Section 4 Promoting Inward and Outward Investment Activities in Japan

In the increasingly globalized world economy, there is a need for Japan to become a more open and attractive place for overseas investors and to promote outward investment in order to strengthen its economic ties with the overseas economies through trade and investment. This section describes the actions required for such efforts in detail.

1. Promoting of inward direct investment

As explained in Chapter 2, one of the measures that Japan needs to take to become a more open and attractive place for outward direct investment is to aggressively attract and use various superior-quality resources from abroad. As discussed in Section 4 of Chapter 2, the inward direct investment into Japan is expected to accelerate the process to taking such measures. The Japanese government has adopted the expansion of the inward direct investment as one of its major policies and has been aggressively promoting such investment for a long time. First, this subsection describes the current status of inward direct investment in Japan. Next, the efforts made by the Japanese government to increase the inward direct investment are described, such as efforts to improve business environment.

(1) Current status of inward direct investment

The balance of the inward direct investment in Japan has been increasing steadily since 1999[1] (see Figure 4-4-1). The United States and European countries account for a major share of the investment. However, in recent years, the diversity of countries investing in Japan has steadily increased. In particular, there has been an increase in the investment from NIEs and South and Central American countries (see Figure 4-4-2).

However, the balance of the inward direct investment in Japan accounts for about merely 1% of the global balance of inward direct investment, which is far lower than that of the United States and European countries (see Figure 4-4-3). The inward direct investment in Japan is concentrated in specific industries such as finance and insurance. Thus, it is important for Japan to consider measures to promote investments even in other services industries (see Figure 4-4-4).

The balance of the inward direct investment in Japan accounts for about 2.5% of Japan's GDP in 2005, which is lower than that of major western countries (see Figure 4-4-5). The return on the inward direct investment in Japan, on the other hand, is higher than that in major western countries (see Table 4-4-6). The higher return on foreign investors in Japan indicates that Japan still has a great potential to expand its inward direct investment[2]. It is necessary for Japan to make aggressive efforts for further expansion of the foreign direct investment in Japan through steady implementation of policies such as the "Program for Acceleration of the Foreign Direct Investment in Japan."

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[1] The financial big bang in 1998, in which the foreign exchange and foreign trade act was revised and restrictions on the entry of foreign capital in the Type 1 Telecommunications Business were lifted, is believed to have encouraged foreign companies to enter Japanese markets.

[2] In fact, investments related to large-scale corporate restructuring, such as the acquisition of the Nikko Cordial Group by Citigroup (U.S.) in 2007 (at about 920 billion yen), are expected to boost the foreign direct investment in Japan in the future.

Figure 4-4-1 Balance of Inward Foreign Direct Investment in Japan and Nominal GDP Comparison

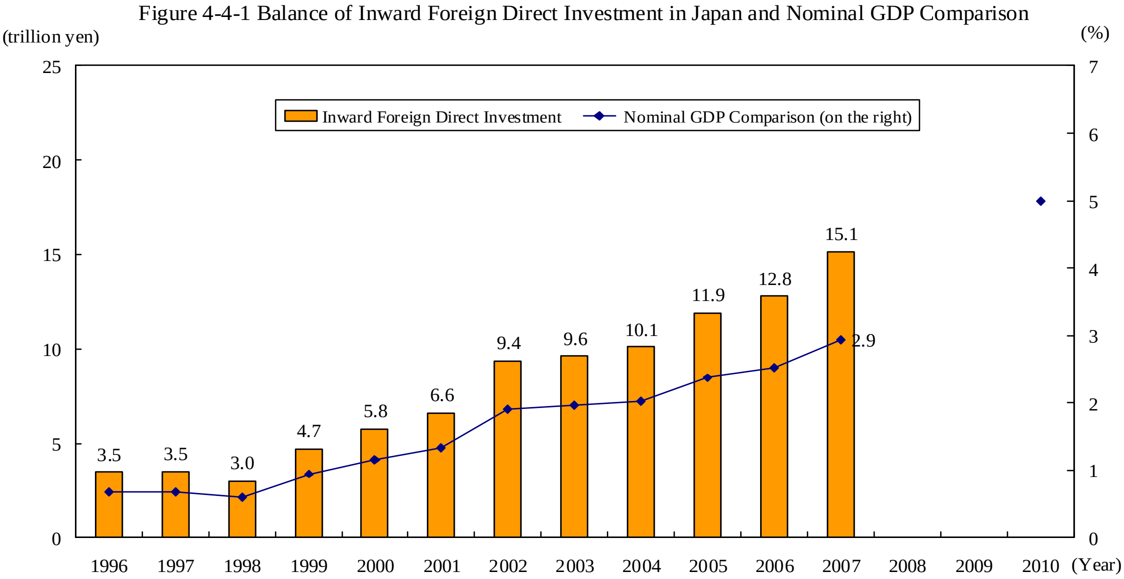
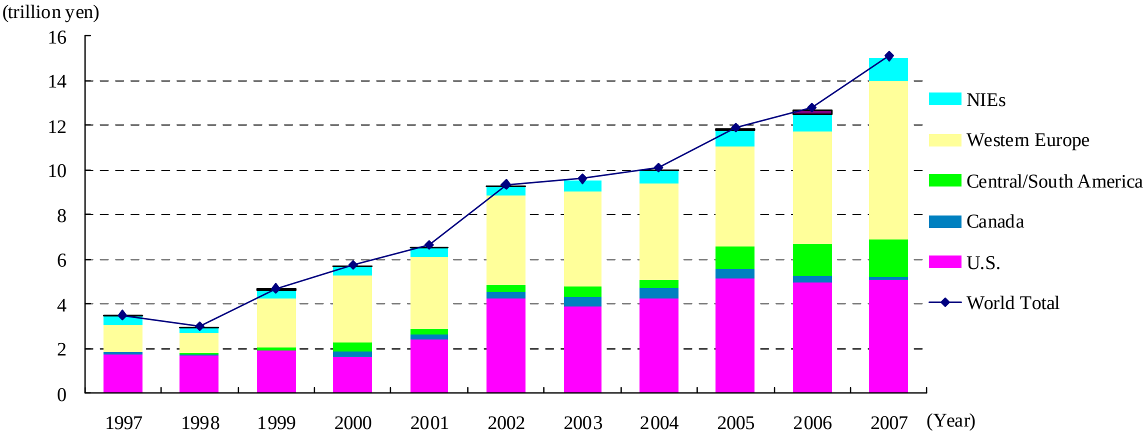
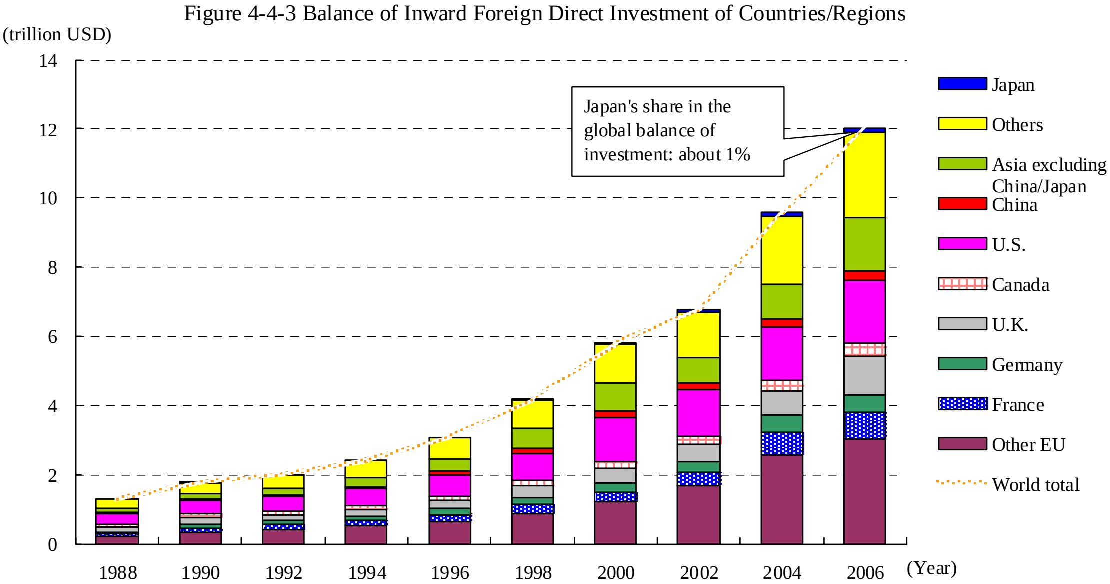


Figure 4-4-2 Breakdown of Balance of Inward Foreign Direct Investment by Country/Region



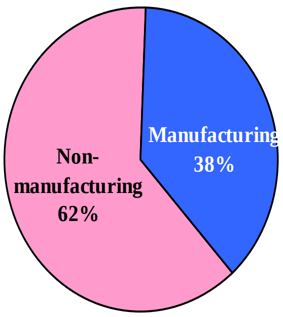
Note: Western Europe: U.K., France, Germany, Italy, Netherlands, Luxemburg, Belgium, Spain, Switzerland, Sweden.
Source: Ministry of Finance, Japan / Bank of Japan, HONPOU TAIGAI SHISAN FUSAI ZANDAKA

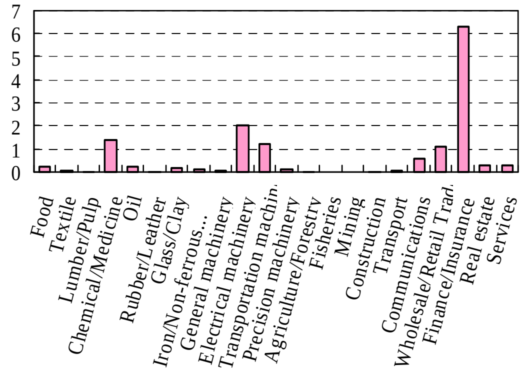
Figure 4-4-3 Balance of Inward Foreign Direct Investment of Countries/Regions



Source: UNCTAD, *World Investment Report 2007*

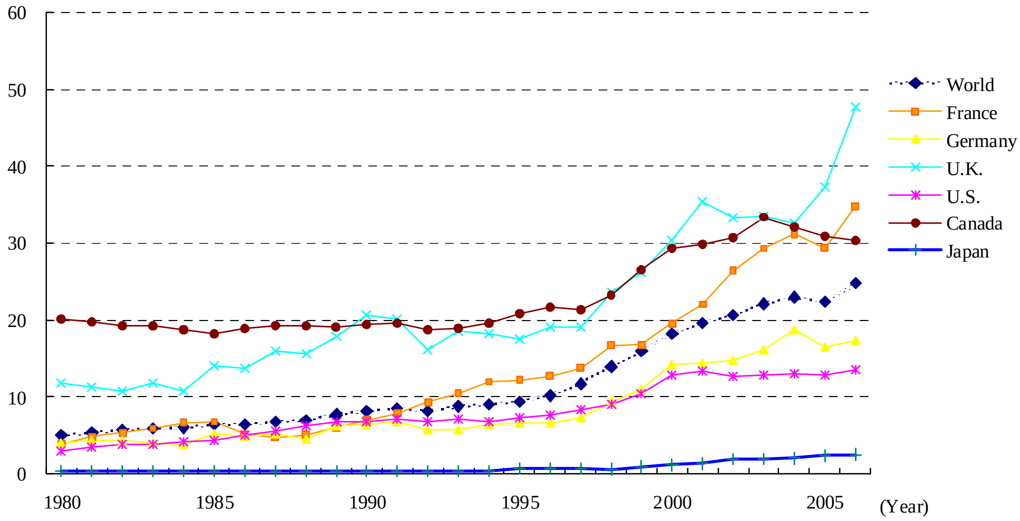
Figure 4-4-4 Balance of Inward Foreign Direct Investment in Japan by Industry (2007)





Sources: Ministry of Finance, Japan; Bank of Japan, HONPOU TAIGAI SHISAN FUSAI ZANDAKA.

Figure 4-4-5 Balance of Inward Foreign Direct Investment and Nominal GDP Comparison



Note: For Japan, Ministry of Finance, Japan / Bank of Japan, HONPOU TAIGAI SHISAN FUSAI ZANDAKA after 1995
Source: UNCTAD, *World Investment Report 2007;* Ministry of Finance, Japan / Bank of Japan, HONPOU TAIGAI SHISAN FUSAI ZANDAKA

Table 4-4-6 Balance of Inward Foreign Direct Investment and Return on Inward Foreign Direct Investment of Countries (2006)

Balance of Inward Foreign Direct Investment of Countries

(billion USD)

1	United States	1789.1
2	United Kingdom	1135.3
3	France	782.8
4	Hong Kong, China	769.0
5	Belgium	603.4
6	Germany	502.4
7	Netherlands	451.5
8	Spain	443.3
9	Canada	385.2
·		
·		
·		
21	Japan	107.6

Return on of Inward Foreign Direct Investment of Countries

(%)

1	Chile	25.28
2	Ireland	22.04
3	Russian Federation	17.5
4	Poland	12.64
5	Hungary	12.49
6	Switzerland	11.41
7	Czech Republic	10.4
8	China	9.99
9	Australia	9.78
10	Germany	9.36
11	Sweden	9.25
12	Austria	9.14
13	Japan	8.37
14	Hong Kong, China	8.01
15	United States	7.6
16	United Kingdom	7.72
17	Canada	7.12
18	Netherlands	7.11
19	Denmark	6.84
20	South Africa	6.29

Note 1. ROI is calculated as follows: Return on investment (payment)/balance of inward foreign direct investment.

2. The above table presents the ROI comparison of the top 30 countries in terms of the balance of the inward foreign direct investm

Source: Institute for International Trade and Investment, KOKUSAI HIKAKU TOUKEI

Source: IMF, BOP, UNCTAD, World Investment Report 2007

(2) Issues pertaining to the expansion of inward direct investment

In the increasingly globalized world economy, many countries are actively engaging in cross-border economic activities. One example of this is the international division of labor whereby each country takes advantage of its special characteristics. Japan currently has the advantage of having the expertise in many fundamental technologies, including precision parts and materials, while China has abundant cheap labor. However, such advantages are considered to be gradually eroding as the other Asian countries are improving their technological skills and raising wages as their economies grow.

Under such circumstances, the business environment along with the legal, tax, and other systems in each country and region will have large impact on the future investment and location strategies of companies. As explained in Section 4 of Chapter 2, the "globalization of the domestic market environment" is important. For example, according to the JETRO (2008), many of the foreign-affiliated companies operating in Japan cite the difficulty in securing human resources (66.2%) and high business costs (60.2%)[3], among others, as factors hampering their business activities in Japan. According to the JETRO (2004), these foreign-affiliated companies cite the following as effective measures to increase the foreign direct investment in Japan: reduction of tax burden (77.9%), systemic reforms such as commercial laws (61.7%), and labor market reform (61.2%)[4]. These survey results suggest companies are strongly interested in the business environment, tax systems, legal and other systems while making investment decisions.

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[3] Source: JETRO (2008), "The 13th Survey on Attitudes of Foreign-Affiliated Companies toward Direct Investment in Japan" (Survey period: September–October 2007, among 2,766 companies)

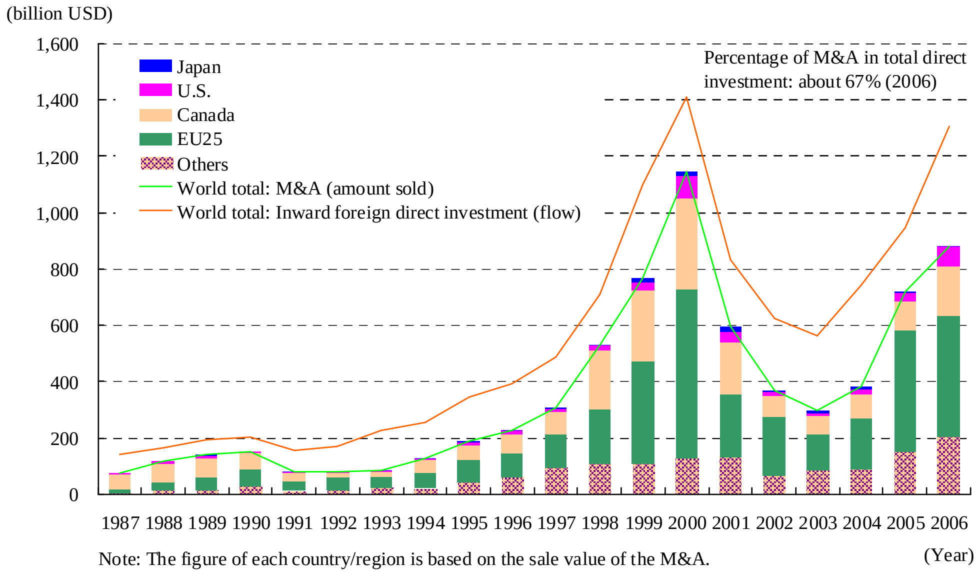
[4] Source: JETRO (2004), "The 9th Survey on Attitudes of Foreign-Affiliated Companies toward Direct Investment in Japan" (Survey period: January–February 2004, conducted among 2,684 companies)

Given such strong interest by companies in the business environment and various business-related systems in deciding and choosing investment and locations, it is important for Japan to secure an equal footing with the rest of the world in the business environment and various business-related systems in order to enhance its international competitiveness. As described in the "Japan's Course and Strategy - Path to New Creation and Growth" adopted at the Cabinet meeting in January 2007, Japan needs to improve tax, legal, and other system infrastructures and make its investment environment more attractive to investors by securing an equal footing from the international perspective.

(3) Improving business environment for expansion of inward direct investment
(Facilitation of cross-border mergers and acquisitions (M&As))

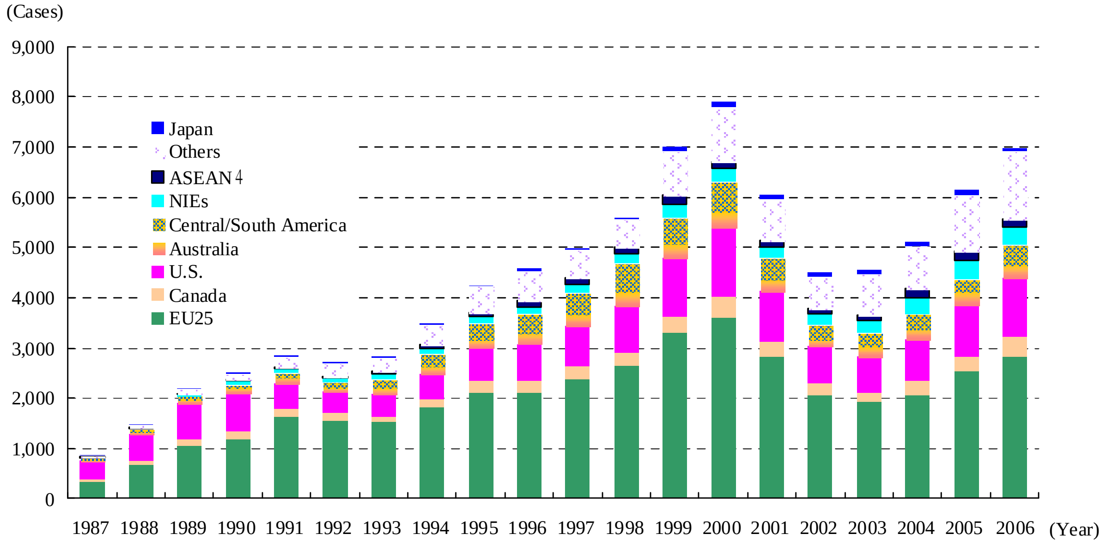
There are two major forms of the inward direct investment: Greenfield Investment (setting up a new corporation, production facility, etc. in a destination country) and M&A. As of 2006, M&As accounted for about 67% of all the inward direct investment in the world. Facilitation of cross-border M&As is very important for promoting the inward direct investment (see Figures 4-4-7 and 4-4-8). The number of M&As in Japan has been increasing in recent years. Most of the M&As have taken place between Japanese companies, but the number of M&As involving foreign companies is also on the rise (see Figure 4-4-9).

Figure 4-4-7 Global Cross-Border M&A (sale value)



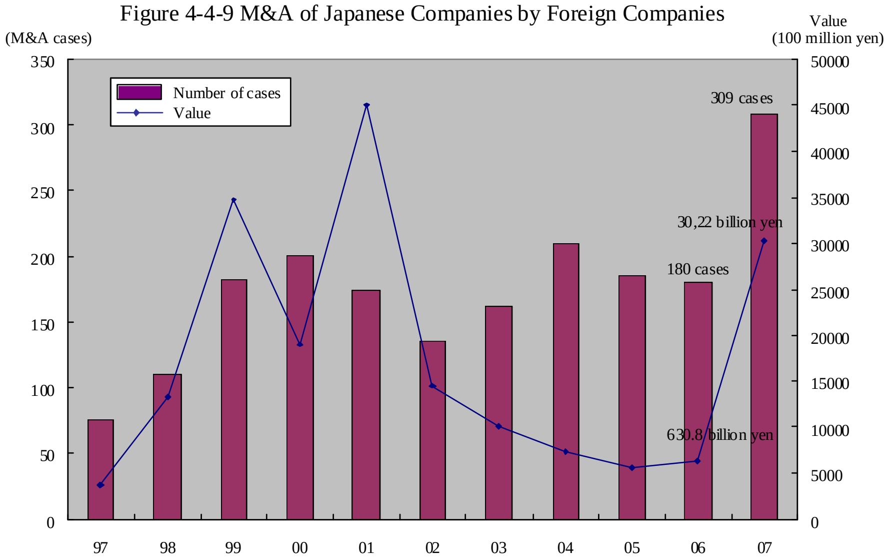
Note: The figure of each country/region is based on the sale value of the M&A.
Source: UNCTAD, World Investment Report 2007

Figure 4-4-8 Number of Global Cross-Border M&As (Sale value)



Source: UNCTAD, *World Investment Report 2007*.

Figure 4-4-9 M&A of Japanese Companies by Foreign Companies



Note: The values indicate the sum of all M&A figures that were available for calculations.
Source: Ministry of Economy, Trade and Industry, Japan, based on data obtained by RECOF.

M&As offer several advantages such as the effective utilization of the existing management resources, economies of scale through corporate restructuring, increased R&D investment and improved efficiency through expansion of sales networks. By taking advantage of each company's strengths, the acquiring company can bring about innovations in its business operation, product development, and production process. Such innovations will help improve the productivity of the industry as a whole[5].

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[5] The Ministry of Economy, Trade and Industry, Japan analyzed the effect of M&As of Japanese companies with foreign companies published the results in the "White paper on International Economy and Trade 2006," which shows that foreign companies involved in M&As (companies with over 50% of foreign capital successfully carrying out M&As) generally achieved higher business performance than the national average, in both manufacturing and services industries. The other possible effect of foreign companies entering the Japanese markets is the increased employment opportunities in terms of not only quantity but also quality as people who are skilled and willing but unable to get jobs may have more opportunities to participate in economic activities.

Making the environment more conducive for M&As is one of the most important policy measures that the Japanese government should take in order to promote the inward direct investment and take full advantage of the potential benefits of M&As for revitalization of the Japanese economy.

[Column 43] Scale of cross-border M&As

There are several high-value M&As taking place worldwide. According to the "World Investment Report" published by UNCTAD (2007), the number of successful M&As with transaction value of US$1 billion reached 172 in 2006.

Of the 172 M&As, the biggest M&A in terms of transaction value was the acquisition of Arcelor by Mittal Steel at US$32.2 billion. By 2006, 9 successful M&As with transaction value of over US$10 billion had taken place. In none of the 172 M&As had a Japanese company been acquired by foreign companies; however, there were 2 cases of Japanese companies acquiring foreign companies.

The report also includes the top 50 M&As in terms of transaction value that were financed by private equity funds and hedge funds. In one of the top 50 M&As, a Japanese company provided the capital (investment in Kokudo by Cerberus).

Japan has seen few high-value M&A cases. However, an increasing number of Japanese companies are seeking capital investment from private equity funds to further improve their corporate values jointly with the funds. For example, Fund C offered friendly terms of business (TOB) to Company K, which manufactures and sells cargo handling machines, in 2004 and succeeded in the management buyout (MBO). Thereafter, Company K accelerated its growth through management reform with the support of Fund C and was successfully re-listed on the Tokyo Stock Exchange in 2007.

(Current status of efforts for improving systems related to corporate restructuring)

Japan has made efforts for reforming systems related to corporate restructuring in order to expand options available to companies for swiftly and flexibly coping with changes in the economic environment. In this regard, the major progress made so far includes reform of systems and development of guidelines to facilitate corporate restructuring through the lifting of the ban on the establishment of holding companies (1997); introduction of equity swap/equity transfer system (1999); introduction of a system to fractionalize a company and improvement of corporate restructuring-related tax systems (2001); and enactment of laws such as the revised Industrial Revitalization Law (2003)[6] and Corporate Law (2006).

The Corporate Law (which deregulated the provisions pertaining to payment for mergers) introduced in May 2007 allows triangular mergers wherein the shares of the parent company are swapped as payment for the acquisition. These efforts are expected to promote the inward direct investment in Japan.

(Recommendations by the Expert Committee on Foreign Direct Investment Promotion)

After the Expert Committee on Foreign Direct Investment Promotion was set up in 1994, the

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[6] A plan to reuse management resources to improve productivity of a business acquired from another entity was added to the support measures stipulated in the law.

Japanese government has worked on promoting the foreign direct investment in Japan by developing plans to double the foreign direct investment in Japan. As described above, the amount of the foreign direct investment in Japan remains small in comparison with major countries. In view of such a reality, the Japanese government set up the Expert Committee on Foreign Direct Investment Promotion in January 2008. It is an advisory committee to the state minister in charge of economic and fiscal policy and is authorized to hold detailed discussions on measures to promote the foreign direct investment in Japan including factors and structural problems hampering its growth. After intensive discussions, the Committee compiled the "Five Recommendations Toward the Drastic Expansion of Foreign Direct Investment in Japan." It serves as a specific "prescription" to increase the amount of investment and was presented to the Council on Economic and Fiscal Policy on May 20 (see Table 4-4-10). Based on the recommendation report, the Cabinet Office, Government of Japan will revise the "Program for Acceleration of the Foreign Direct Investment in Japan" by the end of 2008 and will review its progress on a regular basis.

Table 4-4-10 Five Recommendations Toward the Drastic Expansion of Foreign Direct Investment in Japan

1. Enhancement of system toward the facilitation of M&As
In order to contribute to the facilitation of M&As, which are an important means of FDI in Japan, wide-ranging studies should be advanced, including the following matters, and the further improvement of Japan's M&As system should be accelerated. ・Clarification of takeover rules (Discussion by various related parties until this summer regarding how to prevent takeover defense measures from working as hindrances of FDI) ・Promotion of studies for the facilitation of cross-boarder M&As (Studies for the system and taxation regarding various M&A measures) ・Elimination of allergy toward M&As by foreign companies (PR actions to welcome M&As & publishing M&A success stories (job creation etc.))
2. Comprehensive studies on Foreign Direct Investment regulations
While maintaining national security, public order, etc, the regulations with appropriate predictability should be advanced. The scope and grounds of cases where Foreign Direct Investment regulations are necessary as exceptions to the principle of nondiscrimination between domestic and foreign investors should be clarified, and Japan's open investment policy should be shown to the rest of the world. ・Comprehensive studies on Foreign Direct Investment regulations within FY 2008
3. Establishment of priority strategies by sector
In the field of medical devices and pharmaceutical products, which will be especially important in terms of revitalizing the Japanese economy and improving the quality of life, an action program should be formulated that puts the focus on the field of medical devices. ・Eliminating so-called "Device Lag" by tripling the number of medical device reviewers (from 35 to about 100) ・Action programs for other prioritized sectors will be planned
4. Reduction of business costs and improvement of system transparency
Amid global competition, the reform of regulations and systems should be promoted, thereby reducing business costs in Japan and improving system transparency, so that foreign companies and investors can see the merits of FDI in Japan. ・Reduction of the corporate tax rate (nominal rate) in order to attract foreign capital ・Drastic improvement of the "no-action letter" system and written reply procedures for taxes ・Evaluation of regulations and administrative burden survey ・Revision of hearing procedures, etc. under Antimonopoly Act ・Promotion of utilization of private-sector dynamism in public service by government
5.Regional revitalization by foreign capital, strengthening of appeal that foreign capital is welcome, etc.
In order to realize regional revitalization through the attraction of foreign capital, regions should be built in which it is easy for foreign capital to be active, and the appeal that foreign capital is welcome should be strengthened. ・Strategic attraction of foreign capital in wide-area economic zones ("local to local") ・Activities to attract foreign capital centered on former private-sector personnel ・Building of living environments suitable for foreigners (Promotion of good practices by local governments) ・Facilitating continuation of business of small and medium-sized companies through foreign capital M&As ・Strengthening of appeal that FDI in Japan is welcome

Source: Cabinet Office, Expert Committee on Foreign Direct Investment Promotion.

(Basic Policies on Economic and Fiscal Reform 2008)

The "Basic Policies on Economic and Fiscal Reform 2008" compiled in June 2008 urges the government ministries and agencies concerned to revise the "Program for Acceleration of the Foreign Direct Investment in Japan" by the end of autumn 2008 and steadily promote the program to increase the inward direct investment in Japan. It also urges the government to make the following efforts:

- To develop and clearly define the M&A rules by summer 2008
- To hold comprehensive discussions on the rules for foreign capital control, which is an exception to the non-discriminatory treatment
- To develop, an action program to expedite procedure to inspect and approve medical equipment by the end of the autumn of 2008
- To reduce business costs by identifying appropriate effective corporate tax rates that are in line with the drastic tax reforms.

(4) Regulations on FDI in Japan and the Foreign Exchange and Foreign Trade Act

(International investment rules and regulations on FDI in Japan)

There are currently 2 major international investment rules, which define the liberalization of foreign direct investment: (1) OECD Code of Liberalization of Capital Movements (hereinafter the "OECD Code"), which defines the liberalization of capital movements between developed countries, and (2) WTO General Agreement on Trade in Services (the "GATS"), which defines the liberalization of foreign direct investment in services sectors. Some Bilateral Investment Treatys and Economic Partnership Agreements concluded by Japan include similar provisions. Restrictions on FDI which are designed to regulate foreign capital in a manner different from domestic capital have to be imposed only to the extent permitted under such international investment rules.

Article 3 of the OECD Code allows member countries to take measures necessary for (1) the maintenance of public order or the protection of public health, morals, and safety, (2) the protection of its essential security interests, and (3) the fulfillment of its obligations relating to international peace and security. Regulations on FDI for other reasons are stipulated in the Annex B "Reservations" to the OECD Code. The GATS and Economic Partnership Agreements (EPAs) also have similar provisions, which stipulate exceptions for security reasons, etc.

Based on such international investment rules, Japan has introduced regulations on FDI, which limits the scope of implementation only for the reasons permitted under the international rules. There are two major methods of investment restrictions. One method is to impose a cap on the ratio of voting rights held by foreigners in companies belonging to specific industries. This method has been adopted by laws that are targeted at specific individual companies such as the Law on Nippon Telegraph and Telephone Corporation; the Radio Law and Broadcast Law, which are targeted at broadcasters in general; and the Civil Aeronautics Law, which is targeted at the airline industry. Another method is to mandate foreign investors to notify the authorities and undergo a screening when they intend to acquire more than a certain ratio of shares in companies belonging to specific industries. This method has been adopted by the Foreign Exchange and Foreign Trade Control Law (hereinafter the "FEFTA") to regulate the foreign direct investment. Companies and industries subject to the regulation under the FEFTA include manufacturers of weapons and aircraft and companies in the energy industry such as electric power and gas companies (see Table 4-4-11).

Table 4-4-11 Laws Regulating Foreign Capitals

Name	Industry	Voting rights ratio
Law on Nippon Telegraph and Telephone Corporation (NTT)	NTT	Over 1/3
Radio Law	Some wireless stations	Over 1/3 (over 1/5 for broadcasting stations)
Broadcast Law	Consignor broadcasters and certified broadcast holding companies	Over 1/5
Civil Aeronautics Law	Air transportation operators	Over 1/3
Foreign Exchange and Foreign Trade Act	Manufacturesof weapons, aircraft, products related to atomic energy, space development, computer programming and other software services, machine repairs; manufactures of general-purpose products that are highly likely to be diverted for military use (products listed in Appended Table 1 of Export Trade Control Order); production, transmission and distribution of electricity, manufacture of gas; heat suppliers, communications, broadcasting, collection, purification and distribution of water, and sewage collection, processing and disposal; railway transport, passenger transport; biological preparations; guard service	Over 1/10 (on the percentage of shares acquired and notified) (* 1 or more shares for unlisted companies)

Source: Ministry of Economy, Trade and Industry, Japan

(Overview of the foreign direct investment regulation under the FEFTA)

The FEFTA regulates the foreign direct investment only in specific industries (mandating prior notification and screening) in order to maintain national security, public order, and public safety while following the principle of liberalizing the foreign direct investment in line with international investment rules such as the OECD Code.

Article 27 of the FEFTA mandates foreign investors to submit a prior notification to the Minister of Finance and the Minister having jurisdiction over the business for any foreign direct investment, etc.[7] which involves the risk of adversely affecting national security, public order and public safety. The exact scope of the notification requirement has been clearly defined in the ordinance and the scope of industries subject to the notification requirement has been stipulated in detail in the public notice. The public notice was revised in September 2007 and the manufacture of general-purpose products that are highly likely to be diverted for weapons of mass destruction was brought under the regulation in order to effectively prevent the outflow of sensitive technologies for security purposes.

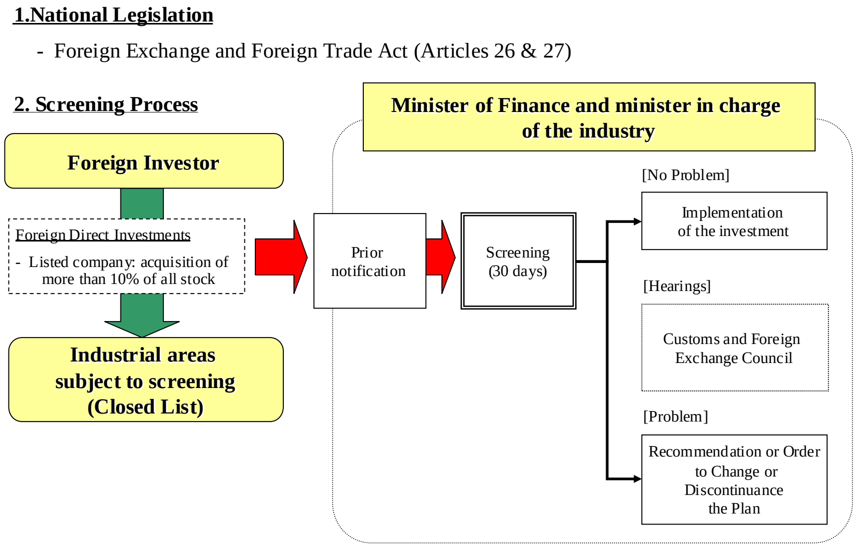
A foreign investor shall not make a foreign direct investment, etc. pertaining to the notification until the expiration of 30 days from the day of acceptance of the notification (Article 27 (2) of the FEFTA). During this period, the Minister of Finance and the Minister having jurisdiction over the business screen the proposed investment from the viewpoint of national security. If deemed necessary, they can extend the period of screening to up to 4 months (Article 27 (3) of the FEFTA). Around 760 investment plans were submitted under the FEFTA in the past 3 years, and all but 1 proposal were approved within the statutory period of 30 days. The secreening period was minimized to 2 weeks or less for about 95% of the investment proposals submitted.

Based on the screening, the Minister of Finance and the Minister having jurisdiction over the business, can recommend to change the content pertaining to the inward direct investment,

[7] The “foreign direct investment” is an act subject to Article 26 (2) of the FEFTA. In particular, such acts include the attempt by foreign investors to (a) obtain shares or equities in an unlisted company (26 (2) (ⅰ)), (b) obtain over 10% of the shares in a listed company (26. (2) (ⅲ)), and (c) provide Japanese companies with a loan for a period of one year or longer of an amount in excess of the upper limits defined by the ordinances (26 (2) (ⅵ)).

etc. ordiscontinue the foreign direct investment, etc. after hearing the opinions from Council on Customs, Tariff, Foreign Exchange and other Transactions (Article 27 (5) of the FEFTA). In the event that the foreign investor notifies the Minister of Finance and the Minister having jurisdiction over the business of the refusal to the advice or fails to serve the acceptance notice, the Minister of Finance and the Minister having jurisdiction over the business can order the modification or cancellation of the foreign direct investment (Article 27 (10) of the FEFTA). Any person who has made a foreign direct investment in violation of the order shall be punished by imprisonment for not more than three years, a fine of not more than one million yen, or a fine of not more than three times the price (Article 70 (25) of the FEFTA). Failure to submit a prior notification is also subject to the punishment above (see Table 4-4-12).

Figure 4-4-12 Outline of the Screening System (1)



Source: Ministry of Economy, Trade and Industry, Japan

(Efforts to review regulations on FDI in major countries)

Recently, many countries have started to review their regulations on the foreign direct investment from the perspective of national security given the recent changes in the international security environment and the recent increase in investment activities. The United States reviewed its investment regulation in 2007; the United Kingdom, in 2002; Germany, in 2004; and France, in 2005.

○ The United States

(a) Brief history of the Exxon-Florio Amendment

The so-called “Exxon-Florio Amendment” (Article 721) of the Defense Production Act vests the U.S. President with the right to intervene in the takeover of a U.S. company by a foreign company for national security reasons. The right of intervention covers all the industries.

The Exxon-Florio Amendment allows the President to take every possible measure to halt the investment if there is clear evidence that the foreign ownership could jeopardize the national security of the United States after investigating the impact of the deal on national security when a foreign company plans to merge with or acquire a U.S. company. Such measures taken by the President are not subject to a judicial screening process.

Foreign companies are not required to submit prior notifications, and the U.S. President and the Committee on Foreign Investment in the United States (CFIUS) assigned with the right to investigate can start the inspection under their own authority. The investigation continues, in principle, for 3 years after the investment is completed. However, in many takeover cases, investors voluntarily notify the CFIUS of their investment plans to avoid becoming the subject to investigation.

Thus far, only 1 investment plan has been rejected by the President under this Article (the investment plan proposed by China National Aero-Technology Import and Export Corporation in 1990). However, there have been some cases where foreign companies have voluntarily withdrawn their investment plans through prior consultations with the CFIUS, and there have also been some cases where post-investment requirements were added (such as confidential obligations, limited involvement in corporate management, and commitment to business continuation).

(b) Recent trend of review

In 2005, the United States became aware of the necessity for reviewing the Exxon-Florio Amendment after a series of takeover attempts including a bid by China National Offshore Oil Corporation (CNOOC) to take over the major oil producer Unocal in June and an attempt by UAE firm DPW to take over the port management company P&O in November.

Both of the above 2 cases were attempts by state-run companies in other countries to take over U.S. companies. In the former case, the following concerns were raised: (i) control over the U.S. oil and natural gas resources by the Chinese government, (ii) outflow of important technologies such as oil drilling, and (iii) reciprocity. In the latter case, a concern was raised over the assignment of control over a port facility that plays an important role in counterterrorism efforts to a state-run Middle Eastern company. In both cases, investors voluntarily withdrew their plans during the CFIUS inspection (in the latter case, the notification was re-submitted after approval) in view of strong Congressional and public opposition.

The Foreign Investment and National Security Act of 2007 (FINSA) was approved by the Congress on June 29, signed by the U.S. President on July 26, and took effect on October 24, 2007.

The FINSA increased the elements included in the concept of “national security” from the previous laws and provides clear screening criteria such as “critical infrastructures,” “critical technologies,” and “the long-term projection of United States requirements for sources of energy and other critical resources and material,” etc. It also enhanced the screening system by adding the Secretary of Energy and the Director of National Intelligence to the CFIUS member list (see Table 4-4-13).

Table 4-4-13 Major Aspects of Foreign Investment and National Security Act of 2007 (FINSA)

(1)	Review of the screening system
	The Act legally stipulates the establishment of a screening body, the Committee on Foreign Investment in the United (CFIUS). CFIUS members were selected from among various departments and agencies such as the Energy Department.
(2)	Expansion of the concept on national security
	The concept of "national security" was expanded by including the impact on critical infrastructures and technologies, impact on long-term projection of United States requirements for sources of energy, etc.
(3)	Developing the procedure for a mitigation agreement
	The Act has laid down procedures (for concerned government departments and investors) for negotiating with investors, monitoring transactions, and violation of the mitigation agreement.
(4)	Developing enforcement measures
	The Act stipulates actions to be taken such as re-screening and civil lawsuit in the event that an investor makes a false notification or violates the mitigation agreement.
(5)	Strengthening monitoring of the Congress
	The Act requires the CFIUS to report to the Congress.

Source: Ministry of Economy, Trade and Industry, Japan

On April 21, 2008, after the enactment of the FINSA, the Treasury Department publicly released on a treasury regulation, which defines details of the regulation and sought public comments. The newregulation expands the scope of the transactions subject to the regulation and clearly stipulates that acquiring less than 10% of the shares in a company is also subject to the regulation if it is not for passive investment purposes, and the passive investment is determined based “whether or not the investor has an ability and intention to take control and whether or not the investor is acting contrary to the passive investment.” It also encourages foreign investors to submit prior notifications although such submission is discretionary. It also expands the content of the notification (to include data such as personal information about directors and information about the composition of group companies) and encourages foreign investors to have prior consultations with relevant departments and agencies before submitting their notifications. It also clearly stipulates that the “critical technologies” subject to the screening include general-purpose technologies that are subject to export control under the International Export Control Regime.

○ The United Kingdom

The Enterprise Act was enacted in 2002 in the U.K. It is designed to regulate corporate mergers in general regardless of whether they involve foreign or domestic capital. It grants the Office of Fair Trading and the Competition Commission the right to inspect corporate mergers, and grants the Secretary of State for Trade and Industry the right to intervene in a transaction only when any concern over public interests arises. The “public interests” are defined to include “concerns over national security” and the Secretary of State for Trade and Industry can reject or order modification to any corporate takeover that are likely to jeopardize national security.

Since June 2003, there have been 6 publicized cases of inward direct investment plans, in which the government intervened under the act. All of the 6 cases involved takeovers of U.K. companies in the defense industry and were screened from the viewpoint of national security and were approved subject to certain investment conditions (maintaining defense production bases and confidential obligations).

○ **France**

A news report about a possible takeover of a French company Danone by a U.S. company PepsiCo in July 2005 triggered strong public opposition in France from the viewpoint of the "Economic Patriotism" and increased the awareness about the need to strengthen investment regulation for security purposes.

The relevant ordinance was enacted under the Monetary and Financial Code in December 2005. The ordinance publicly announced 11 strategic sectors that are subject to prior approval for corporate takeovers by foreign companies. It clearly stipulates that important technologies from the viewpoint of national security including, for example, encryption technology, dual-use technology (military and consumer) and biotechnology are subject to the regulation. When a foreign company plans to acquire over one-third (1/3) of the voting rights of a French company in any of the strategic sectors, it has to apply to the Ministry of Economy, Finance and Industry for approval. The Minister of Economy, Finance and Industry has the authority to reject the investment plan within one month after the receipt of the application if it may jeopardize public order, public safety, or national defense interests.

○ **Germany**

Public concerns over the impact on the domestic defense production bases and the outflow of military technology through corporate takeovers increased in Germany following a bid by a U.S. investment fund to takeover German submarine builder HDW in March 2003. As a result, the Foreign Trade and Payments Act was revised in 2004 and a new provision to regulate investment for security reasons was included.

Under the Act, a foreign company seeking to acquire 25% or more of the voting rights in a Germany company that develops weapons or encryption programs related to the national secrets is required to apply to the Federal Ministry of Economics and Labor for approval. The revised ordinance passed in 2005 expanded the scope of regulation to include makers of tank engines. The Federal Ministry of Economics and Labor has the authority to reject an investment plan within one month after the receipt of the application if the Ministry deems the rejection necessary for the protection of "vital security interests."

Last year, the German government began discussions on a comprehensive investment regulation similar to the Exon-Florio Amendment in the United States and developed a draft amendment (the 13th revised bill on the revision of the Foreign Trade and Payments Act and its implementing regulations) to the Foreign Trade and Payments Act. The latest revision is aimed at regulating takeovers of German companies in all industries by any investor if they are likely to adversely impact "public order and national security."

(Matters related to foreign direct investment)

Foreign direct investment contributes greatly to and is crucial to the Japanese economy as a whole and revitalizing the local economies through the introduction of new technologies and management know-how. The Government of Japan set the goal of "doubling the amount of the foreign direct investment in Japan by the end of 2006 over that in 2001" and was almost successful in achieving that goal (from 6.6 trillion yen at the end of 2001 to 12.8 trillion yen at the end of 2006). In March 2006, the government set a new goal of "doubling the amount of the foreign direct investment in Japan to about 5% of GDP by 2010" and decided to welcome foreign direct investment in a broad range of industrial sectors[8].

As described earlier, the OECD Code allows member countries to take measures necessary for the "maintenance of the public order" and the "protection of its essential security interests." Japan has enforced the minimum regulation on the foreign direct investment under the FEFTA by limiting the scope of industries, which is in line with the OECD Code, by maintaining the balance between the promotion of the foreign direct investment in Japan and the maintenance of "national security" and "public order." As described above, developed countries have also created legal systems to take the necessary restrictive actions (see Table 4-4-14).

Figure 4-4-14 Outline of Foreign Investment Rules in Developed Countries

	Japan	U.S.	U.K.	France	Germany
Regulation	Foreign Exchange and Foreign Trade Law, Article 27-1, 1949.	Defence Production Act (1950), Section 721, as added by 5021 of the Omnibus Trade and Competitiveness Act (1988), and as amended by 837 of the National Defence Authorisation Act for Fiscal Year 1993. 50 U.S.C. App. 2170.	The Enterprise Act of 2002 *	Code Monétaire et Financier	Trade and Payments Ordinance (July 2004)
Competent Authorities	Ministry of Finance Minister in charge of the industry	President Committee on Foreign Investment in the United States (CFIUS)	Ministry of Trade and Industry	Ministry of Economy	The Federal Ministry of Economics and Technology
Industrial Area (Closed List)	Manufacture of weapons, aircraft, nuclear energy, spacecraft, dual use items with a high probability of conversion to military uses, and electricity, gas, etc.	All types of industry	All types of industry	Strategic 11 items ▪ Dual use technologies ▪ Weapons, etc.	War Weapons Cryptosystems Engines for combat vehicle
Coverage of transactions	Listed company: Acquisition of more than 10% of all stock	Listed company: Acquisition of more than 10% of all stock	All type of Affiliations	Acquisition of more than a one-third of the voting right of the company	Acquisition of more than 25% of the voting right of the company
Screening criterion	National security Public order Public safety	National security	Public interest including National security	Public order Public security National defence interests	Essential security interests

* The Enterprise Act of 2002 (UK) provides the government the authority to intervene to block or place conditions on the approve of M&As involving British Companies

Source: Ministry of Economy, Trade and Industry, Japan

2. Smoothening of outward direct investment – Promoting investment agreements

(1) Efforts made by Japan to encourage outward direct investment

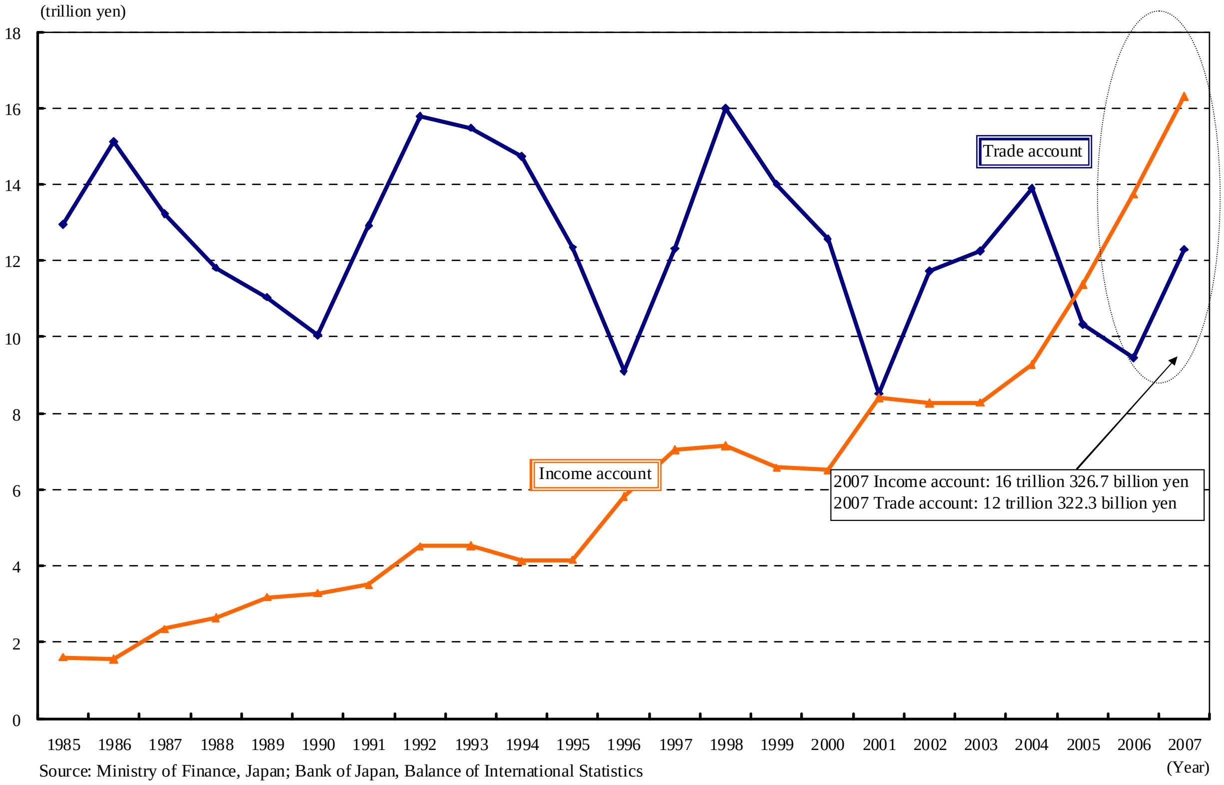
The global foreign direct invest has been increasing rapidly since the 1980s and is playing an important role, together with trade, in leading the global economic growth. The balance of the global foreign direct investment as a percentage of GDP increased from 5.8% for the outward direct investment and 5.3% for the inward direct investment in 1980 to 24.8% and 26.1%, respectively, in 2006.

Japan's balance of international payments shows that Japan has been constantly recording a trade surplus since the late 1980s and, as a result, the amount of Japan's outward investment has steadily increased. The income received from such foreign investment has been increasing in recent years. The income account surplus reached about 16.3 trillion yen in 2007, far exceeding the trade account surplus of about 12.3 trillion yen. The income account has exceeded the trade account for 3 consecutive years (see Figure 4-4-15). The reasons for such increase in the income account surplus

[8] The balance of the foreign direct investment in Japan as of December 2007 increased by 2.3 trillion yen to about 15.1 trillion yen (2.9% by GDP comparison), marking the highest year-on-year increase of 18% in the past 5 years.

include the increased returns received from securities investment and increased profits of foreign subsidiaries of Japanese companies as more and more Japanese companies establish business units abroad[9] (see Figure 4-4-16). The income received from the direct investment increased by 30% over the previous year to approximately 5.31 trillion yen in 2007[10].

Figure 4-4-15. Japan's Trade Account and Income Account

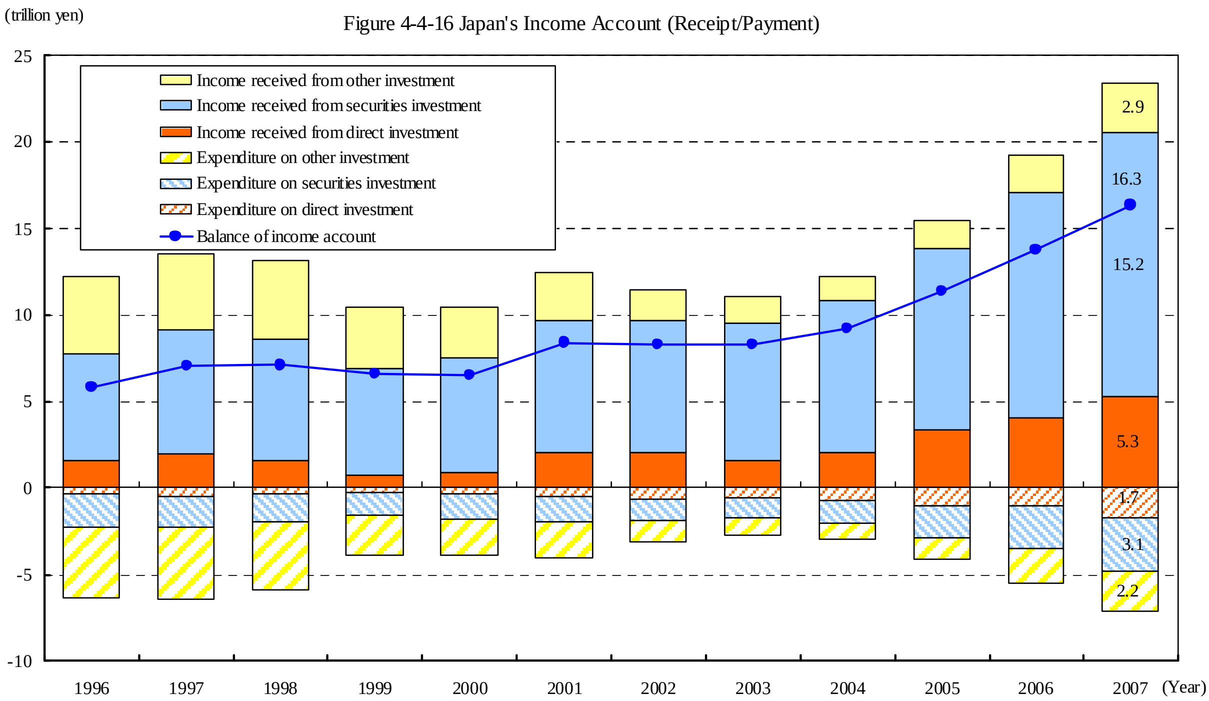


Source: Ministry of Finance, Japan; Bank of Japan, Balance of International Statistics

9 Negative effects of outward direct investment that are often pointed out include reduced employment opportunities in Japan owing to off-shoring and relocation of production bases especially to developing countries (Samuelson 2004). However, according to Kimura (2008), "FTA NO ASIA HATTEN ENO KOUKEN TO WAGAKUNI NO FTA SENRYAKU," the results of the analysis of the 1998–2003 panel data of Japanese companies by Ando and Kimura (2007a and 2007b) reveal that Japanese manufacturers that established or expanded their foreign subsidiaries in East Asia recruited more employees in Japan as compared to companies that did not expand their foreign subsidiaries in East Asia. The survey in the "White Paper on International Economy and Trade 2007" also shows that among Japanese companies that moved their business units abroad, the number of companies that responded that they recruited more employees in Japan after establishing their business units abroad far exceeded the number of companies that said otherwise, indicating no sign of the negative effects of the investment.

10 See Figure 1-1-23 for the performance (as indicated by sales, ordinary profits ratio, and ratio of overseas production) of the outward direct investment by Japanese companies.

Figure 4-4-16 Japan's Income Account (Receipt/Payment)



Note: For accuracy of calcualtion, the income account receipts/payments includes the receipt of employer salary (salary received by a resident worker abroad) and the payment of employer salary (salary paid by a resident to a non-resident worker). Such receipts/payments were excluded from the calculation as their share is less than 0.5% in each of the years.

(2) Bilateral investment agreements concluded worldwide

Given the worldwide increase in foreign direct investment since the late 1950s, many countries have started to conclude bilateral investment agreements to protect their investors and their invested properties against such risks as discriminatory treatment and expropriation (including nationalization) in destination countries.

The number of bilateral investment agreements across the world has been rising sharply in recent times and has reached 2,573 in 2006 (see Figure 4-4-17). As of July 1, 2008, Germany, China, the U.K., and France had concluded about 100 bilateral investment agreements, while Japan had concluded merely 17 such agreements, including economic partnership agreements[11] (see Figure 4-4-18).

Many investment agreements include provisions on procedures for the settlement of disputes over disadvantages suffered by investors (companies) in destination countries. If agreements do not include such provisions, investors who suffer disadvantages may face difficulties in finding a legal basis to seek the removal of such disadvantages through an arbitration agency. According to the UNCTAD, after the first case was reported in 1987[12], only 14 investment arbitration cases (filed with arbitration agencies) between investors and investment destination countries were filed until 1998[13], but this figure has increased sharply since the late 1990s, reaching a total of 290 cases[14] as of December 2007.

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[11] However, the number of bilateral investment agreements concluded by Japan increases to 21 if the agreements (including investment charters of EPAs) already concluded with the Philippines, Brunei, Cambodia, and Laos are combined (as of July 1, 2008).

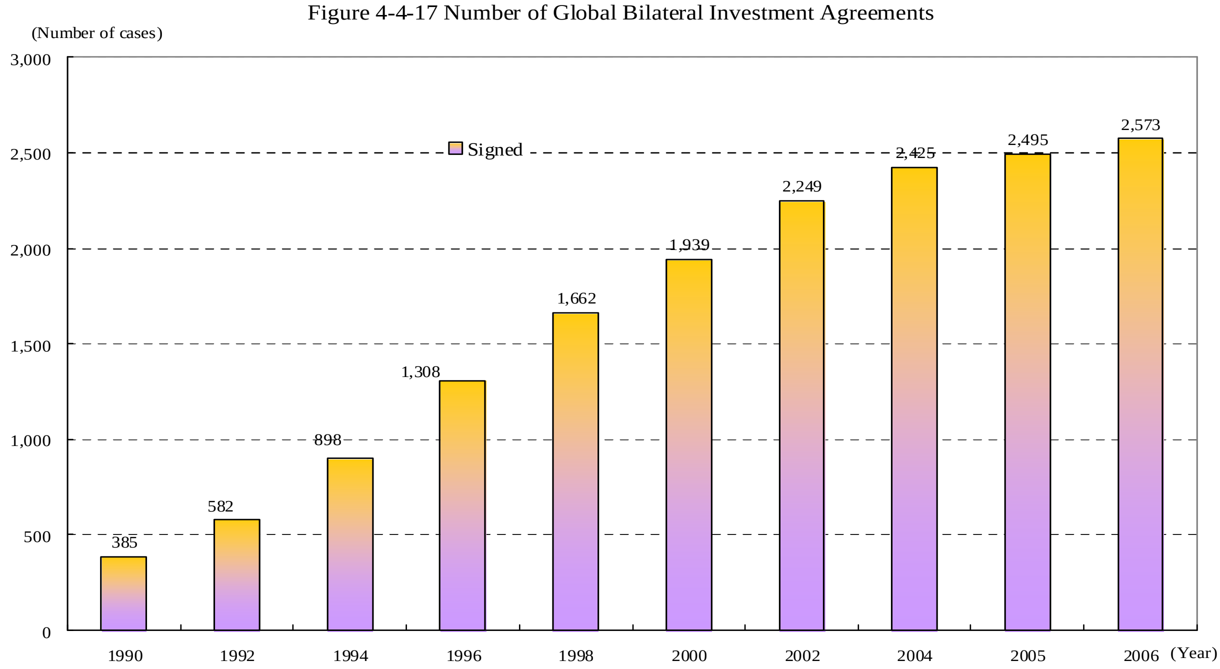
[12] Asian Agricultural Products Limited vs. the Government of Sri Lanka (ICSID Case No. ARB/87/3)

[13] Source: UNCTAD (2005), "INVESTOR-STATE DISPUTES ARISING FROM INVESTMENT TREATIES: A REVIEW"

[14] The "Ethyl" case filed by NAFTA (A U.S. company filed an arbitration case against the Canadian government alleging that the government's environmental policy is tantamount to "expropriation" under the

However, only 1 of these arbitration cases was filed by a Japanese company—a case that involved its foreign subsidiary[15].

Figure 4-4-17 Number of Global Bilateral Investment Agreements



Source: UNCTAD, IIA MONITOR No.3 (2006).

NAFTA. The Canadian government agreed to pay compensation to the U.S. company). This incident has reportedly drawn more attention to investment arbitration.

15 This was a case over an action taken by the Czech government against a Czech bank acquired by a London subsidiary of a Japanese securities company through a "paper company" in the Netherlands in 1998. The case was filed with the United Nations Commission on International Trade Law (UNCITRAL) under the bilateral investment agreement between the Czech Republic and the Netherlands.

Table 4-4-18 Bilateral Investment Agreements Signed by Japan

Country (Region)	Signed	Enacted
Egypt	Jan. 28, 1977	Jan. 14, 1978
Sri Lanka	Mar. 1, 1982	Aug. 4, 1989
China	Aug. 2, 1988	May 14, 1989
Turkey	Feb. 12, 1992	Mar. 12, 1993
Hong Kong	May 15, 1997	June 18, 1997
Pakistan	Mar. 10, 1998	May 29, 2002
Bangladesh	Nov. 10, 1998	Aug. 25, 1999
Russia	Nov. 13, 1998	Mau 27, 2000
Mongolia	Feb. 15, 2001	Mar. 24, 2002
Singapore (EPA)	Jan. 13, 2002	Nov. 30, 2002
Republic of Korea	Mar. 22, 2002	Jan. 1, 2003
Vietnam	Nov. 14, 2003	Dec. 19, 2004
Mexico (EPA)	Sep. 14, 2004	Apr. 1, 2005
Malaysia (EPA)	Dec. 13, 2005	July 13, 2006
Philippines (EPA)	Sep. 9, 2006	TBD
Chile (EPA)	Mar. 27, 2007	Sep. 3, 2007
Thailand (EPA)	Apr. 3, 2007	Nov. 1, 2007
Cambodia	June 14, 2007	July 31, 2008
Brunei (EPA)	June 18, 2007	July 31, 2008
Indonesia (EPA)	Aug. 20, 2007	July 1, 2008
Laos	Jan. 16, 2008	TBD

Source: Website of the Ministry of Foreign Affairs, Japan

(3) Investment agreements as a tool to protect and facilitate investment

Bilateral investment agreements were originally regarded as “Investment Protection Agreements” that defines provisions on the following: (1) granting the national treatment/most-favored-nation status to invested properties; (2) expropriation conditions; (3) the amount and form of the compensation; (4) the procedures for the settlement of disputes between the two countries and between the destination country and an investor in order to protect investors from risks such as expropriation of invested properties and willful legal misinterpretations in destination countries. In the 1990s, however, a new type of investment agreement – the “Investment Protection and Liberalization Agreement” was introduced, which includes provisions to grant the national treatment/most-favored-nation status as soon as the investment is licensed, prohibit the performance requests[16], ban enhancement of foreign capital controls, mandate efforts for gradual liberalization, and secure transparency (mandating the publication of laws and response to inquiries from the signatory)[17] (see Table 4-4-19).

[16] Specific requirements were attached to the investment such as satisfying a certain local content ratio and exporting a certain ratio of goods manufactured.

[17] The major agreements include the Investment charter of the NAFTA, the Investment charter of Japan’s bilateral EPAs and Japan’s bilateral investment agreements with S. Korea, Vietnam, Cambodia and Laos.

Table 4-4-19 Benefits of Investment Agreements

1. Security of investments and fair treatment of investors
(1) **Buisness licenses are not revoked** once granted.
(2) Business assets not **expropriated.**
(3) Prevention of **business discontinuation by means of enhanced regulations** (indirect expropriation)
(4) Making the government of the destination country **strictly adhere to investment agreements, concession agreements, and investment incentives (unbrella clause)**
(5) Securing **free remittance** to Japan
2. Prohibiting discriminatory treatment with competing foreign-capitalized companies excluding **domestic-capitalized companies** (**most-favored-nation status (MFN)**)
3. Prohibiting **discriminatory treatment** with competing domestic-capitalized companies (**national treatment (NT)**)
4. Obligation to provide **fair and equitable treatment** (FET) to investors and invested properties
5. Some agreements prohibit the following investment licensing requirements: (prohibiting **performance requests (PR)**)
(1) Requirement of providing **employment of** a certain percentage or number of **local people**
(2) Requirement that the **directors or managers** be persons from certain **nationalities**
(3) Requirement of technology transfer to a domestic-capitalized partner(s)
(4) Requirement of making **a certain amount of R&D investment** in the destination country
(5) Requirement to locate the headquarters in a certain region
(6) Requirement to provide exclusive supply of goods to a certain region (not setting up another supply base in another country)

* Investors can file a protest with **international arbitration agencies** against countries violating these obligations.

Source: Ministry of Economy, Trade and Industry, Japan

(4) Policy on efforts for investment agreements

The need for such investment agreements is particularly strong for countries where many Japanese companies have or are expected to have their business units, whose markets are less open to foreign countries or whose legal systems are inadequate (for example, laws are revised frequently or less transparent). However, negotiations on bilateral agreements are costly and the government resources available for such negotiations are limited. For this reason, the Japanese government has to prioritize negotiating countries in view of the practical needs and proceed with the negotiations swiftly and flexibly.

Possible candidates for the negotiations include countries where laws are revised frequently, whose investment environments draw concerns such as insufficient transparency, and which satisfy the following conditions: (1) countries which currently or potentially have a certain level of investment stocks from Japan; (2) countries such as those in the Middle East, which produce resources such as oil, natural gas, and rare metals; and (3) countries that serve as regional hubs in South America and Africa. Possible candidates also include countries that are actively promoting the agreements and with which Japan is very likely to conclude high-level agreements with negligible negotiating costs.

The Japanese government should, in addition to expediting the conclusion of investment agreements, actively enhance its cooperation and partnership with the relevant organizations, especially NEXI, JETRO, and JBIC[18].

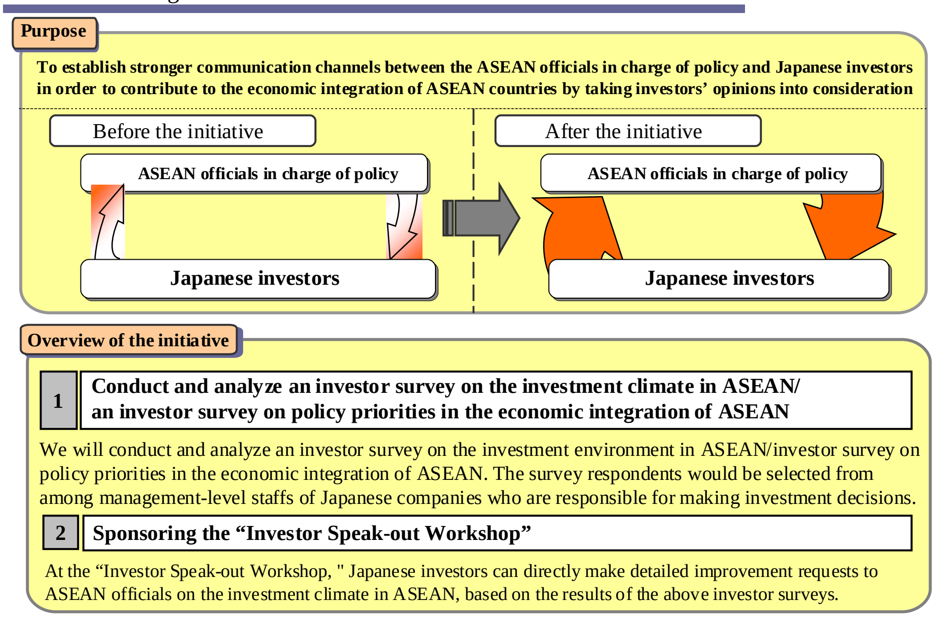
[18] "On the Improvement of Japan's Global Investment Environment - Toward the Creation of a Legal Framework for Japanese Foreign Investment" by Nippon Keidanren dated April 15, 2008 and "Petition for the Acceleration of the Conclusion of Investment Agreements" by Japan Foreign Trade Council, Inc. dated March 19, 2008 also call for early improvement of high quality legal systems to promote investment. Upon such strong call from the business community, the "Basic Policies on Economic and Fiscal Reform 2008" compiled on June 27, 2008 includes a policy of strategically using the investment agreements.

(5) Need for developing a framework for improving business environment in Asia

In order for Japanese companies to continue with their global business expansion with the growth in Asia as the pillar, it is important to improve the investment and business environment in overseas markets so as to increase the foreseeability of their business strategies. This is beneficial to not only Japanese companies but also companies in the destination countries.

Asian countries, in particular, have regulations that considerably hamper international expansion of companies, ill-prepared legal systems, and various problems with the operation of the systems[19]. It is important for the Japanese government to further promote the on-going bilateral governmental and private-sector dialogues with Vietnam, Malaysia, and Indonesia to promote improvements in their system and system operations in Asian countries for the benefit of global expansion of businesses. It is also important for the Japanese government to constantly implement the "ASEAN Common Investment Climate Initiative" to enhance communication channels between Japanese investors and ASEAN policy-makers and to improve the investment and business environment in the ASEAN region by taking Japanese investors' opinions into consideration (see Figure 4-4-20).

Figure 4-4-20 ASEAN Common Investment Climate Initiative



Source: Ministry of Economy, Trade and Industry, Japan

3. Creating a positive cycle of cultivating overseas markets and promoting innovation in Japan

It is indispensable for Japanese companies to reap the fruits of the economic growth in other countries and bring them back to the Japanese market in order for the Japanese economy to maintain sustainable growth amid the rapid growth of overseas markets led by newly emerging economies.

(Developing a system to facilitate the flow of overseas funds into Japan)

As described in Sections 2 and 3 of this Chapter, the Japanese government has actively worked on policies such as those related to the WTO and EPAs/FTAs to help Japanese companies expand into overseas markets. At the same time, it is also important for the Japanese government to create a

[19] For example, remittance control, limited foreign capital ratio and mandatory technology transfer, etc.

positive cycle of "cultivating overseas markets and promoting innovation in Japan" in which profits earned by Japanese companies from their overseas operations can be spent positively on capital investment and R&D in Japan.

However, as pointed out in Section 2 of Chapter 2, while the amount of retained profits of foreign subsidiaries of Japanese companies has increased rapidly, there has only been a moderate increase in the amount of dividend, indicating that the flow of overseas funds into Japan is not increasing as expected. The sluggish flow of overseas funds into Japan could hamper such corporate activities as capital investment and R&D, which are necessary for promoting innovation in Japan and could lead to a decline in the international competitiveness of Japanese companies.

It is necessary for the Japanese government to consider systems that facilitate the flow of overseas funds into Japan. In order for Japanese companies to send their overseas profits back to Japan, such systems should be designed in a manner that enables Japanese companies operating worldwide to send profits of their foreign subsidiaries back to the headquarters in Japan at the necessary amount and time, based on overall investment strategies and/or growth strategies of the corporate groups without obstructions from tax systems. In particular, the international taxation system has to be reviewed in view of replacing the current foreign tax credit system with the extraterritorial income exclusion system (see Table 4-4-21).

In Japan, the Tax Reform Proposals for FY2008 cite as a topic for future study the review of the foreign tax credit system from the perspective of promoting and simplifying the systems regulating the flow of overseas funds into Japan while keeping an eye on the moves in major countries including the United States and European countries.

Table 4-4-21 Comparison of the foreign tax credit system and the extraterritorial income exclusion system

Extraterritorial income exclusion system [21 out of 30 OECD countries including France, Germany, and Canada]
→ The concept basically limits the scope of corporate taxes to domestic income.
(for e.g., dividends received from foreign subsidiaries)
Worldwide income taxation system (foreign tax credit system) [9 out of 30 OECD countries including Japan, U.S. and U.K.]
→ According to this system, taxes are imposed on all income earned by Japanese companies regardless of the location. However, there are the following exceptions:
(1) There is no tax on income of foreign subsidiaries as long as the income is not paid to the parent company.
(Tax deferral)
(2) The tax amount paid by Japanese companies abroad is deducted from their corporate tax in Japan.
(Foreign tax credit system)

Source: Ministry of Economy, Trade and Industry, Japan

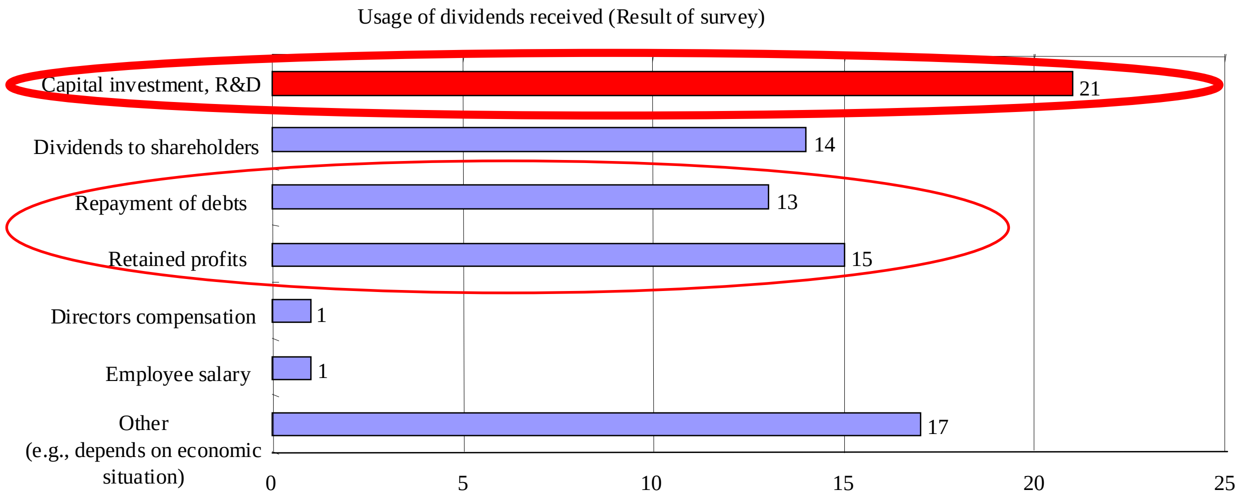
(Effect of flow of funds to Japan)

If the extraterritorial income exclusion system is to be adopted, as described above, there is need to form a positive cycle of "cultivating overseas markets and promoting innovation in Japan," in which profits earned by Japanese companies from their overseas operations can be spent positively on capital investment and R&D in Japan. According to the result of a survey by the Ministry of Economy, Trade and Industry, 27 out of 55 corporate respondents explicitly stated that if the extraterritorial income exclusion system were adopted, they would increase the dividends received from their foreign subsidiaries, and 21 out of 46 companies responded that they would spend the funds on capital investment and R&D in Japan. The result indicates that the flow of overseas funds into Japan can contribute to revitalizing and enhancing the growth of the Japanese economy (see Figure 4-4-22).

The extraterritorial income exclusion system is also expected to simplify and improve the efficiency of Japan's taxation systems as it can reduce the huge clerical costs.

Figure 4-4-22 Usage of Dividends Received from Foreign Subsidiaries
after Adoption of Extraterritorial Income Exclusion System

○ 21 out of 41 companies responded that they would spend the funds on capital investment and R&D in Japan if the extraterritorial income exclusion system is to be adopted. (Survey conducted by the Ministry of Economy, Trade and Industry, Japan)



Note: Respondents are member companies of Nippon Keidanren (Valid answers from 46 companies (with multiple answers))
Source: Survey conducted by Ministry of Economy, Trade and Industry, Japan (November 2005)

(Efforts in major countries (the U.S. and U.K.))

The United States and the United Kingdom are also contemplating the replacement of the current worldwide income taxation system and foreign tax credit system with the extraterritorial income exclusion system.

In the United States, a presidential advisory committee presented the final report in November 2005. The report cites the following 2 major problems with the existing system: (1) deferral of taxation on retained profits of foreign subsidiaries and the resulting impact on corporate decision-making on capital spending and (2) diverted use of maximum deductible amounts and the system complexity, both of which arise from the combined use of the high-tax rate income and the low-tax rate income under the foreign tax credit system. The report proposes the following solutions to these problems: (1) the extraterritorial income should be classified into ordinary income and investment income, and the extraterritorial income exclusion system should be applied to the former while the foreign tax credit system should be applied to the latter, and (2) the enforcement of the transfer pricing tax system should be enhanced as the extraterritorial income exclusion system adopted to the ordinary income could urge companies to move the profits of their foreign subsidiaries to countries with lower taxes.

The Treasury Department Report[20] released in December 2007 describes more specific proposals based on the aforementioned committee report. For example, it proposes that the income subject to the extraterritorial income exclusion system should be the dividend income and the branch office profit,

[20] Source: "Approaches to Improve the Competitiveness of U.S. Business Tax System for the 21st Century"

and offers an alternative proposal for expanding the scope of the exemption to the interest/usage fees[21].

On the other hand, in the United Kingdom, the Ministry of Finance submitted its proposal[22] in June 2007. In view of the problems similar to those seen in the United States, it proposes to apply the extraterritorial income exclusion system to dividends received from foreign subsidiaries of major companies and to enhance controls on foreign subsidiaries (which are equivalent to the anti-tax haven taxation in Japan) for preventing the abuse of the system[23].

4. Improving Japan's ability to deliver a message to the world

Increasing the recognition and presence of Japan in the global economy is an effective means to promote both inward and outward direct investments. This subsection describes efforts by the Japanese government to actively deliver a message about Japan's attractiveness across the world.

(1) Improving Japan's ability to deliver a message abroad through top sales

Global recognition of Japan's attractiveness is expected to lead to an increase in foreign investment in Japan and in the expansion of business opportunities for Japanese companies in overseas markets. For example, by stressing its technological and other strengths and aggressively expressing its willingness to become a major partner for providing support and cooperation for the economic development of other countries, Japan can create an atmosphere for enhancing long-term economic relationship with Japan.

From such a perspective, it is very important for the leader of the central government and the relevant ministers and leaders of municipal governments to join hands with the industries in delivering a message about Japan's attractiveness to leaders and industries of other countries (the so-called "top sales").

An economic mission of about 130 Japanese industry leaders accompanied the then-Prime Minister Shinzo Abe when he made an official visit to Vietnam in November 2006. This is regarded as a pioneering case of such an economic mission. There was a meeting that was attended by the leaders of the 2 countries and the mission was arranged in Vietnam[24] and Prime Minister Abe attended the "Japan-Vietnam Economic Seminar"[25]. Thus, the government and the industries jointly advocated

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[21] There is a concern that the extraterritorial income exclusion system could lead to a increase in tax as the system prevents the diverted use of maximum deductible amounts.

[22] The Ministry of Finance released the report entitled "Taxation of Companies' foreign profits" in June 2007 as a material for discussions on taxation of the extraterritorial income. The adoption of the extraterritorial income exclusion system on extraterritorial dividend income is said to be highly likely as the Fiscal Law will probably be revised in 2009.

[23] It also proposes to impose a cap on the interest deduction.

[24] At the meeting, Prime Minister Abe said that the economic mission accompanying him is indicative of the strong interest in Vietnam among Japanese industries. Further, he expressed his willingness to promote, in cooperation with the Japanese government and industries, bilateral cooperation in IT-related human resource development, development of energy, nuclear power plants and infrastructure, and to identify the possible support for economic development projects through Japanese technology and know-how. The economic mission, meanwhile, expressed its expectation for further acceleration of the negotiations on the Japan-Vietnam Economic Partnership Agreement and sought further liberalization of trade in goods and protection of the intellectual property rights in Vietnam. Vietnamese Prime Minister Dung stated that he would make every effort to improve the business environment to expand trade and investment in Vietnam.

[25] It was sponsored jointly by Investment Ministry of Vietnam and Nippon Keidanren. A total of about 600 people attended the seminar.

further enhancement of the trade and investment relationship between Japan and Vietnam. An economic mission of about 180 Japanese industry leaders also accompanied the then-Prime Minister Abe when he made official visits to 5 Middle Eastern countries (Saudi Arabia, UAE, Kuwait, Qatar and Egypt) in April 2007. The mission attended some of the summit meetings and also some business forums with Prime Minister Abe and exchanged opinions with industry leaders of these countries.

An economic mission of Japanese industry leaders also accompanied the former Minister of Economy, Trade and Industry Amari when he visited India in the period June–July 2007 and both Japanese political and industry leaders exchanged opinions on the India's plan for the Delhi-Mumbai Industrial Corridor Project with Indian government officials including Prime Minister Singh.

A large economic mission of over 2,250 Japanese industry leaders accompanied Prime Minister Abe when he visited Indonesia, India, and Malaysia in August 2007. The mission along with the government successfully promoted the economic relationship with these countries.

The JETRO is sponsoring symposiums on investment in Japan, which are attended by many municipal government leaders because of their increased interest in attracting foreign companies.

Direct high-level exchange of opinions among people from the public and private sectors of Japan and their foreign counterparts at these meetings, seminars, and forums is instrumental in establishing close ties at various levels between Japan and other countries.

The Japanese government should continue to explore ways of forming effective partnerships between the government and industries to increase interest in Japan among countries across the world.

(2) Establishing "Japan Brand" and delivering a message overseas

In addition to its "hardware" advantages, such as high-level skills and advanced technologies in developing products, Japan should also take advantage of its "software" strengths including its unique cultural values to establish a new "Japan Brand" and should actively promote "Japan Brand" throughout the world in order to make Japan open and attractive to the rest of the world.

(Efforts for establishing "Japan Brand")

Specific efforts necessary for establishing "Japan Brand" have been discussed at various governmental bodies including the Strategic Council on Intellectual Property . The Ministry of Economy, Trade and Industry organized the "Neo-Japanesque ("Japanesque Modern") Brand Promotion Council" in May 2005, which discussed how the government-industry cooperation can help create the new "Japan Brand" (neo-Japanesque brand) by re-evaluating various traditional values of Japan in the modern life in order to develop new products and content to meet the modern lifestyle and social needs. The forum developed 3-year action plan consists of 6 campaigns and 28 relevant programs[26] in July 2005. The "Japanesque Modern" Committee led by the private sectors was set up in January 2007 to facilitate the implementation of the action plan. Major activities of the committee include sponsoring various seminars in Japan and abroad and proposing ways to express Japan's cultural values through the existing products and content, convergence of such products and content

[26] Major activities of the committee include developing a network to promote "Japanesque Modern," developing specific products, content and evaluation systems to manage brands, sponsoring a campaign to raise awareness about the "Japanesque Modern" ("Feel Japan" campaign), brand leaders, sponsoring campaigns for overseas promotion, sponsoring various events, selecting "Japanesque Modern 100" and developing human resources.

with advanced technology, and application of such products and content to the modern life. It also selects and introduces the "Japanesque Modern 100" to help promote Japan's international competitiveness and industries[27].

The Ministry of Economy, Trade and Industry also supports the development of local brands through the "JAPAN Brand Development Assistance Program"[28]. These efforts are expected to promote the development of local economies through a combination of the software aspect of Japan's characteristics with the hardware aspect of Japan's strengths.

In May 2007, the Ministry of Economy, Trade and Industry (METI) announced the "Kansei Value Creation Initiative," which proposes a new value of "Kansei" in addition to the traditional values of manufacturing (such as performance, reliability, and prices) for viable development of the Japanese economy and society amid the declining birth rate and the declining and aging population. Based on this initiative, the METI launched the "Kansei Value Creation Years" on April 1, 2008, that will intensively promote measures to raise awareness about the initiative for the next 3 years. In particular, it sponsors the "Kansei Value Creation Fair," which is an event aimed at introducing excellent products and services with strong feeling. It also sponsors the information portal "Kansei Value Creation Bank" and the "KANSEI Café," which is a civil seminar to develop human resources.

(Promoting the delivery of messages overseas through content, fashion, and "KANSEI")

The major driving force for delivering the "Japan Brand" messages is the content (movies, music, animations, games, comics, and TV programs), which can deliver information by combining elements such as tradition, lifestyle, and feeling. However, the current status of the Japanese content industry suggests that the business activity of the industry focuses mainly on the Japanese domestic market and little progress has been made in expanding to overseas markets[29] and global advertisements and public relations activities remain passive. It is important to increase the international competitiveness and promote the strategic global development of the Japanese content industry as part Japan's efforts to deliver a message about Japan's attractiveness to the rest of the world.

The government and industries are working on measures[30] to promote the content industry and

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[27] As of April 2008, 116 products have been selected.

[28] Various efforts (such as market research, development of brand strategies, development of new products and sponsoring of exhibitions in Japan and abroad) have been made by the Japan Chamber of Commerce and Industry and the Federation of Societies of Commerce and Industry to establish a global "Japan Brand" that promotes "Japan" by increasing the value of products through efforts by local communities as a whole to take advantage of their local strengths (such as resources and technologies).

[29] According to an estimate by the Ministry of Economy, Trade and Industry based on surveys by the Digital Content Association of Japan, the content industry's ratio of dependency on foreign markets (the ratio of sales in overseas markets to the total sales) stands at 17.8% in the U.S. and 1.9% in Japan.

[30] This involves, for example, expanding the size of the International Content Market, which co-sponsors events related to character goods, TV programs, games, animations and comics as well as films. In FY2006, 58 out of 1970 business negotiations reached agreements at the Tokyo international Film Festival (co-sponsored by the Ministry of Economy, Trade and Industry and supported by the Agency for Cultural Affairs, the Ministry of Foreign Affairs and the Ministry of Ministry of Internal Affairs and Telecommunications). The JETRO introduced Japanese films in international film markets (In FY2006, 65 out of 271 business negotiations reached prospective agreements). The Asia Content Industry Seminar was organized, which is a ministerial-level meeting of 14 East Asian countries (including Japan, China, S. Korea, ASEAN and India) aimed at enhancing the partnership in the content industry in East Asia. The first meeting was held in Tokyo in October 2005, followed by a meeting in Philippines in May 2006. Measures were taken to counter pirated goods.

enhance its international competitiveness as part of the efforts included in the government's "Intellectual Property Strategic Proogram," which is designed to make Japan an "intellectual property-oriented country." However, such efforts should be enhanced and accelerated further given the rapidly changing environment of the content industry including the rapid progress in the efforts for supporting each field of the content industry in other countries (especially Asian countries such as China and South Korea) and the increasingly diversifying content distribution channels due to wide-spread use of broadband internet.

The Ministry of Economy, Trade and Industry has launched the "JAPAN International Content Festival," which exemplifies the International Content Carnival Initiative[31] proposed in the "Basic Policies for Economic and Fiscal Management and Structural Reform 2006 (the Basic Policies 2006)" and the Economic Growth Strategy Proposals. This festival is designed to promote partnership among different fields of the content industry and to expand the synergy effect on successfully concluding business negotiations and attracting global attention by holding exhibitions simultaneously, as far as possible, instead of holding them separately. In 2007, 18 official events and 11 partner events were held in the span of about one month beginning with the Tokyo Game Show on September 19, followed by events related to animations, comics, music, computer graphics, etc. and culminating in the Tokyo International Film Festival on October 28, attracting a total of about 800,000 visitors.

Given the recent rapidly changing environment of the content industry which has witnessed a rapid expansion of the global content markets including those of developing countries and rapid technological innovation, the Ministry of Economy, Trade and Industry launched the "Content Global Strategy Study Group" in December 2006 to discuss ways to promote the globalization of the Japanese content industry. Given that the domestic content market cannot expect strong growth and moves toward monopoly of the global content markets on the basis of the enormous content created by the U.S. and European media conglomerates, the final report compiled by the group in September 2007 recommends that the Japanese content industry should (1) promote globalization (actively work on international business), (2) "enhance" content business "resources" such as human resources, technologies and funds, (3) make the Japanese market a hub for the content business, and (4) re-establish the "value chain" and develop new business models by inviting and forming partnerships with various market participants.

For the "Kansei value" activities, the first "Kansei Value Creation Fair" is scheduled to be held in Paris in December 2008 to exhibit the excellence of Japanese products, materials, and skills. The fair is part of a series of events to commemorate the 150th anniversary of France-Japanese relations.

It is also important to revitalize industries such as the fashion industry, which can deliver strong cultural messages in order to improve Japan's attractiveness and to increase understanding about Japan among people across the world. It is necessary to further accelerate efforts to increase the international competitiveness of the Japanese fashion industry in order to attract more global attention. The Ministry of Economy, Trade and Industry, in cooperation with organizations such as the JETRO and the Organization for Small & Medium Enterprises and Regional Innovation, Japan, supports the "Japan Fashion Week in Tokyo" as part of its efforts to enhance the ability of the Japanese fashion industry to deliver a message overseas and engage in business negotiations and enhance partnership with the

[31] The initiative is designed to develop events that can attract global attention by putting various Japanese content together through aggressive expansion of the Tokyo International Festival.

Japanese textile industry, thus making Tokyo an Asian hub where many high value-added businesses are located and young prospective designers get together to boost their professional career.