Koizumi's Pledge to Double Inward Investment in Five Years

By Shimada Haruo

Japan has long been closed to investment from abroad. But its government and private sector alike are now moving to induce foreign capital in an effort to revitalize the nation's economy. Prime Minister Koizumi Jun-ichiro has pledged to double the cumulative amount of foreign investment in Japan in five years. The Japan Investment Council, chaired by the prime minister and comprising leading academics and business executives, has drawn up a program for increasing inward investment, including structural reform for facilitating inward investment. Shimada Haruo, a professor at Keio University and chairman of the Expert Committee of the Council, expressed his view on Japan's strategy of promoting foreign investment in an interview with Ito Shuichi, the Economics Editor of Kyodo News.

In his general policy speech delivered to the Diet on Jan. 31, Prime Minister Koizumi Jun-ichiro said that Japan would double the cumulative amount of foreign direct investment (FDI) in five years. His remark was interpreted abroad as quite epoch-making. Never before had a Japanese prime minister called for the promotion of FDI in Japan in such clear, comprehensible terms. As a follow-up to the prime minister's policy speech, the government's Japan Investment Council (JIC), chaired by the prime minister, issued a statement on March 27 to the effect that Japan definitely welcomes inward FDI and would promote it. The JIC's Expert Committee then announced to the world a program for promoting inward FDI in Japan covering five areas and 74 policies.

The five areas are: 1) review of administrative processes aimed at making the process simpler and clearer through the establishment of a single contact point in each ministry; 2) improvement of the business environment, that is, facilitation of cross-border mergers and acquisitions (M&As); 3) improvement of the employment and living environments; 4) improvement of local and national frameworks to assist local governments' autonomous efforts to attract FDI; and 5) dissemination of information within Japan and abroad. These represent Japan's global commitment to promoting FDI in Japan in specific terms.

Japan Still Closed to Investment

Japan's lagging far behind other countries in the inducement of FDI is a shameful reality. Let's compare the ratios of outward and inward investments of major countries. Inward FDI in the United States and the United Kingdom equals the two countries' respective outward investments. Inward FDI in France and Germany accounts for a half or two-thirds of their outward investments.

In stark contrast, inward FDI in Japan had long been only one-fifteenth of its outward investment until a few years ago. This situation has remained unchanged for decades. It can be said that Japan is virtually closed to investment from abroad. Since the high growth period, Japan has vastly expanded its exports. Japan has to import a large amount of raw materials to export commodities. Japan's imports are worth 80% to 90% of exports, and they are more or less balanced. As far as investment is concerned, however, Japan has remained a closed country for decades, with inward FDI totaling only a few percent of outward investment.

Japan's outward investment expanded enormously in the 1980s. Japan's torrential exports to the United States and other developed countries in the 1970s intensified trade friction. Washington blamed Japan for depriving American workers of employment opportunities with its exports, and urged Japan to increase investment in the United States and create employment opportunities if it wanted to boost exports. This prompted Japanese investment abroad.

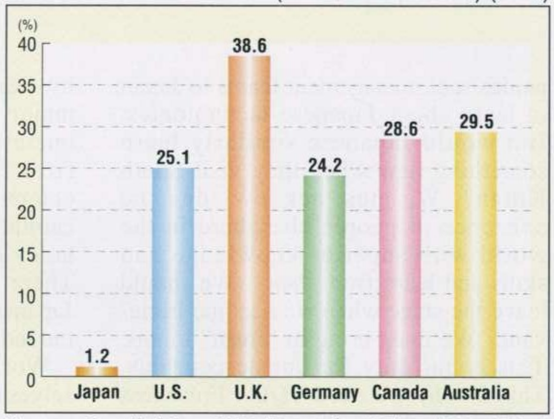
While Japan has boosted investment in Europe and Asia as well as the United States, FDI in Japan has been very limited due to the absence of infrastructure for accepting FDI. Since its high growth period, Japan's outward investment has far outpaced inward FDI.

The JIC was inaugurated in July 1994 to address the investment imbalance problem that had been smoldering for nearly 10 years with the United States, Japan's largest trade and investment partner. At that time, the government was a coalition between the Liberal Democratic Party (LDP) and the Social Democratic Party (SDP), with SDP leader Murayama Tomiichi serving as prime minister. The JIC, chaired by the prime minister and including all relevant Cabinet ministers as its members, would issue a progress report on inward FDI to the world annually to show how Japan was striving to open its doors and accelerate inward FDI.

The first progress report failed even to list the main themes of inward FDI, but the next one managed to clarify such themes, although with some delays. The JIC, like other advisory organs, finds itself hard-pressed to articulate what it wants to do because of bureaucratic barriers. The Ministry of Finance and the Ministry of Justice, for example, have their own turfs and decision-making processes regarding inward FDI and thus were slow to comply with the JIC's programs.

For the first several years, the JIC faced strong bureaucratic resistance. It

Figure 1 Inward Direct Investment in Major Countries
(stock / nominal GDP) (2001)



Source: Compiled from IMF, "International Financial Statistics," May 2003

was just like throwing a wine glass against a stone wall. But the wall began to move after three or four years. Almost all the proposals made by the JIC soon after its inauguration got moving after four to five years had passed. Supplementary legislation on M&As as well as revision of the Commercial Code also gained momentum after years of vicissitudes.

The JIC Gets Moving

The Bush Administration of the United States is looking to Japan to seriously grapple with structural reform and has refrained from telling Japan to do this and that. As the Japanese economy remains in a bad shape, however, opinions among officials over inward FDI have become critical. The opinions calling for opening the country up and accepting more capital, human resources and technologies from foreign countries are now prevailing. It is widely recognized that such a move would revitalize the country and would itself serve as the country's structural reform. Koizumi is well aware of this.

In 2002, people concerned with policy matters spontaneously began discussions on reinforcing the function of the JIC and Koizumi showed a strong interest in the matter. The upshot was the renewal of the JIC Expert Committee, which is chaired by myself. A group of business leaders who identified with our efforts launched a high-powered business forum and formulated a proposal for the promotion of inward FDI. The forum is chaired by Makihara Minoru, chairman of Mitsubishi Corp., and its members include such influential business executives as Miyauchi Yoshihiko, chairman and CEO of Orix Corp. and Carlos Ghosn, president of Nissan Motor Co.

I was quite impressed by the enthusiasm shown by foreign members of the forum in the process of the discussions. They urged us to make a firm commitment to promoting inward FDI and expressed their wish to perform their responsibilities as members of the forum. They were serious about establishing priorities on Japanese inward FDI and compiling their own proposals on the promotion of inward FDI in this country. They held informal meetings among themselves and submitted a series of proposals. Never before had I seen such enthusiasm in the process of discussions at the JIC.

Do Not Be Afraid of Foreign Investment and Be Keen to Accept It: Koizumi

Koizumi is critical of the opinion held by some sectors in the country, including some members of the media, that foreign investors are abominable, alien people, who are like greedy vultures trying to take over Japan. He has repeatedly stated that Japan should not be afraid of foreign investment but should rather positively accept it and use it to revitalize the country.

Foreign capital is meaningful because it is fresh. Anything fresh is good, in particular, fresh capital, fresh human talent, fresh technology and a fresh management style.

Fresh capital is good because it has more value than Japanese "old" capital and Japanese people would be willing to buy it. There is plenty of capital in Japan but it cannot be used for investment. Financial institutions have a vast amount of capital but they cannot invest it because they are burdened with nonperforming loans. They cannot buy stocks even when stock prices plunge. Companies, saddled with huge borrowings, can no longer afford to buy golf courses even though their prices have fallen to only 2% of their original values. Anyway, old capital cannot move. So, regrettably, we have to rely on fresh capital from foreign countries.

We also need fresh human resources and fresh human talent from foreign countries, because they can do what Japanese cannot do. Let's take Nissan as an example. Former Nissan President Hanawa Yoshikazu, now the automaker's chairman, fully knew what he had to do about the ailing company, but he could not take initiatives for reform because he was shackled by old bonds. He had made various commitments before he became president and he was involved in various matters in the process of becoming president. Only Ghosn, sent from Renault, could do the job because he was free from Nissan's old bonds. This is why foreign human resources are good for reform. Japanese are too set in their ways to change.

Similarly only foreigners can inject a fresh management style into Japan's corporate culture. Japan has very low capital efficiency due to various problems inherited from the past. During the high growth period, all companies sought to buy everything that was available and installed the same equipment. The petroleum industry was a good example. But even though demand has declined and the operation rate has sagged, they cannot introduce a new management style focusing on cash flow unless their top executives are replaced. But no top executive is willing to be replaced. They do their best to prevent annual shareholders meetings from taking up such issues.

Japan boasts advanced production technology, but its software solutions are less sophisticated. Many countries are more advanced than Japan in such areas as accounting know-how. We must accept such new methods with an open heart.

When Japanese automobile production technology made great strides in the 1980s, America admirably opened its doors and positively introduced the Japanese technology. American companies sent management teams to Japan to learn about Japanese technologies. But would Japanese similarly learn something new when they visit South Korea? We must acknowledge the existence of people elsewhere in the world with superior knowledge and skills and learn from them. We should leave the stage when we become irrelevant. We must bring in "fresh" things. This is our duty for our descendants. This is why we need FDI. Freshness can greatly change things.

Investment in Japan Increasing to European Levels

From the 18th through the 19th centuries, British outward investment overwhelmingly surpassed inward investment. Britain hardly induced capital from abroad and its capital continued to go outward, annexing India and Australia, among other countries, as commonwealth members. This was an era when Britain put the world under its colonial rule.

But the British Empire began to decline after the Boer War at the end of the 19th century. This was when Britain's steady acceptance of FDI began. Presumably, Britain carried out a thorough structural reform at this time. Britons today are resigned to the fact that they have to learn from foreigners. This is a lesson for Japan. We too must learn from history.

Vibrant, growing countries are not eager to induce FDI, only doing so after they have achieved economic growth and economic maturity to a certain extent. Japan's indifference to inward FDI during the high growth period made sense from the viewpoint of economic history.

This is evidenced by the fact that the ratio between outward and inward investment has risen to 4 to 1 from 15 to 1 since the collapse of the bubble economy. The current ratio is almost equal to that of European countries. There was a vast influx of FDI in the financial sector, but it was not limited to that sector. Mazda Motor Corp. has come under the control of Ford Motor Co., while Nissan has been taken over by Renault. Wal-Mart has become a major shareholder of the supermarket operator Seiyu. The U.S. investment firm Fidelity Investments has also entered the Japanese market. Foreign capital has already established strongholds in the Japanese financial world. There is now little difference between Japanese and European attitudes toward the inducement of foreign capital.

Workers at Mazda now find themselves at home with their foreign executives. Nissan's employees go so far as to take pride in working under a foreign president. Gone are the days when Japanese were said to be xenophobic and have vicious feelings toward foreigners. Japan is now in the process of maturing as seen from the long-range viewpoint of economic history. If Japan's economic muscle weakens, there is no alternative for the country but to accept foreign things for its revitalization. Japan is entering such a historical stage. All Japan has to do is to ease the transition toward accepting foreign things.

Five Key Policies

The problem is that Japan has no mechanism for inducing and coexisting with foreign capital as a result of closing itself off from FDI for decades. The government is not structured in such a way as to introduce and incorporate FDI. If we try to introduce it, we face a myriad of barriers. The JIC's latest proposal is designed to change such a mechanism. We have worked on it for eight years and have made considerable progress. We identified 74 points necessary for promoting FDI, and classified them into five areas.

The first involves a review of administrative processes. Below are examples of barriers against FDI in Japan. When a foreign investor visits a government ministry to inquire about the legal procedures involved in investment in Japan, he is sent from one section to another under the current administrative mechanism. When a foreign investor submits an application for buying land and investing there, the application is shelved for years. If a foreign investor wants to buy a golf course and improve its condition, he has to make the rounds of 17 offices of the central government and local governments. Such procedures are unbearable even for the Japanese. Therefore, we considered offering "one-stop total services" for foreign investors allowing them to visit just one office to take care of all related procedures. As a result, we decided to establish an "Invest Japan" mechanism similar to the "Invest UK" and "Invest France" programs. Other developed countries have been striving to induce FDI and have already established mechanisms for promoting it, while Japan has been slow to act.

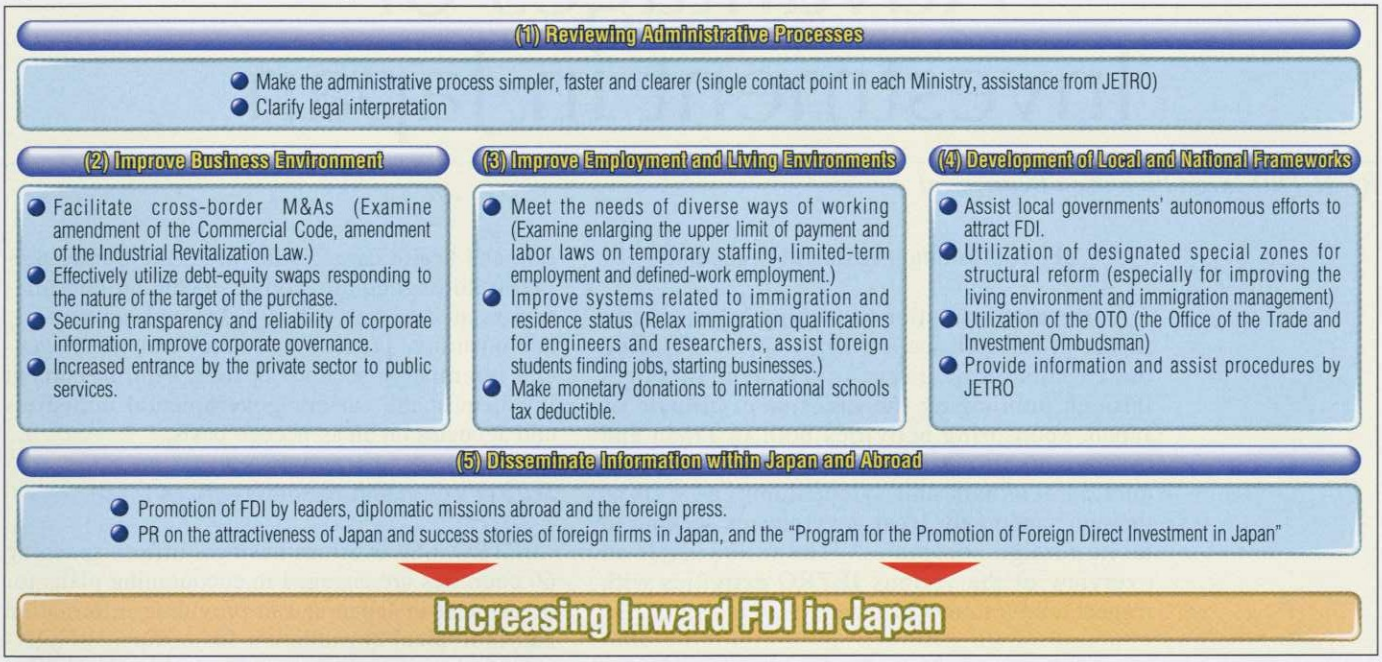
The second policy is improving the business environment, with the facilitation of cross-border M&As at its core. Cross-border M&As are not recognized in the Commercial Code and other laws in Japan. But the next regular session of the Diet will approve cross-border M&As (officially called "share swaps") as a special case of the Industrial Revitalization Law. Under cross-border M&As, shareholders of a Japanese company (B) can buy shares of an American company (A) which is trying to acquire B through A's Japanese subsidiary in a swap of shares.

However, there is a problem with this type of merger. When shareholders of B receive shares of A, they have to pay income tax under the existing Japanese tax laws, even though they do not earn profits. Due to such legislative restraints, nobody would dare to undertake cross-border share swaps, so we have to make fundamental changes to the relevant tax laws. Share swaps are practiced in other major countries of the world. It is a serious matter that Japan is behind other major countries in this respect.

In my own view, the situation will change in a couple of years, as Japanese Finance Minister Shiokawa Masajuro and U.S. Treasury Secretary John Snow agreed in June to drastically revise the Japan-U.S. taxation treaty for the first time in 30 years. The change will come about as part of a revision of the bilateral treaty.

The second policy also includes

Figure 2 The Program for Promoting FDI : Five Areas, 74 Policies



effective utilization of debt-equity swaps. This issue will make progress since the Industrial Revitalization Committee is eager to take advantage of debt-equity swaps to revitalize Japan's non-performing assets.

Other points included in the second policy are securing the transparency and reliability of corporate information, improving corporate governance and increased entrance by the private sector into public services, including such sectors as water supply and care homes.

The third policy is improving employment and living environments, which concern two points. The first involves the fact that when FDI in Japan makes progress, foreigners, who will handle capital and technology, will come to Japan. They need good living environments.

Unlike Japanese, foreigners will never leave their family members in their own countries when posted abroad. They will bring their children when they come to Japan. Under the current system, if their children study in Japanese universities, they will not be able to find jobs in Japan after graduation because foreign students lose their accredited status after graduation. Japanese companies do not employ students who have no accredited status, which makes it difficult for foreign students to find work at top-rate companies in Japan.

This situation is set to improve as Konoike Yoshitada, minister of state for special zones for structural reform, worked hard to obtain endorsement from the Ministry of Education, Culture, Sports, Science and Technology on extending by six months the accredited status for foreign students who are expected to graduate from Japanese universities. Foreign students now find it easier than before to find jobs in Japan. The employment environment must be improved so that more talented foreigners can play more active roles in Japan.

Another issue is how to make it easier for foreign companies to employ capable Japanese. When foreign companies set up businesses in Japan, they need Japanese staff with management capabilities. At present, few Japanese are willing to jump ship to foreign companies because they will forfeit their pension rights in their Japanese companies. Japanese workers therefore stay with Japanese firms until the mandatory retirement age even if they are not satisfied with their work.

It is not an easy task to change the current system so that Japanese workers can transfer to foreign companies mid-career without losing their pension rights. We have already started discussions on the need to revamp the current concept of the employee pension scheme and the 401(k)-type pension program. It will take time before we put this issue in our action schedule, but we will do it.

The fourth policy is development of a local and national framework, which means assisting local governments' autonomous efforts to attract FDI.

The fifth policy is dissemination of information within Japan and abroad. This clause is aimed at making it clear that the Japanese government welcomes FDI and that it is easy for foreigners to invest in Japan. Above all, Koizumi has to take the lead in publicizing the Japanese stance. In fact, he is making the appeal to the world.

As I mentioned earlier, Koizumi has declared Japan's determination to double the cumulative amount of FDI in Japan in five years. The amount, which stood at ¥3 trillion in 1998 and ¥6.6 trillion in 2001, is believed to have already expanded to about ¥7 trillion now. Koizumi's pledge can be easily fulfilled. JJTI

Shimada Haruo is a professor at Keio University and chairman of the Expert Committee of the Japan Investment Council. He specializes in labor economics and economic policy research.