REPLY

By KIYOSHI KOJIMA*

The primary intention of my paper[1] was to present the model of comparative investment profitabilities in Section III, perhaps the first attempt in this field of study to show the relationship between comparative advantage and foreign direct investment. Although still imperfect, I believe this to be my most important contribution, and my main concern therefore is whether this theoretical model stands.

The second main aim of the paper was to show, by using the two contrasting models of trade-oriented direct foreign investment and the anti-trade-oriented pattern which involves oligopoly, that policy should aim at free trade with investment policy adjusted to it.

By comparison with these two points, all other matters are not very important. The comparison of Japanese and American experience, the expositions by Vernon and Hymer, etc., have merely helped me in the construction of the two models. I have barely sketched the complexity of the phenomenon of foreign direct investment in the real world, and this may account for misunderstandings or errors on which Professor Arndt comments.

I defined trade-oriented and anti-trade-oriented foreign direct investment on page 8 of my paper: (a) "Foreign direct investment is trade-oriented, or more exactly trade-reorganization-oriented, if it transfers a package of capital, technology and managerial skill from an industry which has a comparative disadvantage in the investing country to recipient country in which it develops a comparative advantage." (b) "If foreign direct investment moves out from an industry in which there is a comparative advantage in the investing country, . . . this is foreign direct investment of anti-trade-reorganization-oriented type." If foreign direct investment takes place in conditions of free competition, it follows lines of comparative advantage and is therefore trade-oriented; the anti-trade-oriented type of foreign direct investment, by contrast, is due to such factors as oligopoly, product differentiation, monopoly of technology, etc.

My welfare criterion for the evaluation of the various kinds of direct investment is not "international trade growth", but whether it is trade-oriented or anti-trade-oriented in the sense defined in the preceding paragraph. Whether or not trade-oriented foreign direct investment results in greater international trade growth than the anti-trade-oriented type is not obvious a priori and deserves to be thoroughly examined——I certainly did not express any views on this point. But it is clear that trade-oriented foreign direct investment helps the reorganisation of the international division of labour and upgrades the industrial structure of both countries, whilst the anti-trade-oriented one blocks the reorganisation of international trade. Thus, I expect the former to be more conducive to the welfare of the world than the latter.

* Professor (*Kyōju*) of International Economics.

[1] Kiyoshi Kojima, "A Macroeconomic Approach to Foreign Direct Investment," *Hitotsubashi Journal of Economics*, June 1973, pp. 1—21.

My classification of foreign direct investment into five categories is not intended to be exhaustive but merely to give illustrative examples of my trade-oriented and anti-trade-oriented types. My examples were chosen mainly from the point of view of the investing country. I am grateful to Professor Arndt for stressing criteria from the point of view of the recipient, developing countries. He introduced "the other welfare criteria", such as "direct and indirect (spillover) developmental effects", which seem to me of secondary importance. If chief importance is attached to spillover effects, the advanced countries had better make this the criterion for selecting the industries in developing countries in which to invest.

Professor Arndt distinguishes between (A) the product-cycle type and (B) the labour-oriented type of foreign direct investment. My view is rather that (A) and (B) represent stages in the course of the product cycle, (A) the new-product, oligopolistic stage, and (B) the standardised-product, competitive stage. The first is referred to in the passage from my paper quoted by Professor Arndt: "Exports of this product grow in so far as a 'technological gap' exists between the product-developing and foreign countries. Foreign producers imitate the new technology and follow suit. Then exports slow down and through direct investment an attempt is made to secure foreign markets"——this is investment of type (A), the anti-trade-oriented type. "When the technology is standardised and widely disseminated and the limit of scale economies is reached", direct foreign investment assumes the form of type (B), the trade-oriented type. Both types result in reverse imports, but the effects on restructuring of the national economies are quite different. Professor Arndt mentioned a good example: "It was the same process that led to the United Kingdom losing its earlier comparative advantage in cotton textile and other light consumer goods production first to Western European countries and the U.S.A. and later to India, Japan and other low-wage countries." Where this happened through direct investment, it was the trade-oriented type. But if the United Kingdom had invested in Hong Kong's cotton industry in the 1860s, instead of in the 1930s or later, this would have worked in the anti-trade-oriented fashion.

Past experience of Japanese and American foreign direct investment merely gave me hints for the construction of my trade-oriented vs. anti-trade-oriented model. I certainly did not mean to suggest that *all* Japanese investment is of the one kind and *all* American investment of the other. I do not deny——indeed I am much concerned——that Japanese foreign investment is already in part of the oligopolistic anti-trade-oriented type and is likely to resemble the U.S. type increasingly in the years to come. That is why, I think, we need such a model and the policy conclusions I presented.

My proposal for agreed specialisation in innovation is perhaps at present no more than a dream, but one day we may recognise it as a necessity. Incidentally, I have in mind not the specialisation between the U.S.A. and the Soviet Union in space exploration, but rather the fact that other countries are prepared to allow the U.S.A. a monopoly in space exploration and nuclear fission. A specialisation and cooperation between advanced countries in developing new energy sources other than petroleum would become a good example.

I would like to take the liberty of quoting *Introduction* written by Fred Bergsten to *Toward A New World Trade Policy*: *The Maidenhead Papers*, edited by him (forthcoming), for it shows an accurate summary of intentions of my paper:

"Section II turns to the relationship between multinational corporations and world trade. Kiyoshi Kojima launches the section, in Chapter 4, with an extremely important paper which concludes that some types of foreign direct investment promote trade, by accelerating the transmission of comparative advantage among countries, while some types instead substitute for trade. He views most Japanese foreign investment as trade-creating, motivated by both economic incentives and conscious policy of the Japanese government to export low-wage (and polluting) industries to (primarily) the developing countries. On the other hand, U.S. firms in precisely these same industries (such as steel and textiles) have *not* invested abroad. Instead, most U.S. foreign investment (aside from raw materials) takes place near the top of the product cycle by firms seeking to preserve their oligopolistic positions in world market, which Kojima characterizes as trade-destroying investment ——and hence, in the home country, job-destroying and producing balance of payments problems as well——on the grounds that such market positions could be maintained by exports by the same firms from their U.S. base. This thesis runs counter to the product-cycle view that trade and investment are complements in such industries, not substitutes, and will undoubtedly generate much debate. In propounding it, Kojima concludes that investment policy should be subordinated to trade policy; trade policy should remain liberal and "trade-oriented" investment should be encouraged, subject to a number of guidelines which he enumerates, but "anti-trade-oriented" investment should be subject to restrictions by either home or host countries, or both.

"Kojima's paper, and the three case studies of individual firms which follow, highlight the fact that much foreign direct investment is motivated by tariff or non-tariff barriers to trade. Taken together, they underlie the conclusion in the Communique that liberalization of such barriers is desirable to help reduce the wide variety of concerns, expressed in both home and host countries, about the magnitude and rapid growth of such investment."