

**United States – Japan Economic Partnership for
Growth**

**United States – Japan Investment
Initiative 2003 Report**

May, 2003

Executive Summary

- The Investment Initiative seeks to promote greater FDI flows between the United States and Japan. FDI can play a critical role in the economic growth of a country by improving management efficiency and competitiveness, creating jobs, generating demand, providing risk capital, and strengthening bilateral ties.
- Japan's inward foreign direct investment (FDI) is very small compared to other developed countries and the level of two-way investment flows between the U.S. and Japan remains far below their potential. Prime Minister Koizumi's January 2003 pledge to double Japan's cumulative amount of FDI in the next five years has led Japan to build on its earlier reforms to encourage FDI. In response to his announcement, both government and the private sector are taking further steps to promote FDI.
- In a major step, the Government of Japan adopted legislation that will allow foreign companies to participate in cross-border share exchanges in certain instances. This, along with the implementation of reforms of the Commercial Code and accounting systems, has created promising new opportunities for foreign firms to invest in Japan.
- The Investment Initiative was established under the U.S.-Japan Economic Partnership for Growth (EPG) in June 2001. The Investment Initiative has played a key role in exploring critical investment issues and identifying ways to remove barriers. In addition to the topics mentioned above, the Initiative also examined how to promote foreign investment in education and medical services, lower the costs of conducting due diligence, enhance labor mobility, build positive perceptions of foreign investors, and increase the pool of assets available for investment in Japan. In reviewing the U.S. investment climate, the Initiative examined the implementation of the Sarbanes-Oxley Act, reviewed the impact of post-September 11, 2001 security measures on investment, and considered how legal costs affect investment.
- Under Secretary of State Alan Larson and METI Vice Minister for International Affairs Tadakatsu Sano chair the Initiative. Under their leadership, the Investment Initiative met for high-level talks in March 2003 and at the working level in November 2002 and April 2003. In addition to these efforts, the Initiative has organized several public programs, including seminars in Osaka and Sapporo. The contents of this report will be presented at two symposia to be held in Chicago and San Francisco in June 2003.
- Both Governments welcome foreign investment. The Investment Initiative will continue to promote action to improve the FDI climate as well as to reach out to American and Japanese people to ensure that the importance of attracting FDI is well understood.

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- I. Investment Seminars
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I. Introduction

President George W. Bush and Prime Minister Koizumi established the Investment Initiative under the U.S.-Japan Economic Partnership for Growth in 2001. Alan Larson, Under Secretary of State for Economic Affairs and METI Vice Minister for International Affairs Tadakatsu Sano chair the Initiative. Under their leadership, the Investment Initiative met for high-level talks in March 2003 and at the working level in November 2002 and April 2003. In addition to these efforts, the Initiative has organized several public programs, including seminars in Osaka and Sapporo. The findings of this report will be presented at two symposia to be held in Chicago and San Francisco in June 2003.

As outlined in last year's report, foreign direct investment can play a critical role in the economic growth of a country.¹ FDI has been shown to improve management efficiency and competitiveness, create jobs, generate demand, provide risk capital, and strengthen bilateral ties. American companies have a long history of investment in Japan, playing a key role in transferring new technologies and reinvigorating local economies. Similarly, Japanese companies have been important players in the U.S. market, especially in the 1980s when they helped create employment and revitalize state economies. The Investment Initiative seeks to build on this history to promote even greater investment ties between the two countries with the ultimate goal of having two-way investment between Japan and the U.S. reach the level of two-way investment between the United States and the EU.

II. FDI in the U.S. and Japan

1. FDI in Japan

(1) Trends in FDI in Japan

Reflecting the close economic ties between the two countries, the United States and Japan are major foreign direct investors in each other's economies. The United States is the largest investor in Japan.

Major Foreign Direct Investors in Japan and the U.S. as of the end of 2001

Japan		U.S.	
Outward Direct Investment Stocks	Inward Direct Investment Stocks	Outward Direct Investment Stocks	Inward Direct Investment Stocks
\$325,476	\$54,572	\$1,381,674	\$1,321,063
U.S.(46.7%)	U.S.(36.6%)	U.K.(18.0%)	U.K.(16.55)
U.K.(11.0%)	Netherlands(14.5%)	Canada(10.1)	Japan(12.0%)
Netherlands(6.5%)	France(13.9%)	Netherlands(9.5%)	Netherlands(12.0%)
Singapore(3.4%)	Germany(7.7%)	Japan(4.6%)	Germany(11.6%)
China(3.3%)	U.K.(4.8%)	Swiss(4.6%)	France(11.1%)

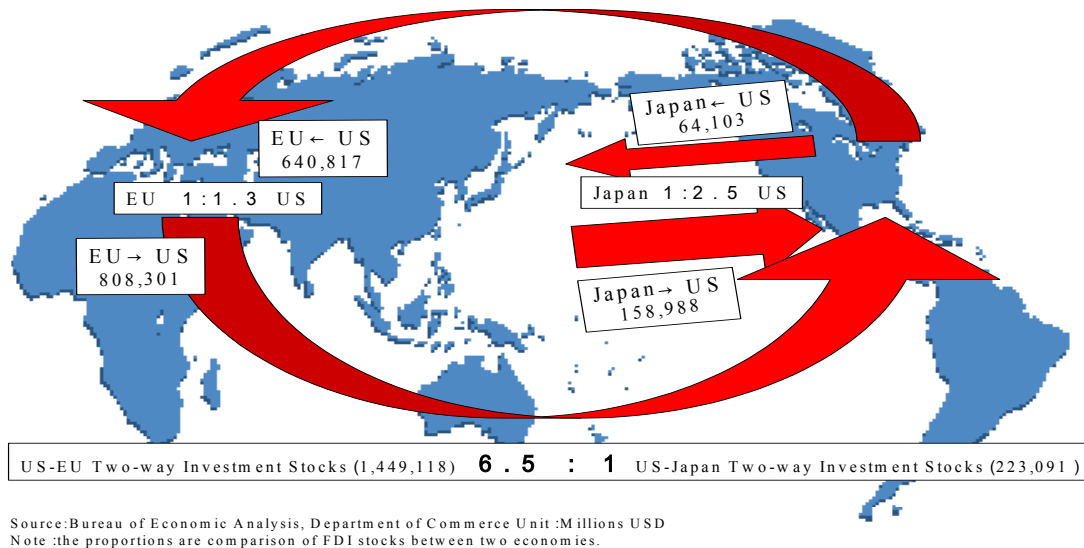
Source: Bank of Japan and Bureau of Economic Analysis, Department of Commerce

Unit: Millions of dollars, calculated by average exchange rate (121.53yen/\$) in 2001. Note: (%) = share of total amounts.

¹ http://www.meti.go.jp/policy/trade_policy/n_america/us/data/juii2002report_e.pdf or <http://www.state.gov/p/eap/rls/rpt/11438.htm>

However, the FDI figures show that U.S. investment in Japan is extremely small compared to Japanese investment in the U.S. Total two-way investment flows between the U.S. and Japan are very low compared to that of the U.S. and the EU. Clearly, the investment environment in Japan is not as developed as in other advanced nations. Given this situation, the critical challenge for Japan is to develop an investment environment that is attractive to foreign investors.

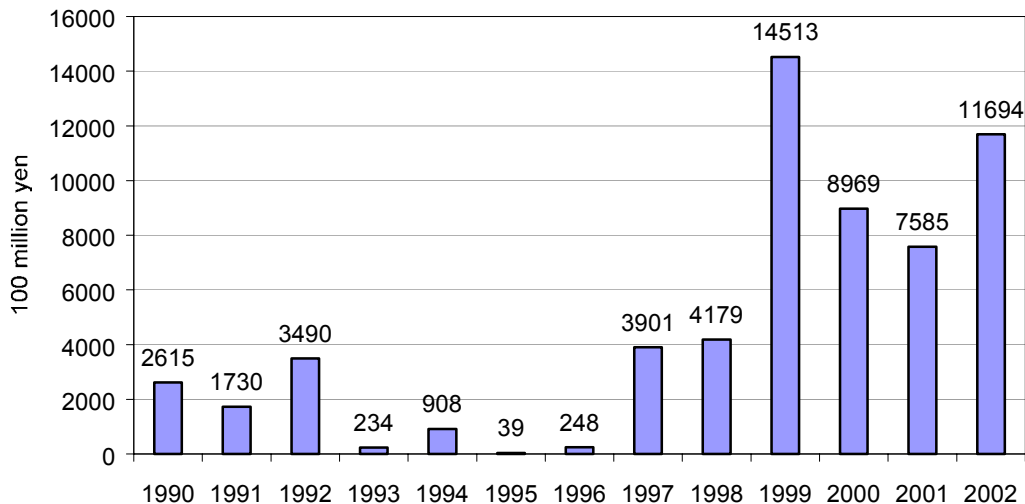
FDI stocks of US-Japan and US-EU (as of the end of 2001)



Japan's inward FDI, although still small, has soared since the mid 1990s. Reforms in the financial, communications and distribution sectors have encouraged foreign investment into these sectors. Furthermore, improvements in corporate law, bankruptcy law and accounting principles helped attract foreign capital to Japanese companies.

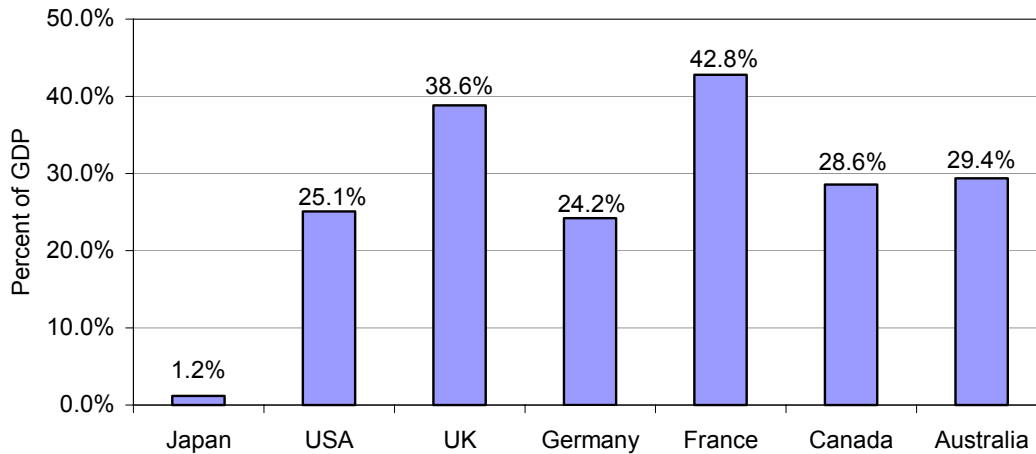
In 2001 and 2002, a worldwide economic slowdown contributed to a slackening in investment activities. Japan's inward FDI declined in 2001, but increased in 2002 against a backdrop of asset sell-offs related to corporate re-organization and financial restructuring.

Trends in Inward FDI in Japan



Source: Bank of Japan
 Note: This figure shows net inward FDI

Inward FDI Stocks as a percentage of GDP (2001)



Source: IMF, *International Financial Statistics*, March 2003

(2) Recent Topics: Activities to Promote Inward FDI

In Japan, both government and the private sector are increasingly promoting inward FDI. At a meeting in June 2002, the Cabinet established FDI promotion as one of the key strategies for revitalizing the Japanese economy, and resolved to put teeth into the measures needed to attract investment. In a General Policy Speech in January 2003, Prime Minister Koizumi pledged to double the cumulative amount of FDI in the next five years. Following this announcement, in March 2003, the Japan Investment Council (JIC) prepared a report setting out a “Program for Promoting Foreign Direct Investment,” which discussed five target sectors and 74 measures. The Japanese Government endorsed these proposals and declared it would promptly implement them. (For more details of the report, see http://www5.cao.go.jp/access/english/jic_main_e.html)

The Program for Promoting FDI: 5 Priorities, 74 Measures

(1) Reviewing Administrative Procedures

- Make the administrative procedures simpler, faster and clearer; clarify legal interpretation.

(2) Improve business environment

- Facilitate cross-border M&As; effectively utilize debt-equity swaps depending on the nature of the target of the purchase; secure transparency and reliability of corporate information, improve corporate governance; increase entry by the private sector to public services.

(3) Improve employment and living environments

- Meet the needs of diverse ways of working; improve systems related to entry and residence of foreign nationals; make donations to qualified international schools tax deductible.

(4) Development of local and national framework

- Support local governments' autonomous efforts to attract FDI; utilize special zones for structural reform system; utilize the Office of the Trade and Investment Ombudsman (OTO); provide information and support procedures by JETRO.

(5) Disseminate information within Japan and abroad

- Promotion by the leaders, diplomatic missions abroad, foreign press; public relations on the attractiveness of Japan and success stories of foreign firms in Japan, and on the "Program for the Promotion of Foreign Direct Investment in Japan".

Based on this report, the Invest Japan Business Support Center, a one-stop office to provide investment information to foreign companies, will be established in the Japan External Trade Organization (JETRO) on May 26, 2003. (More detailed information is available at <http://www.jetro.go.jp/investjapan/>). Furthermore, information desks will be established in all concerned ministries as a center for investment information and support for navigating administrative procedures.

Previous to this, in September 2002, the business sector established the Invest Japan Forum (IJF), composed of top Japanese and foreign managers. In December 2002 the IJF made recommendations for promoting FDI to the Prime Minister and the JIC. Many of these suggestions were incorporated in the IJF's report. The U.S.-Japan Private Sector/Government Commission held on April 14, 2003, also shared the view that the two countries should dramatically increase FDI and follow up on the suggestions made by the IJF.

Local governments are also increasing their efforts to attract foreign capital. Osaka and Hokkaido held the Investment Initiative Seminars in April 2003 during which these prefectures introduced their measures to attract foreign capital.² In order to support these local government efforts to promote inward FDI, the Japanese Government started a project in FY 2003 called the “Advanced Areas to Promote Foreign Direct Investment.” Through this project, JETRO will give special support to local governments, that are actively trying to attract foreign capital. For fiscal year 2003, five regions have been selected: Osaka/Higashi-Osaka/Ibaraki, Sendai, Hyogo/Kobe, Hiroshima, and Fukuoka/Kita-Kyushu/Shimonoseki.

Another Japanese Government program started in April 2003 is called “Special Zones for Structural Reform.” This program designates certain areas as exempt from regulations in order to develop the areas’ special features. These zones are based on ideas developed by local governments and private companies. In the first phase, 57 special zones were certified on April 21. Among them is a Special Zone for International Distribution with a 24-hour/365-day customs clearance, which is expected to greatly enhance the environment for FDI. Under the zone program, it is possible to set up other special regulatory exemptions that benefit the investment environment. For instance, zones could eventually be developed allowing corporations to own hospitals, schools, agricultural enterprises and special elderly nursing homes that have been barred to private companies and could introduce special exemptions for visas/resident qualifications to expand the acceptance of foreign engineers, tourists and exchange students.

² Osaka Prefecture, Osaka City and the Osaka Chamber of Commerce established the Osaka Business and Investment Center (O-BIC) as a one-stop center for providing information on entering the Osaka market and shortened the processing time for starting a company to six months instead of 12 months. The prefecture also improved tax incentives so that incoming companies in Osaka Prefecture receive up to 90% corporate enterprise tax cuts as well as a 50% reduction in the real estate acquisition tax. Hokkaido Prefecture provided information on Hokkaido’s investment environment by setting up Hokkaido industrial tours, targeting foreign diplomatic offices, promoting the prefecture’s investment environment, and assisting JETRO’s Invest in Japan Study Program (IJSP), which invites foreign companies interested in investing in Japan.

The Headquarters for the Promotion of Special Zones for Structural Reform will continue to invite ideas on new zones from local governments and private companies. Foreign governments and companies can also submit ideas to the local government. When local governments and private companies join with foreign governments and companies, creative ideas for new special zones could be developed that contribute to attracting inward FDI. Therefore, active involvement of all parties is encouraged.

(3) Japan's Advantages

Although Japan's inward FDI is low, it has the potential to attract much more.³ Japan has a large market (four times larger than China's), sophisticated consumers, high business predictability backed by a well-organized legal system, a diligent and well-educated labor force, advanced infrastructure, and a good, secure living environment. Furthermore, the high cost structure--long an obstacle to investing in Japan--has improved in recent years. As deregulation advances, especially in the telecommunications and energy fields, the cost of business infrastructure has declined. Historically low interest rates make capital funds available at low cost, and commercial properties in the six major cities now cost a sixth of what they did in the 1990s. The environment for M&A has also improved with reforms in commercial law, corporate accounting principles, legal services and labor legislation. Stock prices have tumbled almost 80% from their peak at the end of 1989, according to the Nikkei index.

The Japanese Government continues to improve the business climate to encourage inward FDI as well as to review ways to further improve the social climate for accepting investment. The Government of Japan seeks to increase awareness both inside and outside of Japan that under the Prime Minister's leadership:

- Japan welcomes inward FDI;
- the climate for investment is improving in Japan, and
- Japan's economy has attractive features for FDI.

To help spread this information, the U.S.-Japan Investment Initiative will hold symposia in the United States in Chicago and San Francisco on June 24 and 26, 2003, explaining investment opportunities in Japan.

2. FDI in the United States

(1) Trends in FDI in the United States

³ The "World Investment Report 2002" by UNCTAD shows the Inward FDI Performance Index and the Inward FDI Potential Index of 140 countries around the world (the Inward FDI Performance Index compares the share of a country's inward FDI amount to the world inward FDI amount with the share of the country's GDP to the world GDP). The Inward FDI Potential Index shows a country's rank in the world based on eight indicators: per-capita GDP, GDP growth rate, export share of GDP, number of phone lines per 1,000 people, per-capita commercial energy use, R&D spending share of national income, higher education students share of the population, and political/commercial country risk. Japan's Inward FDI Performance Index ranks 131st of 140 countries, whereas its Inward FDI Potential Index ranks 14th, indicating a significant imbalance between the two indexes.

The United States consistently attracts FDI inflows from countries around the world due to its open economy, strong growth, and high rate of return. Deregulation and technological change make the United States particularly attractive to investors. At times of economic growth, FDI has capitalized on opportunities and helped reinforce economic successes. At times of economic weakness, FDI has played a key role in restructuring the U.S. economy. For example, in the 1980s, Japanese FDI, among others, provided critical support for change, which increased U.S. competitiveness, employment and productivity.

In 2001, foreign direct investment stock in the United States rose 9 percent bringing FDI measured at historical costs to \$1,321.1 billion (see chart below). The largest positions remained those of the U.K. (16 percent) and Japan (12 percent). After three years of exceptionally rapid growth, foreign direct investment into the United States slowed substantially in 2001, reflecting the slowdown in the U.S. and world economy.

**Foreign Direct Investment Position in the United States
on a Historical Cost Basis, 1997-2001**

Year end	Billions of Dollars	Percent Change from Preceding Year
1997	681.8	14.0
1998	778.4	14.2
1999	955.7	22.8
2000	1,214.3	27.1
2001	1,321.1	8.8

source: BEA, Department of Commerce

**Investment Outlays in the United States
by Type of Investment, 1996-2000**
(millions of dollars)

	1996	1997	1998	1999	2000	2001
Total Outlays	79,929	69,708	215,256	274,956	335,629	132,943
By type of investment:						
U.S. business acquired	68,733	60,733	182,357	265,127	322,703	127,946
U.S. business established	11,196	8,974	32,899	9,829	12,926	4,996

source: BEA, Department of Commerce

(2) Recent Topics

A. Mergers and Acquisitions

The slowdown in economic growth in the United States and a number of European and Asian countries contributed to the drop in merger and acquisition activity in 2001 compared to the previous three years. The drop in M&A activity also reflected uncertainty around the world about the prospects for future economic growth. Business conditions in many of the industries that contributed to the wave of M&A from 1998 to 2000 deteriorated in 2001. In particular, the excess capacity and large debt obligations accumulated by the telecommunications industry in the late 1990s led to a substantial decrease in M&A activity in that industry. However, even with the overall slowdown in M&A activity, equity capital inflows, which are mainly used to acquire U.S. firms, were still higher in 2001 than in any year prior to 1998.

B. Outreach: State Efforts

Most states have international affairs offices, which promote investment. For example, the State of Tennessee International Affairs Office website offers a wide variety of services to businesses looking to locate in Tennessee (see Appendix II), and even offers tips on Japanese etiquette for Tennesseans hoping to attract Japanese business. As of 2002, Japanese investment in Tennessee totaled \$7.88 billion (out of \$17.5 billion in overall FDI) and accounted for 37,024 jobs.

States and localities in the United States compete for FDI by offering a variety of incentives including tax exemptions and targeted investment in infrastructure. For example, "the total incentive package that state and local governments offered DaimlerChrysler to bring its \$750 million Sprinter van plant to Pooler, Ga., adds up to \$322 million, including a reduced rate for use of the Port of Savannah, roads, a rail line and a museum on the plant site, as well as free English language classes for German executives and their spouses."⁴ Similarly, Toyota Motor Manufacturing North America Senior Vice President Dennis Cuneo said that the creation of a special rail district and the state's commitment to underwrite training for the 2,000 workers at the plant were important elements that set San Antonio apart when Toyota decided to put its new manufacturing facility there. In both cases, other locations had offered more money in incentive packages, but the companies chose to locate in areas that offered the best package tailored to their needs.

(3) U.S. Advantages

The United States continues to be an attractive investment destination because of its market size and openness. In response to recent corporate scandals, the U.S. Government acted swiftly to improve and strengthen its corporate regulatory systems to restore confidence in capital markets. At the same time, since the September 11 attacks, the United States has been identifying ways to enhance security protection for the country. As it does so, the United States is striving to ensure that trade and investment flows are

⁴ As reported in the [Atlanta Business Chronicle](#), February, 28, 2003.

not disrupted. In fact, the U.S. Government is taking this as an opportunity to identify new ways to speed the flow of legitimate business and to increase logistical integration between domestic and foreign businesses. By using IT and other technology, the United States hopes that legitimate trade and investment can flow in a seamless, secure fashion even faster than before. In designing these new systems, the U.S. Government continues to listen to the views of the private sectors and governments of other countries to ensure that the new measures meet the desired goals without impeding legitimate trade and investment flows.

III. Discussion of the Investment Initiative 2003

1. U.S. Concerns

(1) International Share Exchanges

The U.S. raised this issue at last year's Investment Initiative talks as one of the main U.S. concerns. At this year's talks, the U.S. Government requested the Japanese Government to allow merger techniques such as Triangular Mergers and Cash Mergers as tools for foreign companies seeking to invest in Japan. Such mergers would accelerate industrial restructuring and corporate reorganization in Japan.

Share exchanges between Japanese companies were made possible due to a 1999 Commercial Code revision. But it has been assumed that this revision does not allow foreign companies to use their shares in exchange for a Japanese company. Cash Mergers have also been considered impossible. With proposals from the U.S.-Japan Investment Initiative and requests from foreign companies in Japan in mind, the Japanese Government promulgated the Revised Industrial Revitalization Law on April 9, 2003. Among the measures allowed by the law are Triangular Mergers (a merger in exchange for parent company's shares) and Cash Mergers as special exceptions to the Commercial Code. This law applies equally to Japanese companies with foreign parent companies. Thus, a foreign company subsidiary can develop a restructuring plan for a Japanese company through a merger, and if the Government authorizes the plan, the subsidiary company can conclude a Triangular Merger or a Cash Merger in exchange for parent company shares as a special exception to the Commercial Code.

While welcoming this new Japanese Government measure, U.S. officials raised some further issues including taxation and the revision of the Commercial Code needed to further facilitate M&A transaction. It is important that both foreign and domestic investors are able to participate in M&A transactions. Further, since the new measures are special exceptions to the commercial code, applied only to a company whose plan is authorized by the Government, the Commercial Code itself should be revised so that all companies can benefit.

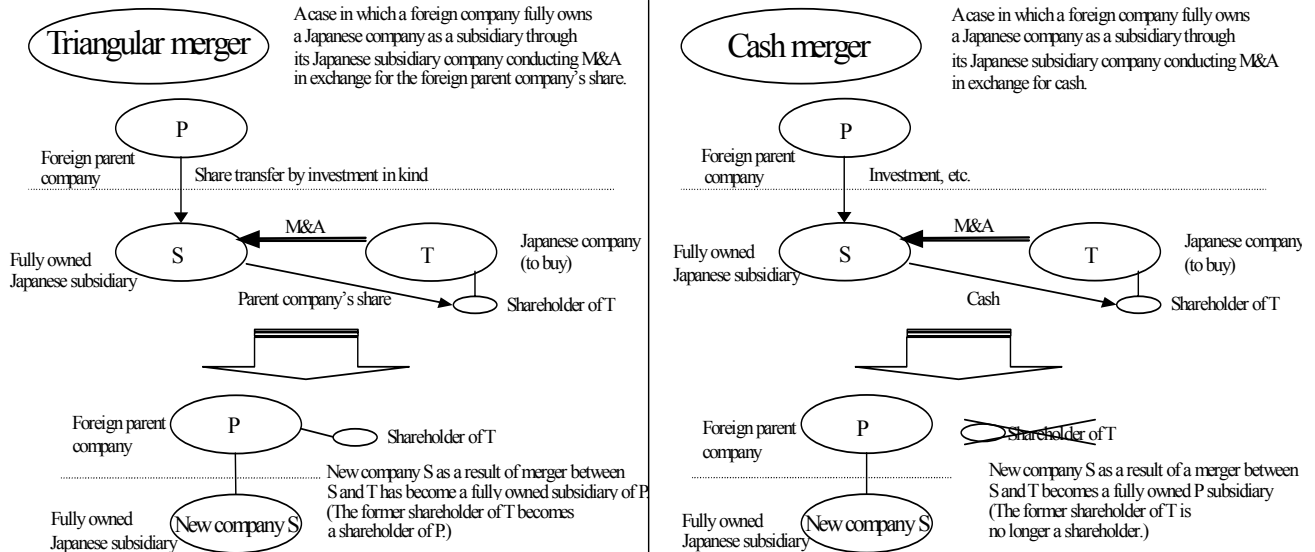
The Japanese Government is reviewing the Commercial Code and will submit a bill to an ordinary Diet session in 2005 in which Triangular Mergers and Cash Mergers will be discussed as permanent measures. An interim draft of this bill will be presented for

public comment in the fall of 2003. Tax measures could continue to be discussed within the Japanese Government.

Case of viable cross-border investment

The special exception “flexible compensation for merger, etc.” allows a foreign company to fully own a Japanese company as a subsidiary through its subsidiary company already established in Japan.

※ The case below is a merger, but merger & division and share exchange are also possible.



(2) Demographic Issues and Investment (Education and Medical Services)

The U.S. Government pointed out that demographic changes in Japan resulting from its low birth rate and graying society make it important to invest in education and medical services. They suggested that American companies could provide high quality services to help Japan achieve its plans to restructure these fields. To promote this investment, the U.S. Government requested reform that would enable investment in these fields.

Education

The U.S Government requests in the area of education are: (a) a second category of accreditation for universities that would allow foreign university branches in Japan to act as accredited schools; (b) extend such measures as student discount railway pass for students at foreign university branches not yet accredited in Japan; (c) provide a residence status for students to attend foreign university branches not yet accredited in Japan for the full course of their studies.

With regard to the accreditation request, the Japanese Government responded that the Ministry of Education, Culture, Sports, Science and Technology has set up a study group to examine the issues of the quality assurance of universities in the internationalization of higher education, including the issue of accreditation for branch campuses of foreign universities. As for train passes, the Japanese Government explained that the allocation

of student discount railway pass is implemented by private companies taking into account the status of students in the Japanese education system and is outside of the direct control of government. The Japanese Government, however, will convey the U.S. Government request to these companies. As for the status of residence, the Japanese Government explained that a student at the main campus of the university which has a branch in Japan can basically acquire the status of residence called “Cultural Activities” for one year to stay in Japan, and a student enrolled at a foreign university’s branch in a third country can also do this as long as the student studied at the university’s main campus for one year just before coming to Japan. The student can in principle renew the period of stay of the status of residence, “Cultural Activities”, upon request. The Governments of Japan and the United States agreed to continue to review the status of residence question in light of possible developments concerning the accreditation status of foreign institutions.

Medical Services

The U.S. Government requests in medical services are: (a) allow private companies to own medical institutions; or at a minimum, (b) expand the range of medical service jobs that can be outsourced to private companies (particularly testing and imaging services). In response, the Japanese Government explained that, on February 27, 2003, the Headquarters for the Promotion of Special Zones for Structural Reform decided to allow corporate enterprises to enter the management of medical institutions as a special measure in the Special Zones for Structural Reform, and will map out a concrete plan in June 2003, and will submit to the Diet the amendment bill by the end of JFY 2003. As for (b), the Government of Japan permits outsourcing jobs that do not involve the practice of medicine. Imaging and certain other testing are not permitted because the Japanese Government believes a doctor’s presence is required.

The U.S.-Japan Investment Initiative continues to review the current state of the education and medical services sector and to exchange opinions on developments.

(3) Reduce Due Diligence Costs

The U.S. Government pointed out that when an American investor evaluates a possible investment in Japan, it is very difficult to conduct due diligence, thus inhibiting investment in Japan. To solve this problem, the U.S. Government suggested promoting mutual understanding of U.S. and Japanese business cultures, improving transparency in accounting/auditing, increasing the number of experts such as accountants, and building a database of court lawsuits and real estate transactions to promote transparency.

The Japanese Government has launched the following measures.

Accounting Standards, Auditing, Accountants

To ensure greater accounting transparency, the Japanese Government has implemented measures to achieve an accounting system that is consistent with international accounting standards. The Government revised the consolidation range and launched tax-effect accounting in fiscal year 1999, introduced retirement-benefit accounting and financial-

instruments fair value accounting in fiscal year 2000, made impairment accounting applicable to capital assets on a voluntary basis in fiscal year 2003, and will make it compulsory in fiscal year 2005. In view of international developments, the Business Accounting Council is reviewing business combination accounting in Japan.

1999:	Review the consolidation range, introduce cash-flow statement and tax-effect accounting, and review R&D expenses.
2000:	Introduce retirement-benefit accounting and financial-instruments fair value accounting.
2005:	Introduce impairment accounting.
Under examination:	Business-combination accounting.

The Government submitted a Certified Public Accountant (CPA) Law reform bill to the ordinary Diet session. The bill includes measures to strengthen the independence of auditors by prohibiting non-auditing services such as consulting, as well as strengthening the supervision of auditors by establishing a CPA and Auditing Oversight Board (CPAFOB) and enhancing powers of the Financial Services Agency.

In addition, the CPA Law reform bill includes measures to augment the number of CPAs, aiming to increase the current 14,000 CPAs to 50,000 by simplifying the exam for CPAs in order to increase the current number of successful candidates from the current level of 1,000 or less to 2,000-3,000 per year.

Real Estate Appraisal/Database Building

The real estate appraisal standards, which real estate appraisers use as a guideline in appraising real estate, were drastically revised in July 2002. The new standards became effective in January 2003. The new standards further detail and specify how real estate appraisers assess properties, which will greatly enhance due diligence efforts. The National Land Development Council is examining building a database on real estate dealings in the context of revisions in land policy and is expected to reach its conclusions by the end of 2003.

(4) Labor Mobility

The U.S. Government pointed out that in Japan building a more flexible labor market is an important key to attracting foreign investment. The rapidly aging society is expected to face a significantly reduced traditional labor force and, therefore, it is necessary to utilize non-traditional labor such as women. In this context, the United States made several suggestions: raise contribution limits of the Defined Contribution Pension which was recently introduced in Japan in order to promote its adoption; clarify dismissal standards and diversify vocational education and job training so that more people can participate in the labor force.

The Japanese side responded that since the Defined Contribution Pension system started in October 2001, it has been adopted by 361 companies and about 308,000 employees for their corporate pensions, as well as about 12,000 individuals as of the end of February

2003, indicating steady growth for the last 16 months. The Japanese Government will continue to examine the possibility of raising the contribution limits while keeping an eye on how well the system succeeds.

As for clarification of the dismissal standard, the reform bill of the Labor Standards Law submitted to the ordinary Diet in March 2003 stipulates that an employer can dismiss its workers. However, the bill also states that if there is no reasonable cause for a dismissal, on grounds commonly accepted as appropriate, the dismissal is invalid because the right of dismissal was abused.

Job training was traditionally the responsibility of the individual company, and the Government's assistance was focused on that. But recently, the Government is directing more assistance to make vocational education available for temporary workers and women. The Government's policy is shifting to provide grants to support individual workers enrolled in job training programs.

(5) Assets Available for Investment

The U.S. Government pointed out that American investors are highly interested in investment opportunities in Japan, but find few assets available on the market. For this reason, as well as the need to accelerate corporate reorganization, they suggested that Japan take measures to release assets held by companies with financial and business problems to the market. Corporate restructuring would address the non-performing asset problem and moving assets into the marketplace would return those assets to productivity. The Japanese Government explained that the current ordinary Diet session passed legislation to set up the Industrial Revitalization Corporation (IRC), which began operations on May 8, 2003 in the expectation of making assets available for investment. The IRC will purchase loans held by banks other than the main bank to consolidate creditors and mediate among creditors from a neutral position. After the creditors agree on a plan, the corporation can smoothly sell off its loans to the final buyers within three years and regain the confidence of the market. As a result, corporate reorganization will further accelerate and more assets will be available for investment. The United States Government welcomed the establishment of the IRC and urged it to take prompt and effective action to restructure companies and move non-performing assets into the market.

(6) Public Relations/Perceptions

Both the United States and Japanese Governments continue to be concerned about the perception of FDI in Japan. Speakers at the investment seminars and the U.S.-Japan Private Sector/Government Commission noted that negative public reaction could chill investment in Japan. The Japanese Government also noted the need for U.S. companies to have a better understanding of the changing investment conditions in Japan. The two Governments confirmed that they would continue to hold seminars in Japan and symposia in the U.S. in order to improve awareness of FDI opportunities.

This year, investment promotion seminars were held in Osaka on April 23 and in Sapporo on April 25. The participants vigorously discussed how to attract foreign capital to local cities in Japan. When Prime Minister Koizumi's intention to double the cumulative amount of FDI in five years was announced at the seminars, attendees were keen to be a part of this effort. They urged the government and private sector to coordinate their efforts to attract investment because they are competing against domestic and overseas cities. The seminars also encouraged awareness of the urgency to utilize M&A or anything available so as to revitalize local economies, reorganize businesses and secure jobs, rather than to talk about the threat of foreign capital.

On June 24 and 26, the Investment Initiative plans to hold symposia in Chicago and San Francisco to improve American awareness of improved investment conditions in Japan and to showcase successful foreign companies in Japan.

(7) Implementation Issues

In monitoring the results of last year's Investment Initiative activities, the Governments reviewed the implementation of recent Commercial Code revisions, particularly those which allow Japanese companies to choose a U.S. style corporate governance system. A number of companies expressed an interest in using the new corporate governance system, though companies will not decide whether or not to opt for the new system until their annual shareholder meetings this summer. Both sides observed that many companies were taking advantage of the new consolidated tax provisions that make it easier for companies to acquire loss-making entities and restructure them. The Government of Japan explained that over a hundred companies are filing consolidated returns. Finally, both the United States and Japanese Governments welcomed the increase in investment in Real Estate Investment Trusts (REITs) compared to previous years, as they offer yet another valuable investment option in Japan.

2. Japan's Concerns

(1) Sarbanes-Oxley Act

The Investment Initiative devoted considerable time to discussion of the new Sarbanes-Oxley Act requirements. Through this process, the Government of Japan clearly articulated its concern about the applicability of the Act to Japanese firms and auditors. In response to Japanese concerns, the Securities and Exchange Commission has adopted a rule which provides an exemption for jurisdictions, such as Japan, with boards of auditors or statutory auditors, provided that such auditors are authorized by home country requirements, they are either separate from the board of directors, or composed of one or more members of the board of directors and one or more members that are not also members of the board of directors, they are not elected by management of the issuer and no executive officer of the issuer is a member.

The regulations require that firms using an audit committee system must have an audit committee with 100 percent independent directors, and there is no exception for Japan's

system of audit committees where majority members must be outside directors. However, the SEC remains willing to receive further information on how this provision is affecting individual firms. Finally, regarding the audit firms, the Public Company Accounting Oversight Board and the SEC have authority over accountants who audit the financial statements of public companies that have elected to access U.S. markets. There were many public comments from foreign countries, including Japan, requesting an exemption to foreign public audit firms from the registration requirements. The Board will be submitting for SEC review, solicitation of comments and approval rules that would require the registration of both U.S. and non-U.S. accounting firms. The Board is considering the appropriate scope of its oversight authority with respect to accounting firms located outside the United States.

(2) Visas

In the Investment talks, the Government of Japan expressed concern over the process for revalidating U.S. work visas. As a result of Investment Initiative sponsored meetings, consular experts clarified the process and explained the different ways Japanese citizens can revalidate their visas. U.S. officials noted that Japanese businesspeople could apply in Washington, where processing for revalidations is done as quickly as possible. Japanese businesspeople can also apply for renewals at U.S. embassies and consulates in Canada or Mexico, which offer a convenient appointment system through their websites, which can be accessed at <http://www.nvars.com>. Finally, Japanese businesspeople also have the option of applying for revalidations at the U.S. Embassy in Tokyo, where the number of staff handling visas increased, and which can offer flexible response times and application periods when needed to address urgent situations. More detailed information is available at the following websites: usembassy.state.gov/tokyo and http://travel.state.gov/visa_services.html.

(3) Driver's Licenses

The Government of Japan raised a concern over the processing of state driver's licenses for Japanese citizens in non-work status in certain states. In the Investment talks, the U.S. officials explained the steps being taken by a number of states to resume issuing driver's licenses in this situation. In March of 2003, the Social Security Administration published a rule proposing to stop assigning Social Security numbers solely for state driver's license purposes. In the April Investment discussions, the United States Government advised the Government of Japan and affected firms to participate in the SSA public comment process, which ends May 27 to alert the SSA to their concerns. The Government of Japan submitted a comment to the SSA on May 13, requesting SSA to work with the remaining states which have not yet introduced an alternative identifier system, especially Illinois, and to suspend the implementation of new rule until the remaining states complete introduction of such a system. The SSA, with the assistance of the American Association of Motor Vehicle Administrators and the support of the Department of Transportation, is working to assist states that require SSNs for driver's licensing to develop alternative identifier systems.

(4) Movement of Cargo

A. West Coast Lockout

The Government of Japan in the November 2002 Investment talks expressed concern over the West Coast dockworkers lockout. After the Presidentially mandated "cooling off" period under the Taft-Hartley Act, resolution was quickly reached and a prolonged disruption to the flow of goods into the United States was avoided.

B. Trade Act of 2002

In the high level talks, the Government of Japan noted its interest in our planning for requiring cargo manifests in advance for air, rail, and truck shipments. The U.S. Government advised that it is still in the process of considering requirements for cargo manifests for air, rail and truck shipments under the Trade Act of 2002 (TPA), which authorizes Customs to require electronic advance information for both inbound and outbound cargo for all modes of transportation. Customs is holding public meetings on its proposals and when it publishes the Notice of Proposed Rulemaking for this issue, public comments will be requested. Both Governments desire to encourage speedy trade, while at the same time improving transport security to ensure illicit goods do not enter either country.

(5) Legal Costs

The Governments of Japan and the United States share concerns that legal costs can impact the business environment. The U.S. Government indicated that this issue is a subject of on-going government and legislative discussion in the United States and explained that judicial review continues to overrule excessive damage awards.

(6) Exon-Florio Provision

The Government of Japan expressed concerns on the Exon-Florio clause regarding predictability of regulations, legal stability of completed transactions, and ensuring due process. The U.S. Government responded that they are fully mindful of the Government of Japan's concerns in operation of the clause.

(7) Foreign Agents Registration Act (FARA) and International Investment and Trade in Services Survey Act (IITSSA)

On FARA, the Japanese Government, while understanding the basis for the law, hopes that its restrictions could be eased. The U.S. Government responded that proper levels of transparency are of vital importance, but that every effort is made to ensure the restrictions were limited to those needed to meet the goals of the Act. On the IITSSA, the Japanese Government requested that the reporting burden be eased. The U.S. Government explained the need for the data collection but noted that it aims to make the amount of information required as minimal as possible, while still ensuring the needed

data is obtained. With the new electronic filing system, the collection of this data has become even easier than before.

(8) Greenfield investment in areas outside of Tokyo

To revitalize local economies and help encourage greenfield investment in local areas, the Government of Japan, in its 2003 budget, earmarked grants for local governments committed to attracting foreign capital. The grants as described on page 4 can be used to support incoming foreign companies and to run publicity campaigns promoting improved local investment conditions. To enhance these efforts, the Government of Japan requested the U.S. Government's assistance in promoting greenfield investment in local areas.

The United States Government while noting that M&A investment is also an important way to save jobs and promote growth, agreed to work closely with the Government of Japan to assist local areas in understanding what business environment best attracts investment. As part of this effort, the U. S. Government participated in seminars in Osaka and Sapporo in April 2003, bringing along the first U. S. Government sponsored investment mission to these areas as described on page 4. The U.S. Government also suggested arranging opportunities for Japanese local officials to be in contact with U.S. local officials to exchange ideas and experiences on attracting investment.

IV. Conclusion

The progress outlined above shows the important steps the Investment Initiative has taken to promote greater flows of investment between our two countries. While much remains to be done, it is clear that there are more lucrative investment opportunities in the United States and Japan than there were just a few short years ago. This is good news not just for firms looking for new potential investment opportunities but also for our domestic communities, which stand to gain more and better jobs as well as increased economic growth.

With the reforms of recent years, the investment climate in Japan has been improving. Looking ahead, Japan needs not only to pursue the challenges raised in the U.S.-Japan Investment Initiative, but also to seriously review regulatory reforms to expand investment opportunities in some areas where private sector investment has been considered inappropriate. At the same time, it should examine why FDI has not dramatically increased in Japan despite the reduction of some barriers. One obvious reason is the economic slowdown in Japan and the rest of the world. However, other major factors appear to be that the Japanese public still needs to fully welcome foreign investment and local government systems to attract foreign capital need to be improved. The Initiative hopes that Prime Minister Koizumi's forceful call to promote FDI and the growing awareness of investment opportunities in Japan by foreign companies, as well as efforts to attract FDI by both Japanese local governments and business communities will improve this situation.

The United States also continues to welcome foreign investment. Recent corporate scandals have caused the U.S. Government to implement systemic reforms to improve and strengthen corporate governance to rebuild confidence in capital markets. Another significant change in the marketplace has been the enhanced security measures put into place since the September 11, 2001 attacks. In designing these new systems, the U.S. Government continues to listen to the views of the private sector, both foreign and domestic, to ensure the new measures meet the desired goals without impeding legitimate trade and investment. The Initiative will continue to provide an avenue for these views to be made known to the U.S. Government.

The Initiative is committed to building on the Prime Minister's and President's leadership on FDI. The Initiative will continue to promote action to improve the climate for FDI in both countries as well as to reach out to the U.S. and Japanese people to ensure the importance of attracting FDI is well understood.

Appendix I

Investment Seminars (Examples of Successfully Entering the Japanese Market)

On April 23 and 25, 2003, the U.S. and Japanese Governments held Investment Initiative Seminars in Osaka and Hokkaido co-hosted with local governments, business groups and JETRO. The seminar panelists presented a number of examples of U.S. companies that have successfully entered the Japanese market. Below are summaries of their presentations:

General Electric (GE): GE has been in Japan for more than 100 years, supplying power generation equipment since the Meiji era. In fact, GE's founder Thomas Edison sourced the filament for one of his first light bulbs from a bamboo forest near Kyoto. GE now has over \$30 billion invested in Japan and intends to expand its businesses to fully serve its customers' product, service and technology needs. GE's history is grounded on solid partnerships with some of Japan's best companies, including Hitachi, Toshiba, Yokogawa, Mitsui, Nikkei, Fanuc, ANA, JAL and IHI. Since 1995 GE's workforce has grown from 3,000 to 14,000+ Japanese employees.

GE has made significant investments in commercial leasing, life insurance, real estate, auto leasing, consumer financing and restructuring non-performing loans -- creating a win/win for GE and Japan. These businesses have created new jobs, expanded Japan's GDP and tax base, and introduced new global technologies, capabilities and best practices. A great example of a win/win business model is GE's joint venture with Nissen, a leading mail-order and catalog sales firm. GE-Nissen has benefited from the complementary skills of both parents and grown 40+% annually, such that the value of each partner's fraction alone is worth significantly more than the original platform—clearly a win for everyone.

Pfizer: Pfizer established operations in Japan 50 years ago and has been one of the fastest growing pharmaceutical companies in Japan. With continuous, sustained investment, it is expected to become Japan's prescription pharmaceutical industry leader in 2003. Pfizer is also an industry leader in Animal Health products and a major producer of over-the-counter Consumer Health Care products in Japan. Pfizer now employs over 6,000 persons locally and almost all of these highly skilled jobs are filled by Japanese. About 700 are research scientists, many working in Aichi Prefecture where Pfizer just invested an additional US\$83 million (10 billion yen) in a new research building. The Pfizer site in Aichi Prefecture also has a large high-tech manufacturing and packaging facility. Pfizer has also been investing heavily in development of its people in Japan and has one of the industry's biggest and most sophisticated training and educational facilities centered in Ota-ku, Tokyo. In spite of Japan's economic difficulties and a drug market, which has been stagnant for the past decade, Japan remains the world's second biggest single-country pharmaceutical market after the U.S. and has an excellent science base. Pfizer is committed to continuing its investment and making a growing contribution to the Japanese economy.

Ripplewood : Ripplewood is an investment firm headquartered in New York, which has been in Japan for four years. Its funds for the Japanese market consist of two types: a fund exclusively for Shinsei Bank and another investment fund for other companies. The investment fund is on a 10 year term. Ripplewood invests in a company and aims to turn the company into a profitable one in 3-5 years by sending a team of business experts to the company. It is sometimes called a “vulture fund ” but Ripplewood explains that its purpose is not to buy an ailing company cheap and sell its assets piece by piece to make a profit. Instead, it aims to acquire a company to which it can add value and return it to profitability in a short time by sending in an expert reorganization team. In this way, Ripplewood saves jobs, restores profits, and brings economic growth to a locality.

Morgan Stanley: With a presence in Tokyo since 1970, and with 1,300 employees, and capital of JPY36 billion, Morgan Stanley Japan is a leading player in the Japanese securities and asset management business. Over the years, the Firm has provided significant support to American companies seeking to establish or build activities in Japan. In addition to our advisory work for individual clients, Morgan Stanley has actively contributed to the public debate on foreign direct investment in Japan and has assisted the Governments of the United States and Japan in formulating policies for future economic development and welfare through FDI. Thierry Porté, President of Morgan Stanley Japan, was named to the Invest Japan Forum, established in September 2002 by 12 members of the private sectors who support expanding FDI into Japan. The Invest Japan Forum presented its recommendations to Prime Minister Koizumi in December 2002. On April 14, 2003, Robert G. Scott, President and COO of Morgan Stanley Group, served as U.S. Chair of private sector participants in the U.S.- Japan Private Sector/Government Commission established under the U.S.- Japan Economic Partnership for growth, created by President Bush and Prime Minister Koizumi in June 2001. In the Commission, the private sector participants endorsed the recommendations of the Invest Japan Forum and expressed the view that increased FDI into Japan will promote sustainable growth. In summary, Morgan Stanley is strongly supportive of measures to increase FDI as a means of revitalizing the Japanese economy and enhancing the relationship between Japan and the United States.

Nikko Citigroup: A joint venture between Citigroup, the world’s largest financial services firm, and Nikko Cordial Corporation, one of Japan’s most respected financial services groups, Nikko Citigroup is a leader in the investment banking, financial advisory, and securities trading and institutional brokerage businesses.

Combining global experience with deep Japanese business relationships, Nikko Citigroup is a model for high quality financial services in Japan. The effectiveness of this partnership is shown in the numerous accolades the firm has received since its establishment just over four years ago. These include: Japan’s top equity underwriter, top Samurai bond underwriter, best equity capital markets house, and best derivatives house.

Citigroup, with over 100 years in Japan, has been an important part of Japan’s financial community since the founding by one of its predecessor companies of the Yokohama-

Shinbashi Railway during the fifth year of the Meiji Era (1872). Citigroup continues to support its clients in Japan through a full complement of financial services businesses, including: corporate, private and investment banking, asset management, insurance, consumer finance, and trust banking.

Nikko Cordial Corporation is one of Japan's best-known financial services groups. The core of the extensive group comprises: Nikko Citigroup, Nikko Cordial Securities, Nikko Asset Management, Nikko Beans, and Nikko Principal Investments. The group's companies maintain relationships with millions of private clients, as well as nearly every listed company in Japan.