

# Washington Law Review

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Volume 39 | Number 3

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8-1-1964

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Dan Fenno Henderson

*University of Washington School of Law*

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### Recommended Citation

Dan F. Henderson, *Introduction to U.S.-Japanese Investment*, 39 Wash. L. Rev. 405 (1964).

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# WASHINGTON LAW REVIEW

VOLUME 39

AUGUST 1964

NUMBER 3

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## INTRODUCTION TO U.S.-JAPANESE INVESTMENT

DAN FENNO HENDERSON\*

The legal environment for foreign investment in Japan has undergone sweeping changes in the past year, both in the Japanese domestic legislation and in the international law spheres. New international law commitments started with findings of the International Monetary Fund (IMF) about a year and a half ago that Japanese economic conditions warranted a relaxation of foreign exchange controls, and after the necessary adjustments, on March 12, 1964, Japan arranged to shift her IMF status from an Article XIV country to an Article VIII country,<sup>1</sup> meaning essentially that thereafter her foreign exchange budget was abolished and her current accounts (*i.e.*, import-export payments, interest, royalties, dividends, etc.) became freely convertible into foreign exchange. But quota allocations were instituted to serve as new import control mechanisms for all non-liberalized import items (8-10%) in place of the prior foreign exchange controls. In parallel negotiations Japan arranged to become a member of the Organization for Economic Cooperation and Development (OECD) effective April 27, 1964. Japan thus became the twenty-fifth Article VIII nation out of 105 IMF members, and the twenty-first member of OECD.

Symbolizing her graduation into the ranks of the developed nations, Japan's OECD membership entails commitments to liberalize her capital transactions in due course, although, for the time being, OECD has granted<sup>2</sup> reservations to Japan which allow her to continue tight controls on capital transactions. These reservations were deemed necessary because, though the Japanese economy is approaching a de-

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\* Professor of Law and Director, Asian Law Program, University of Washington.

<sup>1</sup> IMF Agreement, Art. VIII, §§ 1-4 cover these obligations.

<sup>2</sup> OECD, MEMORANDUM OF UNDERSTANDING BETWEEN THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT AND THE GOVERNMENT OF JAPAN CONCERNING THE ASSUMPTION BY THE GOVERNMENT OF JAPAN OF THE OBLIGATIONS OF MEMBERSHIP OF THE ORGANIZATION; for the Convention and subsidiary regulations, see OECD, THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT 43 (no date, circa. 1963).

veloped status, it still faces a difficult transition and adjustment. For example, in 1962 the Japanese per capita gross national product was still only \$554 compared with the United States, \$2939; United Kingdom, \$1478; Belgium, \$1579; and France, \$1545.<sup>3</sup>

These new international commitments have required basic changes in the Japanese legislative and administrative controls related to foreign trade and investment. Basically, since 1950 the whole of Japanese foreign trade and investment (defined to include technological assistance) had been rigidly controlled by a foreign exchange budget and an official License (*kyōka*) or Validation (*ninka*) apparatus set up in 1949 and 1950 under the Foreign Exchange and Foreign Trade Control Law<sup>4</sup> (FECL) and Law Concerning Foreign Investment (FIL),<sup>5</sup> respectively, and administered primarily by the Ministry of Finance (MOF) and the Ministry of International Trade and Industry (MITI),<sup>6</sup> with a dual purpose of manipulating Japan's scarce postwar foreign exchange holdings so as to (1) insure balance of payments abroad and (2) rehabilitate her trade and war devastated industry in an orderly manner.<sup>7</sup> This system required a validation (FIL) or license (FECL) for all foreign investments which sought guaranties of foreign exchange repatriation of principle or income. As a rule, "orderly development of Japanese industry" has also meant in postwar Japanese administrative circles the exclusion of foreigners in the management of validated Japanese enterprises, except in cases where necessary foreign technology could not be obtained by patent and know-how licensing alone, in which case selected minority equities were occasionally validated, especially before the occupation ended (1952) and since 1960. Alternatively, before July 1, 1963, non-validated foreign management participation was possible, however, by use of the so-called yen base company, whereby foreigners were allowed to go into business for a yen return only. They simply established a Japanese subsidiary or branch without obtaining a validation and consequently, without obtaining the right to repatriate capital or earnings in foreign currency. At first the yen base vehicle was little used by foreigners because the Japanese economy did not offer an at-

<sup>3</sup> OECD, ECONOMIC SURVEY BY THE OECD: JAPAN 9 (1964).

<sup>4</sup> Foreign Exchange and Foreign Trade Control Law (*Gaikoku kawase oyobi gaikoku bōeki kanrihō*) (Law No. 228, 1949) in 2 EHS No. 5010 [hereinafter cited FECL].

<sup>5</sup> Law Concerning Foreign Investment (*Gaishi ni kansuru hōritsu*) (Law No. 163, 1950) in 5 EHS No. 5410 [hereinafter cited FIL].

<sup>6</sup> For procedures see JŪKAGAKU KŌGYŌ TSŪSHINSHA, GAIKOKU GIJUTSU DŌNYU YŌRAN (Guide to induction of foreign technology) 21-44 (1964).

<sup>7</sup> FECL art. 1 (1949); FIL art. 1 (1950).

tractive investment potential without foreign exchange guaranties, but after 1959, as the economy strengthened more and more firms availed themselves of the yen base company, looking to a future date when the economy would be generally liberalized. Although the official policy favoring loans, licensing, and portfolio investments and against direct foreign investment, especially majority owned ones, was never clearly articulated in the regulations, such a policy has been strictly pursued, and thus there developed a conflict between the strong underlying Japanese policy to control Japanese industrial development and exclude foreign management and, on the other hand, the foreigners' growing interest in the yen base mode of non-validated Japanese enterprise.

The foregoing background will assist newcomers in the Japanese investment field to understand why it has happened that in the course of the liberalizations in the past year attendant upon the new OECD and IMF commitments, the Japanese controls over direct foreign investment have become much more comprehensive than ever before, although perhaps not stricter.

Starting with the IMF Article VIII requirement that current accounts, including foreign shareholders' dividends, be made remittable in foreign exchange, the Japanese Government deemed it necessary to abolish the yen base company as a future vehicle for foreign investors in order to prevent foreign management control of important industries and to prevent the Article VIII repatriation of earnings from uncontrolled direct yen base investments from possibly becoming a balance of payment problem. So on July 1, 1963, by administrative order<sup>8</sup> and newspaper announcements, new yen base investments were prohibited, and thereafter all acquisitions of any Japanese corporate shares involving management participation have required validations. This was a fundamental policy shift from requiring validation for payments to foreign investors to requiring validation for the basic transaction itself.

Finally, amendments<sup>9</sup> effective April 1, 1964, to the FIL and FECL abolished the foreign exchange budget and controls on conversion of

<sup>8</sup> Cabinet Order No. 228, June 29, 1963, effective July 1, 1963, which amended the Cabinet Order Concerning Exceptions, etc., to Standards of Validation Based on the Law Concerning Foreign Investment (*Gaishi ni kansuru hōritsu no kitei ni motozuku ninka no kijun no tokurei-tō ni kansuru seirei* (Cabinet Order No. 221, July 1, 1952) in 5 EHS No. 5470. Thus, the FIL was left in its original form until April 1, 1964, and it seems that between July 1, 1963, and April 1, 1964 (when the FIL was amended), there was no legal basis for preventing yen base investments, since the unamended FIL art. 10 only prohibited acquisitions requiring foreign exchange payments.

<sup>9</sup> Law No. 33, Mar. 31, 1964.

current accounts, thus completing the changes in the legal structure so as to require approvals for all transfers of capital and technology between foreign parents and Japanese subsidiaries or branches.<sup>10</sup> Whereas before the official sanction was required only for the payment, now the license is required for the underlying obligation and validation is required for all transfers, whether gratuitous or not, between parents and subsidiaries or branches. It is said that validations are more freely and more quickly granted than in the past. But it is certainly more difficult now for a foreigner to get a validation and establish a majority owned business in Japan than it was when the yen base was available as a free, if underprivileged, alternative to the validation system.

Foreign portfolio (indirect) investments in Japanese securities within percentage limits on holdings in any given corporation were finally freed for immediate repatriation of income and capital in April, 1963.<sup>11</sup> But such securities have felt the impact of recent legislation—in this case the U.S. Interest Equalization Tax of 1964.<sup>12</sup> Ever since President Kennedy announced in July 17, 1963, that such a tax bill, covering certain acquisitions of foreign securities from July 18, 1963, would be introduced in the U.S. Congress, the effect has been almost as if it were already law. For immediately the demand for Japanese securities which was being developed in the cheap New York capital market<sup>13</sup> dried up, and foreign share issues of Japanese firms have since migrated to the European capital centers.

Despite these recent developments, it seems very likely that Japan will continue to be a capital importing nation for some time to come.<sup>14</sup> In their various categories, the total foreign investments (including technological assistance agreements) which have been validated from the effective date of the FIL and FECL (1950) to March 1, 1964 (roughly to the end of the various changes chronicled above), are as follows:<sup>15</sup>

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<sup>10</sup> Also, note the issuance of Ministerial Ordinance Concerning Report of Non-Residents' Branches, Factories, and Other Places of Business in Japan (Joint MOF & MITI Notification No. 1, July 1, 1963), based on FECL art. 27(3), which requires a report upon the establishment of a corporate branch, etc., in Japan. This report system is aimed at obtaining the information necessary for determining whether to grant official approval for transfers to branches.

<sup>11</sup> GAIKOKU KAWASE BŌEKI KENKYŪKAI, BŌEKI-GAI SHIHARAI BENRAN (Manual for payments other than trade) 7 (1964); TRADE BULLETIN CORP. (Tokyo), COMMENTARIES ON THE FOREIGN INVESTMENT LAW xii-xiv (6 Social and Economic Laws of Japan series 1963).

<sup>12</sup> 8 P-H FED. TAX. EXCISE TAX, ¶ 190821 (1964); 7 CCH STAND. FED. TAX ¶ 8520 (1964). H. Res. 8000, effective Sept. 2, 1964. P.L. 88-563.

<sup>13</sup> Christensen, *Japanese Equity Financing*, 38 WASH. L. REV. 105 (1963).

<sup>14</sup> OECD, *op. cit. supra* note 3, at 51.

<sup>15</sup> KATAYAMA & NISHIGAKI, INVESTMENT IN JAPAN 6 (1964).

CHART I  
FOREIGN INVESTMENT IN JAPAN (1950-FEB. 1964)

I. Technological Assistance and Licensing	2545 cases (almost two-thirds from U.S.)
II. Securities and Loans	
1. Common Stocks	\$ 633,127,000
2. Beneficiary Certificates	4,634,000
3. Corporate Debenture	530,000
4. Loans	2,067,976,000*
5. Foreign Currency Bonds	437,125,000
	\$3,143,392,000

\*About half of these loans were from the World Bank (IBRD) and the U.S. Export-Import Bank.

It is significant to note, however, that stock acquisitions involving management participation (*i.e.*, direct investment, mostly joint ventures) only amounted to less than 20% (\$196,644,000) of the \$1,070,000,000 in corporate securities. The non-validated (yen base to July 1, 1963) and validated (as of March 1, 1964) direct investments are compared below.

CHART II  
FOREIGN JOINT VENTURES AND BRANCHES (1950-1963)

<i>Types of Enterprises</i>	<i>No. of Enterprises</i>
1. <i>Validated</i> <sup>16</sup>	
Foreign Majority	27
Foreign/Japanese 50-50	34
Foreign Minority	148
	209
2. <i>Non-validated</i> <sup>17</sup>	
Subsidiaries	289
Branches	273
	562

<sup>16</sup>*Id.* at 20. See also TSUSHOSANGYOSHŌ KIGYŌKYOKU (Enterprise Bureau, MITI), WAGAKUNI NO GŌBEN GAISHA NO JITAI (Survey of joint venture companies in our country) 36 (1964).

<sup>17</sup>TRADE BULLETIN CORP. (Tokyo), THE APRIL 1964 SUPPLEMENT TO FOREIGN INVESTMENT, FOREIGN EXCHANGE CONTROL AND IMPORT CONTROL SYSTEM (Book II) 31 (26 Social and Economic Laws of Japan series 1964).

After the yen base investments were shut off by decree on July 1, 1963, the Ministry of Finance made an investigation and found that including both subsidiaries and branches the total investment was only about \$140,000,000 (book value) with an estimated annual income after taxes of about \$13,000,000 and \$40,000,000 in accumulated income. Not counting the past year, this figure (\$140,000,000) is about the same as the total for validated direct investments since 1950.

The figures thus show the heavy emphasis in Japanese policy on loans, technological tie-ups, and portfolio securities as opposed to direct investments. It also shows the strong interest of foreign investors in the latter since 1959. However, in 1963 the validated, direct investment, including capital increases in existing enterprises, increased markedly (1963: 547; 1962: 328), and portfolio investments, which had been growing significantly each year, leveled off (1963: 95 million; 1962: 95 million; 1961: 60 million; 1960: 25 million) as a result of the U.S. Interest Equalization Tax.

The rapid changes which have taken place in the past year, during which the articles in this symposium were in preparation, have required us to select topics related to the underlying institutions of abiding interest to foreign investors, leaving for another time a fuller treatment of the current regulatory changes and their effect on foreign investment.<sup>18</sup> Particularly, basic to all foreign projects in Japan is the need for competent legal counsel, and Professors Ohira and Stevens have pursued their prior interests<sup>19</sup> in this regard to explore and compare the Japanese and U.S. treatment of alien lawyers. Michiko Ariga and Professor L. Rieke have summarized the history and current posture of Japanese antimonopoly law, and its influence on business organization and commercial practices, a topic of general interest to all enterprises on the threshold of a Japanese investment.

The next article deals with contract and corporate problems raised by the foreigners' minority position in Japanese joint ventures. Professor Mizushima, Mr. Sekiguchi, and Howard Lund, Esquire, have investigated the investment trust in Japan and indicated its importance in the public's participation in the Japanese stock market. They have at the same time, underscored some important problems raised by

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<sup>18</sup> The writer is preparing a country study on Foreign Investment in Japan for the American Society of International Law, which will be completed toward the end of 1964.

<sup>19</sup> Ohira & Stevens, *Admission to the Bar, Disbarment and Disqualification of Lawyers in Japan and the United States—A Comparative Study*, 38 WASH. L. REV. 22 (1963).

Japanese practices. The central position of foreign technology in Japanese industrial rehabilitation and its importance to the foreigners' role in direct investments are as conspicuous as the lack of English language literature on the subject. Messrs. B. Takino and W. French have dealt with one aspect of the problem; namely, the employee's rights to his inventions made during employment.

Security transactions are important to the financing and sales operation of direct investors as well as lending institutions, and Professors Sono and Shattuck have done a comparative survey of the Japanese legal devices and practices in this important field.

It is also noteworthy that in the postwar period there had been no book-length studies on contemporary Japanese law until this past year when besides our prior Symposium on U.S.-Japanese Business Transactions in 38 *Wash. L. Rev.* 1-248, three books appeared on Japanese law: (1) *Law in Japan* (von Mehren ed. 1963); (2) Maki, *Court and Constitution in Japan* (1964); and (3) Ehrenzweig, Ikehara and Jensen, *American-Japanese Private International Law* (1964). The editors have asked Harold Wren, Alfred Oppler, and David Stern, respectively, to review these new works.