

Construction Economy Report

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The Japanese Economy and Public Investment

A Flagging Japanese Economy and Construction Industry

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Chapter 1 Trends in the Construction Investment

1.1 Trends in the Japanese economy and construction investment

- There are signs that the Japanese economy, as of the end of 2008, is slowing due to lower demand from abroad and a reduction in capital investment. There are risks, such as the worsening global financial crisis that may drag the economy down further, and it is likely that the Japanese economy will remain stagnant for the time being.
- A 1.5% year-on-year decline in construction investment is expected for FY2008. Although the effects of amendments to the Building Standard Law have mostly faded, private-sector construction investment will likely remain weak due to the economic slowdown. A further decrease is expected in FY2009 due to the contraction of public-sector construction investment and a decline in private-sector non-housing construction investment, since private businesses will likely be less willing to make capital investments.

● Trends in the macroeconomy (FY)

年度	1990	2000	2004	2005	2006	2007	2008	2009
Real GDP	4,679,132	5,056,219	5,279,826	5,407,061	5,541,143	5,628,644	5,648,844	5,704,468
(Increase over previous year)	6.0%	2.6%	2.0%	2.4%	2.5%	1.6%	0.4%	1.0%
Real private final consumption expenditure	264,565	203,609	186,619	184,299	184,718	160,229	157,529	160,809
(Increase over previous year)	6.0%	-0.1%	1.7%	-1.2%	0.2%	-13.3%	-1.7%	2.1%
Real private business investment in facilities	904,887	729,631	783,254	835,762	882,951	882,225	881,837	889,357
(Increase over previous year)	12.0%	7.2%	6.8%	6.7%	5.6%	-0.1%	0.0%	0.9%
Real public fixed capital formation	298,240	344,449	245,210	231,581	210,486	206,731	189,908	180,646
(Increase over previous year)	4.1%	-7.6%	-12.7%	-5.6%	-9.1%	-1.8%	-8.1%	-4.9%
Nominal GDP	4,514,728	5,041,188	4,984,906	5,037,885	5,121,841	5,150,837	5,131,556	5,197,225
(Increase over previous year)	8.5%	0.9%	1.0%	1.1%	1.7%	0.6%	-0.4%	1.3%

(Units: 100 million yen, real figures are chain-based with 2000 as a reference year)

● Trends in construction investment (FY)

Actual ← | → Tentative | → Forecast

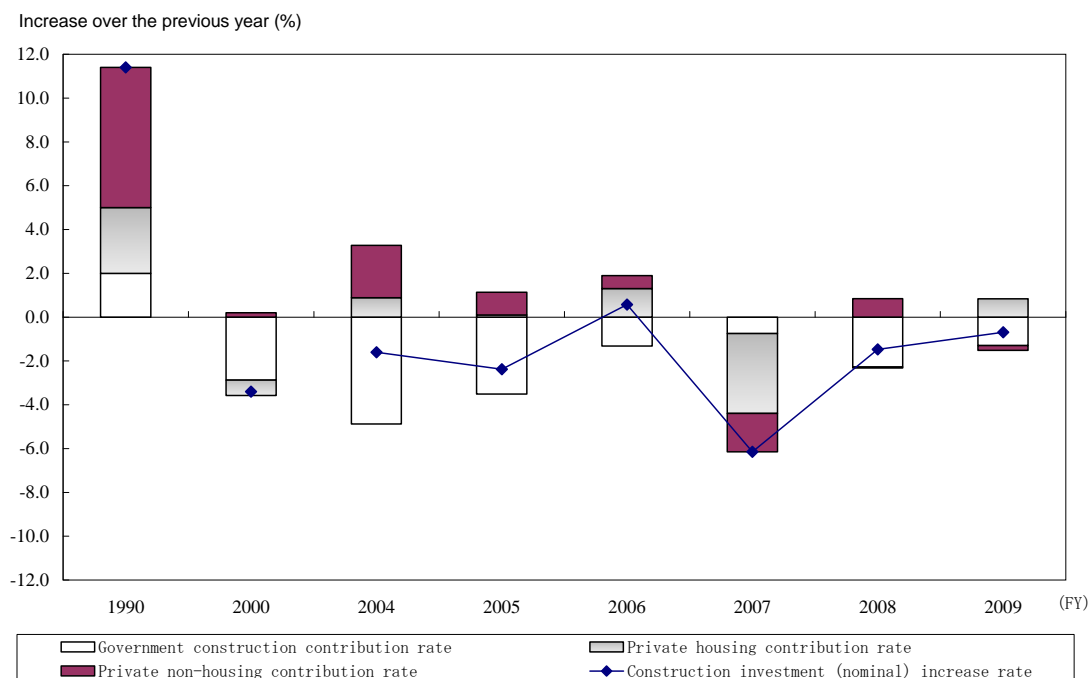
FY	1990	2000	2004	2005	2006	2007	2008	2009
Nominal CI (Increase rate)	81,440 11.4%	66,195 -3.4%	52,825 -1.6%	5,568 -2.4%	51,860 0.6%	48,670 -6.2%	47,950 -1.5%	47,620 -0.7%
Nominal government CI (Increase rate) (Contribution rate)	25,748 6.0% 2.0	29,960 -6.2% -2.9	20,828 -11.2% -4.9	18,974 -8.9% -3.5	18,290 -3.6% -1.3	17,900 -2.1% -0.8	16,790 -6.2% -2.3	16,170 -3.7% -1.3
Nominal private CI (Increase rate) (Contribution rate)	25,722 9.3% 3.0	20,276 -2.2% -0.7	18,375 2.6% 0.9	18,426 0.3% 0.1	19,100 3.7% 1.3	17,210 -9.9% -3.6	17,190 -0.1% 0.0	17,590 2.3% 0.8
Nominal private NH CI (Increase rate) (Contribution rate)	29,970 18.4% 6.4	15,959 0.7% 0.2	13,622 10.4% 2.4	14,170 4.0% 1.0	14,470 2.1% 0.6	13,560 -6.3% -1.8	13,970 3.0% 0.8	13,860 -0.8% -0.2
Real CI (Increase rate)	85,442 7.6%	66,195 -3.6%	53,334 -2.7%	51,478 -3.5%	50,780 -1.4%	46,730 -8.0%	44,900 -3.9%	44,140 -1.7%

(Units: billion yen. Real figures are based on 2000 prices.)

Notes:

1. CI: construction investment NH: non-housing
2. Private NH CI = private non-housing construction investment + private civil engineering investment.
3. Data from the "FY2006 Construction Investment Outlook" by the MLIT up to FY2006

● Trends in construction investment (nominal contribution rate, FY)



1.2 Economic trends affecting private-sector construction investment

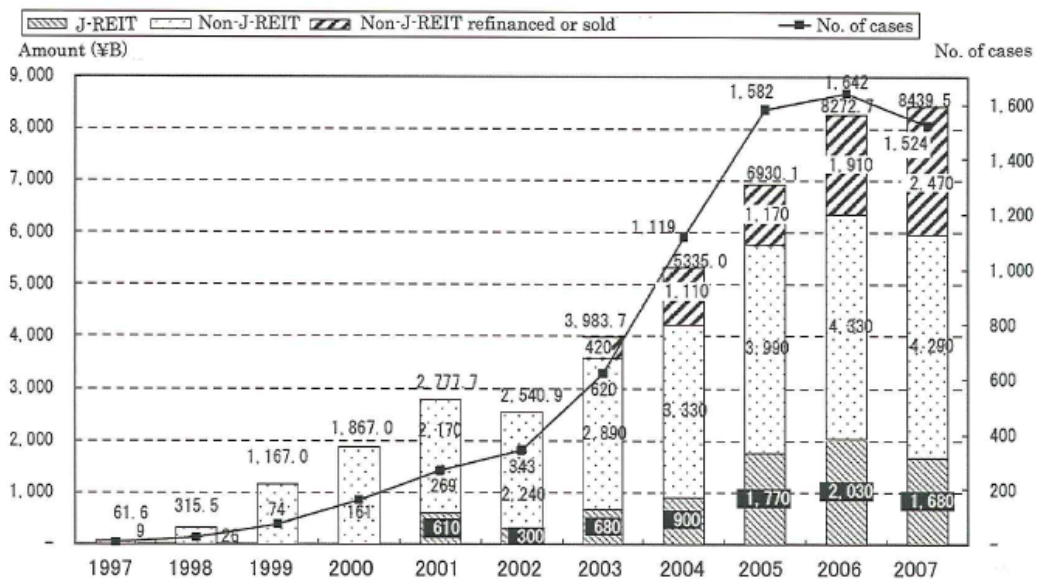
(The subprime mortgage crisis, surging commodity prices and the real estate securitization market)

- Countries around the world are drafting plans to recapitalize and assist their financial institutions to help them tackle the financial crisis engulfing the US, EU and other nations. Many countries fear that the slowdown in their export markets will lower production, suppress spending and eventually force a downturn in their economy.
- The surge in international commodity prices has abated, but is likely to reoccur due to active demand in the medium term in emerging economies, as cited in the Bank of Japan's "Statement on Monetary Policy" announced in October 2008. This is a risk factor for the Japanese economy and may retard private-sector construction investment.
- The Japanese real estate securitization market was established in FY1997 and continued to grow steadily until the advent of the subprime crisis. The total value of securitized real estate assets grew from 62 billion yen in FY1997 to over 8 trillion yen (\$80 billion with 1USD=100JPY) in FY2006.
- Construction companies, involved in real estate securitization in many ways, have been affected by the securitization slowdown. Since the collapse of the subprime mortgage market last year, foreign financial institutions in Japan have made huge losses on securitized products. Some have lost the power to invest and have withdrawn from the Japanese real estate market. This has driven some Japanese real estate companies into bankruptcy and in turn induced the bankruptcies of some construction companies.
- Major general contractors and some other construction companies have entered the securitization market and have become major players in securitization and fee-based businesses. They often undertake projects utilizing the securitization mechanism ordered by special-purpose companies. It is essential for construction companies to have personnel with expertise and experience in securitization, to negotiate with clients and further develop fee-based business.

- How the subprime crisis affected Japan's construction investment and other activities in the real economy
 - **Speculative money avoiding the US and other financial markets** poured into oil and other natural commodity markets, pushing up prices, which **put pressure on consumer spending and corporate profits** (Prices in general have then fallen due to the subsequent economic slowdown).
 - Foreign funds and investment banks withdrew funds. Financial institutions tightened their lending criteria. These factors led to a **worsening global real estate recession spreading to related industries**.

- **The slowdown of the US economy** suppressed imports from Japan, EU and the emerging countries, slowing their economies in turn. Within Japan, companies became **less willing to make capital investment, and housing demand declined**.
- The deflation of asset prices created a '**negative wealth effect**' which **dampened consumer and corporate spending in Japan**.
- **A higher yen**, due to lower creditworthiness and expected economic stagnation in Europe and North America, **affected the profits of Japanese companies**.

● Growth in the real estate securitization market



Chapter 2 Regional Economies and the Construction Business

2.1 The supply-demand gap in the construction business analyzed by region and approaches to restructuring

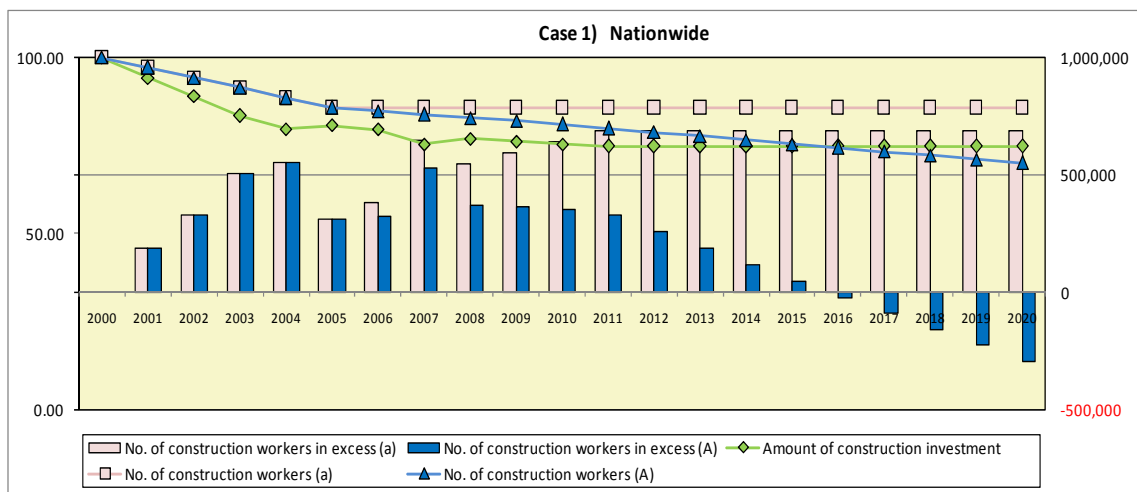
- RICE estimated the future number of construction employees in each region of Japan, using a demographic analysis of age brackets that took into consideration the retirement of senior workers in their 50s or older (who currently comprise a large proportion of the workforce). The estimated numbers of employees were then used to project the future labor supply-demand gap among regions. The year 2000 (when supply and demand were roughly in balance) was chosen as the base year, and the hypothetical rate of change in future construction investment (public investment decreasing by 3% annually and private investment to remain stagnant) was applied. The results indicate a shortage of construction workers in the metropolitan regions but an oversupply in general in the rural regions of Japan.
- Japan's employment adjustment speed, calculated by using an employment adjustment function, was estimated at about three years during the economic slowdown phase. In another estimate using a) the amount construction investment and, b) the percentage of government investment to the total construction investment as explanatory variables (lag periods set for both variables), the results were significant when FY1996 was used to divide the two phases, i.e., the increase phase and the decrease phase of employee numbers. The estimated time required to solve the supply-demand gap was longer in the case of an oversupply of workers.
- As a measure to alleviate the supply-demand gap, the possibility of dual employment between construction and agriculture/forestry was examined. Historically, many farmers migrated to the cities during winter and worked as construction workers, so there is some synergy between the two types of work. The results suggest that dual employment has the potential to narrow the gap, provided that conditions to support job-seekers are put in place.

- Method of calculating the supply-demand gap
 - Supply side: Estimates in different age brackets were made to understand the effects of senior workers in each region retiring.
 - Demand side: Estimates were made based on the assumption that private investment will remain stagnant at its recent level and public investment will continue to decrease at an annual rate of 3% until: Case 1) FY2011 and Case 2) FY2020.

The results were compared based on the year when supply and demand were roughly in balance (2000).

Case 1): **At a national level** the number of construction workers will be **in short supply from FY2016** (see the figure below). However, there will be a wide gap among the regions. **The shortage will become more acute in southern Kanto** (the area that includes Tokyo and other major cities) where there is already a shortage. On the other hand, **an oversupply of construction workers will persist even until FY2020 (the end of the projected period) in the provincial regions of Hokkaido, Tohoku and Shikoku.**

Case 2): Compared with Case 1) there will be a significantly lower demand from FY2012 and thus there will be an oversupply even in FY2020 at a national level. The regional trends (a shortage in southern Kanto and an oversupply in the provincial regions) are the same as in Case 1).



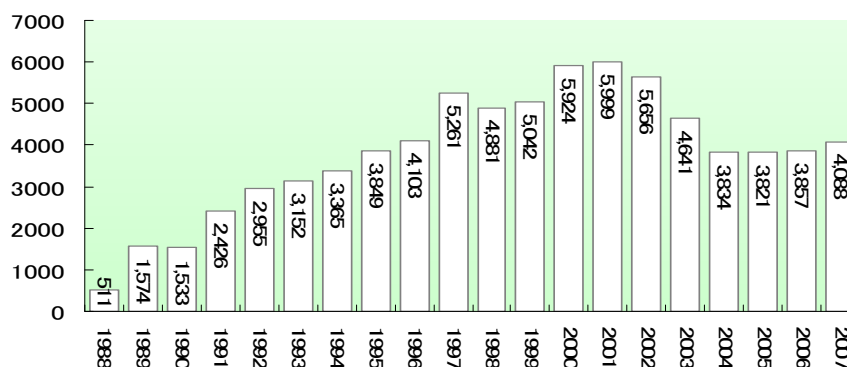
2.2 Bankruptcy trends in the construction sector

- A number of major construction companies playing key roles in local economies have filed for bankruptcy. The situation surrounding the construction sector is worsening due to the shrinking market, revisions to the construction laws and regulations, deteriorating financial conditions and the rising cost of materials. There is a problem inherent in the construction business, where too many companies result in excessive price competition.
- Recent bankruptcy cases are typified by two patterns: 1) a company accumulates deficits by taking orders below cost; and 2) regional general contractors, driven by the reduction in public investment to enter condominium/apartment construction, become caught up in the bankruptcies of newly emerging developers.
- Low-cost order-taking that accumulates deficits has bad effects on both the industry and the region and should be avoided. If it is necessary for some companies to “leave” the construction market (due to the continuing trend of oversupply) then there should be some support measures in place to minimize the negative effect and make the withdrawal easier. The time has come for the government to examine appropriate and practicable measures to ensure the healthy development of the construction industry as a local core industry.

● Analyzing the number of bankruptcies

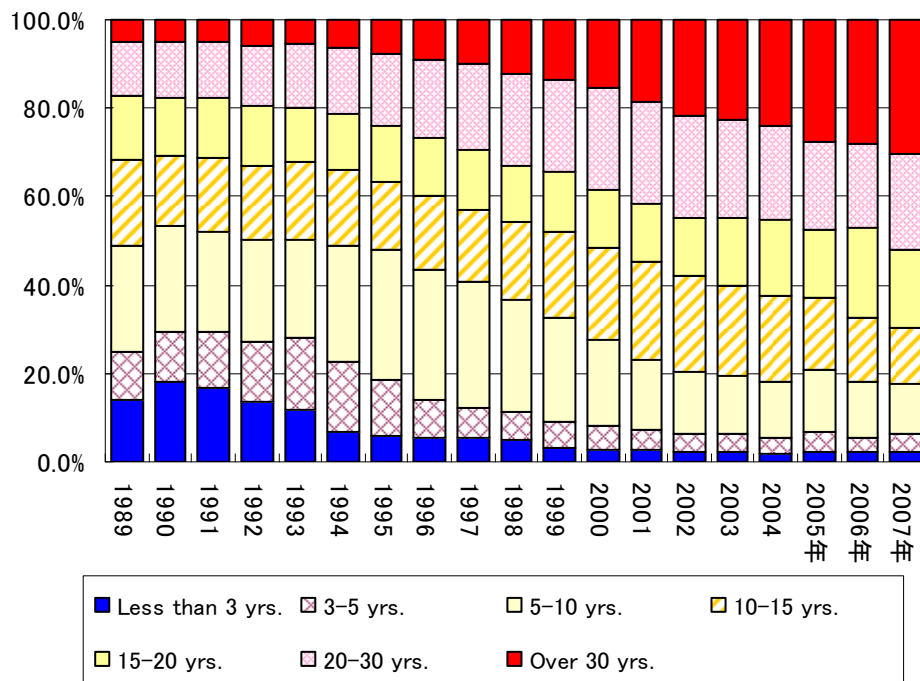
Until the early 2000s, companies that went bankrupt tended to be “young” companies. Now that these youngsters have been weeded out, the number of more experienced companies going bust is increasing, and the survivors are facing tougher competition.

<Figure 1> Trends in the number of bankruptcies among construction companies



Data from Tokyo Shoko Research

<Figure 2> Bankruptcies among construction companies classified by the number of years in operation



Data from Teikoku Databank.

● Factors behind the increase in bankruptcy filings

1. Worsening business conditions

- 1) A shrinking construction market
- 2) Tougher competition due to the introduction of general competitive bidding and the revision of the Antimonopoly Law
- 3) The revised Building Standard Law
- 4) The slowdown in the real estate market due to the subprime mortgage crisis and financial institutions implementing stricter lending standards
- 5) Rising materials costs

2. Structural factors in the construction industry

- 1) Local construction companies highly dependent on public works projects
- 2) Excessive price competition, due to the oversupply and multi-layered subcontracting system, leading to low profit margins
- 3) Weak sales, management and financial capacity

- Measures to prevent bankruptcy and ensure the proper development of the construction industry

There is a need to support companies that have management and technical expertise, to help them survive competition in the market:

- 1) Ensure fairer competition by abolishing the system of local governments announcing the scheduled price prior to bidding and by introducing a general evaluation system.
- 2) Provide employment assistance to workers, counseling services for consolidating companies, and job creation in other industries to facilitate smooth “departures” from the construction industry.
- 3) Prevent financial institutions from abruptly stopping or reducing credit, and make public funds more easily available.

Chapter 3 The Construction Industry

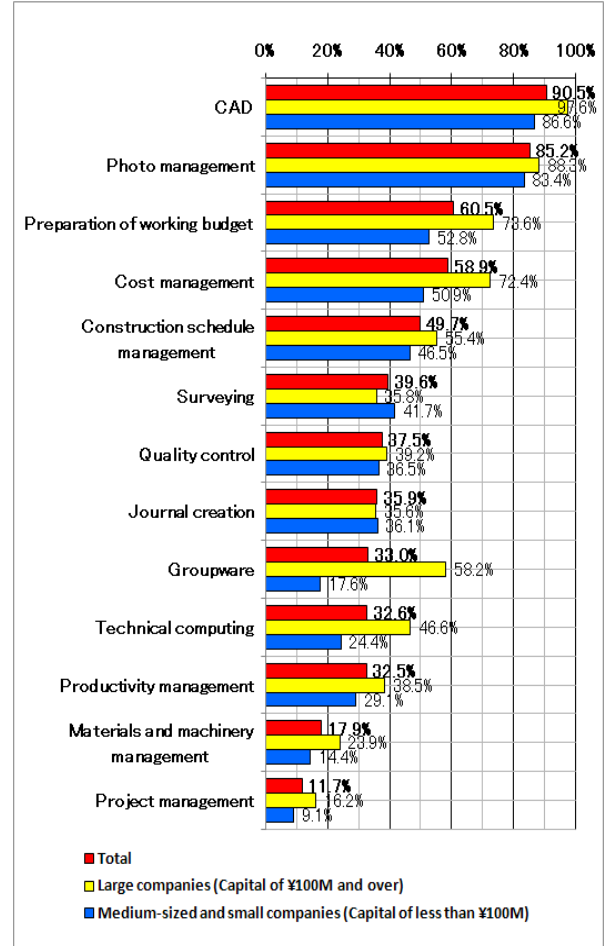
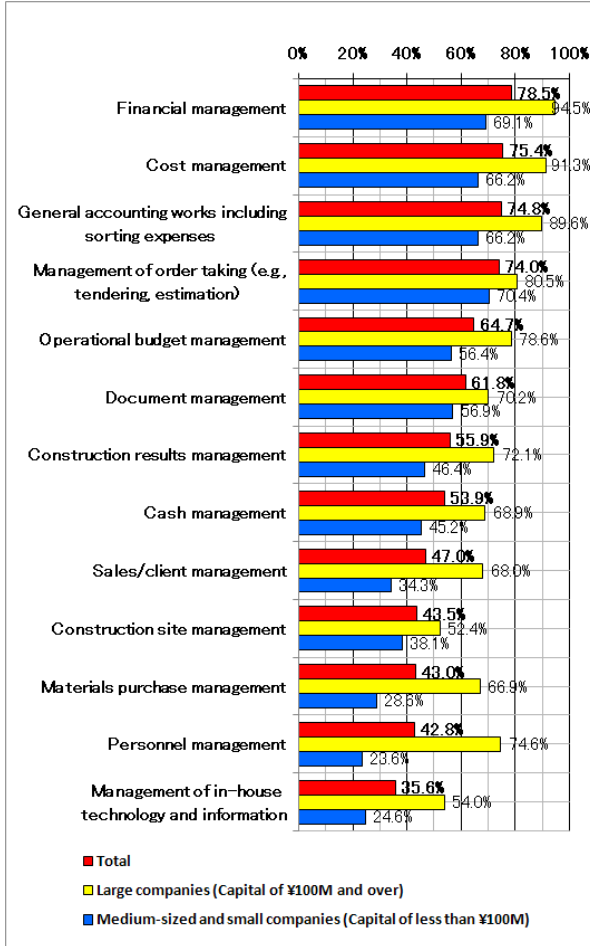
3.1 ICT (Information and Communication Technology) in corporate management

- RICE conducted a survey on how construction companies use ICT to increase business efficiency. Administrators use ICT for “financial management,” “cost management” and “general accounting works including sorting expenses.” In operational management, CAD and other ICTs for “photo management” and “working budget management” are widely used.
- Nevertheless, ICT has not automatically improved business performance as it has done so in other industries. In future, construction businesses should cover the entire lifecycle of buildings and structures, from initial planning through to operation and management. In other words, more client-oriented, efficient business systems should be established. Large general contractors are striving to establish business strategies based on vast amounts of client information. They are utilizing ICT to set conditions to venture into new businesses. On the contrary, smaller companies lag behind.
- In other advanced countries, BIM or Business Information Modeling and other ICT solutions suited for the construction industry have been introduced. These may make Japanese construction companies more competitive and efficient in the face of a tougher business environment.

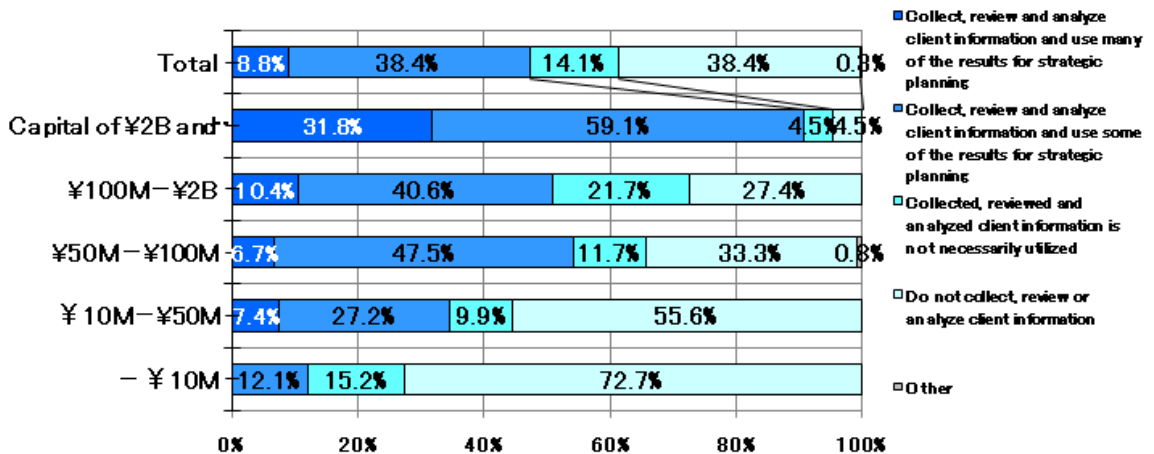
ICT introduction rate by company capitalization

Administrative sector

Operational sector



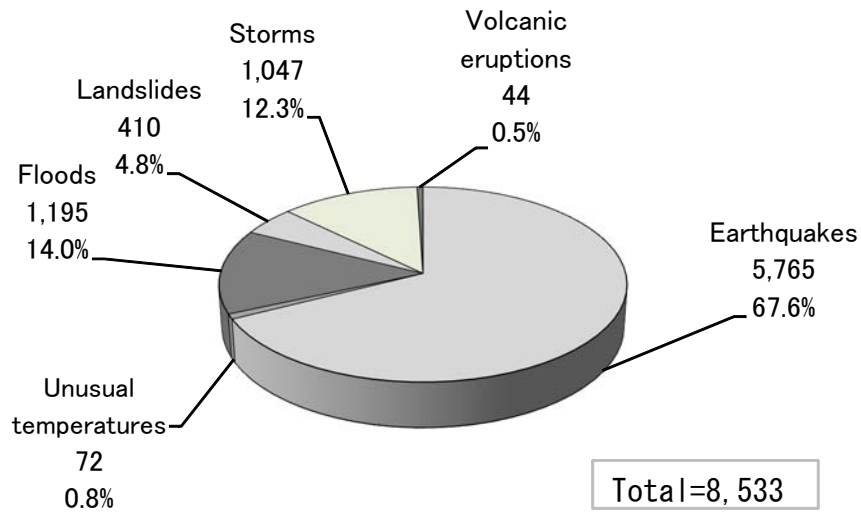
Use of ICT for corporate management (Strategy planning utilizing client information)



3.2 A comparison of Japan's construction industry with those of France and Germany

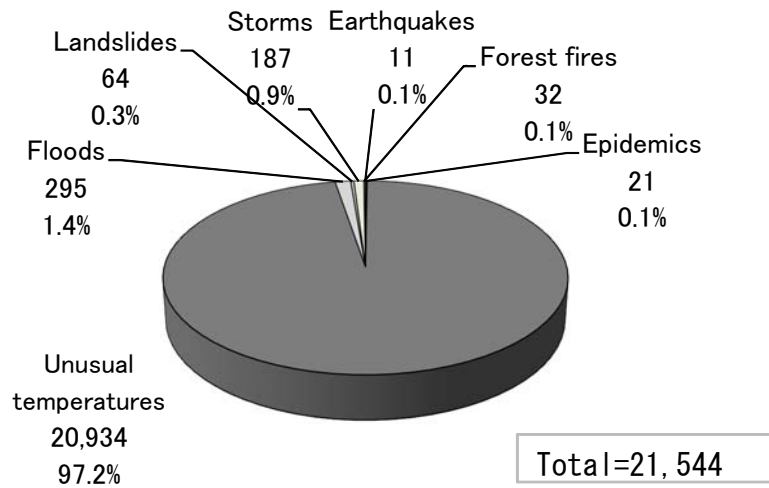
- RICE compared Japan's construction industry with those of France and Germany to derive implications for discussing the future of Japan's construction industry. The two countries were chosen because their markets have more differences than similarities with the Japanese construction market. Comparisons were made from the three perspectives of: 1) natural disasters, 2) group-oriented management, and 3) employment patterns of construction workers.
- Japan is prone to landslides, embankment collapses, flooding, coastal erosion and other natural disasters, which result in numerous deaths. On the other hand, such natural disasters and their associated fatalities are rare in France and Germany. But because Japan is frequently hit by natural disasters, the country has a higher level of preparedness at a regional level. Its major players (local construction companies), however, are losing their capacity to respond. The *raison d'être* of these companies should be discussed not only from the viewpoint of economic viability but from that of sustainable societies and public policy.
- Unlike the hierarchical and multi-layered Japanese construction industry, the French construction industry in general is group- or local-oriented. The big French general contractors are capable of conducting core construction works on their own. They receive orders for large-scale projects and share the works with themselves and specialized companies (group-oriented). Small-scale local projects are awarded not to the headquarters of general contractors but to their subsidiaries, or related and affiliated companies. Japan should consider such management techniques that will enable more efficient allocation of major resources (construction engineers, skilled workers and construction materials and equipment).
- Sustainable construction production is impossible without the stable employment of skilled construction workers. In France and Germany these workers in general are full-time employees and paid a salary on a monthly basis. Such employees account for only ten percent of all construction workers in Japan; the rest are paid on a daily basis. This is considered the major reason for frequent dumping of wages.

1. Number of deaths by type of disaster (Japan, 1978-2007)



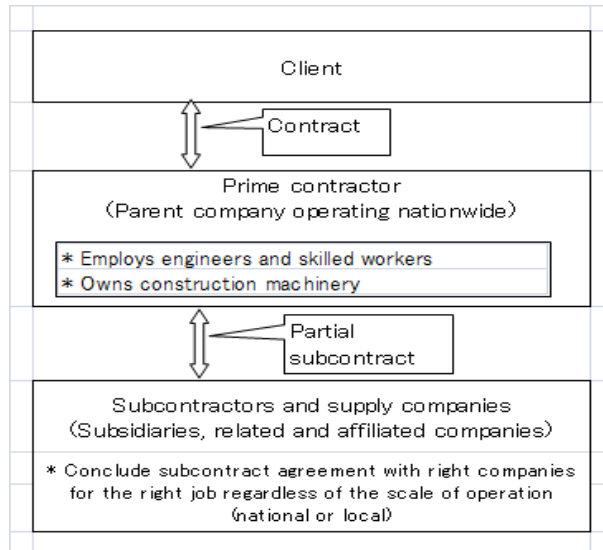
Compiled based on data from the Centre for Research on the Epidemiology of Disasters (CRED), Catholic University of Leuven.

1. Number of deaths by type of disaster (France, 1978-2007)

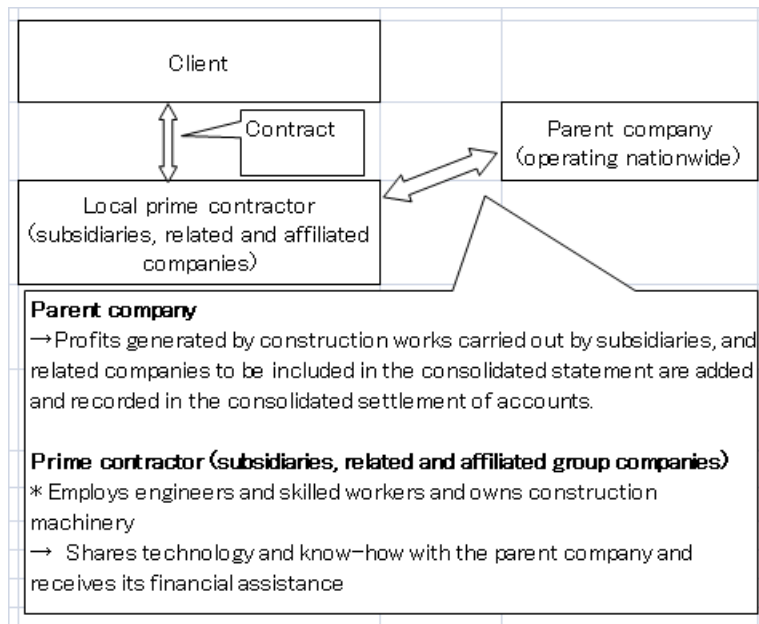


Compiled based on data from the Centre for Research on the Epidemiology of Disasters (CRED), Catholic University of Leuven.

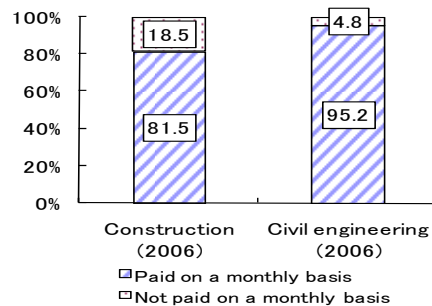
2. How large-scale projects are implemented in France and Germany



2. How small-scale projects are implemented in France and Germany



3. Percentage of workers paid a monthly salary in France



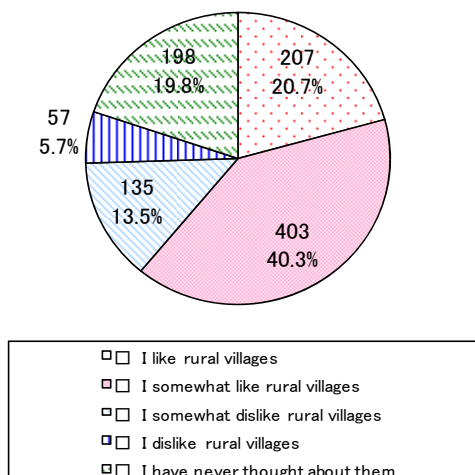
Data from the Ministry of Ecology and Sustainable Development

Chapter 4 National and Regional Planning

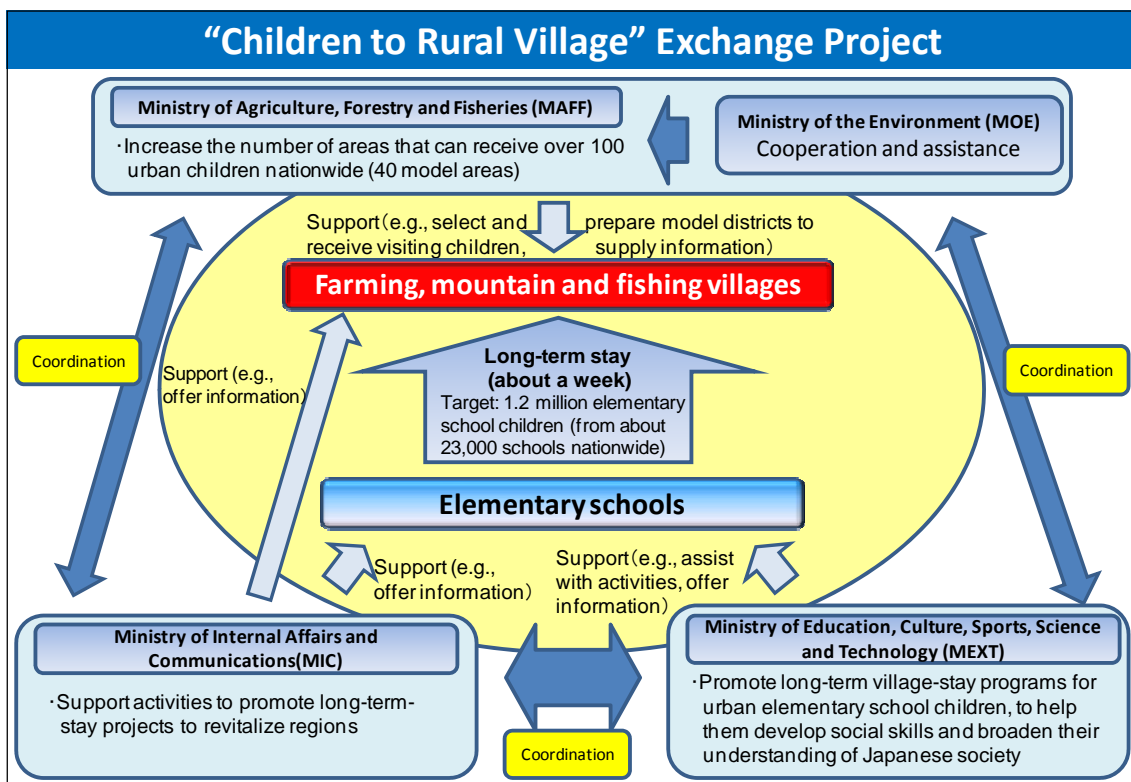
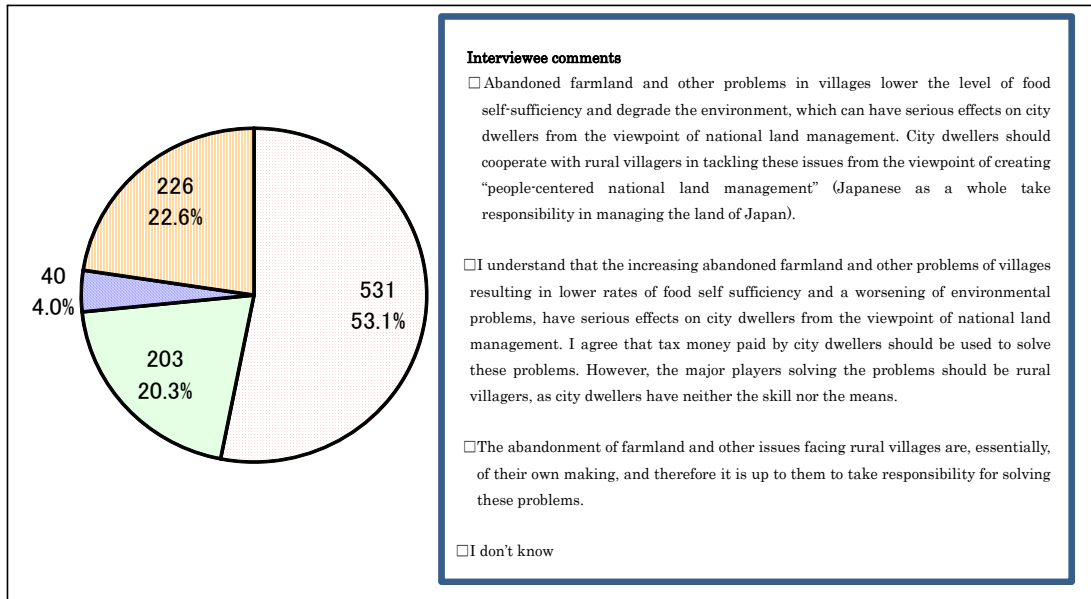
4.1 Exchanges between cities and rural areas

- The urban-rural balance is under threat in Japan. The over-concentration of population into metropolitan regions has caused serious environmental and disaster control problems in these regions. Depopulated rural villages have become unsustainable, and the area of abandoned farmland is increasing.
- RICE surveyed young people about their attitudes toward farming and mountain villages. When asked if they agreed with the statement “I have good impression toward farming and mountain villages,” 61.0% said “yes.” A total of 53.1% agreed with the statement “city dwellers should cooperate with rural villagers in solving problems like restoring abandoned farmland.”
- A project to send urban elementary school fifth-graders to farming, mountain and fishery villages for a week was launched this fiscal year (see the figure below). The project is expected to trigger a large and continuous flow of people from cities to villages and promote exchanges between the two environments.
- Ways to stimulate exchanges between cities and villages:
 - 1) The national government should take the initiative in promoting exchanges among cities and villages and making people the center of land management.
 - 2) Continuous exchanges should be supported by providing essential facilities (including transport links) so that people can live comfortably in rural areas.
 - 3) The traditional role-sharing between the government and the private-sector should be changed. Private companies, NPOs and citizens should work together to create a new form of public-private cooperation.

1. About 60% of respondents have good impression of rural villages.



2. Half of respondents replied that city dwellers should cooperate with villagers in solving problems like restoring abandoned farmland.



Data from the "Children to Rural Village Exchange Project" by MIC, MEXT and MAFF

Chapter 5 The Current Status of the Construction Industry and Social Infrastructure Overseas

5.1 Efforts in the US to manage, maintain and renew social infrastructure

- The history of social infrastructure in the US goes back many years. Infrastructural facilities are becoming old and obsolete. The jurisdiction over upkeep and management in almost all cases resides with state or local governments. The level of upkeep varies widely among the states and among the various maintenance and enhancement projects.
- Overall, awareness of the seriousness of the problem of social infrastructure upkeep and management has grown markedly in the US in recent years. Nevertheless, systems for evaluating the state of infrastructure as well as budgetary provisions are insufficient. In the US, awareness of the important role that social infrastructure plays in economic development is increasing, and administrators are facing the dilemma of having to choose whether to invest in new infrastructure or fund the upkeep and maintenance of existing stock.
- Under such limitations, many public bodies are on the point of adopting asset management approaches that will seek to comprehensively assess the usefulness of stock, the effectiveness of stock maintenance and new investment, and lifecycle cost, so that they can clearly prioritize infrastructure projects.
- In Japan, although the aging of social capital stock is not as serious a problem as it is in the US, the accumulation of knowledge and the awareness of the gravity of the situation lags behind that in America in many areas. The issue of maintenance, management and renewal is an area that requires a range of data to be gathered and comprehensively assessed over the entire lifecycle of a facility; moreover, the assessment of different facilities has to be based on a unified standard. For this reason, central government needs to play an active role in accumulating know-how and setting up the systems of assessment.

● Roads and highways

- Of the paved roads in the US, 44% are in good condition, but 15% require work (Data: Federal Highway Administration (FHWA))
- Although authorities have been aware of the need for the road maintenance and management for some time, they have not been able to secure as much funding as they would have liked. (Data: FHWA, States of New Jersey and California). Awareness of the seriousness of problem increased following a bridge collapse in

Minnesota in August 2007.

- Many state and federal highway administrators have adopted an asset management approach to transportation infrastructure. Although there are budgetary restrictions, the allocation of funding gives full consideration to the expenses necessary for the maintenance of the capital stock. (Data: FHWA, States of Florida, Ohio and California)

● Dams and levees

- About 3 percent of dams and a few percent of levees under federal administration are in a dangerous state, but overall the condition of this infrastructure is good. Note however that only about 1 percent of the dams in the US are under federal administration. The administrators and experts recognize that the level of upkeep and management of many dams and levees that are under state government or private ownership is insufficient. (Data: United States Army Corps of Engineers (USACE))
- Although about half the dams in the state of New Jersey are privately owned, the owners are obliged to repair them if they are at risk under the law. The state assists with funding for repairs. (Data: State of New Jersey)

● Sewer systems

- The sewers in the great American cities were laid in the 19th century and are still in use today. Aging and obsolete infrastructure is a serious problem. (Data: New York, Washington DC, San Francisco)
- None of the cities can allocate sufficient funding for the maintenance, management or renewal of this infrastructure.
- Authorities in Washington DC are systematically inspecting and assessing their sewers, starting with the ones in the worst condition. The purpose is to clearly identify work projects that will minimize risk most effectively given the funding restrictions.
- Although the federal government is cannot become involved in these projects, it recognizes that the issue of aging stock will be a serious problem in the 2010s and has warned state and local governments to respond to the problem. The federal government has collaborated with private companies and issued guidelines. (Data: Environmental Protection Agency (EPA))

5.2 Trends in overseas construction markets

- Owing to the influence of the subprime crisis, the US economy has experienced two consecutive quarters of low economic growth since the fourth quarter of 2007, where the annualized growth over the previous quarter has been less than 1%. This is the clear sign that the US economy is slowing. A report on the outlook for construction investment in the US in 2008 (published in August 2008) has announced a 28.4% year-on-year decline for private-sector housing, a 7.7% year-on-year increase in public works, and a 13.0% increase year-on-year for private non-housing construction compared with figures for August 2007. In September 2008 the number of private-sector housing starts posted a year-on-year decline of 39.7%, crossing the 1-million-house line to reach 817,000 units.
- Economic growth in Western Europe began to slow down in 2007. Annual growth in construction investment in the second quarter of 2008 slowed by 0.2% over the previous quarter at an annualized rate and a 1.8% increase over the previous year at an annualized rate. On the other hand, economies in Central and Eastern Europe have continued their high rate of growth in comparison with the western part of the continent. Through the EU Structural Fund, social infrastructure is being planned and constructed in Central and Eastern Europe. Although construction investment is forecast to grow, the direction of the European economy as a whole is unclear, and there is little cause for optimism.
- In Asia and Oceania until 2007, China, India, Vietnam, Singapore and many other nations continued to experience high levels of both construction investment and GDP growth. Nevertheless, with the slowdown in the global economy, their GDP growth rates have slowed and there are concerns that growth in construction investment will also falter. On the other hand, demand for resources in Australia has expanded, against the backdrop of the boom in resources. Although infrastructure to help transport these resources is being built, and as a result, construction investment in this country is expected to grow, the slowing economies of the nations that are consuming these resources are likely to have an effect on the economies of the resource-exporting nations, and therefore the situation should be watched closely.

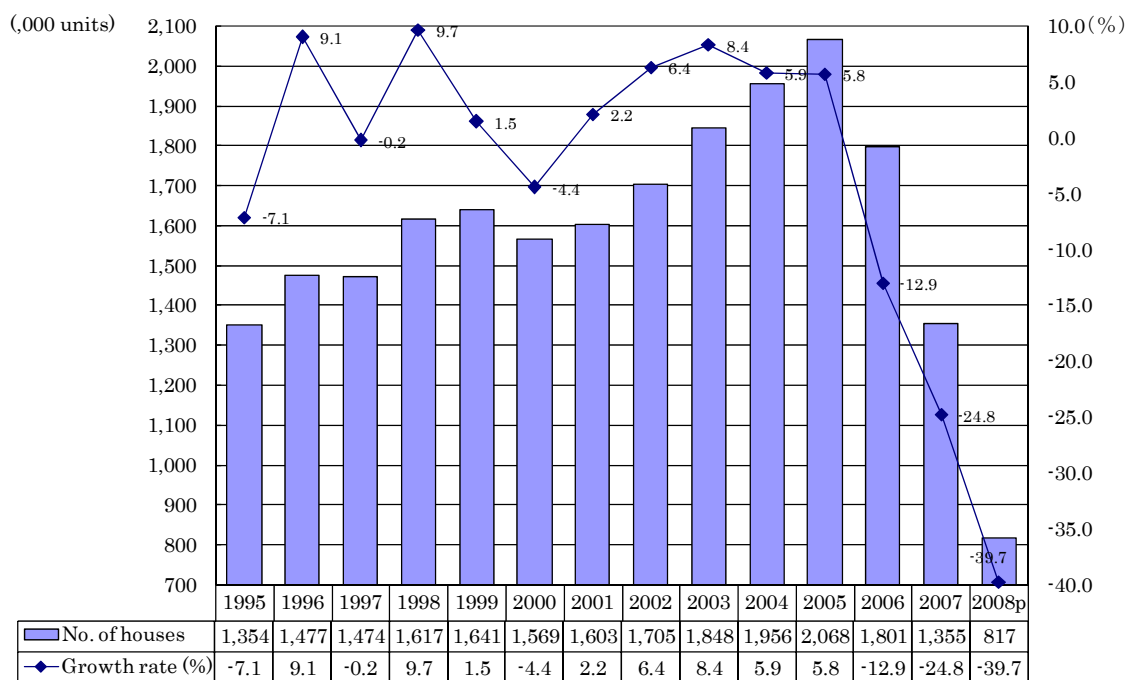
Construction markets in various nations and regions (nominal values, converted into trillions of yen)

	Japan FY2007	US 2007	Western Europe 2007	Central and Eastern Europe 2007	Asia (Note 1) 2007
GDP	515.0 (100)	1,625.8 (315.7)	1,887.4 (366.5)	95.6 (18.6)	963.8 (187.1)
Construction Investment (Note 2)	48.7 (100)	134.3 (275.8)	131.5 (270.0)	7.9 (16.2)	189.0 (388.1)
As a % of GDP	9.4	8.3	7.0	8.3	19.6

Note 1: Not including Japan.

Note 2: Figures are for investment in new construction; not the repair of existing structures. Nevertheless, construction investment in Japan includes expenditure on the maintenance and repair to government civil engineering projects.

Trends in the numbers of private-sector housing starts in the US



Note: Data published by the US Department of Commerce on October 17th, 2008.

Construction investment in Asia and Oceania

Country/region	Nominal GDP in 2007 (units: US \$100M)	Construction investment (units: US \$100M)	Construction investment as a % of GDP	Population (,000)	Per capita construction investment (units: \$US)
China	32,790	10,975	33.5	1,321,050	831
Hong Kong	2,072	119	5.7	6,972	1,707
Taiwan	3,796	344	9.1	23,082	1,490
India	10,408	919	8.8	1,123,970	82
Indonesia	4,329	79	1.8	224,938	35
Japan	43,744	4,133	9.4	127,761	3,235
Korea	9,698	1,753	18.1	48,456	3,618
Malaysia	1,866	256	13.7	26,841	954
Philippines	1,441	63	4.4	88,712	71
Singapore	1,610	162	10.1	4,589	3,530
Sri Lanka	300	5	1.7	19,928	25
Vietnam	706	12	1.7	85,593	14
Thailand	2,453	211	8.6	65,740	321
Australia	9,105	1,059	11.6	20,983	5,047
New Zealand	1,279	100	7.8	4,235	2,361
Total	125,597	20,190	16.1	3,192,850	632
Total excluding Japan	81,854	16,057	19.6	3,065,089	524

Note: Figures for construction investment (nominal) are in principle those for 2007, with the exceptions of 2000 for The Philippines, 2005 for Sri Lanka, and 2006 for Indonesia.