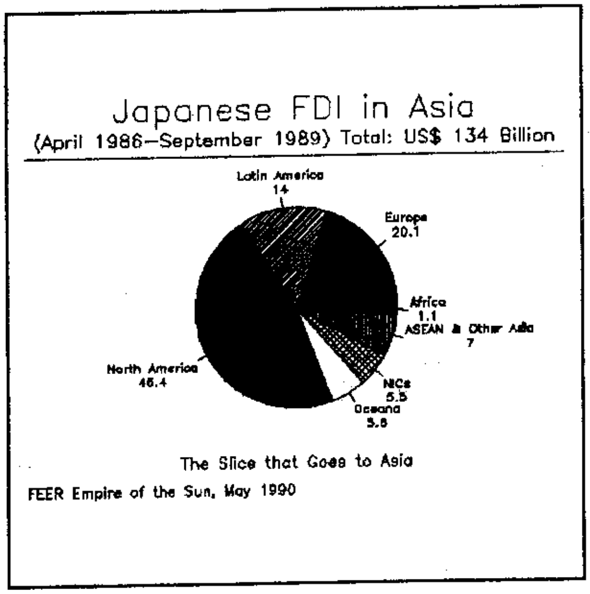
30/A recent study by Nomura and Mitsubishi Research Institutes shows that only 20% of Japan's late 1980's FDI in American began yielding profits within two years. The figure for Asia was 80%. ("Japanese Investment in Asia: The Second Wave", The Economist, Ibid.)

31/Hong Kong, South Korea, Singapore, and Taiwan.

32/Including Thailand, Malaysia, Indonesia, and The Philippines.

eight months through to November 1992. 33/ As a result, investments in Japan's traditional American and European markets have also fallen. 34/ In contrast, direct investment in Asia is up, albeit modestly at a rate of 5.5% or $6.3 billion. 35/ A closer analysis of where in Asia those investment dollars are being placed tells us even more about Japanese investment priorities.



54. Upon first glance, it is surprising to find that direct investments in Japan's traditional Asian markets [The Four Tigers] has fallen off sharply since late 1991. Over the last two years investment rates in South Korea and Thailand have decreased 6% and 57% percent respectively. This is indication of an overall shrinking in the pool of Japanese venture capital, combined with increasingly unattractive labor markets for Japanese manufacturers in the more industrialized East Asian nations. However, Japanese investments in China have increased exponentially since 1990, nearly tippling to the current volume of $882 million. 36/ This level of investment has made Japan the fourth largest investor in China after Hong Kong, Taiwan and the United States.

33/"Japan's Investment Targets in Asia", <u>Global Finance</u>, February 1993.

34/ This would indicate that there is less of a chance that Japanese investments in Europe will draw on the natural resources of Africa, and develop a new channel for investment promotion.

35/"Japan's Investment Targets in Asia", <u>Global Finance</u>, <u>op.cit.</u>

36/Ibid.

55. Similar to the level of investment in China, ODA has also taken on much stronger emphasis. 37/ Total bilateral technical assistance to China between 1987 and 1991 was nearly five billion dollars. Of this, $368 million was in grant form and the remainder in ODA loans. 38/ During 1991 Japan conducted 22 infrastructure development projects in China, described in further detail in the *End Notes* section of this paper. 39/ Compared to this, Africa as a whole received approximately $270 billion for the years 1989-1991. These figures clearly display the level of public and private sector investment taking place in countries that have been strategically targeted by the GOJ and Japan's private sector. It

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37/Japan's ODA Disbursements to China.

Japan's ODA Disbursements to China

Year	Grants			Loan Aid		Total Millions ($)
	Grant Aid	Technical Cooperation	Total	Gross	Net	
1987	54	76	130	422	422	553
1988	52	102	154	519	518	673
1989	58	106	164	669	668	832
1990	37	163	201	538	521	723
1991	56	137	194	423	391	585
Total	368	754	1,123	4,323	4,271	5,394

38/¥1,416,370,000. (Ministry of Foreign Affairs (1992), Japan's ODA: Annual Report, op. cit.)

39/ Sample List of ODA Loan-Funded Projects in China in 1991.

Sample List of ODA Loan-Funded Projects in China in 1991

- Wuquiangxi Dam Construction ($81 million)
- Weihe Fertilizer Plant Construction ($9 million)
- Mongolia Fertilizer Plant Construction ($60 million)
- Yunnan Fertilizer Plant Construction ($56 million)
- Shenzhen Port Construction ($36 million)
- Hainan Highway Construction ($67 million)
- 9 Province Telecommunications Network Expansion ($115 M)
- Traffic Control Modernization ($78 million)
- Shenmu-Shuoxian Railway Construction ($99 M)
- Baoji-Zhongwei Railway Construction ($93 M)
- Tienshangqiao First Hydropower Project ($43 M)
- Urban Road Bridge Construction Project ($47 M)

is evident that when a market is perceived to have strategic economic importance, ODA andinvestment fund flow there in abundance. But what is it that causes the initial flow and spark of interest?

56. As mentioned earlier, Japanese businessmen have two primary concerns when evaluating potential investment sites. Infrastructure is one, and the other is access to consumer markets which hold demand for their commodities and products. Although Japan is notorious for exporting to tertiary markets, the current trend is to locate production sites in countries that offer their own domestic demand. Although investors do not consider GNP figures outright when making investment decisions, when we take a combined look at regional investment trends and economic growth rates, a pattern starts to emerge which might help explain why Japanese investors have targeted Asian rather than African markets. Nomura Research Institute projects economic growth in the ASEAN region at a rate of 6.4% over the next year, while China is expected to attain increases of close to 9.2%. The IMF predicts that between 1984-1993 Asia's combined GDP will have grown by 6.7% a year, more than twice as fast as the OECD, around three times faster than Latin America, and dramatically faster than Africa.

Table I
Fastest GDP Growth; Average Annual Real GDP Growth Rate (1980-1990%)

Oman	12.8
Bostwana	11.3
S. Korea	9.7
China	9.5
Thailand	7.6
Bhutan	7.5
Hong Kong	7.1
Singapore	6.4
Pakistan	6.3
Mauritius	6.0
Chad	5.9
Mongolia	5.6
Indonesia	5.5
India	5.3
Malaysia	5.2
Turkey	5.1
Egypt	5.0
Nepal	4.6
Bangladesh	4.3
Burkina Faso	4.3
Kenya	4.2
Japan	4.1
Mali	4.0
Morocco	4.0
Sri Lanka	4.0

Source: Euromoney's World Economies Handbook, 1992.

57. ***Euromoney's World Economies Handbook*** published in September of 1992, listed the 25 countries with the fastest growing annual average real GDP, with rates ranging between 4.0% and 12.8% This list included fourteen Asian and six African nations. Euromoney also listed the 25 countries with the lowest average annual real Gross Domestic Product (GDP) growth rates, ranging between 1.3% and -4.7%. Included in this list are eight African and one Asian nation.

58. It is obvious that Asian economic growth rates and Japanese FDI flows are directly related. The Japanese public and private sectors see Asia as one of the fastest growing and most profitable markets in the world. Not only are the Japanese not investing in Africa, they are pulling investment funds from traditional markets in the United States and Europe, and reallocating scarce investment funds in countries that seem to be the 'movers' of the 1990s.

When Asian economic growth rates are coupled with Asia's huge population of roughly three billion, the market potentialities are enough to spark the interest of any investor.

59. As described in the earlier sections of this paper, Japan finds itself in an interesting but precarious position. The recent Yen appreciation has decreased exports and damaged profitability for manufacturers in many important industries. 40/ Uncommonly poor domestic savings habits 41/ coupled with an emphasis on the part of traditional Japanese goods importers to reduce their deficits, indicates that existing markets are not the answer to excessive manufacturing and inventory capacities and future expansion. The only real option left to Japanese manufacturers is new market development. However, this new market entry has been thought out carefully by the Japanese and their Asian trading partners, and it involves a strategy that does not include Africa. As mentioned before, Japanese manufacturers' needs are no longer restricted to finding the lowest labor and raw materials costs. They are now banking on developing new markets for existing and future inventories. And, in fact, increased expansion in new overseas markets may be the only viable option to further downsizing for many manufacturers.

C. China as the Progressive Investment Site for Japan

60. China is an example of the sort of investment haven that Japanese manufacturing organizations will search out over the next decade to respond to their mounting needs. China offers inputs that are reasonable priced compared to other Asian manufacturing countries, natural resources, huge potential in terms of conceivable domestic demand, and a political situation that looks to be stabilizing over the long-term.

61. China is an unusual 'developing country' in that its domestic consumption capacity is widely believed to be greater than official figures. When looking at real income gathered from all sources to measure GNP, China's annual per capita income is approximately $1,600, and it's economy is the third largest in the world after Japan and the United States. This figure does not take free health, education and welfare into consideration, which increases the figure even more. The Hong Kong Trade Development Office estimates that if second or evening jobs are taken into consideration, this figure should be inflated by nearly 40% 42/. If China's imports and GDP growth rates continue along their present trends, by the year 2010 China's demand for imported products will be $480 billion annually. or equal to

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40/Although Yen appreciation has caused hard time for many organizations throughout Japan, perhaps the hardest hit are the automobile and electronics industries. Some experts calculate that at an exchange rate of ¥100 to the Dollar, Japanese cars are now 40% more expensive than their American counterparts. Six of Japan's largest consumer electronics companies are experiencing a 16% decrease in pre-tax profits, compared to 1992. (This Time the Yen's Really Making Everyone Crazy. Global Finance, October 1993.)

41/ and the projection that Japanese consumers will be spending the next several years digging themselves out of debt holes.

42/"Japan's New Target for Investment is China", Global Finance, June 1993

present U.S. imports.

62. Many manufacturers who have already entered the Chinese market are finding that their original sales projections were widely underestimated. Hitachi's Chinese joint-venture partner was forced to increase production capacity in the manufacture of air-conditioners to 1.4 million, from its original estimate of 400,000 per year, due to underestimated consumer demand 43/.

63. One of the most attractive aspects of investing in China is the fact that the government has set a definite development schedule, including specific plans for infrastructure improvement. Having a substantial and specific government-backed development strategy is critical to corporate restructuring by Japanese manufacturers. It provides large multinational corporations with concrete opportunities to relocate expensive production sites overseas, while offering them consumer markets of enormous potential. A specific example is China's plan to accelerate the development of its telecommunications infrastructure, which calls for the installation of 10 million telephones annually, by the year 2000. This, and other development plans like it are attracting some of the industry's largest competitors. 44/

D. The Development of an Asia Regional Trade Block

64. The global recession and its bite on profitability; production and inventory excesses that leave manufacturers with balance sheet deficits; and trends in Japanese ODA that negatively effect investment promotion all indicate that Japanese businessmen will be searching out new opportunities for their (more) scarce venture and investment capital. In fact, it seems as if the GOJ and private investors have devised an unwritten plan to recuperate from their current economic doldrums. This plan seems to focus even more on regional market development, and does not seem to include Africa.

65. Many experts believe that Japan will soon lead an effort to develop an Asian regional trade block in order to counter exclusionary tenancies that may result from European Economic Community (EEC) and North American Free Trade Agreement (NAFTA) activities in Europe and the United States.

66. Japanese economists are probably correct in assuming that American imports from Asia may shrink dramatically over the next five years because of NAFTA and continued efforts to reduce the trade imbalance between the United States and Japan. American import decreases translate into two choices for Japan and other Asian countries, especially NICs, which are: (i) growing at decidedly smaller rates; or (ii) promoting economic growth and

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43/Ibid.

44/ Some would say that the infrastructure development activities in China's export processing zones alone are saving the Japanese steel industry. Japan's steel exports to China for the first half of 1993 reached a record 4 million tons, and another 3 million tons are expected for the end of this year. That compares with a total of two million tons sold in all of 1992. (Global Finance, Ibid.).

consumer demand in other regions. Logically, the Japanese have chosen the second option,and the market they been and are continuing to target is Asia.

67. Export dependance on the United States is not only a problem that Japan faces, but also one for its Asian neighbors. From the early to mid 1980s, NIC reliance on U.S. imports ranged around 40%, but has fallen since 1986 to a current level of 24%. Simultaneously, NIC exports to other Asian countries has risen from 21% to 32.1%, making the Asian market more important that the United States. 45/ Financial sector experts in Japan, such as Toyoo Gyoten, Chairman of the Bank of Tokyo, maintain that Japan should try to absorb as many Asian exports as possible. They believe that fostering Asian export dependance on Japan is a sure bet for achieving economic stability within the region. This puts Japan in a difficult position. they need to foster regional development to ensure their own economic security, by increasing their imports from other Asian countries. However, because of decreases in U.S. imports, Japanese manufacturers also feel the need to find new markets in which to sell their own goods.

68. To understand how Japan's interests in East Asia are driven by the need to develop an integrated regional economic system, and why export dependance is a key component of regional shifts in Japanese FDI, it helps to understand how the East Asia has been evolving throughout the 1980s. In the early 1980s, many Japanese organizations shifted production and labor intensive elements of their operations to other counties, keeping final production at the home office in Japan. However, beginning in the mid-1980's many companies began moving entire operations abroad and retaining little more than R&D and support responsibilities at the home office. Moving entire production operations overseas has broadened the economic base of Japan's East Asian countries.

69. One of the most important impacts of inter-Asian foreign direct investment is the development of consumer markets in countries benefiting from large investment inflows. In Asia, undeveloped economies that once exported raw materials to and imported finished goods from Japan, are now becoming importers of raw materials and capital goods, and exporters of consumer products. Through the late 1980s, over half of Japan's investment in NICs was in construction, real estate, and services. In Thailand, Indonesia, Malaysia, and the Philippines, resource development and manufacturing each accounted for approximately 40% of total investments. Today, more than 60% of Asian exports to Japan are manufactured goods, including some of those made by Japanese subsidiaries. 46/ However, demand for equipment remains strong, and over 60% of Japan's exports to Asia are machinery. As Japan's regional investments facilitate growth, and as economic prosperity puts money into people's pockets, East Asian economies are developing substantial consumer markets of their own. 47/

45/"Japan's Investment Targets in Asia", Global Finance, op.cit.

46/"Empire of the Sun", FEER, May 1990.

47/"Japan's Investment Targets in Asia", Global Finance, op.cit.

70. In fact, even in the absence of an Asian regional trade agreement, a new economic cohesion has been developing between Japan and the countries of East Asia since the late 1980s. Starting with the first Yen revaluation, NIC exports to Japan have risen at an annual average rate of 37%. Trade between East Asian countries themselves grew at an even faster pace, of approximately 70% in the late 1980s, 48/ demonstrating that intra-regional investment is promoting even closer regional economic integration.

V. CONCLUSION: CARVING A NEW NICHE FOR AFRICAN NATIONS IN THE JAPANESE FDI ARENA

A. General Comments

71. The reasoning behind Japan's renewed interest in Asia over its traditional investment havens is understandable. Conventional markets in Europe and the United States are threatened by the EEC, NAFTA, and the U.S.'s push to reduce their trade imbalance; excess domestic inventories and production capacity are forcing manufacturers to locate viable new consumer markets; and the credit excesses of the 1980s have caused a domestic purchasing crunch that is likely to get worse before it gets better.

72. The question that is before us today is why are new Japanese investments channeled back to Asia, instead of the developing world and Africa? African countries have stepped up their investment promotion efforts, and even seem to hold some of the natural resources needed by Japanese manufacturers. Perhaps the biggest answer to this question lays in what we call a "new investment conservatism" on the part of Japanese investors. Whereas in the 1980s, Japanese investors were willing to invest in risky or unsure regions and industries in hopes of developing new markets, in the 1990s they face a set of profitability problems which force them to place investments in regions that are <u>sure</u> to yield returns quickly.

73. Investment conservatism refers to the hesitance that many Japanese investors feel about venturing into unknown markets [namely Africa], and is caused by a number of factors. One is the poor reputation that Africa seems to hold in Japanese business circles. Although this perception may be caused more by the Japanese private sector's inferior entrance into the African market during the 1970s 49/ than the current investment situation in Africa, it is nonetheless strong and its impact is felt. Poor perception problems are complicated further by a host of supply-side difficulties, the most serious of which is the on-going Yen to Dollar appreciation. Yen appreciation has stemmed the flow of investment capital, and is forcing Japanese MNCs to become much more conservative in their investment decision making. As a result, many of the demand-side efforts being made by African countries go largely unnoticed.

48/"Seeking a New Role", <u>Far Eastern Economic Review</u>, June 1989.

49/as compared to its entrance into other new markets.

74. The Japanese public and private sectors both feel that a feasible option to many of their problems lays just outside of Japan's borders. This becomes obvious when one takes a look at how both sectors have been targeting Asia over Africa and other regions. The Japanese Government has been dedicating large amounts of Official Development Assistance (ODA) to Asia in the form of loan-assisted infrastructure development projects. These projects promote Japanese FDI in Asia through procurement for project implementation and through the benefits accrued from better roads and more reliable communications. ODA in Africa does not compare, and is largely made up of grant-based humanitarian assistance projects which do not facilitate investment, and may even discourage FDI.

75. Why does Asia seem to hold the investment appeal that Africa does not? The primary reason is market potential. MNCs need to fill both short- and long-term needs by making up for last fiscal year's profitability slump, while at the same time cultivating and developing new sources of consumer demand. GDP growth rates for many Asian nations are more than double that of the United States, Europe, Latin America and Africa. Potential consumer demand triggered by GDP growth and large population figures is almost inconceivable, and the benefits of a more cohesive Asian economic market, if managed correctly, all point to profit and increased market stability for Japan. However, not all markets in Asia offer the same benefits or fill the same needs, and even within Asia, Japan's investment priorities are changing. Competition for scarce investment funds is heightening, and the winners are those countries and regions that seem to be the most familiar with Japanese investors. In a decade begun in conservatism, investors are looking for markets where stable levels of return on investment can be guaranteed. Japanese businessmen know the Asian market, and know what they can expect from it. Africa does not offer the same assurances, and until the flow of investment Yen strengthens again, there is little hope for increased Japanese FDI in the region.

B. Carving Out a New Niche for Africa in the Japanese FDI Arena

76. Given the bleak prospects for Japanese involvement in Africa over the short- to medium-term, should Africa give up hope for ever becoming a major player in the Japanese economic forum? No! However, the governments of Africa should consider a few facts. Dedicating more scarce government resources to Japanese FDI promotion will be a feudal activity until Japanese MNCs have more venture capital in their coffers. As discussed above, demand-side efforts to attract FDI will be largely discounted until the supply-side economic picture becomes a little more stable for Japan. However, since the Japanese public and private sectors seem intent on using Asian markets to solve their immediate needs, African countries should consider tapping the secondary benefits that can be accrued through Japanese FDI in Asia.

77. There is no doubt that many of the Asian markets and investment sites targeted by Japanese MNCs [like China] will require some of the raw materials and sub-components that can be supplied by African countries. In fact, Africa may have a comparative advantage in providing natural resources to external manufacturing operations, since 63% of all FDI in Africa has been dedicated to mineral and natural resources extraction operations. Although it is preferable to establish manufacturing operations in Africa itself, [because the value on

raw materials and sub-components is lower than that of finished consumer goods 50/]. African countries should consider how they can capitalize on the residual effects of FDI. By strengthening supply channels with countries that do receive Japanese investments, African countries can accomplish many things. The first and most immediate benefit to this "secondary promotion" would be to work down trade deficits with Asian countries. Also by strengthening the reliance of Asian markets on African raw materials and sub-components, African governments may help to refocus ODA on real investment promotion activities. 51/. Other benefits come in the form of breaking down the perception problem that many Japanese MNCs hold, and strengthening export channels for future domestic manufacturing operations.

78. In summary, African countries should expect very limited FDI from Japan for the short- to medium-term, or until the flow of investment Yen begins to strengthen. Until Japanese investors can afford to give Africa's demand-side efforts more consideration, it would be feudal for African governments to spend scarce investment promotion funds trying to attract their venture capital. However, African nations do have an option. They can spend their funds on developing export channels to supply natural resources and sub-components to Japanese subsidiaries and manufacturing operations in Asia. The benefits to export promotion activities will be much greater than those gained by continuing to pursue Japanese investors now. By dedicating time, effort and resources towards improving export channels in the short- and medium-term, African nations can position themselves to attract larger Japanese investments in the long-term. This will happen when Japanese MNCs are in a position once again to test out new markets, and have gained experience with Africa through their manufacturing subsidiaries in other Asian counties. By thinking long-term like the Japanese, Africa may be able to attain its investment goals.

50/Also because export development does not provide the technology transfer benefits accrued through direct investments in manufacturing.

51/Through loans to Africa to help improve the flow of basic materials to Asia.

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