

July 7, 2005, Speech By Mr. Richard Collasse, Chairman, European Business Council in Europe.

### 1. Introduction.

Honda-san, thank you very much for your presentation.

Dear Co-chairmen, colleagues, It is a great pleasure for me to stand here today to, once again, present our views on the important topic of trade and investment between EU and Japan

I have been working together with Honda-san for some years now on this topic and I must say that it has been a true pleasure. We both take the task of presenting concrete recommendations most seriously as we want to support our governments in their continuous efforts to steadily improve the trade and investment environment in our countries.

Together, we are following closely the developments in both regions and I must say that this year has been intensive indeed.

As far as the environment in Japan is concerned, we are encouraged by the general movement towards regulatory reform and welcoming foreign direct investments but are equally concerned about the problem of filtering down this political intention all the way in the bureaucracy.

### 2. Maintaining Stable Rules for Legal Presence for Foreign Companies

I find it a bit depressing that our first recommendation this year to the Japanese government has to focus on a new issue. The sudden restriction on so-called “pseudo foreign companies” on Article 821 in the new corporation law has caused a lot of concern among many companies and is one of the most unwelcome surprises foreign business has seen in Japan in many years.

The authorities maintain that introduction of the article implies no real change. A simple comparison of the wording tells you that under the current commercial code foreign companies with their main business in Japan merely have to follow rules that

apply to domestic companies, whereas article 821 of the new Corporation Law prohibits such companies to continuously do business in Japan.

That, ladies and gentlemen, is in my opinion a huge difference!

The article challenges more than fifty years of legal tradition and regulatory practices. Everybody was caught completely off guard as the article was discovered by many firms long after the legislation passed the House of Representatives of the Diet, and only days before it was expected to be submitted to a vote in the House of Councillors.

The introduction of Article 821 was clearly not sufficiently communicated. The article itself was finalized first in February this year, only a month before it was submitted to parliament.

A large number of companies are potentially affected. And it is worth noting here that many of them are affected just *because* they followed the requirements of the Japanese regulations in the first place. In contrast to the universal banking practice in Europe, when doing business in Japan, European Banks have to separate their business entities in Japan as Article 65 of the Securities and Exchange Law prohibits banks from conducting securities business and vice-versa. Given the difficulty of registering two branches of one head office, a special head office is usually set up in Europe for the purpose of heading the Japan branch of the security operations. This set-up has been chosen with the full knowledge and consent of the Ministry of Finance (MOF) and also by the financial services agency (FSA).

As you can imagine, re-incorporation is highly costly – consumption taxes on all assets transferred would have to be paid, employment and customer contracts renegotiated, and valuation losses would crystallize and require funding etc. For a typical mid-sized European securities firm, this cost could amount to as much as 155 million euros.

The EBC has been heavily involved in rectifying the issue this far and I would like to take the opportunity to thank all parties in the Japanese government who have patiently listened to and eventually also shared our concerns. We understand that the political situation did not allow the straight revision of the bill that we proposed, but we are pleased that a resolution was added to the bill, acknowledging that the problem must be fixed.

With the law having passed the Diet, it is crucial that the government delivers on its guarantees that the introduction of the article implies no change in regulatory practices. We welcome the understanding of our serious concerns about this issue on the part of the Japanese governments as expressed in the bill rider.

Given the strict language and apparent risk of a different interpretation by a third party in court, we would like to work together with the GOJ towards a revision of the text itself before the law is implemented.

I should not spend more time on this subject here now but, before moving on, I would just like to conclude that a prerequisite for investment is legal transparency and stability. With this in mind, it really goes without saying that suddenly changing fundamental rules governing legal presence with no notice is not a good way to promote investment!

#### Promoting Economic Reforms Through Decisive Reforms

Let's now return to the more general topic of trade and investment environment in Japan,

Although the economic recovery has decelerated slightly this year, we can see that corporate sentiment remains strong. Many factors contribute to the positive development - corporate restructuring, a slow but steady increase in consumer confidence, new capital investments and a stabilisation of the financial system and an expanding monetary policy. Especially encouraging is the progress in dealing with the non-performing loan problem by banks and authorities.

We all feel, however, that the recovery is still fragile. In order to avoid a return to the depressed situation of some years ago, it is absolutely imperative that the Japanese Government resolutely implements the structural reform efforts initiated by the Koizumi Cabinet in areas such as privatisation, financial system reform, public finance, and decentralization.

Certain progress can be seen in a range of policy areas, but still much effort is needed to rapidly translate this into action at all levels of government.

### Modernizing the Legal and Tax System to Support foreign investments

One of the areas where we would like to see more reform is, as always I am tempted to say, in the area of cross-border M&A.

At the moment, foreign firms face clear discrimination when they pursue M&A opportunities with Japanese firms.

Wholly domestic reorganizations are tax deferrable in qualifying circumstances, but not reorganizations involving the stock and assets of overseas parent firms.

Last year we reported that triangular mergers were slated for introduction in the new Corporation Law. A high public profile attempt for a hostile take-over of a broadcaster in Japan by a Japanese company caused the government to irrationally postpone the introduction for one year of the triangular merger scheme that will be used by foreign companies. The move is difficult to understand as triangular mergers cannot be used for hostile takeovers as consent by the board is prerequisite to the transaction.

We would like to encourage the government of Japan to introduce the scheme according to the plan and to recover damage caused to Japan's reputation by moving swiftly on the important issue of tax deferrals.

We can only repeat what we said last year – if Japan is serious about improving the environment for investment, cross-border reorganizations using foreign stocks as payment should be tax deferrable also in Japan!

### Take-over defenses should be introduced with caution

Let me move to another issue related to the introduction of the new corporation.

The new law in question introduces an array of defensive measures against hostile take-overs. The problem is that the introduction of those measures is not paralleled with strengthened requirements on corporate governance. We fear that they can do

much harm to the general investment environment if improperly used.

A Corporate Value study group of the Ministry of Economy Trade and Industry has produced sensible guidelines to balance misuse of the new measures, but we would like to see their guidelines become compulsory and fully integrated with other laws.

The new defensive measures in the upcoming law, at first, did not receive much attention. But the same hostile take-over attempt that forced politicians to delay the introduction of triangular mergers for one year, created also a sudden interest, if not panic, in many Japanese board rooms. I am encouraged to see that most shareholders have opposed the introduction of anti-takeover measures proposed at the many general shareholders meetings held at the end of June.

Protecting boards, whatever the cost, does not promote new investments.

Let's continue to an area where we have seen some progress!

#### Championing business activities at the local level

Local governments have become much more active in recent years in attracting foreign investment into their particular region. Many European firms have reported success in securing subsidies and special treatment for new business.

More can be done, however, to champion business activity at the local level.

For example, we encourage local authorities to make more use of the new "special deregulation zones" and other incentives to attract more investment into their regions.

We feel that more efforts could be made to make use of foreign expertise in the provision of public services through Private Finance Initiatives (PFI). European firms have much expertise in this field and a lot to offer to Japan.

#### Ensuring transparency and consistency in the regulatory process

A lack of transparency and consistency in the application of regulations continues to be one of the factors most frequently cited by European businesses as inhibiting the

development of a truly open environment for trade and investment in Japan. This is especially true in areas with complex regulatory environments such as financial services and taxation.

It is still common for rule interpretation and enforcement to vary substantially depending on the officer in charge and the current political situation. It is difficult in many cases to challenge decisions of the regulator for fear of negative treatment from the authorities in the future.

Although we appreciate the actions taken, such as the revision of the no-action letter system under way, we firmly believe that the Japanese regulators should make more efforts in this regard.

Another problem we are facing now is that, in the good spirit of promoting “deregulation”, many new laws are created and old ones revised at a pace that does not allow the ministries to devote enough resources to develop clarifying guidelines and cabinet orders. Being too generally stated, the law itself seldom gives practical guidance for businesses.

The revision of the Pharmaceutical Affairs Law implemented in April 2005, for instance, still needs to be complemented with clarifying guidelines on approval procedures for in vitro medical diagnostics products.

When new laws are formulated or old laws revised, we therefore suggest, guidelines and cabinet orders should be swiftly formulated or business will be plagued by costly uncertainty.

A lack of transparency creates uncertainty, and this makes business planning difficult.

#### Strengthening the market mechanisms in the procurement of aircraft

Another area that is extremely important for the future of the trade and investment flows between Japan and EU, which in previous years maybe not have been given enough attention, is the strategic field of the aeronautical industries.

Despite numerous efforts over many years to engage in greater industrial cooperation

with Japanese manufacturing companies, European aircraft and aerospace manufacturers have had only limited success with their business in Japan. One of the main obstacles to this cooperation is the fact that Japanese companies have had close ties with a few aircraft and aerospace manufacturers which, it is reported, strongly discourage their Japanese partners from working with European companies. We welcome the Frame Agreement on “Japanese-French Cooperation on Supersonic Technologies,” signed on June 14, 2005 at the Paris Air Show between the Groupement des Industries Francaises Aeronautiques et Spatiales (GIFAS) and the Society of Japanese Aerospace Companies (SJAC). It is a positive step to foster and enrich the relationships between the aerospace industries of Japan and France. However, we note that there is still a far way to go as the Japanese financial support being allocated for this project remains significantly below that for cooperation between the Japanese and other foreign aerospace industries

Given the huge potential for industrial cooperation in the future and, with that, trade flows, Japanese manufacturing companies should be encouraged to diversify cooperation in commercial aircraft development and production by working also with their European counterparts, rather than being so exclusively tied to one company.

Despite the demonstrated competitiveness of European commercial aircraft around the world (last year, they led the American competition by 57% to 43% in worldwide sales), Japan’s major airline companies continue to buy almost exclusively American aircraft.

The Japanese government could encourage true competition in the Japanese commercial aircraft market by taking the positive step of it self buying large European aircraft to complement its own current all-American fleet.

That, I believe, would set a good example and spur the cooperation in this, for both regions, extremely important industry.

#### Reform in specific sectors

I have thus far highlighted areas that we have not been emphasizing so strongly in previous years, but which we believe are extremely important for the development of trade and investment between our countries.

This does not mean that all our old concerns have disappeared. I would be happy to update you on the status in each sector but that would be impossible given our time constraints here today. If you are interested, I suggest you consult the EBC's annual white paper entitled "The EBC Report on the Japanese Business Environment", the latest version dated November 2004, which has been distributed to you today.

We have decided to limit our sector-specific proposals here and would finally just like to have your brief attention for the following areas that we feel could influence the direction of government policy: the privatization of Japan Post, the modernization of Japan's food additives list, the protection of test data for pharmaceutical development, and telecommunications reform.

#### Privatization of Japan Post

The privatization of Japan is an extremely timely subject as it is under intense discussion in the Japanese diet these days. The government has had difficulty in getting the bill accepted also within among its own. The Bill submitted to the parliament passed the lower house two days ago only with a five votes margin and first after a revision to satisfy the skeptics. As the outcome will have enormous repercussions on all aspects of the Japanese Economy, it is in a sense understandable that the outcome is politically sensitive. Japan Post's Kampo insurance business is the largest insurer in the world. And Japan Post's Yucho is the largest bank. The thought of those entities being run as privatized entities free of restrictions on their lines of business, and, in worst case scenario, *partially* subsidized by the government, is frightening indeed. We support the privatization of Japan Post, but are concerned *about the bill that just passed the lower house of the parliament* as it provides for letting the four entities cross-hold shares after full privatization in 2017 and of setting up a mutual fund as a safeguard for those businesses. The possibilities for foreign financial services to conduct business in Japan will be heavily influenced by how Japan Post is privatized and hence also heavily influence the investment flow to Japan.

#### Food Additives

With regards to Japan's food additives list, we note that the Japanese Government has approved three items from its own priority list of 46 items first proposed in December 2002. We appreciate that the Ministry of Health Labour and Welfare has made public

the timetable for its proceedings as the first stage of the approval process, but are discouraged by the failure of the Food Safety Commission, the final approval body, to do the same.

The lack of conformity between Japan's food additive list and international standards remains a major barrier to the import of food into Japan. The 46 priority items have all been approved by the WHO and are in wide use in both the US and the EU and we are wondering: what's the delay?

#### Protection of Pharmaceutical Test Data

The protection of test data for pharmaceutical development is another extremely important area. The cost of developing innovative new drugs and obtaining regulatory approval is substantial. Pharmaceutical companies spend on average 10 years and several billion yen to bring a new drug to market. Data submitted along with new drug applications is therefore valuable intellectual property and should be protected. Without protection of intellectual property rights in the field of pharmaceuticals, Japanese consumers will not be able to have access to new, often life-saving, drugs. Last year, we asked the Japanese government to expand protection of test data to at least 8 years, just like the EU, and we can only reiterate this request this year.

#### Telecommunications

Telecommunications is always a controversial topic, and we have, just like last year, included a number of recommendations concerning ongoing reforms in the telecommunications sector that impact the trade and investment environment, which is the main subject of this working party. New for this year is a concern about Japan's spectrum allocation policy. The MIC has issued draft guidelines on allocations which we believe will only entrench the position of the dominant carrier and discourage foreign operators to continue their business in Japan. I would like to recommend that you read a new EBC position paper on telecommunication reform, which is available here today for those of you who are interested.

As I said, this is just a brief overview of the issues in our report, I invite you to look through it yourself and would be happy to discuss these issues further with you in more detail if you so wish.

Thank you very much for your attention.