

Facilitating European FDI in Japan

The Japan Economic Research Institute Seminar

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I would like to thank the Japan Economic Research Institute for your very kind invitation to address this meeting today. I am both pleased and honoured to be here. I will start by giving you some very brief background information about myself, the European Business Community in Japan (EBC), and our views on the Japanese business and investment environment in order to set the framework for today's comments on facilitating European FDI in Japan.

My name is Alison Murray and I am the Executive Director of the EBC. The EBC is the trade policy arm of 17 European National Chambers of Commerce, Business Associations and other organisations in Japan that are shown in this slide. Established in 1972 as an ad hoc committee of national European chamber presidents, the EBC now carries out a variety of activities to improve the trade and investment environment for European companies in Japan. The primary objective of the EBC is to promote the interests of European businesses in Japan through trade policy-related activities.

The current EBC Chairman is Mr. Richard Collasse, President & Representative Director of Chanel K.K. This is his third year as EBC chairman. The EBC formulates its policies and recommendations through the deliberations of 27 sector committees, which you can see listed on this

slide. They include sectors ranging through such diverse areas as Aeronautics, Banking, Human Resources and Telecommunications. The members of these committees are the most senior executives of European companies based in Japan. The EBC has a secretariat with an executive director, a policy director and support staff.

The main EBC activities are:

- Identifying the obstacles that European companies face doing business in Japan and lobbying the Japanese Government for changes in government policy.
- Providing information to the European Commission and EU member nations on the Japanese business environment.
- Participating in Government commissions and specific hearings
- Commenting on proposed legislation through the Japanese Government's Public Comment Procedure.
- Participating in OTO (Office of the Trade Ombudsman) hearings on behalf of EBC Committees
- Publishing policy proposals in annual EBC reports such as:
 - *Promoting Foreign Investment Through Decisive Reform: The EBC Report on the Japanese Business Environment 2003*
- Participating in high-level business forums such as the EU-Japan Business Dialogue Roundtable.

From our experience in the EBC, we have accumulated some insights on the European Perception of Japan

We believe that there is a deeply rooted European presence in Japan. Some European companies, such as Siemens K.K., and the Swedish firm, Gadelius, have been here for the best part of one hundred years or more. Others such as Renault and DaimlerChrysler, have important partnerships with leading Japanese companies.

The European firms already in Japan have a strong commitment, and many have European presidents who speak Japanese, have lived in Japan for a long time and many have Japanese wives. European companies know that Japan remains the second largest economy accounting for 13% of world GDP. Japan holds 25% of accumulated world cash savings, hence the market is large. The market is characterized by a high level of homogeneity – what sells well in Tokyo sells well everywhere. There are very few direct entry barriers.

Yet having said this, the European presence in Japan is still lower than the Japanese presence in Europe. Japan is still regarded as a difficult and expensive location for FDI.

So why is this?

Is Japan open for establishing new businesses?

Yes...

1. Japan has one of the lowest average tariff rates on industrial products of all the industrialized nations (2.7% in 2002)
2. Even for agricultural customs duties, rates are surprisingly low. (12% on average in Japan,

compared to a 20% average in the EU, and a 36% average for the OECD)

3. There are almost no investment restrictions, and it is actually relatively easy to set up a business in Japan.

...and No

Japan is a huge, attractive market...If it is so open, then why are there not more foreign firms here? For example, the ratio of foreign investment to domestic investment in Japan is only about 1%. In other words, only 1 yen of every 100 yen invested in Japan is from overseas. The cumulative inward FDI versus GDP stands at 38.6% for the UK, 25.1% for the US, and more than 20% for most advanced industrial nations. In contrast, as we know, the figure for Japan is just 1.2%. In marked contrast, China's FDI inflows in 2002 were almost 6 times bigger than Japan's and were equivalent in size to Japan's entire cumulative stock of FDI

These figures suggest that Japan is open, but not necessarily open for business. A number of challenges remain if a company plans to set up or enlarge a business in Japan:

The transparency challenge

For example, our member companies constantly tell us that:

- It is difficult to receive binding, written clarification from regulatory authorities on issues of concern
- There is often no body of regulatory precedent available for companies to predict how regulatory authorities will react in a given situation

- Decisions handed down by regulatory authorities are often based on criteria unavailable to the public
- Decisions often lack consistency from one official to another and from one day to another, and firms regularly complain about arbitrary treatment

The regulatory burden challenge

- Regulatory authorities overzealously micromanage the product approval process
- Many regulations are not based on sound science
- Many regulatory requirements are duplicated
- Many regulatory requirements are outdated
- Many regulations do not adhere to international best practice

Other challenges...

- Stagnating Japanese economy
- Competitive environment
- Border control issues
- Tax environment
- Human resource considerations – largely immobile labour market due to loyalty of Japanese

workers

- Cultural issues – difficulties in language, customs and business procedures, buyer behaviour, the distribution system, slower pace of decision-making, need for consensus, etc.

The Result?

Practical difficulties lead to a high cost of doing business in Japan and discouraging investment

WHAT NEEDS TO BE DONE TO ENCOURAGE FDI BY EUROPEAN COMPANIES?

■ Substantial incentives especially tax breaks

Many of the Japanese prefectures are offering a variety of incentives, including reasonable rent for office and factory space in preconstructed sites. Some are offering subsidies based on the number of local people employed. We believe that these incentives, while helpful, do not go far enough to attract the level of investment needed to put the economy back on track.

Korea, for example, provides a variety of tax incentives to attract foreign investment in many ways. Most new businesses involving advanced technologies and service industries that support the manufacturing sector are eligible for tax exemptions and reductions that include a 7-year corporate and income tax exemption with a 50% reduction in years 8-10.

In Japan, the vast majority of FDI is in the form of M&As. The Ministry of Finance must be convinced to give the same tax treatment to cross-border mergers as for wholly Japanese mergers and the commercial code and other company laws should be amended to facilitate cross-border corporate restructuring

The recently introduced factor-based tax, which levies a corporate enterprise tax based on criteria other than profits and is aimed at raising revenue by the prefectural authorities is a strong disincentive to FDI and should be abolished or at least be non-applicable for several years.

Major Business Opportunities created for new and existing players

This measure is summarized by the slogan:

“At private risk, for public service”

In Europe, it is accepted that the public sector can be made more efficient and public services more effective if the government were to entrust the administration of certain services to private organizations. The sharing of resources and skills between the public and private sectors has led to a public-private partnership between the European Commission via the European Investment Bank and the private sector in Europe today.

Privatisation of prefectural/public enterprises and outsourcing to the private sector – not just posts and highways – but also water service provision, sewerage, waste management, and welfare facilities - would create major investment opportunities that would attract substantial investment from European companies that are already investing in Japan and more importantly, major European companies that are not yet in Japan. For example, according to the World Bank, the water markets of the world are worth up to US\$800 billion, making them comparable in scale to the fossil fuel markets. Privatisation of a public water supply or treatment operation in a prefecture would attract many European firms, provided the bidding procedures were to be open and fair. There are plenty of opportunities in the prefectures for public works to be outsourced to the private sector complemented by a partnership with a policy-based financial institution.

Regulatory reform

The prefectures can facilitate FDI by proactively lending their support on national regulatory reform issues that serve as deterrents to business. Local governments can also lobby the national government on these issues. They can also understand the problems faced by companies and utilize the special zone (tokku) system to encourage them to set up in these regions

Some specific examples of key regulatory reform issues inhibiting potential FDI include:

- Companies cannot own for-profit medical facilities that provide treatment with high-tech equipment, such as dialysis machines
- Food additive regulations are out of step with the rest of the industrialized world

For example, Over 600 substances accepted as safe by the WHO Expert Committee on Food Additives (JECFA) are not allowed in Japan, including many in common use around the world. This situation acts as a barrier to the importation of European foods and related investment. Moreover, of the 828 food additives authorized in Japan, only 294 are accepted by JECFA.

- There is a continued requirement for national assays for animal-use vaccines and diagnostics even though such requirements for human-use products have been eliminated
- Reimbursement prices for medical products, such as equipment, diagnostics and pharmaceuticals have been drastically reduced in recent years, making it increasingly difficult for producers in the health science sector to invest in new product development and facilities.
- Applications for business licenses filed with local authorities under the revised Large Store Location Law (*Dai Ten Ricchi Ho*), which was enacted in June 2000, can take upwards of 1

year to be processed. Some local authorities have even imposed new conditions on applications, making the procedures even more complex, not less as was the intent of the revision.

- The 2% surcharge levied on companies choosing to use the consolidated tax system should be abolished. No such surcharge exists in Europe.
- The ceiling price system (*yotei kaku*) for public works tenders should be abolished
- and there should be more transparency in the screening process.
- At ports, competitive bidding for stevedore services should be conducted through open tenders
- And the list goes on. Please refer to *Promoting Foreign Investment Through Decisive Reform: The EBC Report on the Japanese Business Environment 2003*

Strong Leadership at national and prefectural government levels to overcome the Japanese people's antagonism to FDI and attract specific investors

Firstly, there should be a campaign of events and advertising to increase interest, receptivity and understanding about FDI among the local people and to dispel the myths about FDI, such as loss of jobs. The reality is that many studies have shown that FDI leads to:

- More jobs
- More capital inflow

- More productivity
- More local employment
- More technological know-how
- New management methods
- 10% higher profitability
- Higher spending on R&D per worker
- Higher average wages

These benefits should be made known widely to the general public.

The prefectures should also reach out and target new investors to their region, consulting with them to facilitate the process of investment. Merely offering office or factory space at reasonable rent to anyone who might be interested is not enough

- Target specific companies for special zone applications, finding ways to overcome or reduce their regulatory barriers
- Design investment programs for specific company needs. In Korea, the playing field is not even, but favours investment by companies that will bring new money into the country rather than by local firms who will just redeploy money
- Allocate an “assistant” to streamline the procedural aspects of a company’s

investment and speed up the beaurocratic response

- Offer attractive tax incentives as mentioned above
- Support English language training for Japanese employees of foreign firms
- Rapidly and willingly translate the encouragement and support provided by the prefectures' top officials (governor level) into swift action at the level of implementation in the local government.

Having said this, I should point out that there have been several success stories, although fewer than we would like:

Success stories

- Carrefour:

Having already established 4 stores in Japan, Carrefour has gone on to open 4 new stores in the last 3 months in the Kansai region. The company now has around 2,000 local employees

- Ikea

At a much slower pace than desired, Ikea managed to purchase 2 land sites to establish large stores – one in Chiba and the other in Kawasaki. The first store is scheduled to open in 2005

- Fresenius

Fresenius Medical Care, a large German firm, established a factory in Fukuoka thanks to the proactive assistance of the prefectural officials, including the governor. Once the firm decided to build the plant, the prefecture continued to provide detailed support ranging from construction of the

plant to the hiring of personnel.

- Chanel

Chanel invested a large sum of money to purchase the Daiei building in the Ginza in 2002 and is investing further in the construction of its Asian Headquarters on the site. The company will shift to the new building this May and it will open officially in December this year. The company also constructed a large distribution center last year on a site in Chiba, with the assistance and encouragement of the governor.

- Inergy Automotive Systems

Inergy Automotive Systems constructed a factory in Kitakyushu in 2003 thanks to the positive assistance of the Kitakyushu City government officials

In conclusion, it must be said that the Japanese national and prefectural governments have worked hard to promote FDI through measures such as the dissemination of information, setting up the one-stop shop at Invest Japan and establishing special (tokku) zones. However, these can only be regarded as somewhat makeshift measures that will not achieve Prime Minister Koizumi's goal of doubling FDI in 5 years. Major reforms, new business opportunities and serious incentives are needed.