

fdi update

So far, top marks, but substantial change will require determined, sustained effort.

In response to Prime Minister Junichiro Koizumi's target of doubling Japan's stock of foreign direct investment (FDI) over a five-year period, the ACCJ established a 40-strong FDI Task Force to give the initiative greater significance and effect. The task force commissioned Prof. Kyoji Fukao of Hitotsubashi University and Assistant Prof. Tomofumi Amano of Toyo University to produce an objective, thorough report that would raise the level of the FDI debate, demonstrate FDI's economic impact and contribute substantially to ideas for policy formation. Fukao and Amano followed up their October 2003 report, "Foreign Direct Investment and the Japanese Economy," known as the Fukao Report, with a co-authored book titled *Inward FDI and Japan's Economy* (Nihon Keizai Shimbunsha, 2004). Fukao talked to the ACCJ Journal about the FDI Task Force, responses to the Fukao Report and current FDI issues.

ACCJ Journal: What impact has the Fukao Report had so far?

Fukao: The Financial Times and other international journals have made references to the report. Newsweek Asia was very interested.

And, since we said that it would be difficult to reach the goal set by Prime Minister Koizumi, some Cabinet Office bureaucrats became angry. Prof. Shimada ("Japan at War with Itself over Foreign Investment," *Australian Financial Review*, November 21, 2003) was quite critical of our argument.

There were also positive responses. Government people – especially at the Ministry of Economy, Trade and Industry (METI) and the Japan External Trade Organization (JETRO) – were interested in our report. The Japan Investment Council (JIC), of which Koizumi is chair, has placed the study of how

to promote inward FDI on its list of topics for study. As a part of this study, the Cabinet Office started a study group, headed by myself, so I have conducted research for the government. Our report will probably be submitted to the JIC this autumn, and Prime Minister Koizumi will be briefed on it.

Regional governments are also interested. I was invited to Nippon Keidanren (Japan Business Federation), Keizai Doyukai (Japan Association of Corporate Executives), the Nikkei Center and the Tokyo Metropolitan Government. Both the government and private sector are interested in the report. There was no serious criticism, except for the initial response of Professor Shimada.

ACCJ Journal: What was his concern?

Fukao: Professor Shimada objected that the prime minister's goal could be attained and that to say otherwise would only make it more difficult to reach. He felt that the report was pouring cold water on sincere efforts.

The Financial Times story was quite negative, reporting that the government is not doing enough, and Professor Shimada reacted to that.

International institutions are also interested in the report. I was contacted by the IMF (International

Monetary Fund), the OECD (Organisation for Economic Co-operation and Development) and the UN. The OECD country report, in particular, made reference to our report.

ACCJ Journal: Have all the right people been able to read the report, form an opinion and respond to it?

Fukao: We did not succeed in making it a very hot general topic. But I think many experts and bureaucrats concerned with this issue have read the report.

ACCJ Journal: Are any of the recommendations being acted upon?

Fukao: Not really, yet. But at least our argument about the importance of government policy on stock swaps for M&A has had some impact. Recently, the Nihon Keizai Shimbun reported that the MOF (Ministry of Finance) has a plan to introduce tax deferral for cross-border stock swaps. This will be one of the most important examples of progress, if it is really introduced.

ACCJ Journal: Part of the purpose of the report was to counter a negative media image of FDI. How was media response to your analysis?

Unhealthy Health System

The Ministry of Health, Labour and Welfare is being "dragged kicking and screaming" toward the notion of deregulation. Especially galling to the medical-devices industry, according to Derrick Buddles, director of public affairs at Stryker Japan K.K., is that lives are on the line.

"The advisory commission to Prime Minister Koizumi on deregulation has come out and said that Japan should go down that road, but at every turn groups with inter-

ests in maintaining the status quo just block it full stop," says Buddles, who provided the specific policy recommendations for the ACCJ report concerning medical devices. Given the sensitive nature of the healthcare issue, he is not optimistic that the government can overcome the combined influence of bureaucrats and doctors' lobby groups.

One area that concerns Stryker Corp., which is based in Kalamazoo, Michigan but has

around 600 personnel in Japan, is the pricing mechanism for orthopedic devices. The price of an item (everything from artificial hip joints to titanium rods for fractures) is cut every two years, according to discounting in the domestic market and arbitrary overseas pricing comparisons. After repeated cuts, the U.S. list price for some products is now above the Japanese reimbursement price. This issue "is not funny for the company any more," says Buddles. However, red tape keeping the

latest medical technology out of Japan's hospitals may be of even greater concern for patients.

"We have products that have been on the market for years outside Japan, but for which we would still have to do a four-year clinical trial, which might cost us \$1 million, before we can release it here," says Buddles. That repeat investment eats into profitability.

For products such as pacemakers (an area in which Stryker is not active), where the technology makes leaps and bounds in

mere months, the problem can be much worse. They cannot be used here without extensive testing, even if widely used elsewhere.

"By the time it exits a clinical trial, after four years, the product is often two years out of date. I have heard that some pacemaker companies have to keep special pacemaker lines open just for Japan, as there isn't a sensible way to bring the newer products to market," says Buddles.

In Europe, authorities recognize that new tests are not necessary

for every minor change to each device. Instead, makers are rigorously tested and inspected for quality control and safety systems. Despite bureaucratic mischief, Buddles believes that doctors will eventually side with industry as they comprehend the impact of the technology gap on patients.

"Society and medical technology are changing quite quickly, yet we've got this old-fashioned structure of gatekeepers, and that is just slowing everything down," he says.

– Julian Ryall

The regional governments need to challenge that system, and we should help.

FDI and Privatization

According to the Fukao Report, the government needs to inject a new sense of urgency into efforts to reform and deregulate.

"FDI and regulatory reform are inseparable, and unless certain regulations are eased, the increase in foreign investment can only be very limited," says Shojiro Makino, president of Pacific Consulting Co., Inc. and a key member of the panel that compiled the deregulation policy document. "But I'm hopeful that we will see change now because a government white paper released in July mentioned

the ACCJ's activities in this area and, on August 3, for example, the Cabinet Office issued a report by the Council for Regulatory Reform examining the opening up of municipal or prefectural businesses to the private sector."

Makino particularly favors changes in the medical-care field that would allow hospitals to provide expensive and specialized procedures as well as those currently covered by health insurance. However, he also believes there are boundless opportunities for foreign companies that have

spent years practically developing other areas of expertise.

"Areas that are presently functions of the government but could very easily be opened up to the private sector include air-traffic control, the management of waterworks and sewage systems, the management of penitentiaries and the operation of ambulances," he says. "Look at the example of garbage collection in Britain. There it is an open bidding system, but in Tokyo it is done by the metropolitan government and paid for out of taxes. If it was put out to tender, the chances are that it would be cheaper and taxes would be lower." – Julian Ryall

Fukao: I am surprised that the media are still quite negative regarding M&A and inward FDI. In a recent Toyo Keizai article, the content was not so negative, but the title was really sensationalist – depicting some kind of horror coming toward Japan. Another bit of bad news is that METI started a study on the introduction of a poison pill as a measure against hostile takeovers. Earlier this month, it also emerged that the government was considering helping companies use poison pill share issues to defend themselves against hostile takeovers. The Ministry for the Economy, Trade and Industry said the initiative had been spurred in part by coming cross-border share-for-share deals. The proposals would allow companies to issue discounted stock options to dilute the stakes of potential acquirers. This kind of news has a negative impact on foreign media and potential investors. They think that the Japanese government is not serious about increasing inward FDI.

The Nihon Keizai Shimbun is improving. After all, M&A is a domestic issue. For example, Sumitomo Mitsui (Financial Group, Inc.) launched a kind of hostile takeover bid for UFJ (Holdings, Inc.), and this

sort of thing is very common already. There's no reason to be afraid of out-in M&A. The Nikkei understands that we have to make changes.

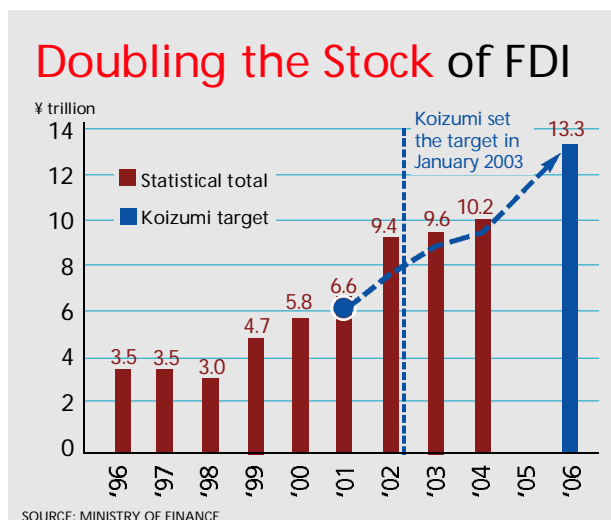
ACCJ Journal: Is the message reaching the man on the street?

Fukao: I really don't think so. This may be in part because the economy seems to be recovering somewhat, so people think outside help is unnecessary.

The main point we wanted to make in our report is that Japan is competing with other countries, particularly Asian countries, for the involvement of not only foreign companies but also domestic companies. Japan has a great deal of outward FDI now, with Japanese companies investing and establishing factories overseas. Against that, Japan cannot entice many foreign-owned companies.

Airlines are launching direct flights from cities such as Singapore, Hong Kong and Shanghai to the U.S., so that Narita is losing its role as a hub. That is very important. People don't appreciate the risk. A recent Morgan Stanley report says that in 10-15 years China's gross domestic product will be larger than

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that of Japan. The time left for Japan to act is very limited. We have to hurry if we are to be the Asian transportation, business-services or financial hub.

There is a crisis, but the man on the street does not really understand.

ACCJ Journal: In January 2003 Prime Minister Koizumi set a goal of doubling Japan's stock of FDI in five years. How does that target look now?

Fukao: After our report was published, I found that several bureaucrats and scholars had negative views regarding Koizumi's goal. They say that Koizumi should not set a quantitative goal, because the government will then be forced to make it happen, by giving special treatment to foreign investors or corporations. There are precedents for that.

I think it was good for the government to have something to focus on. The most recent data on the stock of inward FDI (see chart) indicates an even chance that the goal will be reached, but the goal itself is not at all ambitious when compared with inward FDI in other countries, based on the most recent data. The goal is to double inward FDI from ¥6.6 trillion to ¥13.2 trillion. There was a big increase just before the goal was set, but there has been almost no increase since.

ACCJ Journal: Is this the right kind of goal anyway?

Problem in the Open

"There is a pretty solid recognition in the business community and among the political leadership that deregulation needs to occur, that FDI is good, and that there is so much pressure because of the nonperforming-loans crisis and the banking crisis," says Edward Johnson, a partner of Paul, Hastings, Janofsky & Walker G.J.B.J., and a member of the FDI Task Force. The combination, he says, has forced people to admit that "something is awry" with Japan's traditional methods. – Julian Ryall

Fukao: I recently wrote a report for the government, arguing that more inward FDI will benefit Japan, and one of the responses from bureaucrats was to ask: "What is the optimum level of FDI for Japan?"

We cite the case of Britain as around 25%, the U.S. 10% and Japan 1.5% or so. But I have no exact answer about what the level should be. When the investment environment changes, then you will see what level of FDI occurs. The goal itself is not the important issue. Liberalization is the issue.

ACCJ Journal: Were there findings that surprised you when you were compiling the report commissioned by the ACCJ?

Fukao: I had done research on Japan's so-called lost decade, and found a close correlation between the lost decade and FDI. The key is productivity.

The other thing is that the issue concerns not only foreign companies. Also, Japanese companies are exiting Japan. It's an issue of whether Japan can be a good place for business. If Japanese companies are leaving, why would foreign companies want to come in? If we cannot solve that problem, we'll continue with another lost decade and will be unable to keep wages at current levels.

Instead of a Japan Investment Council concerned with inward FDI, the government should have a

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Opportunity in Education

Kirk Patterson, dean of Temple University Japan, was for years frustrated by inflexibility within the Ministry of Education, Culture, Sports, Science and Technology regarding Temple's unique situation. But now he sees light at the end of the tunnel.

"If you looked at Japan's education sector, it has clearly been the same convoy system that exists in many industries here," says Patterson, who provided the FDI Task Force report on education. "All the ships have been moving together at the same speed and in

the same direction – even if they didn't know why they're moving in that direction. Japan is a very modern, complex, industrial-service economy that has a diversity of education needs, and that one-size-fits-all approach did not serve students, the economy or society well. So there is now an opportunity for education providers – such as foreign universities with an entrepreneurial spirit – to come here and provide a unique and valuable service."

Despite having operated here for 22 years, it was not until early

October that Patterson learned that years of lobbying are paying off. Temple is likely to be the first institution in a new category – Foreign University Japan Campus – recognized by the education ministry, probably by early December. Previously, it failed to meet the ministry's strict recognition criteria, such as having a certain percentage of full-time faculty members, a given ratio between student numbers and square meters of classroom space, a certain debt-to-equity ratio and ownership of its own land. While those criteria may once have been necessary to ensure that a university did not go bankrupt, today they miss the point, says Patterson.

council to promote investment in Japan – by Japanese companies as well. They should be asking why a major Japanese company locates its regional headquarters in Singapore or Shanghai.

It's not good if people think the government is doing some special trick or favor for the benefit of foreign companies.

ACCJ Journal: How do you rate the work of the ACCJ's FDI Task Force?

Fukao: They did an admirable job. And the ACCJ is really a frontrunner on this issue, so the influence is spreading to other foreign organizations.

ACCJ Journal: What needs to be done next in terms of research or follow-up?

Fukao: One problem, as we wrote in our report, is that the government does not properly evaluate the results of policy. It's just a wish list and then they achieve whatever is achievable from that. They don't evaluate, for example, how much is expected and at what cost.

Now, that is gradually changing. We, Japanese voters, should be demanding more of this ex-post and ex-ante evaluation of each policy.

As I said, Japanese companies are leaving Japan. For regional governments, this is a very urgent matter. They want to be able to attract new investment.

ACCJ Journal: Should regional governments be taking more independent initiatives?

Fukao: Of course, but we have more of a federal system, like France, where the central government is more powerful compared, for example, to that of the U.S. The regional governments need to challenge that system, and we should help. They understand their own problems better than the central government does.

ACCJ Journal: How important is FDI to Japan's economic revitalization?

Fukao: FDI is important as a catalyst for change and for deregulation, not only to attract foreign

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"Not one of the requirements has anything to do with the content of the education. Providing an education should be the main concern," he says.

Not having recognition has had some major implications for Temple: it had to pay corporate income tax, it could not sponsor foreign students' visas, its students were ineligible for commuter-pass discounts and they paid consumption tax on tuition. Accordingly, other foreign universities were reluctant to set up campuses here. Instead they opted for China, Thailand or Singapore.

The official change of heart, however, means that Temple will

be able to approach other ministries to request that it be treated the same as its Japanese counterparts, Patterson says. He hopes the Ministry of Justice will quickly approve Temple's effort to sponsor foreign students' visas, although approval of discount student commuting passes may take a little longer. An even larger hurdle will be the tax issues, although he is optimistic that "within a year or two" the entire playing field will have been levelled.

Temple's focus has been to try to get many of the benefits of recognition while maintaining the freedom necessary to provide a U.S.-style education, says Patterson.

With that aim in mind, it filed three proposals to be covered under the government's plans to set up tokku, or special administrative zones, and received the backing of the U.S. Embassy, the ACCJ and Japanese politicians, and held wide-ranging discussions with ministry officials.

It helps that education is of concern to areas of the government beyond the education ministry. The Ministry of Economy, Trade and Industry (METI) recently called for an increase in MBA programs here. "I'm very optimistic that this new status will allow Temple to attract a lot of students,"

– Julian Ryall

capital but also to create a better environment for Japanese investment.

ACCJ Journal: It has been said that Japan needs a corporate governance revolution so that investors can put capital to work in this economy, and that foreign ownership is the only way to revolutionize corporate governance in Japan. Would you agree with that?

Fukao: Japanese corporate governance is changing. M&A, foreign private equity funds and foreign companies have some influence on that.

ACCJ Journal: What are the best examples showing the benefits to Japan of FDI?

Fukao: Starbucks is a good example of FDI bringing in new culture and new benefits for consumers. A no-smoking coffee shop was amazing for Japanese. Foreign insurance companies, also, introduced strategies that became so successful in this market that Japanese insurance companies are now following them as well.

Before WWII, Japan learned a lot from foreign companies. For example, NEC Corp. was started as a joint venture. Ford and GM had knockdown factories in Japan. Their suppliers learned a lot about how to make automobiles. Companies like Toyota and Nissan emerged from that.

ACCJ Journal: What about the short-term things that need to be done now?

Fukao: If the prime minister or the bureaucrats find that achieving the five-year goal is becoming difficult, it is possible that they will realize we have to do something new. Or, at that time, the ACCJ and others can raise the issue again.

Another strategy may be to let ordinary people know how many foreign companies – and Japanese companies – are going to Shanghai, for instance, instead of Japan. Or, how many direct flights are being added between Hong Kong and the U.S. east coast. That kind of education may be necessary.

ACCJ Journal: Thank you.