U.S.-Japan Economic Partnership for Growth

United States-Japan Investment Initiative 2004 Report

June 2004

United States-Japan Investment Initiative 2004 Report

Executive Summary

- As of the end of 2002, foreign direct investment (FDI) in Japan totaled 9.4 trillion yen (approximately $78 billion at the end-of-2002 exchange rate of 119.9 yen/dollar), an increase in yen terms of more than 40% over 2001. According to current figures, the stock of FDI as of the end of 2003 had increased to 9.6 trillion yen, up 2.6% from 2002. Reasons for the growth of Japan's FDI include: a trend toward alliances with foreign capital as a response to global competition and worldwide industry realignment; increased interest in attracting foreign capital as a means for business reorganization and financial restructuring; and an improved investment climate which has resulted from regulatory and structural reforms.

- Nevertheless, Japan still receives relatively little FDI compared to other developed countries.

- In government-to-government Investment Initiative talks this year, the two sides noted several areas of progress, including: steps to improve the treatment of foreign universities in Japan; increased staffing and a new appointment system for visa interviews at U.S. diplomatic missions in Japan; eased requirements for Japanese citizens to obtain a driver's license in American states; and the elimination of a surcharge on consolidated taxation in Japan.

- FDI is a catalyst for economic revitalization; not only does it increase consumer benefits and choice, FDI also promotes structural reforms by introducing new technologies and management expertise, maintaining and creating employment, and providing a broader mix of goods and services. Countries such as the United States have long used inward foreign direct investment as a means to improve productivity, reduce unemployment, and promote economic reconstruction in their economies.

- Japan is in the midst of an economic recovery. In the first quarter of 2004, the real growth rate of GDP in Japan increased by 5.6% on an annual basis. The Japanese economy continues to show steady growth in personal consumption, capital investment, and other areas. The use of FDI is one effective way to ensure that these promising signs will lead to lasting results.

- The Governments of both Japan and the United States welcome FDI. Our hope is that this report will contribute to a deeper understanding of the investment climates of Japan and the United States for businesses and individuals who are considering direct investment in either country, and that it will promote activities to improve the investment climates of Japan and the United States in the future.

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I. Introduction

Prime Minister Junichiro Koizumi and President George W. Bush established the U.S.-Japan Investment Initiative in June 2001 as a forum for the exchange of views on how to improve the investment climate in the two countries. The Investment Initiative, which is part of the U.S. - Japan Economic Partnership for Growth, is chaired by Vice Minister Tadakatsu Sano of the Ministry of Economy, Trade and Industry and Under Secretary of State Alan Larson. High-level talks were held in March 2004, and working groups met in November 2003 and April 2004. At the meetings, which included participation from the private sector, the two sides discussed issues related to the current state of the investment climate in both Japan and the U.S. and suggested specific improvements.

The Investment Initiative is based on the understanding that FDI can play a critical role in the economic development in a country by introducing new technologies and management expertise. It expands benefits to domestic consumers by providing new goods and services that were previously unavailable. FDI also maintains and creates employment, provides risk capital, and strengthens bilateral ties.

As part of a public outreach program, the Initiative held Investment Initiative Seminars in Kitakyushu and Kyoto in April 2004 to promote investment in Japan, which included participation by 20 U.S. companies. Invest-in-Japan Symposia will be held under the Investment Initiative in Atlanta and Los Angeles in October 2004.

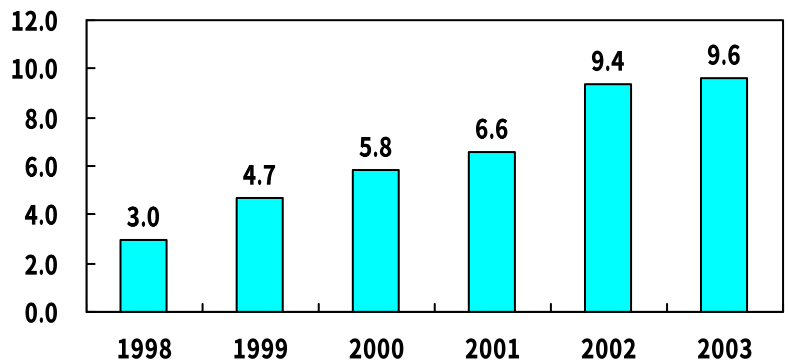
II. FDI in the U.S. and Japan

1. FDI in Japan

(1) Trends in FDI in Japan

Japan’s inward FDI has soared since the mid-1990s. Reforms in the financial, communications and distribution sectors have encouraged foreign investment into these sectors. Furthermore, improvements in corporate law, bankruptcy law and accounting principles helped attract foreign capital to Japanese companies. Recent indicators on FDI in Japan have been very positive. As of the end of 2002, FDI in Japan totaled 9.4 trillion yen (approximately $78 billion at the 2002 end-of-year rate of 119.9 yen/dollar), an increase of 41.3% from the previous year. According to current figures, the stock of FDI as of the end of 2003 totaled 9.6 trillion yen, up 2.6% from 2002.

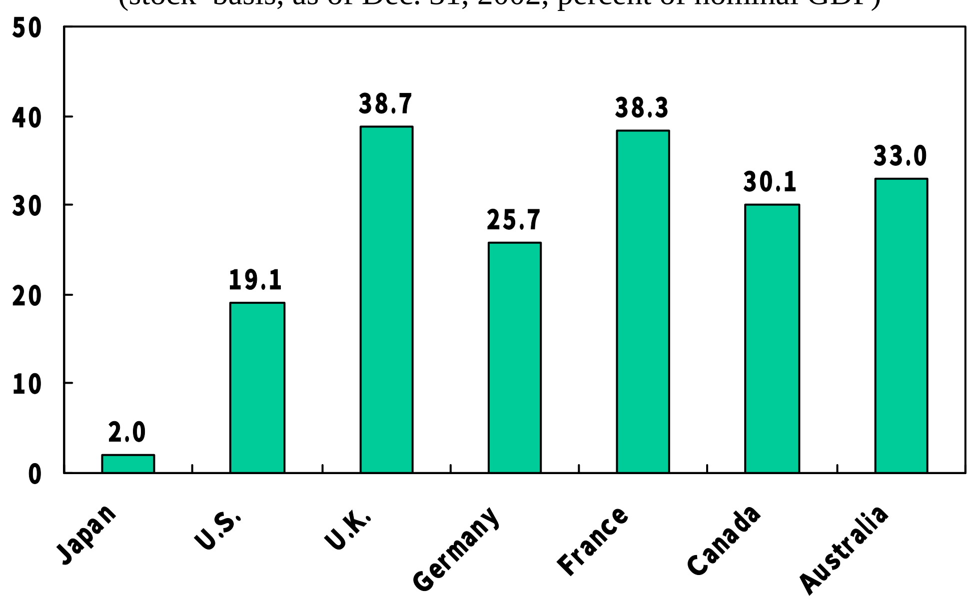
Cumulative Stock of Foreign Direct Investment in Japan (trillion yen)



Statistics on the balance of foreign assets and liabilities, Ministry of Finance/Bank of Japan

Although FDI in Japan is showing remarkable growth, it remains low compared to other developed countries. According to the IMF, FDI levels equal 19.1% of GDP in the United States, 38.7% in Great Britain, 25.7% in Germany, and 38.3% in France, but only 2.0% in Japan.

Inward Foreign Direct Investment Levels in Major Countries
(stock basis, as of Dec. 31, 2002, percent of nominal GDP)



IMF 'International Financial Statistics April 2004'

(2) Recent Topics

A. Program for the Promotion of Foreign Direct Investment in Japan

In January 2003, Prime Minister Koizumi announced the target of doubling the stock of FDI in Japan over the next five years. In March 2003, the Japan Investment Council formulated a "Program for the Promotion of Foreign Direct Investment into Japan" consisting of 74 measures in five categories. In May 2003, the Invest Japan Business

Support Center (IBSC) was established in the Japan External Trade Organization (JETRO) as a one-stop service center to provide information and support to foreign companies wishing to enter the Japanese market. IBSC collects and makes available a wide range of information on doing business in Japan, provides consultation services on expanding or establishing business operations in Japan, and provides assistance to foreign company representatives with their business start-ups in Japan. At the same time, Invest Japan offices were established at all government agencies, ministries and the Cabinet Office to help clarify, simplify, and expedite administrative procedures for would-be investors. As a result, from the time of the establishment of the JETRO IBSC in May 2003 to the end of March 2004, there were a total of 93 successful cases of new FDI.

The Government as a whole continues to engage in efforts to improve the investment climate, including follow-up by specialized subcommittees of the Japan Investment Council aimed at the implementation of these programs.

B. Special Zones for Structural Reform

A new government program to create Special Zones for Structural Reform came into effect in April 2003. Special deregulatory measures are provided in these zones for education, international exchange, medical care, and other sectors. Local governments may apply for special deregulatory measures in these special zones, and new businesses can be developed, which may include foreign participation. The goal is to promote structural reform and regional revitalization through FDI in these special zones. If special deregulatory measures are successfully applied in special zones and no significant problems are uncovered in the process, the measures will be promptly applied nationwide.

C. FDI in the Corporate Revival Process

According to the revised Industrial Revitalization Law, which came into effect in April 2003, triangular mergers and cash mergers can now be concluded in exchange for parent company (including foreign parent company) shares or cash as a special exception to the Commercial Code, subject to the approval of the Japanese Government.

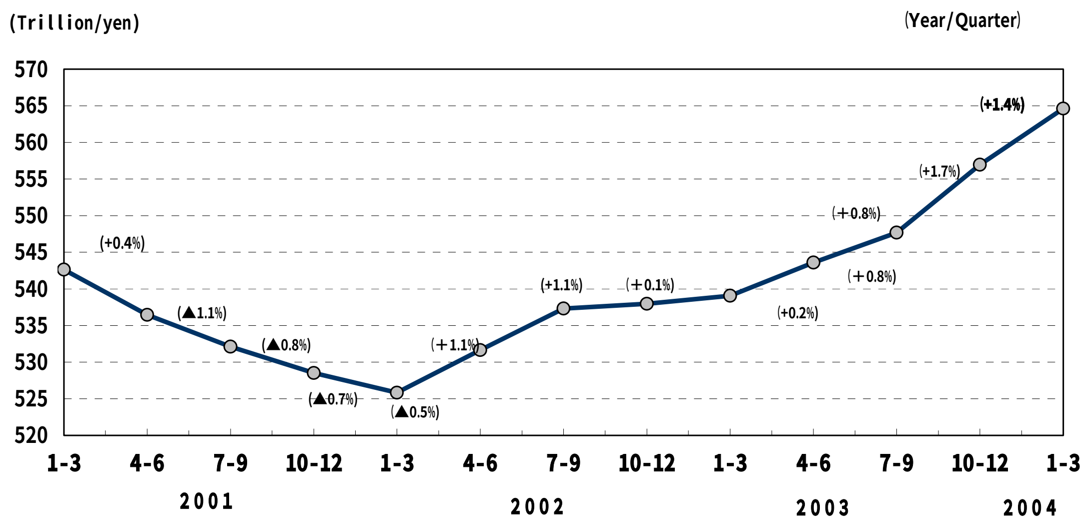
There has recently been a rise in foreign investment in corporate revival projects led by the private sector, such as the purchase of Daiei's Fukuoka business by Colony Capital. The expertise of foreign companies and risk capital are expected to contribute to the revitalization of the Japanese economy through mergers, acquisitions, and debt-for-equity swaps as part of the corporate revival process.

(3) Japan's Advantages

Japan is an attractive investment destination. Japan ranks twelfth out of 140 countries on UNCTAD's Inward FDI Potential Index. Its strengths include a huge domestic market that accounts for about 15% of global GDP, skilled human resources and advanced technological capabilities, a safe and comfortable living environment, and the potential to function as a business hub for the entire Asian market. As an investment destination, Japan provides outstanding reliability, security, and predictability. It has an excellent business and economic infrastructure that includes a high level of protection for intellectual property rights. Based on these strengths, both the Government of Japan and local governments are working to attract more inward FDI.

Japan's GDP has grown for eighth consecutive quarters since the first quarter of 2002. In the first quarter of 2004, GDP grew at an annual rate of over 5.6%. The Japanese economy continues to show steady growth in personal consumption, recovery in capital investment, and in other areas. Business earnings were higher than the same period of 2003 in both manufacturing and non-manufacturing industries. Japan is in the midst of an economic recovery. This upturn in the Japanese economy raises the potential for new business opportunities and sends a positive message to businesses interested in entering the Japanese market.

Real GDP Growth Rate



Source: Cabinet office

2. FDI in the United States

(1) Trends in FDI in the United States

The United States attracts significant FDI inflows from countries around the world due to its open economy, strong growth, and high rate of return -- FDI inflows reached a peak of over 3% of GDP in 2000. Although FDI inflows 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. FDI inflows are recovering, though, and more than doubled in 2003 compared to 2002. Deregulation and technological change make the United States particularly attractive to investors. At times of economic growth, FDI has capitalized on opportunities and helped reinforce economic successes. At times of economic weakness, FDI has played a key role in diversifying and stabilizing the economy. For example, in the 1980s Japanese FDI, among others, provided critical support for change, which increased U.S. competitiveness, employment and productivity.

In 2002, the most recent year with available data, foreign direct investment stock in the United States was essentially unchanged from 2001; FDI measured at historical costs totaled approximately $1,348 billion (see chart below). The largest positions remained those of the United Kingdom (21%), France (13%), Netherlands (11%), and Japan (11%).

Foreign Direct Investment Position in the United States on a Historical Cost Basis, 1997-2002

Year end	Billions of Dollars	Percent Change from Preceding Year
1997	681.8	14.0
1998	778.4	14.2
1999	955.7	22.8
2000	1,256.9	31.5
2001	1,355.1	7.8
2002	1,348.0	-0.5

Source: Bureau of Economic Analysis, Department of Commerce

Investment Outlays in the United States by Type of Investment, 1996-2002
(millions of dollars)

	1996	1997	1998	1999	2000	2001	2002
Total Outlays	79,929	69,708	215,256	274,956	335,629	147,109	52,558
By type of investment:							
U.S. business acquired	68,733	60,733	182,357	265,127	322,703	138,091	42,773
U.S. business established	11,196	8,974	32,899	9,829	12,926	9,017	9,785

Source: Bureau of Economic Analysis, Department of Commerce

Foreign capital makes an important contribution to the U.S. economy. U.S. affiliates of foreign companies account for 6.4 million jobs and 6.5 percent of private sector GDP, while investment by Japanese companies accounts for 800,000 jobs and about 1% of GDP. To cite two examples, Honda employs 16,000 persons in Ohio and 24,000 persons nationwide; Toyota has created over 35,000 jobs nationwide, including 2,000 new jobs in Texas with a new investment of $800 million.

(2) Recent Topics

State Efforts

Most American states have international affairs offices which promote investment by offering a wide variety of services and information for companies interested in investing in their state. Many states even maintain offices in cities abroad to encourage trade and investment. In one example, the State of Tennessee's International Affairs Office (http://www.state.tn.us/ecd/bizdev_idg.htm) offers a wide variety of services to businesses looking to locate in Tennessee and has been very successful in attracting Japanese business. As of January 2004, Japanese investment in Tennessee totaled $9.5 billion (out of $20.9 billion in overall FDI for Tennessee) and accounted for over 40,000 jobs. Another example is that of the State of Kansas' Department of Commerce, which offers assistance to interested investors including recommending locations based on the company's labor, utility, and other needs, assists with visits to the state, and serves as a single contact point for working with the state government. (More details available at http://kdoch.state.ks.us/busdev/business_info.jsp, "International Investment Recruitment")

Many states and localities in the United States offer incentives including tax exemptions and targeted investment in infrastructure. But incentives are just a small part of the success of the United States in attracting foreign investment. It is the investment climate in the United States, based on strong legal institutions, an open economy, an educated and productive workforce, and an attitude that welcomes foreign investment that has made the United States' success in attracting FDI possible.

(3) U.S. Advantages

The United States continues to be an attractive investment destination because of its market size and openness. In response to corporate scandals in 2001-02, the U.S. Government acted swiftly to improve and strengthen its corporate regulatory systems to restore confidence in capital markets. At the same time, since the attacks of September 11, 2001, the United States has been identifying ways to enhance security protection for the country. As it does so, the United States is striving to ensure that such measures do not hinder trade and investment flows. In fact, the U.S. Government is taking this as an opportunity to identify new ways to speed the flow of legitimate business and to increase logistical integration between domestic and foreign businesses. Through the use of IT and other technologies, the United States hopes that legitimate trade and investment can flow in a seamless, secure fashion even faster than before. In designing these new systems, the U.S. Government continues to listen to the views of the private sectors and governments of other countries to ensure that the new measures meet the desired goals without impeding legitimate trade and investment flows.

III. Discussion in the Investment Initiative 2004

1. U.S. Concerns

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

Cross-border M&A remains a matter of great interest for the United States. The U.S. Government asked the Japanese Government to expand the range of M&A techniques to include triangular mergers and cash mergers as tools for foreign companies seeking to invest in Japan.

In response to proposals from the Investment Initiative and requests from foreign companies in Japan, the Japanese Government implemented the Revised Industrial Revitalization Law in April 2003. This law allows triangular mergers and cash mergers to be concluded in exchange for parent company shares or cash as a special exception to the Commercial Code, with permission from the Government of Japan. This change makes it possible for foreign companies to purchase and reorganize Japanese companies using their own shares or cash as compensation.

The United States welcomed this effort by the Japanese Government. Noting that the tax-related measures regarding such transactions are critical for companies in determining whether or not to participate in an M&A transaction, the U.S. Government pointed to the importance of ensuring that both domestic and foreign investors can use tax provisions, such as allowing deferral of capital gains taxes in cases of stock swaps, to facilitate more M&A activity. It welcomed the plans to revise the Commercial Code to promote further M&A activity and urged further steps to promote FDI, including tax-related measures.

With regard to the Commercial Code, the Japanese Government explained that the Legislative Council is currently conducting a study aimed at submitting a bill for revising the Code to the 2005 regular Diet session. A draft proposal summarizing the proposed revisions to the Code was issued and public comments were solicited from October to December 2003. The proposed changes in this draft include making triangular mergers using foreign shares and cash mergers permanently available. The Government of Japan is studying ways to facilitate corporate restructuring and investment in Japan, including tax treatment of modern merger techniques in line with the decision made by the Japan Investment Council in March 2003.

(2) Demographic Issues and Investment

The U.S. Government believes that education and medical services will become increasingly important areas of investment because of the changing demographics in Japan. It also indicated that American companies have expertise and can provide a variety of high quality services that will confer great added benefits for Japanese consumers and patients. The U.S. Government has asked the Japanese Government to implement regulatory reform to promote investment in the areas in question.

A. Education

The primary request of the U.S. Government in the area of education was that foreign university branches in Japan be treated as authorized schools. As interim measures, the U.S. Government requested the extension of such measures as student discount railway passes for students and provision of visas conferring immigration status for a time period covering the full course of studies for students at foreign university branches not authorized as Japanese universities under the Japanese education system.

With regard to the primary U.S. request, the Japanese Government stated that a study group established under the Ministry of Education, Culture, Sports, Science and Technology (MEXT) has studied ways to promote the internationalization of higher education while assuring educational quality. The study group concluded that branches of foreign universities may either: (1) apply to become a university under the same standards followed by other Japanese universities; or (2) if authorized in their home countries, be treated as a foreign university operating in Japan. The Japanese Government will continue to examine this issue and seek input from experts.

The U.S. Government expressed its regard for these efforts by the Japanese side and showed great interest in the study's implications for the status of foreign university branches in Japan, which may affect the treatment of issues such as discount railway passes, the immigration status of students, and taxes.

The Japanese Government explained that the current treatment of foreign university branches is related to Japan's educational system and immigration law. MEXT noted that other issues (e.g., discount railway passes and immigration status of students) are implemented by private rail companies and relevant government ministries and agencies of the measures. If changes suggested by the study group are adopted, MEXT will implement the necessary measures and inform the relevant government ministries and agencies of the measures.

B. Medical Services

The requests of the U.S. Government in the area of medical services are as follows: (a) expand opportunities for participation in medical services to include for-profit private corporations (including participation by such corporations in Special Zones for Structural Reform); (b) allow the outsourcing of certain medical procedures (for example, tests using advanced equipment, such as MRI and PET scanning); and (c) clarify the scope of medical services covered by Japan's public health insurance system and those services not covered by this insurance and lift the ban on mixed medical services (i.e., to allow treatment for a condition to include both medical services covered by public health insurance and services not covered by public health insurance).

With regard to request (a), the Japanese Government noted the legal principle that medical care should be on a non-profit basis. Following a study by Japanese Government organs involved in regulatory reform, the Government plans to allow the establishment of medical institutions offering medical treatment with advanced technology not covered by Japan's public health insurance, such as regenerative medicine, cosmetic surgery, and gene therapy, in Special Zones for Structural Reform. A bill authorizing this was passed in May 2004, and will come into effect in October 2004.

Concerning request (b), the Japanese Government stated that the outsourcing of medical services such as MRI and PET scans to joint-stock corporations is not permitted under the legal principle that medical care should not be conducted on a for-profit basis. The outsourcing of sample testing such as blood tests is permitted. The Japanese Government plans to allow experimentally the opening of medical facilities by joint-stock corporations in Special Zones as stated above, following which allowing such facilities to be operated through-out Japan would be discussed.

Concerning request (c), in view of its commitment to the universal public health insurance system, the Japanese government is being cautious about lifting the ban on mixed medical services.

The United States expressed interest in the two-year trial currently underway in Japan which is introducing a system of payment for medical services based on DPC (diagnosis procedure combinations). The Japanese Government explained that this trial is collecting data, which will be used to make comparisons with the current fee-for-service system.

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

(3) Assets Available for Investment

The U.S. Government indicated that insufficient investment assets are available on the market in Japan; this has slowed foreign investment. The United States requested an update concerning recent activities by the Industrial Revitalization Corporation of Japan, since it is likely that investment assets will come into the market during the process of disposal of nonperforming loans.

The Japanese Government responded that the Industrial Revitalization Corporation Japan (IRCJ) has been functioning since May 2003, and thus far has made 12 decisions to support companies and 11 decisions to make debt purchases. Assistance has included financial support including debt-for-equity swaps, and clarification of techniques to help potential investors better calculate the value of a business. The IRCJ will continue to help revitalize companies and ameliorate the problem of nonperforming loans through its March 2005 deadline for loan purchasing.

(4) Implementation of Previous Topics

The U.S. Government inquired whether the consolidated surtax would be eliminated two years after its introduction. The Japanese Government responded that it had been eliminated on April 1, 2004.

2. Japan's Concerns

(1) Improving Security While Facilitating Trade and Investment

A. Visas

The Government of Japan has expressed its hope that the new security measures taken by the U.S. to improve border security can be implemented in a way that minimizes negative impacts on Japanese visa applicants. In the Investment talks, the Government of Japan expressed concern about the high travel cost, delays, and inconvenience of applying for a visa, noting that only three of the United States' six diplomatic posts in Japan accept visa applications. The Government of Japan requested that the United States allow Japanese businesspeople, in particular those applying for the Treaty Trader (E-1) and Treaty Investor (E-2) visas, to be exempt from the personal appearance requirement. The Government of Japan again raised concerns over the process for revalidating U.S. work visas.

U.S. consular experts at Investment Initiative meetings pointed out several measures the Department of State has taken to improve visa issuance, including adding new visa officers at U.S. missions in Tokyo and Osaka, and adopting a web-based appointment system which allows applicants to apply at the consulate of their choice. These measures have significantly reduced the visa processing backlog in Tokyo and Osaka. U.S. consular experts clarified the process for revalidating/renewing work visas, explaining the different methods available to Japanese citizens. U.S. officials noted that Japanese businesspeople may also apply in Washington. Alternatively, Japanese businesspeople can also apply for renewals at U.S. embassies and consulates in Canada or Mexico. These embassies and consulates offer an appointment system through their websites, accessible at http://www.nvars.com. Japanese businesspeople also may apply for visas at U.S. missions in Tokyo or Osaka. The new appointment system allowing appointments to be made up to three months in advance at U.S. missions in Japan eases the difficulties of scheduling trips to Japan to revalidate these visas. More detailed information is available at the following websites: http://tokyo.usembassy.gov and http://travel.state.gov/visa_services.html.

B. Movement of Cargo

The Government of Japan expressed concern that U.S. requirements to provide cargo manifests in advance for air, rail, and truck shipments, under the Trade Act of 2002 (TPA), would cause delays for shippers. In addition, the Government of Japan said that the inspection rate of cargo for participant firms in the C-TPAT (Customs-Trade Partnership Against Terrorism) had not declined, as participants had expected. The U.S. Government advised that the cargo manifest requirement is an essential element of our counter-terrorism efforts which would continue. Since the attacks of September 11, 2001, the overall inspection rates for cargo entering the United States have doubled; however, inspection rates for C-TPAT participants compared to non-C-TPAT companies are much lower. Both Governments desire to encourage speedy trade while recognizing the need to continue to improve transport security.

(2) Driver's Licenses

The Government of Japan again raised its concern over the issuance of state driver's licenses for Japanese citizens in non-work status – and thus not holding Social Security Numbers (SSNs) - in certain states. In the Investment talks in November 2003, U.S. officials explained that all states but Illinois had already taken steps to resume issuing driver's licenses in this situation. On May 11, 2004, the Illinois General Assembly passed a bill which would allow foreign citizens temporarily residing in Illinois to obtain driver’s licenses without a SSN. Once approved by the Governor of Illinois, the bill would go into effect on January 1, 2005.

The question of driver’s licenses became a more serious concern to the Japanese Government when the Social Security Administration (SSA) published a notice of proposed rulemaking in the Federal Register on March 26, 2003 announcing their intent to end the assignment of non-work SSNs for the purpose of driver's licensing. The Final Rule regarding this matter was published on September 25, 2003 with an effective date of October 27, 2003. The Government of Japan submitted a comment to the SSA on May 13, 2003 requesting SSA to work with the remaining states which have not yet introduced an alternative identifier system, especially Illinois, and to suspend the implementation of new rule until the remaining states complete introduction of such a system. The SSA, with the assistance of the American Association of Motor Vehicle Administrators and the support of the Department of Transportation, assisted several states that required SSNs for driver's licensing to develop alternative identifier systems.

(3) Sarbanes-Oxley Act

Through the Investment Initiative, the Government of Japan has clearly articulated its concern about the applicability of the Sarbanes-Oxley Act of 2002 to Japanese firms and auditors. In response to Japanese concerns expressed in earlier years, the Securities and Exchange Commission has adopted a rule which provides an exemption for jurisdictions such as Japan with boards of auditors or statutory auditors, provided that such auditors are:

- authorized by home country requirements;
- either separate from the board of directors, or composed of one or more members of the board of directors and one or more members that are not also members of the board of directors; and
- not elected by management of the issuer and no executive officer of the issuer is a member.

Regulations require firms using an audit committee system to have an audit committee with 100% independent directors, and there is no exception for Japan's system of audit committees where a majority of members must be outside directors. However, the SEC is willing to receive further information on how this provision is affecting individual firms. Finally, regarding the audit firms, the Public Company Accounting Oversight Board (the Board) and the SEC have authority over accountants who audit the financial statements of public companies that have elected to access U.S. markets. There were many public comments from foreign countries, including Japan, requesting an exemption to foreign public audit firms from the registration requirements. The Board's final registration rule, as approved by the SEC, requires foreign firms to register, but less information will be required of foreign firms than originally proposed and a mechanism has been included to permit foreign firms to document non-disclosure of certain information that is confidential under home country rules. The Board has proposed rules regarding how it would cooperate with foreign audit oversight bodies in the inspection of foreign registered firms. The Board continues to discuss with foreign governmental bodies the scope of its oversight authority with respect to accounting firms located outside the United States.

(4) Legal Costs

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

(5) Exon-Florio Provision

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

IV. Conclusion

The role of FDI is becoming better understood in Japan. In January 2003, Prime Minister Koizumi announced the target of doubling FDI in Japan over the next five years, sending the Japanese people a positive message that investment from overseas is not a threat, but is a useful contribution to the revitalization of the Japanese economy. This strong message from the nation's leader has resulted in a significant change in attitudes with regard to FDI among private businesses and the Japanese people; outreach programs under the Investment Initiative and increasing numbers of success stories from foreign investments in Japan have also contributed to this improved receptiveness to FDI. Japanese people and businesses are coming to welcome FDI as a means of strengthening the competitiveness of their own businesses, improving productivity, and offering benefits to consumers; there is increasing interest in cooperation with foreign companies.

The investment climate in Japan has seen major improvement in recent years as a result of regulatory reforms, legislative enhancements, and lower investment-related costs. Special note should be given to the emergence of a move to use FDI as a means for regional revitalization. The Special Zones for Structural Reform is providing added impetus to these kinds of trends. Since the first quarter of 2002, rising economic growth rates, improving corporate earnings, and expanding capital investment suggest that the Japanese economy is recovering steadily. This sends an encouraging message to domestic and foreign companies considering business endeavors in Japan. In order to build on the progress above, Japan needs to continue to address issues raised in the U.S.-Japan Investment Initiative, and to review regulatory reforms to expand investment opportunities in some areas where private sector investment has been considered difficult.

The climate for FDI in the United States remains good. Japanese companies doing business in the U.S. currently employ about 800,000 workers and account for about 1% of GDP, reflecting their well-established role in the U.S. economy. Security measures have been enhanced since the terrorist attacks of September 11, 2001, and the U.S. Government continues to listen to the views of the private sector, both foreign and domestic, to ensure the new measures meet the desired goals without impeding legitimate trade and investment. Efforts will continue under this Initiative to ensure that these and other domestic measures have no adverse effect on direct investment from Japan or on the business activities of Japanese companies, which make an important contribution to the U.S. economy. The Initiative will continue to provide an avenue for these views to be made known to the U.S. Government.

The Initiative will continue its work under the leadership of the Prime Minister and President. We share an understanding that FDI plays a key role for economic development in both countries, and through this Initiative, we will continue to engage in a variety of endeavors to improve the investment climate and the understanding of the benefits of FDI in both Japan and the U.S.

Appendix 1. The U.S.-Japan Tax Treaty and the U.S.-Japan Social Security Agreement

The U.S.-Japan Tax Treaty entered into force in March 2004. The U.S.-Japan Social Security Agreement was signed in February 2004. These two agreements will contribute to the promotion of investment and the exchange of people between Japan and the United States by reducing double taxation and avoiding dual coverage of the social security systems in the two countries.

Appendix 2. Investment Initiative Seminars on Promoting FDI in Japan

Since its inception, the U.S.-Japan Investment Initiative has run an educational outreach program to promote better understanding of FDI in Japan and the U.S. So far, the two Governments have organized Investment Initiative Seminars on promoting FDI in the Japanese cities of Kobe, Fukuoka, and Nagoya (March 2002), Osaka and Sapporo (April 2003), and Kitakyushu and Kyoto(April 2004).

In line with the preference of the host governments and local companies, the April 2004 seminars focused on actual business results and matchmaking in addition to promoting better understanding of the significance of investment. The seminars created a venue to promote exchange among private companies from the Kitakyushu and Kyoto areas and those of the U.S. Participating U.S. companies gained detailed knowledge of the local situation, including the investment climate and business needs, while local companies were able to better understand the investment strategies of U.S. companies and how U.S. companies viewed the investment prospects in the area.

Representatives of twenty U.S. companies, many of whom traveled from the United States, were recruited to participate. Leaders of Fukuoka Prefecture, the city of Kitakyushu, and Kyoto Prefecture spoke about the business potential of their regions and urged U.S. companies to consider investing in the region. Individual Japanese and American companies met for commercial talks and exchanges with regard to specific sectors such as information technology, and local governments led tours of industrial sites for U.S. visitors.

Appendix 3. Recent Examples of U.S. Business Expansion in Japan (both FDI and investment by U.S. affiliates)

(1) Investments by U.S. Companies under the revised Industrial Revitalization Law

- Carlyle Japan Holdings Three and Kito Corporation

Carlyle Japan Holdings Three Co., Ltd. acquired stock in Kito Corporation, a manufacturer of industrial machinery, from both owner shareholders and ordinary shareholders, strengthening its management. After the takeover bid, an equity-swap/merger was conducted under the terms of the Industrial Revitalization Law, making Kito a wholly owned subsidiary. The Carlyle Group plans to use Kito's management resources to improve Kito's productivity and financial stability.

- Kodak Japan and Chinon Industries

Following a takeover bid for Chinon Industries Inc., Kodak Japan Digital Product Development Company, Ltd., a wholly owned subsidiary of Kodak (U.S.), made Chinon a wholly owned subsidiary by means of an equity swap under the Industrial Revitalization Law. Kodak's R&D Center was merged with Chinon's, with the goal of improving competitiveness. There are no plans to lay off Chinon employees; instead, the company plans to increase its staff from 203 to 303 employees.

- Colony Capital and Daiei's Fukuoka operations

In an effort to recover from its financial difficulties, Daiei Inc. has been consolidating its management resources in retail – its main line of business - and associated areas. As part of this process, it sold its interest the Fukuoka Dome baseball stadium and neighboring Sea Hawk Hotel and Resort to a company affiliated with Colony Capital LLC, a U.S. investment firm. Colony Capital plans to expand the customer base and increase sales by refurbishing the hotel, expanding the shopping mall, and promoting the resort to families as well as baseball fans.

(2) Examples of FDI with support from the Invest Japan Business Support Center (IBSC) of the Japan External Trade Organization (JETRO)

- RCS Japan (U.S.)

RCS is a software company based in New York which produces software for automated music selection at radio stations. Music is automatically selected according to the tastes of the radio station's listeners, and listener reactions are analyzed by software. This software is currently used at over 5,000 radio stations worldwide, with a global share of more than 80%. RCS opened a branch office in Tokyo in January 2004 to seek customers in Japan. The branch office was initially located at the IBSC. JETRO provided advice on legal affairs, taxation, and labor, and supplied other assistance such as interviews with accountants.

- Advanced Analogic Technology, Inc. (U.S.)

A Silicon Valley manufacturer of semiconductors for LED controls used in cell phones, Advanced Analogic Technology (AAT) opened a Japanese subsidiary in July 2003 to improve its sales and customer service in Japan. JETRO provided technical information on ways to remit funds needed to establish the Japanese subsidiary corporation.

(3) A Recent Investment without Government Support

- Merck & Co. and Banyu Pharmaceutical

In response to changes in the global pharmaceutical market, Banyu Pharmaceutical Co., Ltd. has become a wholly owned subsidiary of Merck & Co., Inc., with which it previously had a cooperative arrangement. This has enabled Banyu to fully exploit the global network and management resources of Merck & Co., further strengthening its R&D, manufacturing, marketing, and sales activities. Merck & Co. plans to use the R&D capabilities of Banyu Pharmaceutical Co. to expand its business in Japan, the second largest pharmaceutical market in the world.