

U.S.-Japan Economic Partnership for Growth

**United States-Japan Investment
Initiative 2008 Report**

July 2008

Executive Summary

For seven years the United States-Japan Investment Initiative has facilitated active discussion and cooperation on ways to improve the climate for foreign direct investment (FDI) in Japan and the U.S. and even globally. The importance of FDI to both countries' continued economic prosperity makes the Initiative a critical pillar of the bilateral economic relationship.

Both Japan and the U.S. welcome FDI. This year, both sides shared concerns on growing investment protectionism worldwide and shared the view on the need to retain the confidence of the investment community. Thus, both sides reconfirmed their basic policy to advance open investment regimes both at home and in third countries.

In Japan, Prime Minister Fukuda has maintained Japan's national goal and policies of promoting FDI. In 2007, Japan's stock of FDI rose ¥2.3 trillion yen to ¥15.1 trillion (\$130 billion), the biggest increase in five years. Merger and acquisition (M&A) activity by foreign companies in Japan also increased substantially in 2007. The Expert Committee on FDI Promotion, established in January 2008, made its recommendations in May 2008. In response to this, the Japanese Government announced it will act on the recommendations and undertake certain new measures to expand FDI.

FDI in the U.S. is growing at a rate faster than that of gross domestic product (GDP). The U.S.' stock of FDI exceeded \$1.78 trillion in 2006. In May 2007, President Bush reaffirmed that the U.S. welcomes inward FDI and invited other nations to join the U.S. in supporting open investment policies. Investment continues to be a powerful force linking our two economies. For example, as of 2006, Japan Automotive Manufacturing Association members had invested almost \$31 billion in parts and manufacturing facilities in the United States and employed more than 400,000 Americans. The Department of Commerce operates the *Invest in America* program to complement the efforts of individual state governments to stimulate economic growth and create jobs through inward investment.

The Investment Working Group (IWG) has developed into a forum for positive and mutually beneficial discussion of a wide range of issues important to investors in both countries. In 2007-2008, the IWG discussed:

- (i) ongoing policy-level efforts in both countries to promote FDI;
- (ii) the regulatory framework in each country to review FDI with national security implications;
- (iii) individual issues raised previously, including revision of Japan's labor-related laws and systems, deregulation in the field of education, M&A related issues including corporate defensive measures, visas and other consular issues, and maritime counterterrorism measures and secure trade;

(iv) aspects of each country's investment agreements with third countries, including reports on progress with negotiations. For the first time, both countries discussed the domestic impacts of the deteriorating global investment climate and reconfirmed their open investment policy.

The IWG expanded its private sector outreach begun in 2007 by inviting business representatives to the IWG. Also, public outreach under the initiative continued with a Japan-U.S. investment seminar in Osaka in September 2007, and Invest Japan Symposiums in Washington, D.C., and Miami in October 2007.

The U.S.-Japan Investment Initiative will continue its activities under the direction of Leaders to promote measures to improve the investment climate in our respective countries.

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I. Introduction

Since its establishment in June 2001, the United States-Japan Investment Initiative has facilitated active discussion and cooperation on ways to improve the climate for foreign direct investment (FDI) in Japan and the U.S. The Initiative is part of the U.S.-Japan Economic Partnership for Growth, and is jointly chaired by Japan's Ministry of Economy, Trade and Industry (METI) and the U.S. Department of State.

Japan and the United States benefit enormously from foreign investment. In the context of global economic development, FDI's importance has increased in each country. The Investment Initiative is a valuable tool for combating global investment protectionism, improving the FDI environment, and contributing to economic growth in both countries. Discussions in the Initiative's Investment Working Group have led to greater understanding by both sides of the critical contribution of FDI to economic growth, as well as the most effective ways to promote cross border investment.

FDI is an effective measure to vitalize economies by enabling access to new technologies and innovative know-how, supplying new products and services and assuring increased employment opportunities. Furthermore, cross-border investment and M&A activities also strengthen multilateral international economic relations. Turmoil in global credit markets and a decline in investor confidence since mid-2007 demonstrated again that investment promotion and facilitation must be a continuing effort.

During the past year both countries' leaders have publicly reiterated their governments' pro-investment policies. In May 2007, President Bush issued a White House statement on investment in which he noted the United States continues to welcome FDI since "both inbound and outbound investment stimulate growth, create jobs, enhance productivity, and foster competitiveness at home and in international markets." Prime Minister Fukuda, at the January 2008 World Economic Forum in Davos, Switzerland, committed Japan to "continue to advance efforts towards market liberalization, including reforms in the areas of foreign direct investment, trade procedures, and the financial and capital markets, thereby enabling the Japanese economy to expand in step with growth around the globe."

The Initiative's bilateral Investment Working Group met twice within the past year, on October 23, 2007 and March 17, 2008. This year, the working group expanded its agenda to include a discussion of the impact of the deteriorating global investment climate and a reconfirmation of open investment policies. The Working Group also discussed the principles and procedures each country uses to conduct reviews of inward FDI with a

potential national security component, precipitated by changes to the regulatory framework in both countries. In 2007 the U.S. amended its law governing the Committee on Foreign Investment in the United States (CFIUS), and Japan expanded its regulatory framework under the Foreign Exchange and Foreign Trade Act to cover newly developed materials that may be used to produce precursors of weapons of mass destruction. In addition, the working group continued the dialogue, begun last year, on the contents of each country's bilateral investment agreements.

As part of the Initiative's public outreach program, Invest Japan Symposiums were held during October 2007 in Washington, D.C., and in Miami. Preparations for another symposium to be held in Chicago in October 2008 are underway. Also, following the Japan-U.S. Investment Initiative seminar held in Osaka in September 2007, an investment seminar is planned for Shizuoka in October 2008. (See: Appendix 1).

This 2008 annual report demonstrates the results achieved through this year's Initiative activities, including a review of the current situation of FDI in both countries and a summary of discussions and public outreach programs associated with the Initiative.

II. Current Situation of Foreign Direct Investment in Japan and the United States

1. FDI in Japan

(1) FDI Trends in Japan

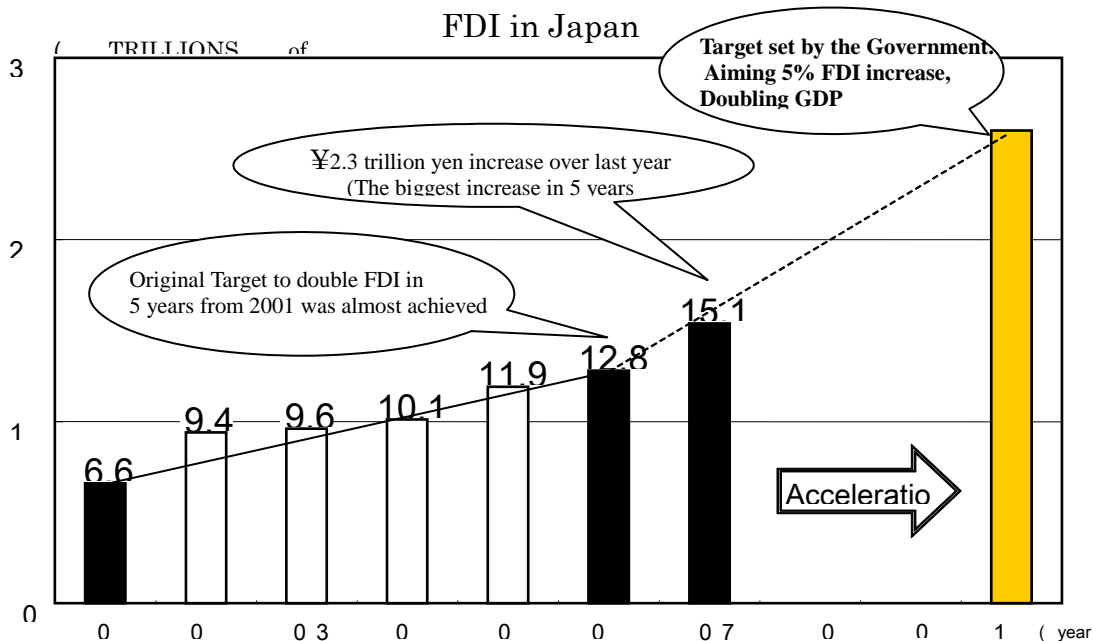
In Japan, FDI has increased significantly since the latter half of the 1990s. This growth stems from reforms in various areas such as corporate laws and systems, bankruptcy laws and systems, corporate accounting systems, and the expansion of business fields open to foreign companies as a result of deregulation.

Japan continues to attract FDI. In recent years, structural reform and policy measures to promote FDI in Japan, initiated by the Koizumi Cabinet and supported by Prime Ministers Abe and Fukuda, have contributed to increasing FDI in Japan. FDI stocks rose to ¥15.1 trillion at the end of 2007 (approx. \$130 billion at an exchange rate of 117 yen/dollar, the official annual average exchange rate of the IMF *International Financial Statistics* for the year 2007). The ¥2.3 trillion increase in 2007, despite the sharp downturn in market sentiment beginning in mid-year and a coincident tightening of worldwide liquidity flows, is the biggest increase in five years. Also, this approximately 18% increase is far bigger than the 1.6% (preliminary figures)

increase in GDP growth.

Of this ¥15.1 trillion, direct investment from the United States accounts for ¥5 trillion. EU investment accounts for ¥6.2 trillion, and ASEAN investment accounts for ¥0.5 trillion.

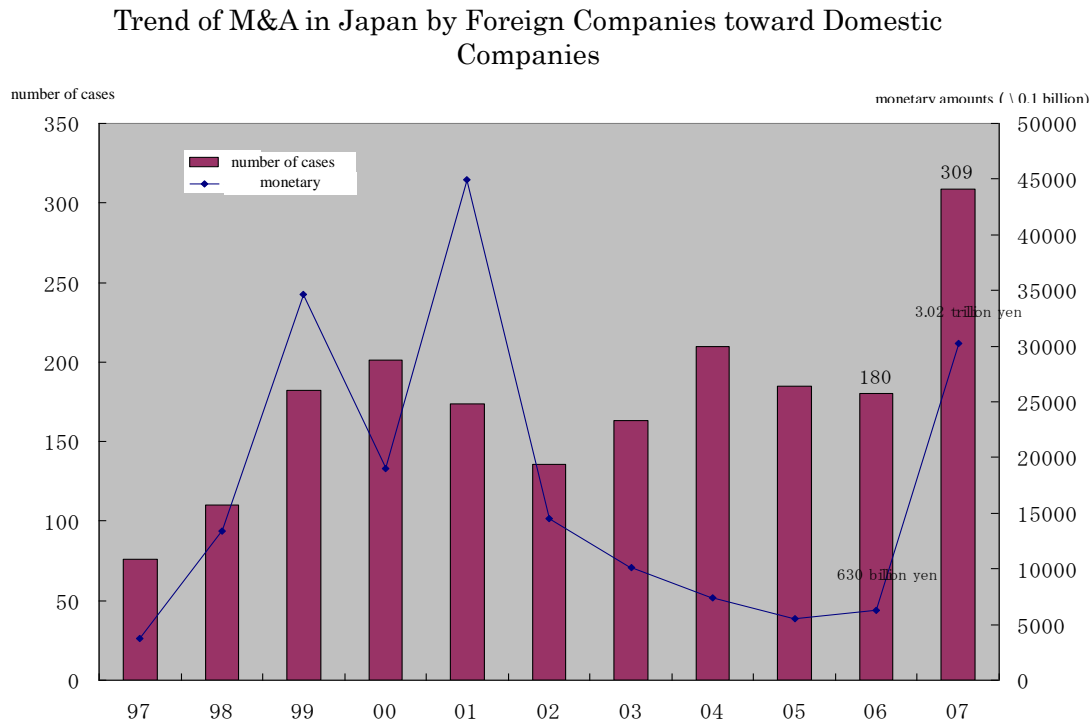
Figure 1:



Source: Ministry of Finance/Bank of Japan

Other statistics show M&A of Japanese companies by foreign companies increased substantially in 2007. The total amount recorded was about ¥3.0 trillion, 3.8 times greater than the previous year, and the number of cases was 309, the highest since 1985. New provisions of Japan's Companies Act allowing the use of stock as consideration in cross-border triangular mergers came into effect in May 2007, and, since that time, one foreign firm, a U. S. company, has used these provisions to acquire a Japanese company.

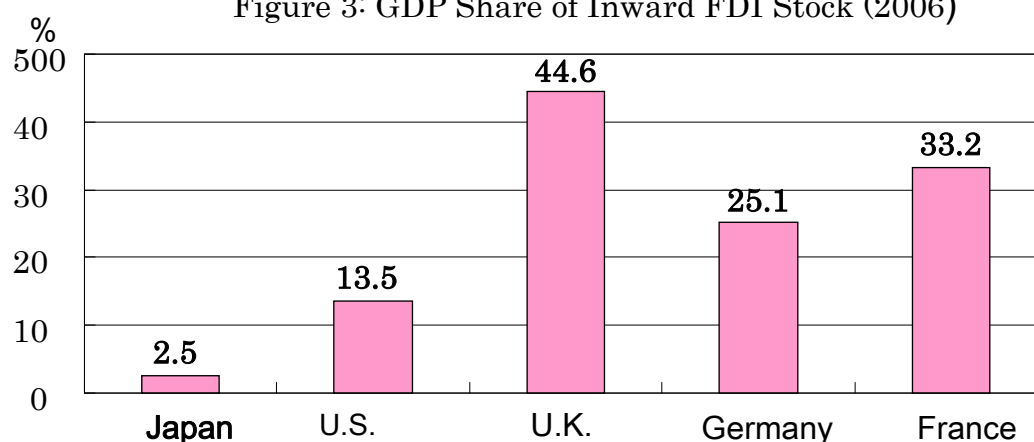
Figure 2:



*This graph was made by METI on the basis of data from RECOF Co.

Although FDI in Japan has substantially increased in recent years, its share of GDP is minimal compared to that of other major countries. Japan's FDI stock was equivalent to only 2.5% of GDP at the end of 2006, compared to 13.5% in the United States, 44.6% in the United Kingdom, 25.1% in Germany and 33.2% in France. According to the World Investment Report 2007 issued by the United Nations Conference on Trade and Development (UNCTAD), Japan's inward FDI performance index ranks 137th among 141 countries (2006), although its inward FDI potential index ranked as high as 24th (2005).

Figure 3: GDP Share of Inward FDI Stock (2006)



Source: Japan / U.K. / Germany: IMF International Financial Statistics (US: Survey of Current Business; France: La Balance des Paiements de la Position Exterieur de la France 2006)

(2) Efforts to Support FDI in Japan

A. Japanese Government Efforts

In January 2003, then-Prime Minister Koizumi announced his goal to “double the FDI stock in Japan in five years.” In March 2003, the Japan Investment Council (JIC), headed by the Prime Minister, formulated the “Program for the Promotion of Foreign Direct Investment in Japan” which established a strategic plan to achieve that goal. As a result of government-wide implementation of various measures, including improvements in the corporate business environment and reviews of administrative procedures, FDI stock increased 94% from ¥6.6 trillion in 2001 to ¥12.8 trillion in 2006. Thus, former Prime Minister Koizumi’s goal to “double the FDI stock in Japan in five years” was virtually realized.

In March 2006, the government set a new goal of “doubling the FDI stock in Japan by raising it to the level of about 5% of GDP by 2010.” In response to this, the JIC in June 2006 established the “Program for Acceleration of Foreign Direct Investment in Japan”. With a close to 20% increase in FDI stock in 2007, Japan is on track to realize this new goal. (See above “FDI in Japan”)

B. Expert Committee on FDI Promotion

Prime Minister Fukuda, maintaining the Japanese national goal and government policies to promote FDI, clearly stated his firm commitment to reform in the area of foreign direct investment in his speech at the January 2008 World Economic Forum in Davos.

In the same month, the Expert Committee on FDI Promotion, an advisory body for Hiroko Ota, the Minister of State for Economic and Fiscal Policy, was established to discuss measures to increase FDI further. The members of this committee include the president of the American Chamber of Commerce in Japan (ACCJ) and the chairman of the European Business Council. On May 20, the Expert Committee submitted “Five Recommendations Toward the Drastic Expansion of Foreign Direct Investment in Japan” to the government's Council on Economic and Fiscal Policy (CEFP), chaired by the Prime Minister. The five recommendations included enhancement of the system for facilitation of M&A, comprehensive studies on foreign direct investment regulations, establishment of priority strategies by sector, reduction of business costs and improvement of system transparency, and regional revitalization by foreign capital and others.

In response to this, the CEFP decided, in its “Economic Growth Strategy” published on June 10, on certain measures to expand FDI, including identification and clarification of M&A conditions, a comprehensive study on foreign capital regulations, and revision of the “Program for Acceleration of Foreign Direct Investment in Japan” by Fall 2008. This strategy was incorporated into the “Basic Policies for Economic and Fiscal Management and Structural Reform 2008” decided by the cabinet on June 27.

Summary of the Five Recommendations Toward the Drastic Expansion of Foreign Direct Investment in Japan

1. Enhancement of system for the facilitation of M&A

In order to contribute to the facilitation of M&A, which is an important means of FDI in Japan, wide-ranging studies should be advanced, and the future improvement of Japan's M&As system should be accelerated.

2. Comprehensive studies on Foreign Direct Investment regulations

While maintaining national security and public order, regulations with appropriate predictability should be advanced. The scope of cases where Foreign Direct Investment regulation is necessary and grounds for doing so as exceptions to the principle of nondiscrimination between domestic and foreign investors should be clarified, and Japan's open investment policy should be demonstrated to the rest of the world.

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.

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.

5. Regional revitalization by foreign capital, strengthening of outreach that foreign capital is welcome, etc.

In order to realize regional revitalization through the attraction of foreign capital, regional structures should be built to make it easy for foreign capital to enter, and the outreach that Japan is welcoming foreign capital should be strengthened.

Excerpt from the “Basic Policies for Economic and Fiscal Management and Structural Reform 2008”

Expansion of foreign direct investment in Japan

The GOJ will expand Foreign Direct Investment in Japan and make Japan a country that is growing along with the global economy. For this purpose, the GOJ will revise the “Program for Acceleration of Foreign Direct Investment in Japan” by Fall 2008 and implement it steadily with periodical reviews.

- The GOJ will identify and clarify the desirable form of M&A (takeover rules) by summer 2008.
- The GOJ will advance comprehensive studies on the desirable form of Foreign Direct Investment regulations as exceptions to the principle of nondiscrimination between domestic and foreign investors in FY 2008.
- The GOJ will formulate an “Action Plan” to speed up the review for approval of medical devices by Fall 2008.
- The GOJ will take measures to reduce business costs by studying the effective corporate tax rate system as part of fundamental tax reform.

Appendix

Expansion of foreign direct investment in Japan

Cabinet Office, Ministry of Economy, Trade and Industry, and relevant ministries and others will revise the “Program for Acceleration of Foreign Direct Investment in Japan” by Fall 2008 and steadily carry it out, and try to

expand FDI in Japan.

A. Studies on desirable form of M&A

GOJ will set up a fair and transparent M&A climate including through identification and clarification by Summer of 2008 of conditions for introduction and invocation of defensive measures by Ministry of Economy, Trade and Industry, Ministry of Justice, and Financial Services Agency.

B. Comprehensive studies on Foreign Direct Investment regulations

In coordination among the relevant ministries, etc. concerned, GOJ will advance comprehensive studies on desirable form of protection of national security and of Foreign Direct Investment regulations as an exception to the principle of nondiscrimination between domestic and foreign investors under FEFTA and other sector specific laws in FY 2008.

C. Formulation of an action program for speedier examination of medical devices

Ministry of Health, Labor and Welfare, Ministry of Economy, Trade and Industry, relevant ministries, industries, universities and others will cooperate and formulate an "Action Plan" to eliminate the "device lag" including reinforcement of the review by Fall 2008, in order to make the domestic market attractive by enabling the use of the world's most advanced medical devices on the front-lines of medical care.

D. Reduction of business costs

- i. Studies on the effective corporate tax rate system in light of fundamental tax reform
- ii. Improvement of the implementation of "no-action letter" system and drastic reinforcement of written reply procedures for taxes

E. Improvement of promotional structure for FDI in Japan

Cabinet Office takes the initiative in expanding the system toward promotion of FDI in Japan.

(3) Japan's Strengths

According to the UNCTAD World Investment Report 2007, Japan ranks 24th among 141 countries in terms of the Inward FDI Potential (2005). This high ranking stems from the fact that Japan's enormous market accounts for approximately 9.1% of world GDP. Japan has rich human resources with valuable expertise; a well-organized infrastructure in the fields of commodity distribution and information and communication; and a good business environment with improved laws and systems.

2. FDI in the United States

(1) FDI Trends in the United States

The United States continues to attract significant FDI inflows from countries around the world because of its open economy, strong long-term growth, and high rate of return to capital. Deregulation and technological change have made the United States particularly attractive to investors even in a time of global economic uncertainty. Year-on-year growth in the United States' stock of FDI reached 12.2% in 2006 (Table 1). This upswing coincides with a decline in the value of the U.S. dollar and a significant increase in merger and acquisition activity.

Table 1:

**Foreign Direct Investment Stock in the United States
on a Historical Cost Basis, 2001-2006**

Year end	Billions of Dollars	Percent Change from Preceding Year
2001	1,344.0	6.9
2002	1,327.2	-1.3
2003	1,395.2	5.1
2004	1,520.3	9.0
2005	1,594.5	4.9
2006	1,789.1	12.2

Source: *Survey of Current Business* (April 2008), Bureau of Economic Analysis, Department of Commerce

In 2006, the most recent year for which data is available, foreign direct investment inflows rose sharply to \$175 billion, compared with \$101 billion in inflows in 2005. The largest investment stock positions in the United States are held by the United Kingdom (17%), Japan (12%), Germany (11%), Netherlands (11%), Canada (9%) and France (9%).

Table 2:

**Foreign Investment Outlays in the United States
by Type of Investment, 2001-2006
(millions of dollars)**

	2001	2002	2003	2004	2005	2006
Total Outlays	147,109	54,519	63,591	86,219	91,390	161,533
By type of investment:						
U.S. business acquired	138,091	43,442	50,212	72,738	73,997	147,827
U.S. business established	9,017	11,077	13,379	13,481	17,393	13,706

Source: *Foreign Direct Investment in the United States* (June 2007), Bureau of Economic Analysis, Department of Commerce

Foreign investment outlays in the United States consist overwhelmingly of U.S. business acquisitions. While both types of investment outlays dropped off after 2001, U.S. business acquisitions have increased substantially since 2004. The influx of foreign capital due to these outlays contributes significantly to the U.S. economy. In 2005, the most recent year for which data is available, U.S. affiliates of foreign companies directly employed 5.1 million people, accounting for 4.4% of total U.S. employment in non-bank private industries. Foreign firms accounted for 5.6% of U.S. economic output in that year. Investment by Japanese companies accounted for 613,600 U.S. jobs in 2005 and almost 1% of U.S. private-sector GDP. To cite a specific sector, as of 2006, Japan Automotive Manufacturing Association (JAMA) members had invested some \$30.99 billion in more than 28 manufacturing and parts facilities in the United States. Japanese automakers, distributors and dealers employ nearly 427,000 Americans, including 60,000 in automotive manufacturing and almost 3,600 in R&D centers.

(2) Efforts to Support FDI in the United States

A. Federal Efforts

The United States Government remains committed to supporting open investment regimes both at home and abroad. President Bush reaffirmed this policy in a Presidential Statement of May 10, 2007 that promoted open investment and trade. The United States, as both the world's largest investor and the world's largest recipient of investment, has a key stake in promoting open global investment. President Bush also noted that "the United States unequivocally supports international investment in this country and is equally committed to securing fair, equitable, and nondiscriminatory treatment for U.S. investors abroad." The President pledged to conclude the World Trade Organization's Doha Development Agenda negotiations and secure congressional approval of all pending U.S. free trade agreements. The President's statement, with an accompanying policy statement addressing the domestic climate for foreign investment, barriers to investment, the WTO rules-based trading system, and the international investment environment can be found at <http://www.whitehouse.gov/news/releases/2007/05/20070510-3.html>.

The U.S. Department of Commerce's *Invest in America* program held an Invest in America week May 5-9, 2008 with events in 12 states highlighting the importance of foreign direct investment for U.S. jobs and economic growth. Commerce Secretary Carlos Gutierrez toured Hitachi Ltd.'s Torrance, California facility with California Gov. Arnold Schwarzenegger May 12 as the final event held in connection with Invest in America week. More information on this initiative can be found at www.investamerica.gov.

B. State Efforts

State governments are the most active promoters of inward FDI in the U.S. Most of those governments offer a wide variety of services and information for companies interested in investing in their state. In addition, many states maintain offices abroad to promote trade and inward FDI. The American State Offices Association (ASOA), established in 1980 to promote mutual interests of U.S. State Offices, has an office in Japan. ASOA provides state and local government agency members with the means for collective action and information exchange.

Twenty-two U.S. state governments currently maintain offices in Japan:

State of Alabama	State of Arizona
State of Arkansas	State of Colorado
State of Georgia	State of Idaho
State of Illinois	State of Iowa
State of Kansas	State of Mississippi
State of Missouri	State of Nebraska
State of New York	State of North Carolina
State of Ohio	State of Oregon
Commonwealth of Pennsylvania	State of South Carolina
State of Tennessee	State of Texas
Commonwealth of Virginia	State of West Virginia

Information on ASOA and links to websites with information on individual state investment and trade promotion activities can be found at <http://www.asojapan.org>.

(3) U.S. Strengths

The United States remains an attractive destination, largely due to the size of its market and the openness of the economy. Trade and investment promotion is a high priority for the United States and takes place at both the national and state levels. While the attacks of September 11, 2001 spurred measures to enhance the security of legitimate trade for the United States and its trading partners, the United States has made it a priority not to allow security measures to hinder trade and investment flows. Accordingly, the U.S. government reviews inward FDI transactions only when there is a potential national security concern. Less than 8% of all inward FDI cases were reviewed in 2007. The United States also seeks to engage in mitigation agreements (agreements in which the foreign investor takes specific actions to decrease national security risk) when addressing a particular transaction, rather than blocking the transaction and thereby eliminating a viable source of inward FDI. The U.S. Government welcomes the views of the private sector and key trading nations, including Japan, to ensure that new security

measures meet desired goals without impeding legitimate trade and investment.

III. Discussions in the U.S.-Japan Investment Initiative 2007-2008

1. Policies to Encourage Foreign Direct Investment

The Investment Working Group had an extensive discussion of the critical importance of pro-FDI policies at its March 2008 session. Both the United States and Japan noted their concern over growing investment protectionism and shared their view on the need to retain the confidence of the investor community.

The United States voiced worries of a possible retreat by Japan from its pro-foreign investment policies, while noting cases of new FDI in Japan during 2007, including the first use of the new triangular merger provisions of the Companies Act. Japan explained that there is no change in its policy of encouraging inward foreign investment. Japan explained how FDI in Japan is rapidly increasing (as described in Section II 1. (1)) and how those investments are contributing to the Japanese economy. Japan also asserted its commitment to an open investment policy remains unchanged, a statement supported by concrete policy developments, including Prime Minister Fukuda's announcement in Davos, the establishment of the Expert Committee on FDI Promotion and its activities and so on (details are described in Section II 1. (2)).

The United States urged senior Japanese government officials to find opportunities to reaffirm publicly Japan's policy of encouraging inward FDI. The Japanese Government explained it will continue to showcase Japan as an investment destination in various ways including seminars and enhanced outreach programs.

In response to Japanese comments, the United States also explained its open investment policy.

2. Inward Investment Regulations

(1) Inward Investment Regulations in Japan

The Government of Japan actively promotes foreign direct investment in Japan, and adheres to the basic concept of "liberal foreign transaction in principle" under the Foreign Exchange and Foreign Trade Act. Inward foreign direct investment in industrial sectors concerned with "national security," "maintenance of public order," "public safety," etc. is subject to prior notification, and a limited number of industries are cited in ordinances as

requiring notification for foreign investment exceeding 10% in companies operating in those sectors. Japan noted its policy is in conformity with the OECD Code of Liberalization of Capital Movements and other international investment rules. Under September 2007 revisions to the system, the category of industries making general-use products with a high probability of being diverted for use in weapons of mass destruction was added to the areas requiring prior notification.

The Government of Japan pointed out that over the past three years, out of approximately 760 advance notifications received, all but one case were approved within thirty days, with the government granting permission within two weeks in approximately 95% of the time, showing the Act to be operating in an extremely restrained manner.

The United States and Japan shared the view on the importance of maintaining an open investment environment. Japan and the United States share common approaches to recognition of the components of national security, and the two sides shared the intention to continue an information exchange on the actual operation of investment regulations.

(2) Inward Investment Regulations in the U.S.

In July 2007, the U.S. Congress passed and President Bush signed into law the Foreign Investment and National Security Act (FINSA). FINSA reaffirms the longstanding U.S. policy of welcoming foreign investment while updating existing regulations governing the Committee on Foreign Investment in the United States (CFIUS) and its procedures for national security review of inward FDI meeting certain criteria. The new law underscores evaluation of foreign government control of potential investments and control of critical infrastructure. In January 2008, President Bush signed an additional Executive Order intended to strengthen the CFIUS process by assigning responsibilities to specific CFIUS agencies. In April 2008, the U.S. Government issued preliminary regulations that clarify further the CFIUS process and welcomed public comments. A key objective of the new regulations is to ensure that the process remains narrowly tailored to national security concerns.

The U.S. side explained the principles behind how and when it undertakes security examinations of inward FDI. If the United States determines there is a national security risk associated with a particular transaction, it will seek to address the problem through existing authorities or limited mitigation measures, rather than by blocking the transactions completely. The CFIUS process is explicitly designed to avoid excessive restrictions on FDI. Foreign owned firms account for 6% of U.S. GDP, 14% of U.S.-based

R&D spending, and 19% of U.S. exports. In 2007, out of nearly 2000 inward FDI cases, only 147, or about 7.5%, were reviewed under CFIUS. Historically, the annual ratio of CFIUS cases to total cross-border M&A transactions was even lower, in the range of 5-6% a year. The United States and Japan both acknowledge the importance of basing reviews on genuine national security concerns associated with a transaction, and on taking any action proportional to the risk posed. Also, both sides shared the view that predictability, legal stability and due process are critical elements for investment-related regulations.

3. Review of Concrete Issues

(1) Cross-border Mergers and Acquisitions (M&A)

The Companies Act provisions relating to the triangular mergers entered into force on May 1, 2007. At the same time, the Government of Japan revised provisions of the Ministry of Justice Ordinance regarding enhanced disclosure to the shareholders of companies subject to such mergers (i.e., the shareholders of the disappearing company) in order to protect these shareholders. However, no revision was added to the provisions of the Ministry of Justice Ordinance regarding the level of shareholder approval required for triangular mergers, which means that the requirements for approval are the same as those for normal mergers, with shares of the surviving companies as consideration. The first case involving the use of the triangular merger mechanism occurred in January 2008.

The Government of Japan continues to observe the effects of Article 821 of the Companies Act (related to the legal status of foreign representative offices) on foreign companies in Japan, and will examine, when necessary, the need to revise Article 821 to ensure those companies are not adversely affected in their lawful operations .

The Government of the United States requested research by the Ministry of Economy, Trade and Industry, or the Corporate Value Study Group (CVSG), into what sort of impact the increasing introduction of takeover defense measures are having on the image of Japan as an attractive country for investment. It also stated its opinion on the necessity of an impartial analysis, utilizing the CVSG or similar entity, of the confusion surrounding appropriate takeover defense measures and their usage as a result of the court decisions concerning Bull-Dog Sauce Co., Ltd.

In answer to this, the Government of Japan explained that the CVSG cannot discuss legal revisions, but can discuss how these laws should be interpreted and what suggestions should be given to the private sector, as

well as what the current status of takeover defense measures are, what impact they are having and what is the appropriate form for those measures. The Government of Japan shared the view that there was confusion over the purpose of these takeover defense measures, and explained that although takeover defense measures should not be designed simply to be invoked to halt a potential acquisition, they had in fact been invoked in that manner and the extremely large sum of ¥2.1 billion of shareholders' money had been spent in the Bull-Dog case. The Ministry of Economy, Trade and Industry indicated it would make an effort to develop suggestions as quickly as possible to address these issues through discussions in the CVSG.

The Government of the United States also expressed its concern that the cross-holding of shares had increased in recent years as part of takeover defense measures, and stated its opinion that it would be of benefit for the CVSG to take up this issue.

In response to this, the Ministry of Economy Trade and Industry explained a view that a reordering of ideas regarding takeover defense measures in light of the situation after the Bull-Dog Sauce decision would be a solution to the issue of cross-holding of shares, and expressed hope that the CVSG will issue a report for the appropriate use and implementation of takeover defensive measures consistent with the proper objective of promoting corporate value and the interests of shareholders rather than protecting management.

The CVSG, in accordance with the Economic Strategy Report, concluded in its report issued on June 30 that hostile takeovers can have positive benefits both for shareholders and the target company by, for example, instilling discipline on management and promoting the interests of shareholders. The CVSG also concluded that takeover defensive measures, in principle, should not be invoked, since invocation of such measures deprives shareholders of a chance to accept an offer if they so choose. The CVSG also determined that management has an obligation to make responsible judgments about the attractiveness of takeover bids from the standpoint of the interests of shareholders, as well as about whether the adoption or invocation of defensive measures will increase corporate value and further shareholder interests.

(2) Education

The United States expressed its continued interest in the establishment of Foreign University Branch Campuses in Japan. Japan explained the Ministry of Education, Culture, Sports, Science and Technology is addressing Temple University Japan's request for the status of school juridical person (*gakko hojin*) in order to become a university based on

Japanese law. The United States welcomed this development.

(3) Labor-Related Laws and Systems

The United States pointed out that increasing the flexibility of the Japanese labor market in order to address severe population fluctuations was best carried out by the introduction of a white-collar exemption scheme, revision of the defined contribution pension system, and the introduction of financial settlements to labor disputes.

The Government of Japan stated its opinion in regard to these points as follows:

A. The Introduction of White-Collar Exemption: The Government of Japan will continue to review the system of working hours for white-collar workers.

B. Review of the Defined-contribution Pension System: Review of the defined contribution pension system will continue, taking into account reform of the public pension system and deliberation on tax reform.

C. Introduction of Financial Settlements for Labor Disputes: Review of the introduction of financial settlements for labor disputes will continue based on trends in existing means of dispute resolution.

(4) Visas

The Government of Japan, as in past years, emphasized that timely visa issuances and renewals are essential to efficient cross-border business operations. The Intelligence Reform and Terrorism Prevention Act of 2004 reiterated the basic requirements for interviews for U.S. visas. In addition, the USA Patriot Act of 2001 and the Enhanced Border Security and Visa Entry Reform Act of 2002 introduced biometric requirements for U.S. visas that could only be fulfilled by appearances in person at U.S. embassies and consulates. Per U.S. law, personal appearance is mandated for visas and therefore domestic visa renewals will not be resumed in the United States. Japanese companies and family members state that the halting of domestic revalidations is creating a burden.

The Government of the United States expanded visa services in Japan by starting monthly non-immigrant visa processing in the United States Consulate General in Sapporo in April 2006 and Fukuoka in May 2007. Sapporo schedules 25 appointments per two appointment days per month to meet the demand, and Fukuoka has a similar schedule.

The existence of five U.S. non-immigrant visa processing posts in Japan compares very favorably with the level of U.S. consular services provided in other countries. The wait-time for an appointment in Tokyo is two days for tourist/business visas and two days for student/exchange visitor visas. Other posts in Japan offer same day or one day appointments. There are currently no plans to accept visa applications at the U.S. Consulate in Nagoya due to logistical and personnel resource limitations.

This year, the Japanese side asked the United States Department of Homeland Security to increase the maximum validity of L visas from 2 - 3 years to 5 years and to increase the allowable number of renewals for L and H-1B visas. The United States noted visa categories for U.S. and Japanese visas are not exactly equivalent, but U.S. law and policy on the issuance of L and H-1B visas are consistent with the principle of reciprocity.

Japan also urged the United States to resume revalidation of visas within the United States and requested U.S. consideration of a procedure to revalidate E visas in nearby third countries as a temporary measure. The United States noted that for policy reasons it has no plans to undertake revalidation of visas in the United States.

The U.S. Department of State is seeking final approval to institute new procedures that may help some applicants renewing visas. These procedures would expand the number of persons who are eligible to apply for visas without having to appear in person at the embassy or consulate that adjudicates their visa application, provided that they are physically present and submitting their application in their country of residence or nationality abroad. For these procedures to be applicable, the applicant must have already submitted all ten fingerprints, have been interviewed by a consular officer, and be applying for a new visa in the same category within twelve months of their previous visa's expiration.

(5) Cargo Security

The United States and Japan both acknowledged the ongoing challenges of addressing the threat of transnational terrorism and securing the global supply chain without hindering the efficient movement of goods. The United States and Japan participate in a variety of bilateral and multilateral discussions addressing the importance of facilitating international trade while improving transport security.

Japan expressed concern about the economic impact of a new U.S. law that will require 100% scanning at foreign ports of all containers bound for the United States by July 2012. Japan noted that World Customs Organization

guidelines do not advocate 100% scanning but rather risk management targeting of containers for inspection and asked the United States to consider measures that do not inhibit the smooth movement of the global supply chain. The United States reiterated its continued commitment to working with both domestic and foreign partners to implement 100% scanning in a responsible and logical manner. Input and concerns from the private sector and international partners are part of the 2008 SAFE Port Act report to Congress.

Japan also conveyed Japanese industry's concerns that the U.S.'s proposed Importer Security Filing regulation (the "10 plus 2" rule) may lead to longer lead times in clearing international shipments at U.S. ports and impose heavy burdens on the private sector to install systems to comply with the new rule, and bring about a situation where a trade secret is not treated as confidential. Japan urged the United States to listen closely to private sector views in order to establish a realistic system when implementing the new regulations. Japan also pointed out the importance of providing incentives for the private sector to implement multiple security measures. The United States stated that government-to-government discussions on cargo and supply chain security can now be most effectively taken up in the Study Group on Secure and Efficient Trade. As part of the Study Group effort, the U.S. Government conducted well-received public briefings in Tokyo in November 2007 for the Japanese government and industry on the new security measures described above, including the subject of maritime cargo security. The United States encouraged the Japanese government and private sector to provide comments on the Importer Security Filing regulation through the official public comment process. The Government of Japan and some Japanese industry groups submitted comments on the Notice of Proposed Rule Making published in the Federal Register on January 2, 2008. The U.S. Government will fully consider all comments received, as mandated by law.

4. Information Exchange on Investment Agreements

The United States and Japan share the view on the necessity of cooperating to see in what way better business environments can be expanded on a global level. Accordingly, in February 2007, a meeting of experts was held to review best practices for international investment agreements (IIAs) concluded by Japan and the U.S. with third countries. The conclusion of the discussion was that both countries had similar approaches to investment protection and liberalization in the legal frameworks of their BITs and their FTA investment chapters, as well as similar strategies towards other countries. Both countries view investment agreements as valuable tools for promoting and protecting investment between economies. Following this meeting, the information exchange continued at the most recent round of the U.S.-Japan Investment Initiative.

In regards to the current status of Japanese investment agreement negotiations¹, thirteen countries have signed BITs, and eight countries have signed EPAs that include investment chapters. As for recent achievement, Japan signed BITs with Cambodia in June 2007 and Laos in January 2008, while Chile, Thailand, Brunei and Indonesia concluded EPAs with Japan in 2007.

The Government of Japan set out its basic policy concerning the future promotion of EPAs in 2004, has created and revised a schedule of EPA negotiations, and is making active strategic efforts aiming at concluding high-quality comprehensive EPAs in a wide variety of fields, including services, investment and intellectual property. In addition to EPAs, the Government of Japan has been positively promoting BITs. The Government of Japan announced the policy for BITs in June 2008. This policy was incorporated into the Basic Policies for Economic and Fiscal Management and Structural Reform 2008” decided by the cabinet on June 27. To realize this policy, the Government of Japan will review the priority among countries and areas for new BITs. Negotiations began with Saudi Arabia and between Japan-China-Korea in March 2007, and with Uzbekistan in February 2008 and Peru in May 2008. Agreement has also been gained to begin BIT negotiations with Qatar. Negotiations for EPAs that include investment chapters are underway with India, Switzerland and Australia. EPA negotiations are also underway with Vietnam but negotiations with Korea have been suspended. Both countries already have investment agreements with Japan.

In this round of the U.S.-Japan Investment Initiative, the Japanese side outlined the state of negotiations for a three-country investment agreement between Japan, China and Korea, taking into account the discussion underway regarding the possibility of an investment agreement between the United States and China. The Government of Japan also expressed its deep interest over U.S. investment agreement strategies regarding the so-called “BRICs” (Brazil, Russia, India and China). The United States provided an update on its exploratory talks with a number of developing countries that have expressed interest in concluding a BIT with the United States. Both governments shared the intention to continue to exchange information regarding their investment agreements in the future.

IV. Outreach to the Private Sector on the Investment Environment

The Investment Working Group met with business organizations

¹ Japan also signed AJCEP (ASEAN-Japan Comprehensive Economic Partnership).

representing Japanese firms active in the U.S. market and American companies active in Japan in May 2007 in Tokyo and in October 2007 in Washington. The aim of these sessions was to learn about the obstacles faced by business when making cross-border investment. The sessions confirmed that many of the issues the IWG is discussing continue to be of interest to businesses in both countries.

Among the issues and concerns raised by the private sector were:

- The importance of regulatory transparency,
- Additional costs and limits on activities due to inconsistency in U.S. state-level regulation, particularly in regard to environmental protection and insurance services,
- Limits on government procurement in the U.S.,
- The need for more types of allowable M&A transactions in Japan,
- The need to ensure fair competition in the Japan Post privatization process,
- The high cost of legal services in Japan and the need for alternative dispute resolution (ADR) systems,
- Additional costs created by U.S. advance manifest rules (the "24-hour rule"), which some participants claimed has increased average shipping time by up to 2 days,
- The impact on international trade and economic activities caused by 100 percent scanning,
- The need for faster visa processing, and
- The importance of consultation before the U.S. acts on antidumping complaints.

In addition, business participants urged the two governments to consider:

- Policies that promote labor flexibility and allow multinational corporations to achieve "global" utilization of their skilled human resources,
- An examination of the issues involved in a future bilateral free trade agreement,
- Harmonization of patent systems, and
- Mutual recognition of technical standards for products and services.

Both the United States and Japan expressed satisfaction with the results of these business outreach sessions and shared the intention to continue them in the future as a way of guiding the future working group agenda.

V. Conclusion

Seven years have passed since the June 2001 establishment of the Investment Initiative under the framework of the U.S.-Japan Economic Partnership for Growth. The two governments' efforts to further improve the investment climate in their respective countries and raise the public's understanding of the role of inward direct investment have taken root. Moreover, public outreach programs under this Investment Initiative have helped to publicize the benefits of inward FDI and to provide opportunities for companies of both countries to meet and discuss concrete business opportunities that facilitate investment, job creation and growth. Both sides reconfirmed the importance of advancing open investment regimes both at home and in third countries.

Japan continues toward its goal of increasing the stock of FDI to the equivalent of 5% of GDP by 2010, with steady gains being made. Prime Minister Fukuda announced in January 2008 the intention to promote further foreign direct investment in Japan in order to make Japan a country that can grow in pace with the rest of the world. As noted above, the Expert Committee on FDI promotion, established in January 2008, made five recommendations in May 2008. In response to this, the CEFP in June 2008 incorporated certain new measures to expand FDI in its "Economic Growth Strategy," followed by the confirmation of these measures at Cabinet level. The Government of Japan has a policy of making greater efforts than before to promote foreign direct investment in Japan.

In a new approach for the Initiative this year, the Investment Working Group held discussions with U.S. and Japanese business representatives that allowed the voicing of a wide range of opinions on the development of the business and investment environments in both countries. Both countries shared the intention to continue to seek dialogue with industry.

The U.S.-Japan Investment Initiative will continue its activities at the direction of leaders of both countries. Both governments will continue to promote measures to improve the investment climates in their respective countries by considering the necessity of further growth of both countries' economies, their importance in the global economy, and the significance of this Investment Initiative and inward FDI.

Appendix 1: Invest Japan Symposiums and Seminar

Every year, the U.S.-Japan Investment Initiative holds symposiums in the United States to publicize the Japanese investment environment, and seminars in local Japanese cities to discuss the mutual benefits of foreign direct investment.

In October 2007, as the Initiative was in its seventh year, Invest Japan symposiums were held in Washington, D.C. and Miami. These symposia featured U.S. companies involved in the service and ICT industries. Companies that have already invested in Japan discussed the attractions of Japan as an investment destination, using their own experiences. This was followed by speeches and panel discussions on the importance of gathering market information and partner tie-ups for U.S. companies attempting to enter the Japanese market. Preparations are underway for the next symposium, to be held in Chicago in October 2008.

The Japan-U.S. investment initiative seminar was held in Osaka in September 2007, in conjunction with the Japan-U.S. Midwest Association held in Tokyo. The U.S. Midwestern state lieutenant governors and Kansai local government leaders exchanged best practices for promoting FDI and U.S.-Japan investment success stories. The event also provided an opportunity for Kansai companies, foreign companies in Japan, and U.S. companies traveling with the governors to interact. This year's seminar will be held in Shizuoka in October 2008.

Appendix 2: Examples of Recent Entries of U.S. Companies

Many U.S. companies investing in Japan have obtained support from the Invest Japan Business Support Centers (IBSC) of the Japan External Trade Organization (JETRO). Thirty-four U.S. companies set up offices in Japan in 2007 with the support of JETRO, three examples being given below.

○ARI Japan Co., Ltd (ARI Technologies, Inc.)

ARI Technologies has advanced technologies to render asbestos harmless at lower costs than seen previously. Using Thermo Chemical Conversion Technology (TCCT), asbestos can be rendered harmless for disposal at low cost. Having already established its business in the U.S. and in Europe, the company set up its Japanese office in Tokyo in May 2007. In the same year it successfully passed an operational demonstration test while following the guidelines of the Ministry of the Environment, and is now promoting the realization of a commercial-scale plant in Japan as soon as possible. JETRO has given a wide variety of support, helping with the procedures to set up the joint venture company and giving support to hold the press conference.

○Datascope Japan K.K. (Datascope Corporation)

Datascope Corp. is a NASDAQ-listed company and the global leader of intra-aortic balloon counterpulsation and a diversified cardiovascular device company that develops, manufactures, and markets proprietary products for clinical health care markets in interventional cardiology, cardiovascular and vascular surgery, and critical care. The corporation had sold its products in the Japanese marketplace through a Japanese distributor, but in order to provide technical support and serve Japanese clients better, it established its Japanese office in Tokyo in October 2007. JETRO has lent an IBSC Tokyo office, provided consultation service for company establishment procedures, information on permits and the local marketplace, and supported the recruiting activity.

○Mueller Japan (Mueller Sports Medicine, Inc.)

Mueller Sports Medicine manufactures and sells sports care goods, health care goods, health products, nursing products and sports-related products. Its products are sold in 70 countries worldwide. In order to widen its customer service in Japan and expand its operations here, it set up a Japanese office in Yokohama in November 2007. JETRO lent its IBSC Kanagawa rental offices, introduced other office properties and provided free consultation service for setting up the corporation in Japan.

Appendix 3: U.S. Investment Related Agreements since June 2007

- February 19, 2008: Rwanda Bilateral Investment Treaty (BIT) (Not yet ratified)
- June 30, 2007: Korea- U.S. Free Trade Agreement (FTA) (Not yet ratified)

Appendix 4: Japanese Investment Related Agreements

- http://www.meti.go.jp/english/policy/external_economy/trade/FTA_EPA/index.html
 - http://www.meti.go.jp/policy/trade_policy/epa/index.html