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## **ACHIEVING ECONOMIC RECOVERY IN JAPAN BY EXPANDING INWARD DIRECT INVESTMENT**

***Shujiro Urata***

- Inward direct investment benefitting the Japanese economy is extremely low in comparison with other countries.
- High business costs stemming from high tax rates, stiff regulations, and personnel shortages are among the factors inhibiting inward direct investment.
- The government must vigorously push forward with deregulation and corporate governance reform to expand inward direct investment.

*The views expressed in this piece are the author's own and should not be attributed to The Association of Japanese Institutes of Strategic Studies.*

Japan's inward direct investment is extremely low compared with that of other developed countries and even its Asian neighbors. In 2013, the ratio of Japan's inward direct investment stock to its GDP was 3.5%, the lowest among major countries and far below the global average of 34.1%. Major developed countries such as the US and Germany have ratios seven to eight times that of Japan, and even those of China and South Korea are three to four times Japan's. Inward direct investment in developed countries is characterized more by M&A investments involving buyouts of existing companies than by greenfield investments entailing the establishment of new companies. In this context, M&A by foreign companies in Japan is sluggish.

Receiving direct investment by foreign companies promotes economic growth by increasing investment, production, and employment. The benefits of receiving direct investment are not limited to these quantitative expansions, however, and they also include qualitative improvements through transfers of advanced technology and management know-how to Japanese companies by foreign companies and higher productivity at Japanese companies stemming from intensified competitive pressure on these Japanese companies. Furthermore, consumers benefit from the availability of new products and services.

Aware of the contributions of inward direct investment to economic recovery and medium- to long-term growth in Japan, the Abe administration in a revised version of its "Japan Revitalization Strategy" released in June 2014 advocated expanding inward direct investment, setting a goal of doubling the 2012 year-end level of inward direct investment stock by 2020. Expanding inward direct investment is a key part of the growth strategy constituting the third arrow of Abenomics' three-arrow approach.

What factors hinder inward direct investment in Japan? In opinion surveys of foreign companies conducted by the Japan External Trade Organization (JETRO), the Ministry of Economy, Trade and Industry and others, the problem most commonly cited by foreign companies seeking to locate in Japan is the high cost of doing business, specifically the high corporate and other tax rates applicable to businesses and high office rents. Among the other obstacles noted

were the closed/peculiar nature of the market, administrative procedures, the complexity of approval and licensing systems, the difficulty of securing needed personnel, and in particular the scarcity of personnel capable of communicating in English. The surveyed companies pointed out that M&A in Japan is sluggish, due in part to tax regimes and procedures that make it harder than in other developed countries to pursue M&A and in part to the significant barrier of closed corporate governance at Japanese companies that inhibits M&A.

Recognizing the need to expand inward direct investment, the Japanese government has since the 1980s been pursuing a variety of policies to encourage such investment, offering foreign companies low-interest loans, tax breaks, debt guarantees and useful information. The second Abe administration inaugurated in 2012 sought to reduce/eliminate factors inhibiting investment in Japan by setting targets to double inward investment, creating a Council for Foreign Direct Investment Promotion to help achieve these targets, and implementing regulatory reforms.

These latest measures to promote direct investment in Japan feature several characteristic elements. One is the connection with National Strategic Special Zones actively introducing regulatory reforms in designated areas. The Abe administration regards National Strategic Special Zones as an extremely important policy measure, so the establishment of such Zones can be expected to produce an expansion of inward direct investment. Another is the reforms to corporate governance being undertaken to encourage M&A. Ensuring that corporate governance is carried out openly and transparently will lead to greater inward direct investment via M&A.

The obstacles impeding greater foreign direct investment in Japan that would assist in Japan's economic recovery and increase the benefits for consumers are apparent. The problem lies in developing and implementing the policies needed to reduce/eliminate these obstacles. Previous administrations have devised policies needed to expand direct investment in Japan, but these policies could not be implemented due to strong resistance from vested interests. The Abe administration, which scored a major victory in the House of Representatives elections at the end of last year and which now holds an

overwhelming majority of seats in both houses of the Diet, must overcome the resistance put up by vested interests prioritizing short-term gains and implement the regulatory reforms needed to make Japan's economy and society prosperous and dynamic. If regulatory reforms can establish a business environment that facilitates the participation of foreign companies in the Japanese economy, foreign companies will expand their direct investment in Japan. Greater direct investment in Japan will speed Japan's economic recovery and boost its future economic potential, resulting in further direct investment in Japan. Thus will be formed a virtuous cycle in which expanded direct investment in Japan leads to economic recovery/growth that in turn attracts more direct investment in Japan. Whether this virtuous cycle can be set in motion will depend on the Abe administration's determination and ability to get things done. 

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