

Policy for Formulating a "Medium and Long-term Strategy for Promoting Foreign Direct Investment in Japan 2021"

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Adopted by the Council for Promotion of Foreign Direct Investment in Japan

1. Developments in foreign direct investment in Japan

Foreign direct investment (FDI) in Japan enhances its growth potential and reinvigorates regions around the country as it helps get resources in and out of Japan fused for innovation and attract more investment and create jobs also in the provinces.

In 2013, the Government of Japan set a target of "doubling the inward FDI stocks to 35 trillion yen by 2020" as a key performance indicator (KPI)¹. The Government has since been working to attract more FDI by, among others, finding and attracting foreign companies interested in investment in Japan, improving the business environment and living conditions for foreign people working in Japan, and offering foreign businesses opportunities to find Japanese companies working as a partner for them. The FDI stocks have grown steadily, almost as planned, to 33.9 trillion yen by the end of 2019².

The said FDI stocks represent 6.1% of Japan's GDP, an increase from a level of 4% in 2014³. However, the figure remains at a significantly low level, compared internationally, as the means stands at 46.0% among the OECD countries⁴.

Since 2018, the focus has been placed on measures to promote inward FDI in regions around Japan. However, a breakdown of inward investment by prefecture has revealed that capital inflows concentrate in several metropolitan areas, specifically Tokyo, Kanagawa, and Osaka. This suggests that inward FDI has only made a limited contribution to efforts to reinvigorate regions around Japan. For instance, more than 80 percent of the foreign-affiliated companies operating in Japan are headquartered in one of these three prefectures, with almost 60 percent of their employees working somewhere in these three⁵.

Now, there is a worry that the spread of COVID-19 may have a significant impact, resulting in sharp declines in FDI between countries⁶, a situation that leaves no

1 "Japan Revitalization Strategy" (Cabinet Decision, June 14, 2013)

2 The Ministry of Finance and The Bank of Japan, "International Investment Position of Japan"

3 The latest figure can only be compared with those from 2014 onwards as statistical standards were revised.

4 The average percentage of inward FDI to GDP among OECD countries comes from "FDI stocks" in OECD Data. The percentage of Japan's inward FDI to its GDP is calculated using "International Investment Position of Japan" (The Ministry of Finance and The Bank of Japan) and "National Accounts of Japan" (The Cabinet Office).

5 The Ministry of Economy, Trade and Industry, "Survey of Trends in Business Activities of Foreign Affiliates"

6 For instance, UNCTAD estimates that the COVID-19 crisis may cause an up to 40 percent decrease in global FDI in 2020 on a year-on-year basis, with a further 5 to 10 percent decline in 2021 (UNCTAD, "World Investment Report 2020").

optimism about successfully achieving the KPI.

2. Current environments for foreign direct investment in Japan and the direction of actions to take

With a view toward enhancing the growth potential of the Japanese economy and to reinvigorate regions around the country, Japan should, placing emphasis on efforts to increase inward FDI seen in the percentage to GDP and attract more investment to regions, continue promoting FDI in Japan, beyond the current KPI. Despite a growing trend of anti-globalization, Japan will refuse to give in to protectionism, and instead take the lead in realizing free and fair investment while actively taking in vigor from the foreign economy. Then, however, amid the moves of some countries, especially in Europe and North America, toward tightening controls over inward FDI for national security reasons, Japan should give careful consideration to issues of potential harm to national security, such as the leakage of national defense-related technologies. Foreign direct investment is expected to bring benefits, such as advanced technologies introduced to Japan, and sales channels developed for Japanese companies that foreign investors have some stake in. At the same time, there are potential detriments, or national security concerns, as any of the defense-related technologies Japan has may leak out. With both the pros and cons kept in mind, Japan should strike the right balance between promotion of inward FDI and security of the country⁷.

For that purpose, as stated in the "Basic Policy on Economic and Fiscal Management and Reform 2020" (Cabinet Decision, July 17, 2020), among others⁸, the Japanese Government will formulate a "Medium and Long-term Strategy for Promoting Foreign Direct Investment in Japan 2021", which should include next-phase KPIs, by the end of spring next year. After a full review of the initiatives that have been made, the Strategy should be designed to respond to current environments of FDI in Japan, that is (1) shrinking regional economies and growing difficulty in business succession with a falling birthrate and aging population, and (2) progress of the Fourth Industrial Revolution around the globe and intensifying competition between countries, under policies stated below as a starting point.

(1) Enhanced effort to attract more investment in regions

(Current environments: Shrinking regional economies and growing difficulty in business succession with a falling birthrate and aging

7 For instance, Japan should (1) implement the Foreign Exchange and Foreign Trade Act in an appropriate manner from the viewpoint of further promoting inward FDI that should encourage sound development of the economy while dealing with any investment that might harm national security or other interests of Japan, and (2) collect relevant information helpful for universities, research institutions, businesses, and other parties concerned to adopt enhanced measures to prevent leakage of technologies they have especially from the viewpoint of securing and maintaining advantage Japan should have in technology.

8 "Follow-up on the Growth Strategy" (Cabinet Decision, July 17, 2020)

population)

Amid a shrinking population due to a falling birthrate and aging population, together with the continuing unipolar concentration of population in the Greater Tokyo Area, concerns are further growing that other regions may see their workforce decrease as well as their consumer markets contracting and their economy dwindling.

Small and medium-sized enterprises (SMEs) and small-scale businesses that underpin regional economies have greater difficulty in business succession due to the aging of business owners and managers and a shortage of successors. By 2025, 2.45 million owners of SMEs will pass the age of 70, the average for retirement. Some 1.27 million of them have no prospective successor, and about half of them may close their business despite profitability it maintains⁹.

(Direction of actions to take: Enhanced effort to attract more investment in regions)

Despite growing difficulty in issues, such as a shrinkage of local economies and succession of SMEs and small-scale businesses, regions around Japan own a range of local resources, including agricultural, forestry, and aquatic products, tourism resources, and many SMEs with technical capabilities. To combine these and the other advantages that they have with sales channels, technologies, human resources and know-how from foreign companies, efforts should be enhanced to attract more inward FDI in regions, as described below. At the same time, care should be fully taken to prevent technologies and human resources flowing out of SMEs and small-scale businesses capable of generating high added value.

- I Continued efforts should be made in an integrated manner in three areas - inbound tourism to Japan, the export of agricultural, forestry, and aquatic products, and direct foreign investment in Japan - through, for instance, initiatives for combining a range of tourism experiences offered to visitors to Japan with "food" to generate new value that helps promote export, and those for leveraging foreign capital to develop goods and services based on the needs and perspectives of visitors to Japan and use them to attract more inbound tourists.
- I As a solution to the growing difficulty in business succession, some mechanisms should be developed to help local SMEs and small-scale businesses find foreign companies that may match them and facilitate business transfer between third-parties (merger & acquisition), so that the business resources that they own, including technologies and know-how, and jobs they have created will not be lost.

⁹ Estimates made by the Small and Medium Enterprise Agency based on the "Unincorporated Enterprise Survey" (The Ministry of Internal Affairs and Communications, 2016) and "COSMOS 2" (Teikoku Databank, 2016).

(2) Effort to attract start-ups

(Current environments: Progress of the Fourth Industrial Revolution around the globe and intensifying competition between countries)

Today in the world, progress of the Fourth Industrial Revolution is gaining further momentum with some emerging technologies with great versatility, such as artificial intelligence (AI), quantum technology, Internet of things (IoT), robotics, and blockchain. For instance, along with development of mobile communications networks, Europe, the United States, and Israel, as well as Asia and Africa, see a rapid rise of start-ups that deliver a range of innovation helpful to solve challenges local societies are faced with, such as environment, healthcare, and energy.

In this context, competition is intensifying between companies and countries around the globe for cooperation with, and invitation of, start-ups, venture capitals, and accelerators. However, they often see Japan and Japanese companies less attractive as investment destination and partner in terms of geographical conditions, market scale, growth potential, depth of human capital, and, most of all, maturity of the ecosystem for start-ups.

(Direction of actions to take: Effort to attract start-ups)

With a view to promoting open innovation and enhancing growth potential, Japan has also developed its investment environments with some investment-related treaties, including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP 11). On the basis of the achievements, Japan will actively encourage innovative foreign companies, especially start-ups operating with a cutting-edge business model, to make direct investment in Japan, as well as help Japanese companies invest in foreign enterprises and start-ups to deliver fruit of their innovation back to Japan through actions mentioned below.

- I Japan will assign a focus sector to regions in and out of Japan to attract start-ups from overseas to regions around Japan in a selective manner and develop a "glocal" hub that can win over venture capitals, accelerators, local financial institutions, research institutions, and other parties. Through the process, cooperation and partnership should be promoted between foreign companies and technology-oriented local SMEs and start-ups to secure Japan a clear position as innovation field for foreign companies.

In addition to what has been stated above, continued effort should be made to find and attract investment projects to Japan as well as improve business and living conditions for foreign people working in the country. As part of strong commitment now being pursued for digitalization in every aspect of the society in Japan, movement triggered by the spread of COVID-19, initiatives should be

accelerated to go online and set up one-stop-service centers, spread once-only principle for formalities businesses need to complete at government agencies, matching between Japanese and foreign companies to help them form partnership, and grants and subsidies local governments could receive.

3. Next steps to take

A working group should be set up under the Council for Promotion of Foreign Direct Investment in Japan to formulate a "Medium and Long-term Strategy for Promoting Foreign Direct Investment in Japan 2021", which should include next-phase KPIs, by the end of spring next year. It will deliberate on the Strategy based on this Policy.