Interview with Haruo Shimada, president, Chiba University of Commerce

Sustained Efforts Vital to Spur FDI in Japan

Fresh Stimulus Aids Economic Recovery

Interviewer: Hiroshi OKABE

Haruo Shimada, president. Chiba University of Commerce

President Haruo Shimada of Chiba University of Commerce has played a leading role over the years in helping the government draw up policies in regard to foreign direct investment (FDI) in Japan. As such, he is a foremost expert on this subject. He has emphasized that the promotion of FDI should be pursued as a national strategy that holds the key to the revival of the Japanese economy and that the government should never slacken its effort to that end. "In order to attract foreign investment, it is indispensable not only to set up an appropriate legal system, but also to prepare an environment attractive to foreign investors in various aspects, including education and medical care. Therefore, numerous problems remain to be tackled," Shimada told *Japan SPOTLIGHT* in a recent interview.

National Strategy Important

Q: What significance does national strategy for FDI have from the viewpoint of the Japanese economy? From a medium- and long-term perspective, foreign investment is expected to contribute a great deal to the development of the Japanese economy in various ways, such as the enhancement of productivity. Could you tell us how you see a potentially favorable impact?

A: The expansion of foreign investment in Japan has immense strategic significance for our maturing economy. Japan's experience of economic success tends to blunt any desire for an institutional change. As a result, the economic and social structures themselves are liable to be rigid. This means that although both external and internal conditions are undergoing drastic changes, Japanese institutions alone remain unchanged, bringing about a decline in productivity and vitality. Moreover, the Japanese population is aging, while the birthrate keeps on falling. Such a situation is feared to continuously weaken the Japanese economy. Under these circumstances, foreign investment, which injects "fresh" stimulus into Japan, can be expected to play the role of reinvigorating the use of capital, production equipment and human resources that remain to be brought into full play. I call these "fresh capital, fresh technology and fresh management." Such fresh stimuli can revive the Japanese economy.

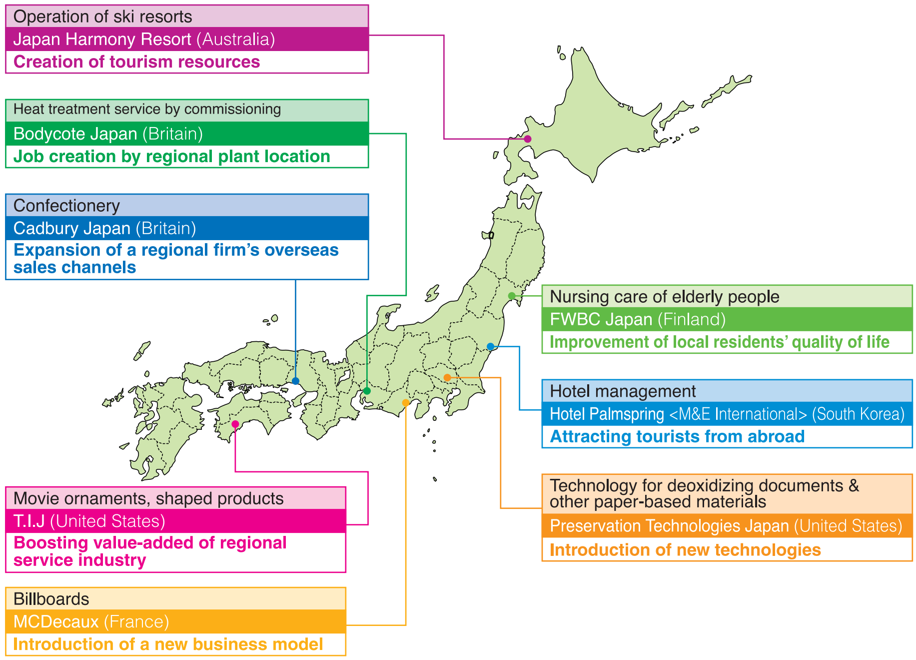
Q: Stimulus from outside the country will bring about structural resuscitation, right?

A: Nissan Motor Co. may be cited as a microeconomic example of success. This company, once afflicted with rigidity, came to life again with the participation of a new manager – Carlos Ghosn – from outside, coupled with the injection of new capital. A typical macroeconomic example is Britain. The British economy accomplished the Industrial Revolution in the 19th century and wielded overwhelming power in the world. But heavy debts, incurred during World War I, shook the country's economic foundation. After World War II, Britain could not maintain its economic hegemony and was forced to turn over the No.1 position to the United States. After that, the British economy fell into a prolonged decline. From about 20 years ago, however, Britain adopted a policy of intensively attracting investment from abroad, bringing about the revival of the manufacturing industry, which once threatened to fade away. Until the recent outbreak of the subprime mortgage issue, Britain had enjoyed sustained economic growth for as long as 15 years. This was made possible primarily by the entry into Britain of excellent foreign firms like Nissan and Toyota Motor Corp.

Q: When it comes to the promotion of foreign investment, do you mean Britain is a good example for Japan?

A: During the (Junichiro) Koizumi government, I was assigned to conduct an on-the-spot survey in Britain as a special advisor on the strategy of promoting foreign investment in Japan. What impressed me most on that occasion was a story I heard when I visited an organization called "Invest UK." Among the general public, I was told, foreign firms that take the trouble to advance into Britain are supposed to be superior to domestic firms in some way or other, and people finding employment in such foreign firms are showered with “Congratulations!” from all around. I thought Britain was 50 years ahead of Japan. Foreign investment in Britain accounts for nearly 50% of gross domestic product (GDP) as against a mere 2.5% in Japan. The inflow of foreign capital as a fresh stimulus is of immense importance for revitalizing and resuscitating the economy. In this sense, it should be promoted as a basic national strategy.

Examples of successful foreign-affiliated businesses



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FDI Given Particular Priority by Koizumi Gov’t

Q: The Japanese government has also been exerting various efforts to promote foreign investment. What is being done at present?

A: The Japanese government inaugurated a council on foreign investment, chaired by the prime minister himself, more than 10 years ago. The Koizumi government took the position that if Japan takes steps to make foreign investors think it is easy to invest in Japan, investment can be made much easier for domestic firms as well. The government thus regarded the promotion of foreign investment as important leverage for structural reform and put up a target of increasing the ratio of the balance of foreign investment to GDP from 1.2% to 2.5% in five years. The Koizumi administration asked the succeeding (Shinzo) Abe government to raise the target figure of 2.5% to 5% by 2010. The government has since taken various measures in line with this policy, including establishment of a proper legal system for M&A (merger and acquisition), improvement of the living environment for resident representatives of foreign firms and a government-led campaign to appeal for investment from abroad.

However, when Mr. Abe handed over the reins of government to Mr. Yasuo Fukuda, it was decided to halve the number of advisory councils, which held meetings at the Prime Minister’s Official Residence. As a result, the council on foreign investment was also to be dissolved. Surprised by the decision, I strongly asked for the maintenance of government efforts to promote foreign investment. Then Minister of Economy and Finance Hiroko Ota reorganized relevant government undertakings into an advisory conference of experts. This conference decided on five policies. One was the creation of a proper environment for facilitating M&A.

As regards investment, the basic principle is no discrimination against either Japanese or foreign investment. But concerning matters related to national security, special regulations are going to be put in place. In Japan, the Foreign Exchange and Foreign Trade Control Law provides for restrictions in this regard. But this alone is considered not effective enough, given the problem of low predictability and low transparency when seen by overseas investors. Moreover, the government is undertaking a review of sector-by-sector regulations on medical apparatus and other products in order to promote foreign investment in Japan. It is also going to review the operation of the Antimonopoly Law and corporate taxation against the background of global competition for the reduction of such tax. It has also been decided to improve the environment for employment and education, and push ahead with a relevant campaign under the leadership of the prime minister himself. These policies have been written into the government’s Outline of Basic Policies for Macroeconomic Management and Structural Reform of the Japanese Economy, commonly known as a “Big-Boned Outline.”

Economic Downturn Unavoidable for Several Years

Q: We understand that various efforts are under way. Yet from an international perspective, foreign investment in Japan still remains at a low level. How do you evaluate such a situation?

A: The target of 2.5% for the proportion of FDI in Japan’s GDP, determined by the Koizumi government, was achieved in six years. Regrettably, however, the ratio has sagged after that. But this is due to a rapid downturn in the Japanese economy resulting from the financial crisis originating from the United States, and in no way means the various measures themselves so far taken to promote foreign investment in this country are wrong. The statistical decline in foreign investment is attributable to the excessive contraction of the world economy as a whole and, in a sense, cannot be helped.

The world economy was in a state of euphoria over two decades up to early 2000. The United States, the No.1 economic power, achieved annual growth of more than 3%. China and India registered 10% growth, while Russia and Brazil achieved 8% growth. Before the world economy entered the period of euphoria, Japan accounted for 14% of the world’s overall GDP. But Japan’s share sagged to 8% during the “Lost 15 Years.” While the world as a whole continued to enjoy rapid growth, Japan was the only exception and suffered from deflation after the collapse of the bubble economy. It was only after the expansion of world trade and the reactivation of international investment that the Japanese economy managed to achieve gradual growth from 2002 to 2007. When we thought that we were basking in the last fallout from the rapid growth of the world economy, this world economy itself collapsed this time. The entire world has now plunged into an age of serious stagnation. Such a situation may be termed an "accident" in a sense, but it will probably take several years to get back to normal. This lapse cannot be helped until after the "next" new balance emerges after three to five years.

Q: Apparently, the yen's appreciation has also slowed down foreign investment in Japan.

A: It is only logical and natural that investment drops as the yen's value rises. However, the yen's present surge is only because the yen value has soared at a time when neither the dollar nor the euro can be bought. It is not that the yen has appreciated due to the increased strength of the Japanese economy. The yen is chosen simply in preference to currencies that cannot be bought without anxiety.

Retribution for Greedy Capitalism

Q: The International Monetary Fund (IMF) has forecast the first negative growth since World War II for the economies of developed countries – Japan, the United States and European nations – in 2009. This is deemed certain to impact the economies of China and other emerging nations as well. How do you think such economic circumstances will affect foreign investment in Japan? Financial institutions in the United States and Europe are now reexamining investment bank business, and the activities of investment funds, which have spearheaded M&A moves, now tend to stagnate. It appears that a stable investment environment cannot be created without a change in the very functions of capitalism that have caused the present financial crisis.

A: The problem of liquidity occurred during the Great Depression of 1929. If apprehensions spread that banks may go bankrupt, banks will be subjected to a run, and the resulting crisis of liquidity could turn the economy itself into something like a world of barter trade. At the time of the Great Depression, there were as yet neither adequate rules nor systems for limiting the activities of banks, such as rules on the capital adequacy ratio, the deposit insurance scheme and compensatory standards for minimum deposits. However, the bitter experience of the Great Depression led to the enactment of laws regulating banks' activities, establishment of the deposit insurance system, stronger control on banks by the Federal Reserve Board and strict supervision of all commercial banks' capital adequacy ratios by the central bank. Because a mechanism for the prevention of a liquidity crisis was thus completed, the subsequent 50 years witnessed not a single such crisis. And this mechanism remains as perfect as ever.

However, there has occurred something nonexistent 15 years ago. That is, financial instruments with a certain level of liquidity have expanded tremendously in speed and scale. They are called derivatives. GDP of all nations on earth, if put together, adds up to some ¥8,000 trillion (¥8 quadrillion), while one estimate puts the total value of derivatives at around ¥60 quadrillion. These "invisible currencies," aggregating about 30 times the actual currencies in circulation, have continued to multiply under the cover of "greedy capitalism." The instant investors thought that these "invisible currencies," swollen by means of leverage, were likely to become unexchangeable, they rushed to get rid of them, which triggered a credit contraction all of a sudden and plunged us into what looks like a world of barter trade. This is how the latest financial crisis has developed.

The money economy has been and continues to be manageable. Yet there has been no methodology for controlling the derivatives-money economy, and it is investment banks that have bloated such a derivatives economy. There have been no rules concerning how to control "greedy capitalism," formed over the past 15 years. However, an overriding principle of capital injection into banks, financial regulation and international cooperation has been hammered out within the framework of the G-20 comprising both developed countries – Japan, the United States and European nations – and emerging countries like China and India. This is indeed an epoch-making development. The failed derivatives economy itself is a separate matter from foreign investment in Japan. Yet it is having a serious negative impact on the real economy in that such a phantom economy has suddenly vanished.

Strategy Presupposing Adverse Conditions

Q: As to how best to attract foreign investment, it is necessary to pitch the attractive points of Japan, such as the high level of technology, the growth of entrepreneurs focusing on high technology, the presence of mature consumers with acute sensibility and Japan's role as an Asian gateway. What do you think about such strong points? On the other hand, what do you think are the weak points of Japan?

A: From the standpoint of investors, a primary attraction is to be lucrative. Handsome profitability means the capacity to enlarge economic scale and raise the expected rate of return on investment. When viewed from a macroeconomic angle, economic growth means population multiplied by per capita productivity. As for Japan, this population factor is a negative element owing to the ongoing decline in population. Internationally, therefore, Japan is not attractive enough. Accordingly, productivity needs to be enhanced to such an extent as to more than compensate for the population decline. Moreover, now that the Japanese economy has become service-oriented, no such rapid economic growth as the country once experienced can be hoped for. That is, from a macroeconomic viewpoint, we must accept that Japan is far from standing at a competitive advantage among the nations of the world and rather finds itself at a disadvantage.

But even under these macroeconomically adverse conditions, there are noteworthy niches for foreign investment. At a time when the Japanese population is aging, the medical care industry obviously promises to quicken its growth, while high growth rates are also anticipated in some fields of the agriculture and high-tech industries. The problem is whether or not those spheres offer an easily accessible environment for foreign investors. For instance, there may be various barriers to their entry into the Japanese market in the existing procedures for foreign investment and a lack of adequate high-level educational facilities for children of the resident representatives of excellent foreign enterprises investing in Japan. It is essential to improve any such investment environment. Foreign investors desirous of advancing into Japan first read papers prepared by the Japanese side for firsthand information. However, if the Japanese language is used for such papers, it is difficult to accurately communicate this sort of information to foreign investors. Thus, scores of problems remain to be resolved, including the language, communication infrastructure, relevant systems, medical care, housing and education. Based on a clear awareness of Japan's disadvantage in attracting foreign investment, it is imperative to steadfastly take measures for eliminating those problems.

"Secluded" Japan Needs to Open Itself

Q: Some foreign companies invested in Japan after laborious efforts on the Japanese side to attract them, but they later retreated. What policy is needed to have them remain in our country?

A: What is required is the preparation of an environment that makes it easier for foreign firms to do brisk business in Japan rather than an effort to prevent their withdrawal. Because withdrawal from Japan represents a decision by the respective companies involved, there is no need whatever to stop them from doing so. Nor is it warranted to provide subsidies to halt their retreat. Subsidies may be likened to poison and contribute to generating unfair competition. Such a step must be absolutely avoided. But it is a good idea to modify the tax system and improve the investment environment in general.

Q: Some foreign firms which have advanced into Japan don't seem to be doing well. Among them is Carrefour, the major retailer of France.

A: Some of them are having a tough time, but many others like IKEA have turned out to be successful. On the whole, however, the environment here for foreign firms doing business in Japan is open to question in many respects. Doctors with no Japanese medical license cannot engage in medical care in this country. Even so, there are too few Japanese doctors who can speak foreign languages. In Paris and New York, for instance, Japanese-speaking doctors are available. Japanese businessmen going abroad as resident representatives of their companies can find schools for Japanese children. But Japan has no adequate educational facilities for foreign children. In regard to medical care and education, Japan is still like a "secluded nation." The present government doesn't appear very eager to make sustained efforts to carry out the basic national policy of promoting foreign investment.

National Security Needs to Be Handled Separately

Q: Concerning foreign investment, some people argue that Japan should demonstrate its open stance to other countries, but others call for a comprehensive study on a desirable system for regulating foreign investment from the viewpoint of ensuring national security and maintaining public order.

A: The overriding principle is no discrimination against either domestic or foreign capital. However, national security is a separate matter. There are spheres which cannot be properly handled through economic principles alone. As for national security, all countries take the stance that intervention by other nations can never be tolerated. This is the second principle. Even so, predictability is required. That is, it must be clear beforehand what legal rules will apply in actual cases. It is also necessary to ensure the transparency of interpretation. Japan has only a single legal system for regulating foreign investment – the Foreign Exchange and Foreign Trade Control Law. Under this law, foreign investment is subject to limitation in case its equity share exceeds 10%. When a foreign investment fund sought to acquire a huge amount of J-POWER's shares, the Japanese government raised objection on the ground that it ran counter to the foreign exchange law. The government's action is taken by investors to indicate a lack of predictability. In my opinion, Japan needs to keep its rules transparent to the entire world. Rather than having only such a half measure as the law, how about enacting a separate law – say a law for special regulations on foreign investment in Japan – to provide an easy-to-understand basis for legal judgment in terms of national security?

Q: From the standpoint that foreign investors should give top priority to shareholders' interests, some people assert that the corporate governance of Japanese firms should be reexamined. On the other hand, there is also the opinion that stakeholders' position should also be given importance from the viewpoint of for whom companies exist. What do you think about these different views?

A: That is the question of why companies exist. Companies are a social existence and must be able to explain to the market and society what they are doing. The European and American way of thinking about corporate governance takes the stand that corporate managers need to maximize investor interests, and there are even instances of outside directors accounting for more than half the board membership. But that is not necessarily the case with Japanese companies. There is no clear-cut answer to the question of what type of corporate governance is desirable. JS

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