



The unexpectedly strong rebound of the Japanese Economy has clearly generated a renewed interest in Japan among European Companies. The previously imbalanced picture of a sinking Japan full of weeping presidents eagerly conveyed by the media seems to finally be fading away. This is good news as the one-sided media reporting, along with the strong focus on China as the market of interest in Asia, has arguably prevented many European Companies from recognising and realising their full business potentials in Japan during the last decade.

As the “sick man of Asia” is now recording the highest GDP growth figures in the industrialised world, this is the time to reconsider old perceptions and assess where Japan stands today.

It is important to remember that throughout the post-war period, many European Companies have in Japan found challenging but also often lucrative niche markets with sophisticated customers and high price tolerance for the right product. In sharp contrast to the rest of the Economy, the profit margins for most foreign companies have indeed increased during the long- drawn-out recession.

It is also crucial to realise that, in contrast to historical preconceptions of Japan as being closed to foreign firms, Japan is actually one of the most “open” economies in the world when considering traditional barriers to trade and restrictions on investment. Japan has one of the lowest *average* tariff rates of all industrialized nations and there are no restrictions on what foreigners can buy and own.

Yet, with the exception of Pharmaceuticals and to a lesser extent, Financial Services, foreign companies have yet to be successful outside rather narrow niche markets in Japan. Most successful “foreign” companies targeting the wider Japanese public with a market share close to expectations based on their performance in other economies are set up either as joint ventures with or represented solely through franchising arrangements with Japanese Companies.

This is hardly a coincidence. The European Business Council in Japan (EBC), the trade policy arm of the 17 national European Chambers of Commerce in Japan, is closely following the regulatory developments through professionals in 29 sector committees. In the EBC report on the Japanese Business Environment 2005, “Key moment for Reform”, we conclude through detailed analysis, that although progress can be seen in some areas, regulatory barriers for Foreign Companies remain significant.

Detailed administrative “guidance” rather than general rules applicable to all cases, lack of consistency and transparency and in certification and application procedures, as well as lack of safeguards against anti-competitive practices continue to hamper the business of foreign companies in sectors such as Cosmetics, Animal Health, Medical Devices, Medical Diagnostics, Telecom Carriers, Asset Management, Banking, Food, Airlines to Construction just to mention a few. Although progress has been made to facilitate the acquisition of licenses and eliminate subjectivity in supervision, there is a long way to go before the system can be classified as efficient and transparent. On top of complicated procedures, Japan still promotes its own standards for products and services which not only effectively hinders the smooth introduction of products available on the global market but also makes it difficult for foreign companies to take advantage of competitive strengths achieved through global operations and logistics.

Take for instance the 828 food additives authorized in Japan. Only 294 of these are accepted as being safe by the WHO/FAO. Over 600 substances accepted as being safe by the WHO/FAO, on the other hand, are not allowed in Japan.

There is no doubt about the commitment to promote reforms on the part of the central government, headed by the cabinet office under Prime Minister Koizumi. It would, however, be a mistake to believe that the recent economic performance is an outcome of the deregulatory measures undertaken. While the private sector has undergone drastic restructuring and rationalisation, partly due to less government support, regulatory reform has lagged behind despite contrary claims on the part of the government.

The problem lies really in getting the collective act together. Curbing the vested interests that unduly influence the policy process still seems to be extremely difficult in Japan. Powerful Ministries defending status quo and administrative rigidity have too often watered down ambitious reform programs in the implementation process.

Even policies of direct importance for foreign companies risk being undermined. Promoting FDI is a stated priority of the Koizumi government as the 1.9% of GDP level is extremely low when compared to other countries (similar figures would be more than 20% in Germany, more than 30% for the U.K. and more than 50% in France). In a meeting of the Japan Investment Council on March 9, the Prime Minister embraced the idea of setting the target to 5% in 2010, after hopefully achieving the modest goal of doubling the level from around 1% in 2001 to 2% in 2006.

Still, it is unsure whether the main policy instrument towards that end, the so-called triangular merger allowing foreign companies to use Mother Company stocks as consideration, can be introduced in a manner that does not hollow out its original intent. In 2005, the parliament decided to postpone the implementation for one year until May 2007 on fears of an influx of foreign hostile take-overs (which by the way is technically impossible under the scheme). Local business groups have since tried to find ways to make the scheme unusable. Tax deferral on unrealised capital gains through the scheme is for instance absolutely essential if to function properly, but this topic has not been taken up out of fears of a backlash from the protectionist lobby!

Not having a functional triangular merger scheme in place will continuously hinder Japan in gaining its share of the 60% of global FDI flow stemming from M&A. This is just one example of how crucial reform policies that would make it easier for foreigners to engage in Japan, risks being undermined by bureaucrats under pressure from vested interests.

Not everything is dark however. The Prime Minister resolutely resisting compromises on crucial details in the postal privatisation made him dissolve the parliament and eventually gain a land-slide victory in the general elections last September. This political mandate for reforms in combination with economic upturn represents an historic opportunity to take difficult decisions, promote policy cohesion, and prevent vested interests from undoing crucial policies.

Doing so is the best way to ensure that foreign companies now turning their attention back to Japan like what they see here and are given the tools and assurances needed to engage in this challenging yet rewarding market.

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