

# **The United States, China and Japan: Economic Prospects and the Role of Foreign Direct Investment**

Kristin J. Forbes  
Council of Economic Advisers

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## **I. Introduction**

The United States is the world's largest economy (as measured by total output or GDP). Japan is the second largest economy, and China was the sixth largest in 2002 (Figure 1). These three countries constitute about half of total global output. Economic developments in these three countries have global effects and are significant determinants of exports, growth, and standards of living around the world.

When evaluating a country's impact on the global economy, however, even more important than the country's share of global GDP at any one point in time is its contribution to global growth. Over the past decade, rapid growth in the U.S. economy has consistently contributed to a large share of global growth. Although China is a smaller economy than the United States, rapid growth in China is quickly becoming an important driver of export growth in many countries. In sharp contrast, Japan has contributed very little to global growth since the mid-1990s. Japan's share of global output has actually decreased over recent years. The global economy has recently been flying on one large engine (the United States), supported by a smaller prop engine (China), while another large engine (Japan) is dormant.

Will these trends continue? Will Japan eventually join the United States and China as engines of growth in the global economy? (Another question is whether Europe will become a driver of global growth, but that is a subject for another talk.) What is the gasoline powering growth in the United States and China, but missing from Japan?

My comments will begin by briefly discussing the economic prospects for each of these three large economies (Figure 2). This comparison indicates that even though growth is expected to recover in Japan, growth will still substantially lag that in China and the United States, as well as in most other OECD countries. I will then talk in more detail about one of the reasons for slower past and expected future growth in Japan—low levels of foreign direct investment. Foreign direct investment, or FDI, is when an investor gains some control of the functioning of an enterprise in another country. FDI typically occurs through mergers and acquisitions or through substantial purchases of a company's shares. FDI has widespread benefits and has been an important driver of growth in many countries. Next, I will discuss why FDI is so low in Japan, despite some recent improvement and efforts by the government to encourage foreign investment. My comments will close with some suggestions for what Japan can do to increase FDI, thereby raising productivity and growth so that Japan might become an engine driving the global economy.

## **II. Economic Prospects**

### **A. Prospects for the United States**

The U.S. economy is recovering from three difficult years. Since the stock market bubble burst and the recession began, growth has been constrained by a series of contractionary shocks—from the terrorist attacks of September 11, to the corporate governance scandals, to the wars in Afghanistan and Iraq. Countering these contractionary forces, however, has been a strong economic stimulus from expansionary monetary and fiscal policy. Largely due to this stimulus, growth has recently improved (Figure 3). Growth in the third quarter was 8.2 percent, and growth in the fourth quarter remained strong at 4.0 percent. Growth in the last half of 2003 was higher than in any other 6-month period in the United States in about 20 years.

Key economic indicators suggest that the United States is finally in the midst of a strong and sustainable recovery. Consumer confidence has improved, especially in the past few months. For example, the Michigan index of consumer sentiment recently rose to its highest value since November 2000 (Figure 4). Consumer spending has strengthened over the past year and is expected to remain strong (Figure 5). Housing starts and housing permits are at record levels, despite the slight increase in average mortgage rates since July 2003 (Figure 6).

Strong consumer spending and the robust housing market, however, have been characteristics of the U.S. economy for several years—even during the recession and uneven recovery. What suggests that this recovery is on a sound footing and sustainable is the recent improvement in other sectors of the economy. More specifically, the business sector, which has struggled over the past three years, has recently shown strong signs of improvement. Business production has increased (Figure 7), business investment in equipment and software has improved sharply, and corporate profits in the third quarter reached their highest level ever (Figure 8). Even exports—which fell sharply after the recent recession and then stagnated—have recently started to increase, rising by an impressive 19 percent in the fourth quarter (annualized).

One sector of the economy that has shown less impressive improvement is the labor market. Employment has been unusually slow to recover from the last recession. There is some concern that the standard “establishment” measure of employment, which is based on business surveys, may be missing sources of job creation (Figure 9). For example, another common measure of employment based on household surveys suggests that employment has actually increased by over 2 million workers, instead of fallen by about 1 million, since October 2001. Other labor market indicators also suggest recent improvements—such as a steady decline in the unemployment rate (Figure 10) and fall in jobless claims (Figure 11). Nonetheless, no matter which data series is considered, employment growth has been much slower than expected given the strong recovery in other sectors of the economy.

The slow rate of job creation is not the only concern about the U.S. economy. There is also growing awareness of the large U.S. budget and current account deficits, as well as increased protectionist sentiment. Nonetheless, U.S. economic prospects are very positive. The U.S. economy is expected to grow by over 4.5 percent in 2004 (Figure 12). Since these growth rates are above estimates of the economy’s potential growth, employment should also improve.

## **B. Prospects for China**

In contrast to the United States, which is finally rebounding from a recession and slow recovery, China has just undergone a rapid boom and growth is expected to moderate. According to Chinese statistics, the Chinese economy grew by 9 percent in 2003—one of the fastest growth rates in the world—and growth even reached about 10 percent (annualized) in the fourth quarter (Figure 13). Not surprisingly, this phenomenal growth has generated substantial improvements in living standards and reductions in poverty. Between 1990 and 2002, average per capita income in China nearly tripled from \$350 to \$940 (Figure 14). The number of people living below the \$1 per day poverty line fell by roughly half over the same period.

This impressive economic performance, however, is not without risks. Rapid economic growth has occurred simultaneously with rapid credit growth, a sharp increase in urban housing prices, and a shift from deflation to moderate inflation. There are signs that the economy may be on the verge of overheating and the banking system is severely undercapitalized. Progress in restructuring state-owned enterprises is leaving millions of Chinese unemployed. Inequality—especially between large cities and rural areas—has increased, generating a surge of migration into the cities and straining limited social safety nets.

Despite these risks, the outlook for the Chinese economy is very positive. The government has taken important steps to restrain credit growth, strengthen the banking system, and reduce the risk of overheating—although there are still substantial risks and much more progress needs to be made. Growth is expected to moderate slightly, but still average about 8 percent in 2004, so that China should continue to be one of the fastest growing economies in the world (Figure 15).

## **C. Prospects for Japan**

The prospects for Japan, although also positive, provide a sharp contrast to those for the United States and China. Japan is (hopefully) at a critical turning point. Average growth in Japan since the early 1990's has been fairly volatile and slow—averaging only 1.2 percent from 1991 through 2002 (Figure 16). Growth has recently been constrained by persistent deflation (Figure 17) and high levels of non-performing loans that restrain bank lending. Slow progress with corporate restructuring has complicated efforts to strengthen the banking system.

After several false starts, however, Japan appears to have finally started a sustainable recovery. Growth improved from -0.2 percent in 2002 to 2.4 percent in 2003 (Figure 18). Unemployment fell in 2003, generating the first year-on-year improvement in unemployment in 13 years. Deflationary pressures are easing, although a sustained increase in prices may still be two or more years away. The government has increased efforts to strengthen the banking system, as indicated by more aggressive targets for reductions in non-performing loans. It will be critically important for Japan to continue its reform agenda, especially efforts to restructure the banking system and corporate sector, even if the economy strengthens. If these reform efforts continue, Japan should be able to sustain its current recovery and grow at about 2.0 percent in 2004.

## **D. A Comparison: the United States, China and Japan**

The United States, China, and Japan, three very different economies with bright prospects, albeit each with their own risks. Even though the outlook for each economy is bright, the contrast in what constitutes “bright” and “good” performance across these three countries is striking.

Growth in the United States is expected to average over 4 percent in 2004—among the fastest in the OECD (Figure 19). Growth in China is expected to slow to 8 percent in 2004—among the fastest in the world. Growth in Japan is expected to “recover” to 2 percent in 2004, slower than most of the other members of the OECD. Moreover, these differences in growth rates are not just short-term differences resulting from shocks or cyclical factors. Instead, they reflect long-term structural differences in growth rates across economies. Potential growth in the United States is estimated to be about three times greater than that for Japan. These differences in potential growth rates may appear small, but when compounded over time, they generate substantial differences in living standards.

But what causes these differences in potential growth rates? Why do China and the United States outperform countries of similar income levels, while growth in Japan lags most developed economies in the world? An extensive academic literature shows that a broad variety of factors determine growth rates—from education and labor force growth to geographic location and institutions. Although there is still quite a bit of disagreement about the relative importance of many of these different factors, there is widespread agreement—even in the simplest economic models—that two of the most important factors determining growth in income per capita are investment rates and productivity growth.

Therefore, in order to understand why some countries grow faster than others, it is necessary to understand why some countries have higher investment levels and faster productivity growth. Once again, a range of factors and policies are important. One of the consistent insights from both the academic literature and case-study evidence, however, is that one factor which is important in raising both investment and productivity growth is foreign direct investment.

### **III. The Benefits of FDI**

There are numerous examples of how FDI can raise investment, productivity, and aggregate growth. Here are a few examples, drawing heavily from a recent study by McKinsey Global Institute and the academic literature (Figure 20):

- *FDI can provide capital needed to raise investment levels.* For example, in the consumer electronics sector in China, entrepreneurs from Taiwan provided a significant source of needed financing.
- *FDI can increase competition in the host country,* forcing local firms to become more efficient and productive. The competitive effects from foreign investment are often greater than from local competition because of the scale, capital, and global capabilities that allow multinationals to more aggressively close existing productivity gaps. Increased competition directly benefits consumers through improved selection and lower prices. For example, as China rapidly opened its auto market to foreign investment, prices for passenger cars dropped by more than 30 percent between 1995 and 2001 (a period during which general consumer prices rose by 10 percent).
- *FDI can create jobs and raise employment.* In 2000, European affiliates in the United States directly employed 4.4 million American workers, and about 7 million workers including indirect employment. In just the state of Tennessee, Japanese investment (which was worth \$8 billion) accounted for 37,000 jobs in 2002.

- *FDI can boost wages.* Extensive research has found that foreign-owned firms tend to have higher productivity and wages than do their domestic counterparts.
- *FDI can bring in new technology, techniques, and skills,* which are then often adopted by locally-owned companies. This transfer of technology can be especially important in sectors such as mobile phones, where complex and rapidly evolving technologies are difficult for domestic companies to acquire without foreign investments. This transfer of technology can also include the transfer of skills in areas such as operations, marketing, management, and organization.
- *FDI can help domestic firms penetrate foreign markets* and therefore increase exports. More specifically, domestic firms can learn about exporting from foreign investors, and even use multinationals' distribution networks, infrastructure, and knowledge about foreign tastes.
- *FDI can improve the productivity of suppliers,* directly benefiting local companies. Coca-Cola's investment in China clearly shows this benefit. In the early 1980's, glass bottles for Chinese production of Coca-Cola were imported, since Chinese bottling companies could not produce at Coca-Cola's standards. Coca-Cola then sent a team of glass experts to China to help bring the domestic bottling leaders closer to the latest international standards. The state-owned bottling companies adopted these improved techniques, so that not only could Coca-Cola use local bottling suppliers, but these improvements could be used throughout the entire Chinese bottling industry.
- *All of these benefits of FDI can raise productivity and long-run growth.* One study estimates that FDI spillovers accounted for about 14 percent of productivity growth in U.S. firms between 1987 and 1996.

The benefits of FDI are clearly widespread and substantial. Not surprisingly, many countries have welcomed FDI and, in turn, reaped substantial benefits. For example, the United States has been very open to and supportive of FDI. As a result, FDI flows into the US have been very strong—with the United States receiving about \$300 billion of FDI at its peak in 2000, equivalent to over 3 percent of GDP (Figure 21). Although FDI into the United States declined in 2001 and 2002, this was largely caused by the global economic slowdown, increased economic uncertainty, and the worldwide decline in mergers and acquisitions. Preliminary data for 2003, however, suggests that FDI is recovering rapidly in the United States, almost tripling between 2002 and 2003 to \$87 billion. Studies show that FDI in the United States has not only provided needed capital to fund investment, but also sustained employment. More specifically, in 2001, U.S. affiliates of foreign firms employed 6.4 million American workers, with compensation per worker higher than the average for American-owned firms.

China, as well as the United States, has been open to FDI and received substantial benefits. FDI in China soared from 1 percent of GDP in 1991 to 6 percent of GDP in 1994, although it has since fallen somewhat to 4 percent of GDP in 2003 (Figure 22). Total FDI is estimated at \$57 billion in 2003. Granted, measuring FDI in China can be problematic due to the difference between “committed” FDI and the lower “actual” FDI. In the mid-1990's this difference became so large it was even referred to as the “Westchester County Syndrome.” Bankers and businessmen from NYC, living in the wealthy suburb of Westchester, became allured with China. They would travel to China, sign a deal for new investment, and then return home with

bragging rights to enjoy at the country club. Then, as the New Yorkers realized how hard it was to actually do business in China, they often quietly dropped their investment plans. As the investment climate in China has improved, however, this difference between committed and actual FDI has fallen. And no matter which numbers one uses, FDI into China has grown rapidly and is substantial, especially when compared to levels in other emerging markets.

Moreover, foreign investment has substantially benefited China. Studies indicate that FDI increased the level and growth rate of productivity in Chinese manufacturing industries. One study suggests that every 1 percent increase in FDI raises Chinese GDP by about 7.5 percent in the long run. FDI can also create new jobs in China. Another study claims that just one company—Coca-Cola—was directly responsible for the creation of about 14,000 jobs in China, but its presence supported about 400,000 more jobs in upstream and downstream industries, from local bottle makers to beverage vendors.

#### **IV. A Closer Look at FDI in Japan**

##### **A. Low FDI in Japan**

In sharp contrast to the important role of FDI in the United States and China, FDI has been miniscule and relatively unimportant in Japan (Figure 23). In 2000, FDI as a share of GDP was less than 1 percent in Japan, as compared to 3 percent in the United States and almost 4 percent in China. In 2003 FDI flows into China were almost 8 times larger than into Japan, equal to more than two-thirds of Japan's entire cumulative stock of FDI. These differences are even more striking when FDI is measured as a share of gross capital formation. In 2000 FDI contributed close to 10 percent of gross capital formation in China and over 15 percent in the U.S, but less than 1 percent of gross capital formation in Japan (Figure 24).

Why is FDI so low in Japan? Is it because there are limited benefits to FDI in Japan? A recent study by the American Chamber of Commerce in Japan (ACCJ) suggests this is not the case. Foreign investment has had, and can continue to have, important benefits to the Japanese economy. More specifically, the study states that foreign-owned and foreign-affiliated companies in Japan have (Figure 25):

- Faster revenue growth than domestic firms;
- Significantly higher profitability and sales margins than domestic firms;
- Greater capital investment per employee than domestic firms;
- Higher total factor productivity than domestic firms;
- Higher spending on research and development per worker than domestic firms; and
- Higher average wages than domestic firms.

The study also indicates that Japan would reap substantial macroeconomic benefits if FDI increased. More specifically, if inward FDI expanded to the average level in other developed countries (from 1 percent to 11 percent of GDP), then the resulting increase in capital investment and improvement in productivity would increase GDP by 1.5 percentage points. Estimates also indicate that if foreign-affiliated firms increased employment to levels in the United States (so that the share of employment due to foreign-affiliates increased from 1.3 percent to 8.6 percent), this would support almost 4 million new jobs. Although these types of effects are hard to

estimate with precision, they suggest that increased FDI could substantially benefit the Japanese economy.

Which once again leads to the question, why is FDI so low in Japan? Cross-country studies suggest that a number of factors can restrain FDI, such as: poor infrastructure, low income per capita, small economic size, poor education, insecure property rights, and/or macroeconomic or political instability. But Japan performs well according to these measures. In fact, Japan's potential attractiveness for FDI is captured in UNCTAD's index of "Inward FDI Potential", which uses a number of structural statistics to rank different countries' appeal for FDI. Japan ranks very high in terms of "FDI Potential"—ranking 12 out of 140 countries. In terms of actual FDI performance (measured by FDI as a share of GDP), however, Japan ranks 128.

Surveys of foreign companies that have done business in Japan provide more information on why FDI is so low in Japan. Some of the key reasons these companies cite are (Figure 26):

- complicated distribution channels;
- competition-restricting business practices;
- limited access to information;
- restrictive licensing;
- high tax rates;
- high cost of doing business;
- difficulty hiring people in the middle of their careers;
- customer's requirement for quality; and
- antipathy to foreign investors.

## **B. Recent Progress Raising FDI in Japan**

On a more positive note, although FDI in Japan is extremely low by cross-country standards, there has recently been progress. FDI flows into Japan nearly tripled between 1998 and 2002, largely due to a surge in mergers and acquisitions (Figure 27). Some of this reflected a global trend toward consolidation as multinationals focused on improving efficiency through a worldwide reallocation of resources. Part of the increase in FDI, however, resulted from changes in the Japanese economy, such as (Figure 28):

- *continued weakness in the banking sector*, which made it more difficult for companies to borrow from banks and made foreign sources of capital more attractive;
- *reduced cross-shareholdings by banks and companies*, which freed shares for purchase by foreigners;
- *increased focus on profitability*, instead of simply asset growth;
- *greater size and diversity of the available labor pool*, due partially to increased layoffs during the recession;
- *improved corporate governance*, which has led to better accounting, reporting and disclosure requirements;
- *deregulation that has lowered barriers to new entrants*, especially in industries such as finance/insurance, telecommunications, retail/wholesale and electric power; and
- *sustained decline in asset prices*, which has lowered the cost of purchasing Japanese companies by foreigners.

Building on these economic developments that supported the recent increase in FDI, the Japanese government has also placed a greater priority on increasing FDI in the future. More specifically, in a speech at the start of 2003, Prime Minister Koizumi announced the ambitious goal of doubling FDI by 2008 (from 1.2 percent to 2.4 percent of GDP). To accomplish this goal, the government has endorsed a proposal including 74 measures in 5 specific areas: disseminate information, improve the business environment, review administrative procedures, improve employment and living conditions, and develop national and local government frameworks (Figure 29). Some of the specific measures that the government has implemented, or is in the process of implementing, to accomplish these goals include:

- Conduct research to analyze the benefits of and obstacles to FDI in Japan;
- Establish a “one-stop” information center to help foreign companies intending to invest in Japan;
- Establish the Invest Japan Forum for Japanese and foreign business leaders to promote FDI in Japan;
- Set up “special restructuring zones” in several areas to support local government’s plans to promote FDI; successful zones can then be used as models for other regions.

A final positive step toward increasing FDI in Japan is the joint U.S.-Japan Investment Initiative, which was launched in 2001 as part of the U.S.-Japan Partnership for Growth. The goal of this Investment Initiative is to promote greater FDI flows between the United States and Japan by exploring critical issues and identifying ways to remove barriers to cross-border investment. This project releases an annual progress report to the President of the United States and Prime Minister of Japan and has already taken important steps to reduce obstacles to FDI.

### **C. Suggestions for Further Improvement in FDI in Japan**

Although there has been some improvement in FDI into Japan—due to a combination of economic changes and government promotion—much more needs to be done. Companies still complain that it is very difficult to do business in Japan, and FDI is still a miniscule share of GDP compared to in other developed countries. Moreover, many of the forces driving the recent increase in FDI are losing momentum (such as deregulation, declining stock market valuations, and sales of cross-shareholdings). FDI into Japan actually fell from \$9.3 billion in 2002 to \$7.5 billion in 2003. This decline in FDI was particularly sharp in the 2<sup>nd</sup> half of 2003, during which FDI flows shrank 42 percent compared to the previous year. (Over the same period, FDI increased in many other countries.) Unless FDI growth improves significantly, Japan is unlikely to accomplish the Prime Minister’s goal of doubling FDI by 2008.

Japan should consider a number of additional steps if it hopes to achieve its target for FDI and reap the corresponding benefits from higher investment, productivity, and growth. For example, some recommendations are (Figure 30):

- *Accelerate deregulation*, especially removing the remaining barriers to entry in non-manufacturing industries such as health care services, education, retailing, professional services, transportation, electricity, gas, water-supply, and postal and delivery services.
- *Adjust the legal and tax framework to encourage cross-border mergers and acquisitions*; for example, foreign firms should be allowed to use convenient methods to purchase

Japanese companies, such as stock swaps on a deferred tax basis (which are involved in the majority of domestic mergers).

- *Accelerate reform of the financial system*, including reduced reliance on main-bank financing and cross-shareholdings, as well as less tolerance for banks that rollover financing for insolvent companies; all of these steps should improve competitive pressures and facilitate foreign investment.
- *Accelerate efforts to close or restructure insolvent companies*, creating opportunities for foreign investment.
- *Strengthen the macroeconomic environment*, such as by taking more aggressive steps to end deflation.
- *Improve labor market flexibility* through mechanisms such as increased use of 401Ks so that pension benefits can easily move with workers.
- *Support training that is valuable for multinationals*, such as English-language skills.
- *Continue efforts to improve corporate governance and transparency*, so that investors are aware of losses and the potential gains from foreign investment.
- *Avoid quick-fix FDI incentives that can be costly and introduce additional distortions*, such as providing subsidies for foreign investment, preferential tax treatment, or import barriers; studies suggest that many of these policies targeted to increase FDI actually have substantial costs (including reduced productivity) and do little to raise FDI.

Many of these suggestions, such as accelerating reforms in the banking system and corporate sector, should be undertaken anyway in order to raise economic growth and ensure a recovery. The additional benefit of raising FDI should only increase the incentive to move aggressively. Moreover, many of these suggested reforms could interact with and build on higher rates of foreign investment, generating a virtuous circle of higher productivity and growth. For example, increased FDI will increase competitive pressures in Japan, making it more difficult for inefficient companies to stay in business, thereby accelerating reform of the corporate sector. These accruing benefits could substantially raise investment and productivity, increasing the growth potential of Japan.

## **V. Conclusions**

The global economic outlook is bright. Global growth is expected to reach 4.1 percent in 2004—its highest rate since 2000 (Figure 31). After a prolonged recession, Japan appears to be on the road to recovery. After a much shorter recession – although still too long for local citizens – the United States is in the midst of a strong recovery. China has been booming, and although growth is expected to moderate, China is expected to continue to be one of the fastest growing economies in the world.

Despite this positive outlook, there are substantial differences in the potential growth of the United States, China, and Japan. Many factors determine these differences in growth rates, and one that can be particularly important is foreign direct investment. FDI has widespread benefits. It can not only raise growth through higher investment, but also through improvements in productivity. The United States and China have substantially benefited from foreign direct

investment, and the Japanese government is correct to highlight the importance of raising FDI. Greater foreign direct investment in Japan is an important step toward raising Japan's long-term growth rate, thereby allowing Japan to join the United States and China as an engine of growth for the global economy.

Figure 1:

## Composition of World GDP in 2002

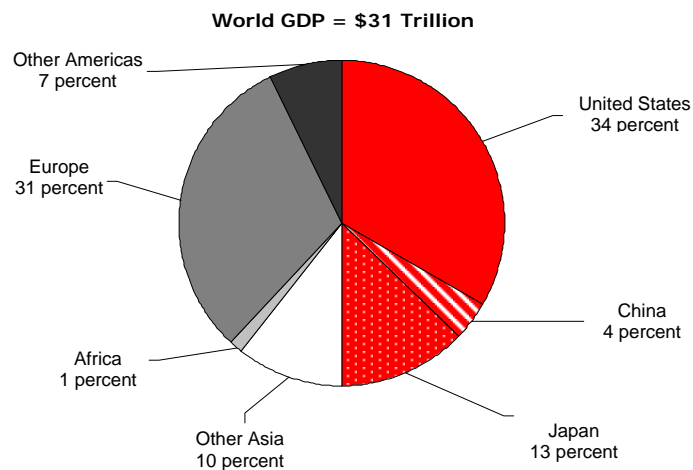


Figure 2:

## Talk Outline

- Economic Prospects: U.S., China & Japan
- The Benefits of FDI
- A Closer Look at FDI in Japan
  - ⊙ Relatively low FDI
  - ⊙ Recent progress
  - ⊙ Recommendations for further improvement
- Conclusions

Figure 3:  
**U.S: Quarterly GDP Growth**

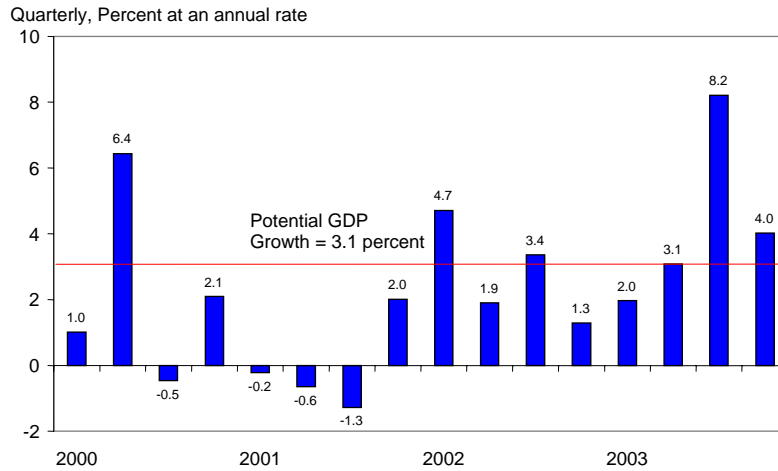


Figure 4:  
**Strong Consumer Confidence**

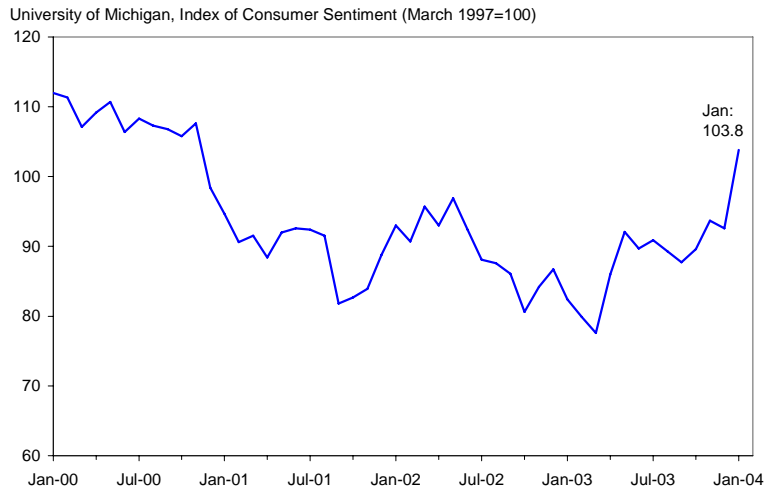


Figure 5:

## Strong Consumer Spending

### Weekly Retail Chain Store Sales

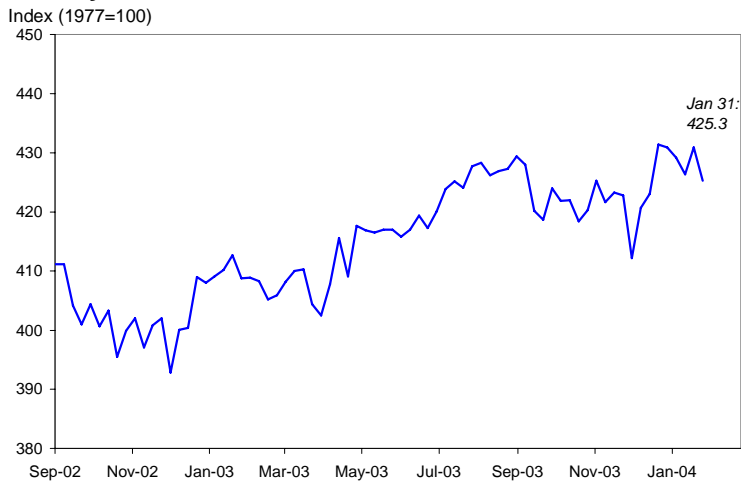


Figure 6:

## Booming Housing Market

### Housing Starts and Mortgage Rates

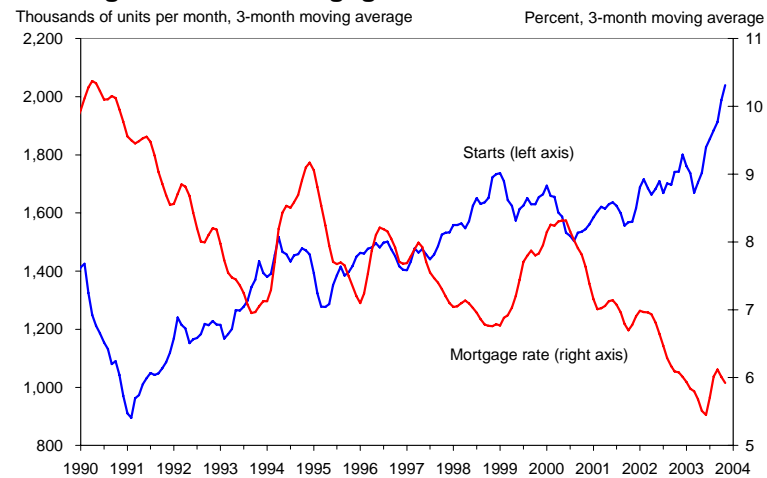


Figure 7:

## Business Production Strengthens

### Weekly Production Index

Business Week Index (1992=100)



Figure 8:

## Record Corporate Profits

\$ Billions at an annual rate

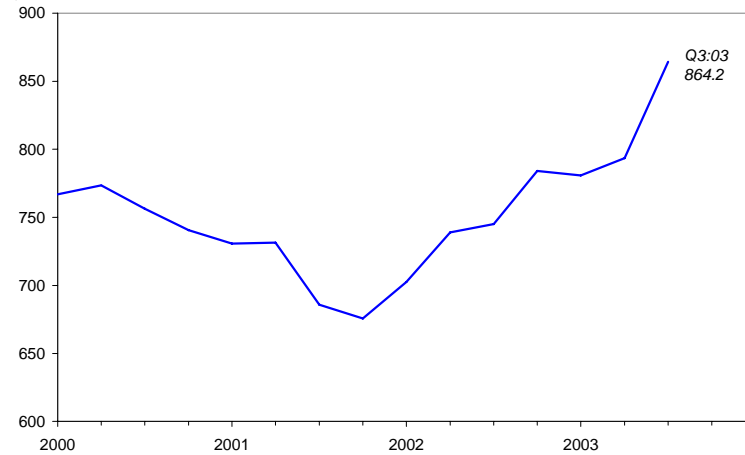


Figure 9:  
**Disappointing Employment**

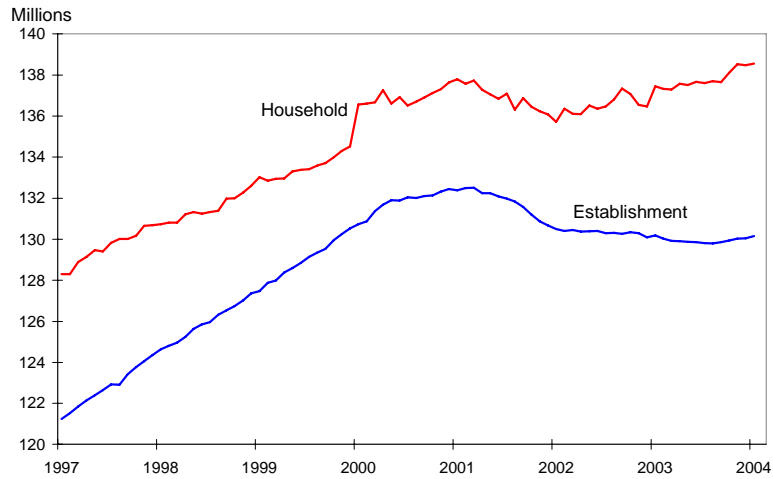


Figure 10:  
**But, Falling Unemployment Rate**

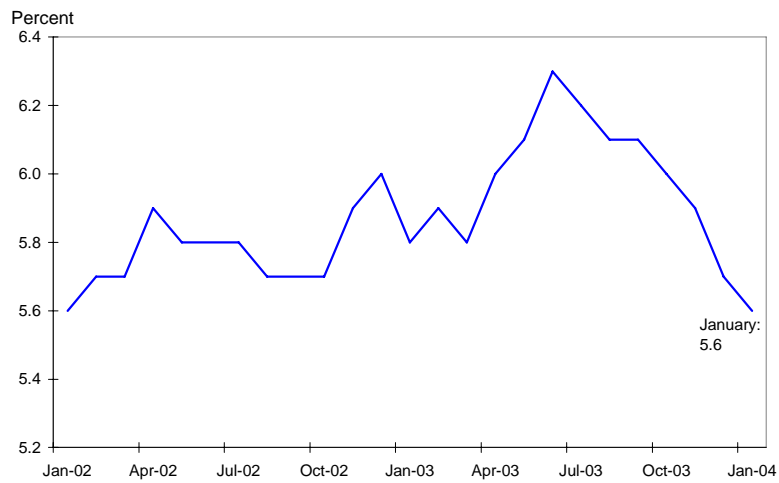


Figure 11:  
**But, Falling Unemployment Claims**

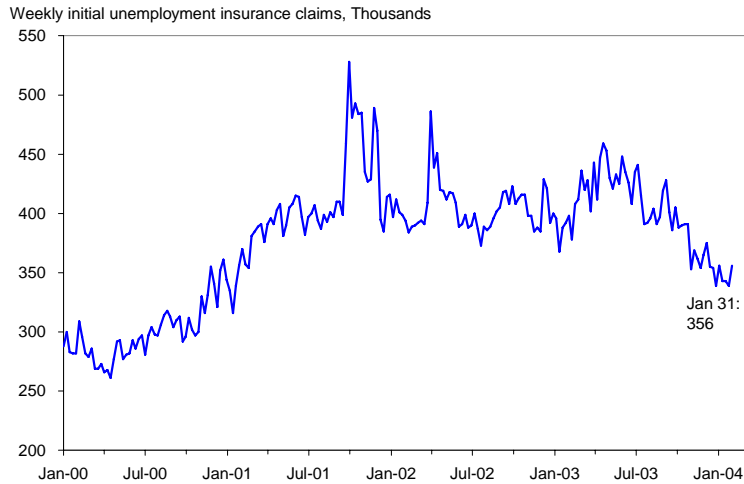


Figure 12:  
**U.S.: Expected GDP Growth**

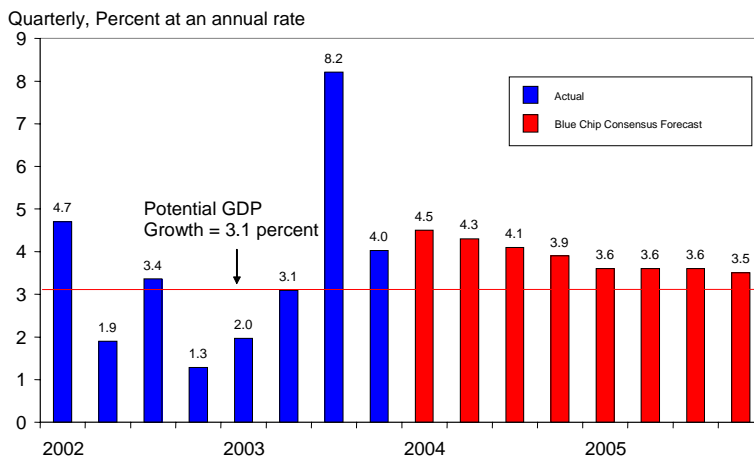


Figure 13:  
China: Strong GDP Growth

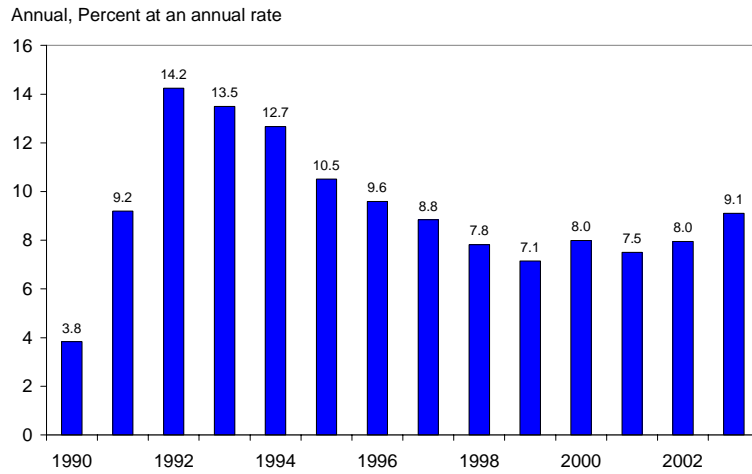


Figure 14:  
China: Improved GDP per Capita

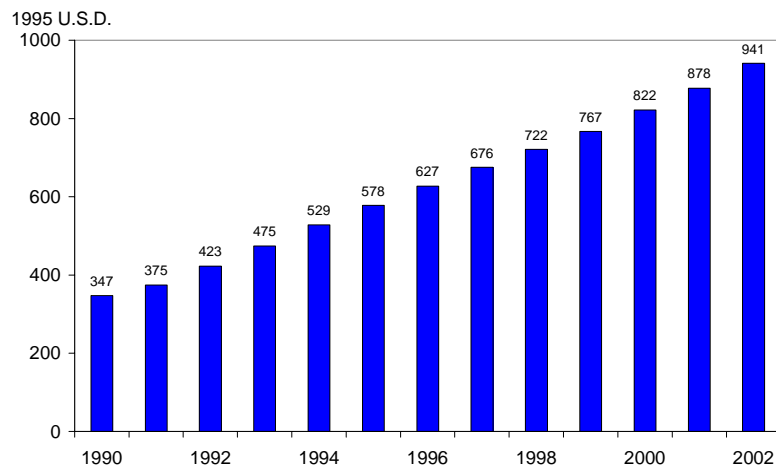


Figure 15:  
**China: Expected GDP Growth**

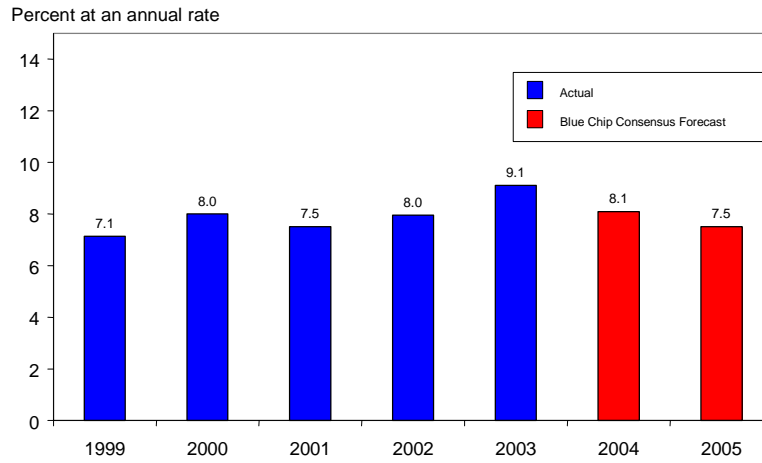


Figure 16:  
**Japan: Volatile GDP Growth**

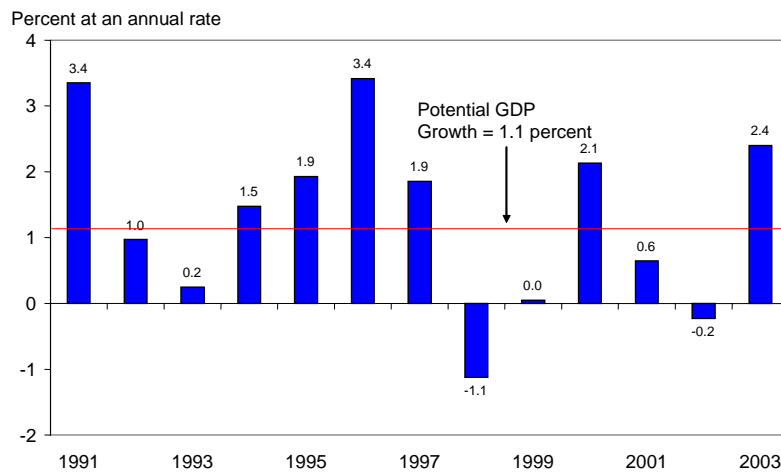


Figure 17:  
Japan: Recent Deflation

**CPI Growth in Japan**

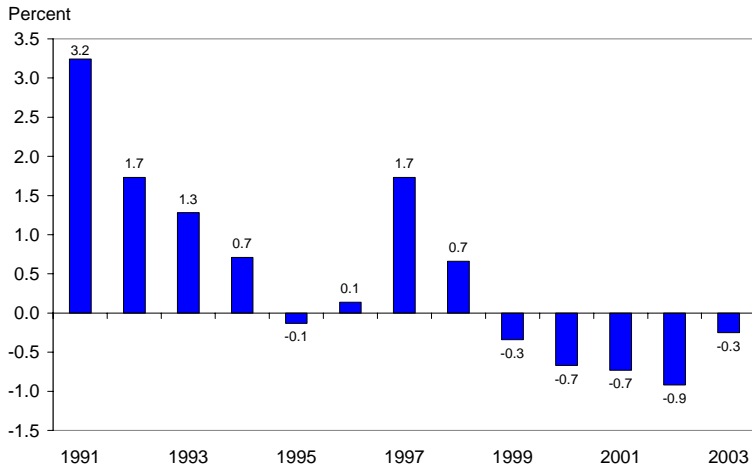


Figure 18:  
Japan: Expected GDP Growth

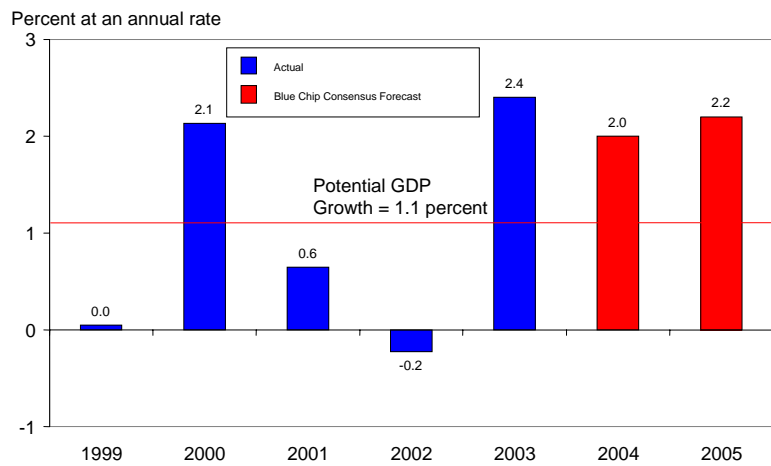


Figure 19:

## Comparison: Expected 2004 Growth

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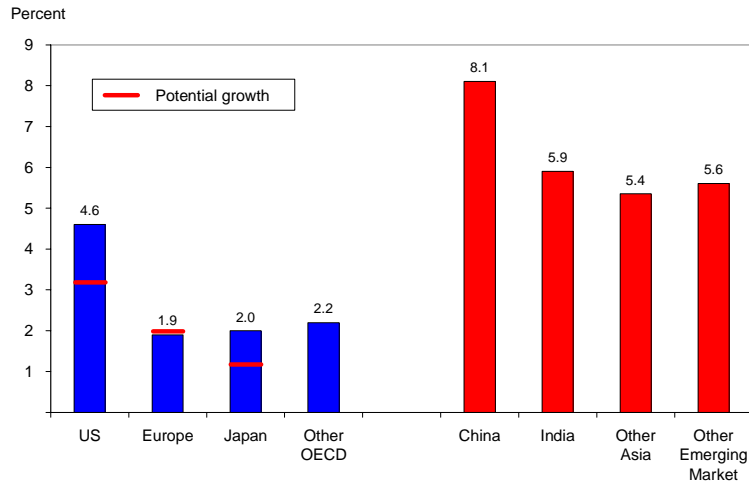


Figure 20:

## Benefits of FDI

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- Provide capital to raise investment levels
- Increase competition in the host country
- Create jobs and raise employment
- Boost wages
- Bring in new technology, techniques, and skills
- Help domestic firms penetrate foreign markets
- Improve the productivity of suppliers
- Raise productivity and long-run growth

Figure 21:  
U.S. FDI (Net inflows)

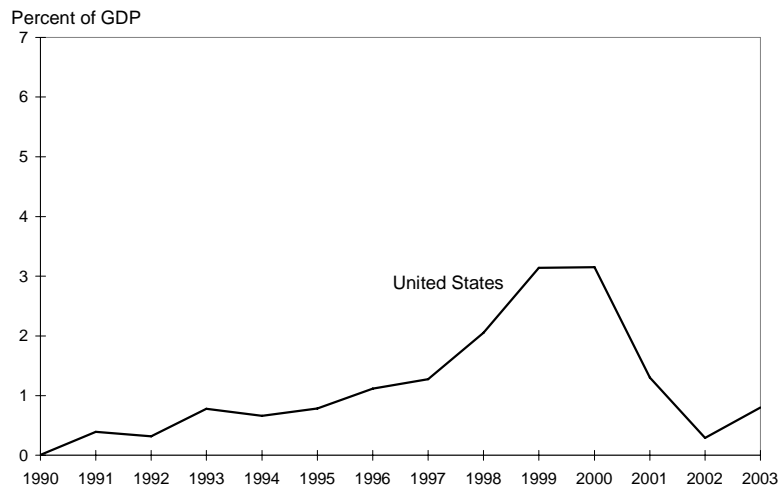


Figure 22:  
China & U.S.: FDI (Net inflows)

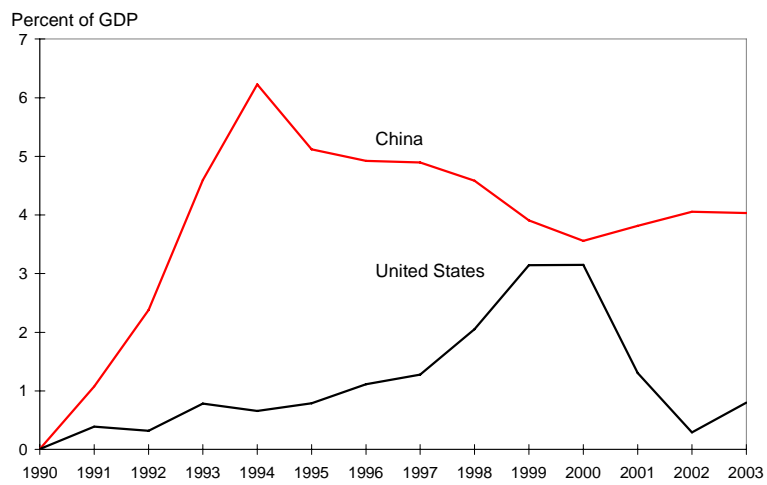


Figure 23:

## Japan: Relatively Low FDI/GDP

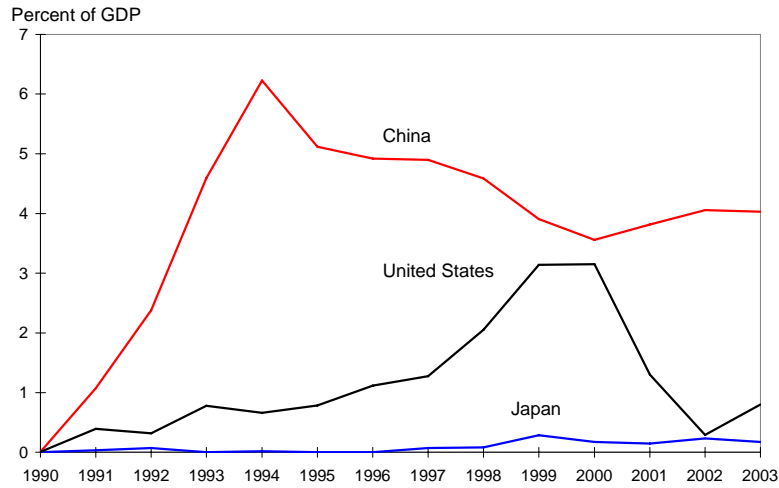


Figure 24:

## Japan: Low FDI/Capital Formation

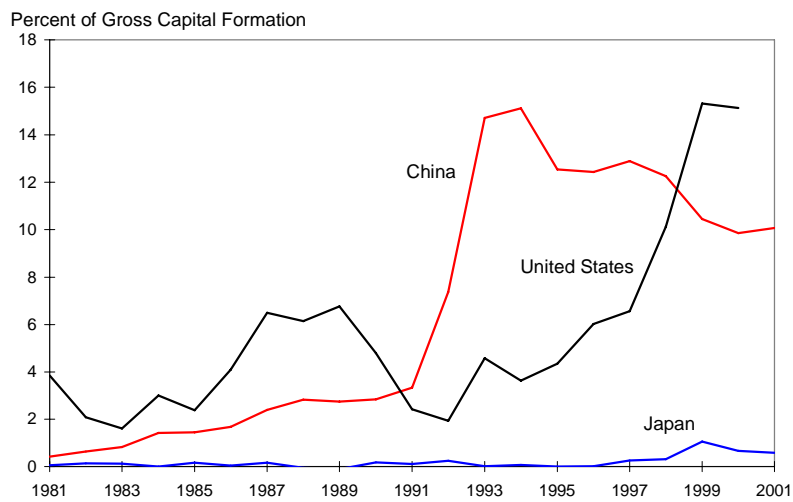


Figure 25:

## Benefits of FDI in Japan

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- ACCJ study shows that foreign-owned and foreign-affiliated companies in Japan have:
  - ⊙ Faster revenue growth than domestic firms
  - ⊙ Significantly higher profitability & sales margins than domestic firms
  - ⊙ Greater capital investment per employee than domestic firms
  - ⊙ Higher total factor productivity than domestic firms
  - ⊙ Higher spending on research and development than domestic firms
  - ⊙ Higher average wages than domestic firms

Figure 26:

## Reasons for Low FDI in Japan

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- Complicated distribution channels
- Competition-restricting business practices
- Limited access to information
- Restrictive licensing
- High tax rates
- High cost of doing business
- Difficulty hiring people in the middle of their careers
- Customer's requirement for quality
- Antipathy to foreign investors

Figure 27:

## Annual FDI (Inflows) to Japan

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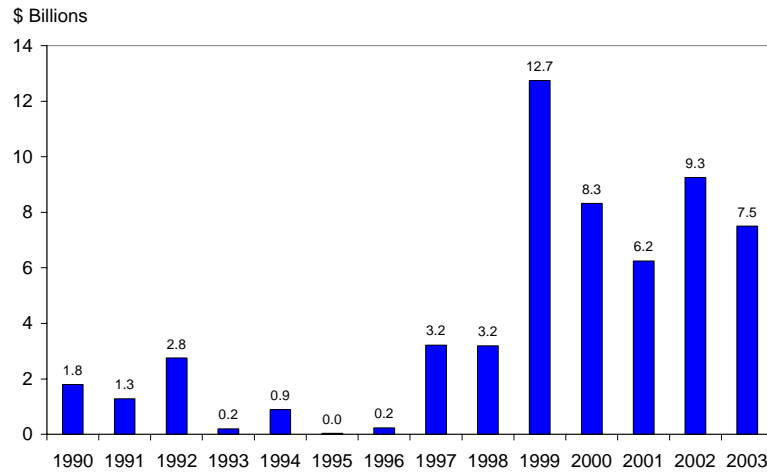


Figure 28:

## Economic Factors Increasing FDI

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- Continued weakness in the banking sector
- Reduced cross-shareholdings by banks and companies
- Increased focus on profitability
- Greater size and diversity of the available labor pool
- Improved corporate governance
- Deregulation that has lowered barriers to new entrants
- Sustained decline in asset prices

Figure 29:

## Government Programs to Raise FDI

- Focus on 5 specific areas:
  - ⊙ disseminate information
  - ⊙ improve the business environment
  - ⊙ review administrative procedures
  - ⊙ improve employment and living conditions
  - ⊙ develop national & local government frameworks
- Ongoing progress:
  - ⊙ research to analyze FDI in Japan
  - ⊙ “one-stop” information center
  - ⊙ “Invest Japan Forum”
  - ⊙ “special restructuring zones”

Figure 30:

## Suggestions to Raise FDI

- Accelerate deregulation
- Adjust the legal and tax framework to encourage cross-border mergers and acquisitions
- Accelerate reform of the financial system
- Accelerate efforts to close or restructure insolvent companies
- Strengthen the macroeconomic environment
- Improve labor market flexibility
- Support training that is valuable for multinationals
- Continue efforts to improve corporate governance and transparency
- Avoid quick-fix FDI incentives that can be costly and introduce additional distortions

Figure 31:

## Expected Global GDP Growth

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