

## **Unfinished Globalisation: Investment and the EU-Japan relationship**

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It's customary to start a speech like this by saying how pleased I am to be here. In this case I can say how nice it is to be back in Japan. I was a regular visitor as the Chair of the UK-Japan 21<sup>st</sup> century group, through which I got to know Japan and made many friends.

I have been fascinated by Japan for a long time. Like most Europeans, since the day I got my first Walkman – and this was back in the days when Walkmans played cassette tapes! - I've admired Japan's industrial strength and capacity for stretching our technological imagination with admiration. I've also become increasingly impressed by Japan's growing internationalist convictions and global presence. The world needs Japan. The blue berets of

Japan's peacekeeping force in East Timor; its active role in UN reform. This year Japan's leadership of the G8 has been a showcase of Japan's progressive international outlook.

The EU and Japan have close relations on trade and our bilateral trading relationship has a huge amount of potential. Between the two of us, we account for more than a third of global economic activity. We've also got similar ambitions for the global trading system. Over the last four years, I've worked closely with my Japanese counterparts at the centre of the WTO Doha negotiations. Japan has always been a defender of a successful Doha round, despite the fact that Doha will inevitably involve concessions from Japan on agriculture.

It is precisely because of that close and friendly relationship that I want to make a speech today that will be honest and frank. I have been billed to talk about investment in the global economy, and particularly in the EU-Japan relationship. The subject presents me with a

diplomatic challenge, because in the thriving and constructive EU-Japan relationship, investment is an area where, regrettably, we have not been able to reach our full potential. What I would like to do today is to suggest that in the EU-Japan relationship, investment remains our own unfinished bit of globalization. I would also like to say something about how we might change that.

## **Globalisation, Investment and Japan**

Globalisation has confronted Europe and Japan with many of the same challenges. We are both developed economies, coping with a fundamental shift in the global economic landscape. The economic reemergence of India and China is shaking our world in Europe; but it is literally re-shaping yours here in Japan. Japan, like the EU, has had to adjust to a world of rapid economic change. Our people and our companies now face greater economic competition, but they have also benefitted from huge new opportunities and growing global markets. Investment is right at the heart of those challenges. It is the oil that keeps the wheels of trade

turning. But it also raises complex political questions about the role of foreign ownership in our economies.

They used to say that trade follows the flag. In a globalised economy in which more than half of trade is in intermediate goods, trade usually follows direct investment. If markets for foreign direct investment are blocked, either directly or indirectly, then so are supply and sales chains. Without these, many of the dynamic economic gains from trade cannot occur. If we want to deepen the global trading system, and indeed if we want to deepen our bilateral trading relationships, then the investment question cannot be ignored.

Of course, Japan was a globaliser long before the term globalization was even widely used. For decades Japan has been an active global investor. It has poured capital into production and market building in Western Europe and the US. Elsewhere in Asia, its investment played an important role in underwriting the modern Asian growth boom. It is present in every key market and pioneered the supply chain

models that are now an integral part of the global economy. Those with long political memories will remember that twenty years ago that first wave of Japanese investment in the EU and the US was as emblematic of globalization as China's export powerhouse status is now.

That first big wave of post-war foreign direct investment of which Japan was a leader turned out to be one of the most important drivers of economic globalization. It also turned out to be one of its most important benefits. When Japanese or European companies invest abroad they don't just take their capital, but their experience and their skills. For the host country it creates jobs and industries, and the presence of new players encourages local companies to improve their game. For that reason, FDI is part of pretty much every credible growth model and ubiquitous in OECD economies. If you go through the books of a typical globalised developed economy in 2008 you would expect to find foreign direct investment worth about, say, one fifth of the host country's GDP.

Many of you will know where I am going with this.

Because, the striking exception to this picture is Japan. It is not that Japan does not know how to exploit the benefits of FDI. Japan invests abroad actively and successfully, not least in Europe. Net investment outflows rose to more than fifty billion dollars in 2006, which is a sixteen year high. Japanese direct investment in the UK – up 150%. Japanese direct investment in the Netherlands – up 156%. Seventeen billion dollars worth of new investment in Asia.

These numbers are impressive. But what is really telling is what flows the other way. Europe invested a net total of less than half a billion dollars in Japan in 2006. For every dollar Japan invested in the UK and the Netherlands alone, European companies were able to invest a net total of only *three cents* in Japan.

This is, frankly, hard to understand. Europe is the biggest exporter of FDI in the global economy. It has about three trillion dollars invested globally. Yet only 75 billion is here in Japan – less than three percent. Nowhere else in the

developed world is EU investment so thin on the ground. In fact, Japan is the only country in the developed world with which the EU has a negative balance of investment flows.

It is not that European companies do not want to be active here. I can assure you that they see huge potential in Japan and are frustrated by the difficulty of investing here. The problem lies in the difficulty we have in bringing productive investment into the Japanese economy. The numbers just jump out at you: FDI stocks in most European countries are around 20% of GDP. In Japan FDI stocks are less than 3% of GDP.

### **Can we open the investment door?**

So as a foreigner looking at Japan from the outside, what I see is a globalization paradox. For decades Japan has taken advantage of an open global investment climate. Both Japan and the host economies have benefited from that investment and the jobs it has created. Yet at home it remains the most closed investment market in the

developed world. Japan speaks up as a staunch defender of the multilateral trading system and a proponent of liberalization. Yet it has the lowest import penetration rate in the developed world – about one seventh of the OECD average. Japanese companies have been manufacturing in Europe for decades. Yet until the reform of the Large Retail Store Law last year, a foreigner setting up retail operations in the Japanese market was extremely cumbersome. Japan is the second largest economy in the world, but Europe trades more with Switzerland. Japan went global long ago, but holds back from becoming globalised.

Obviously Europe loses from this state of affairs. Our companies struggle to access one of the largest and richest markets on earth. But is it good for Japan? Here as a foreigner I step onto very sensitive territory and I tread carefully. But I have to say, respectfully, that I don't believe Japan wins if European companies abandon Japanese plans in favour of China or other locations in Asia. As they have for example in aircraft research and development. Not surprising, perhaps, in this case, because

despite the huge, worldwide success of the European aeronautics industry – in the last five years it has won half of orders worldwide – in Japan it has obtained a mere 5%!

If Japan is turning away European capital it is also turning away the import of technology and new managerial skills. The Japanese Ministry of Economy, Trade and Industry has commissioned work that shows that labour productivity in foreign affiliates in Japan is 60% higher than the national average in manufacturing and 80% higher in the services sector. Japan has the largest deficit for services trade in the OECD. That's not a measure of anything innate about foreign companies or Japanese companies. It's just a simple measure of how companies improve when they operate in more competitive environments. It's like the competitive pressure that turned my brick-shaped walkman into a Panasonic MP3 player the size of a matchbox in twenty short years. These pressures are good for companies and for consumers, who benefit from wider choice and lower prices. These are precisely the competitive pressures that Japanese companies applied in the European and American

markets by investing there twenty years ago. Although that pressure forced us to adjust, we emerged stronger from it.

There are some signs that Japan wants to reverse this imbalance. Back in 2003 the Japanese government set the goal of doubling FDI stocks by this year. It later set the objective of increasing FDI stocks to 5% of GDP by 2010. The Japan Investment Council has been proactive in trying to attract new investment. As I mentioned a moment ago, some deregulation in the retail sector has made it easier, at least in theory, for European retailers to set up shop here. These measures are all welcome. But the targets set for 2010 still look ambitious. FDI flows are volatile and capital outflows actually reached a record high in 2006. Japan experienced net capital loss for American, Western European and Asian investment.

Why is this happening? I would identify a few basic reasons. The first is the lack of a developed mergers and acquisitions market, which is an obvious precondition for FDI flows and the basis of most FDI globally. The 2007

revision of Japan's mergers laws to allow triangular mergers of foreign companies with Japanese companies have widened the possibilities for foreign participation here, but the merger between Citibank and Nikko has been the only result so far, and was more an internal realignment than an example of a genuine merger. And many Japanese companies have responded to the prospect of mergers by creating poison pill schemes.

And of course there are still many restrictions on FDI in Japan, far more than Japanese companies face in Europe. European companies cannot participate in the agricultural sector, the forestry sector or maritime transport. There are also disincentives that operate at one remove: European construction companies put off Japanese plans because they are unable to secure public procurement contracts in open tenders.

It is also often difficult for foreign companies to navigate the Japanese system. Laws are published in Japanese only and transaction costs are high. Whatever the reasons for

these things, the impression they leave is of a lack of transparency and a message that outsiders are not welcome. I welcome the fact that there is now an attempt to translate 180 of the most relevant laws for foreign companies into English. These are the small changes that can make a difference.

### **Open to the world**

I know that there are some in Japan who remain reticent about foreign investment and ownership. I understand well concerns over issues like intellectual property rights protection. But experience suggests that there is no reason to be overly fearful. Especially when we are talking about two cultures with strong traditions of respect for intellectual property.

I know enough Japanese history to know that some of these doubts have deep historical roots. When the Dutch traded with Japan up until the middle of the nineteenth century they were required to live on Dejima, an artificial island in

Nagasaki harbour. They could cross over a causeway to the mainland only with a special permit and only during the day. At night, they were locked in.

Now, Dejima was the only opening in an otherwise entirely closed economy – so from one perspective it represented the persistence of trade, even when barriers are erected against it. But of course Dejima was also a symbol of suspicion of the outside world. Suspicion of trade. Dejima is the very opposite of globalization. In Europe, there have always been some who believe that the EU should be a type of Dejima. But we are prosperous today, as Japan is prosperous, because Dejima is a thing of the past.

Especially at a time of global economic uncertainty, the single greatest threat to the economic openness that underwrites our prosperity in Europe, the US and Japan is a return to the Dejima mindset. The economic nationalism and protectionism that makes us see foreign participation in our economies as a sign of vulnerability. This is an argument that is increasingly powerful in the US and

Europe, especially as the global economy and the growth of world trade has slowed. But the Japanese experience in Europe has shown that openness works. The powerful dynamic that open flows of foreign direct investment have created at the heart of globalization have shown that openness works. Openness to the world is the key to our strength, not the beginning of weakness.

### **Conclusion: a new balance**

So my proposal to you today is that the EU and Japan make a balanced investment relationship one of the fundamental goals of our trade relationship in the years ahead. That we finish our unfinished globalization. You know that Europe is committed to maintaining an open climate for inward investment from Japan. Europe will throw its weight behind any Japanese government efforts to attract new European investment here. I hope that Japanese business and industry, which has been such a vocal advocate of a closer commercial relationship with the EU and global liberalization will make the same argument here at home. I

hope that as we balance the investment dimension of our relationship we will also be able to resolve many of the market access problems that keep productive EU investment, as well as goods and services, out of the Japanese market.

This week's EU-Japan Summit will reinforce the depth and importance of the ties between the EU and Japan. It will reinforce our vital global partnership on climate change – where as great industrial societies we have a unique global leadership role in building a successor to an agreement that has made the name Kyoto shorthand for action in the climate crisis.

We will also reinforce our joint commitment to managing the global financial system – bringing our economies through the current instability and building a stronger global economy for the future. We will reinforce our joint commitment to completing the Doha Round of WTO trade talks in 2008 with a substantive agreement that delivers above all for the poorest.

My sense is that one of the reasons why Japan has always expressed such strong commitment to the need for a new global trade deal through the WTO Doha Round is precisely because it is integrated so deeply into the global trading system. Because, like Europe, it has seen in its own experience the value of open markets and rules-based trade – especially at a time like this of global economic uncertainty. Because it has seen the capacity here in Asia for trade to act as a conveyor belt for greater prosperity, and ultimately stability.

Japan will be an important voice over the weeks ahead if we are successfully to reach a framework deal in Geneva that will allow us to complete a Doha deal in 2008. In particular, on agriculture, Japan has had to make tough decisions. So has Europe. Both Japan and the EU need to see the package on agriculture balanced with a agreements of services and industrial goods trade that are genuinely ambitious. Here, I urge Japan to back Europe in pushing for strong language on questions like non-tariff barriers. For a

big commodity importer like Japan, especially in a world of rising commodity prices, there is a clear interest in strong rules that limit export taxes and other restrictions. As big exporters, both the EU and Japan have an interest in an anti-concentration clause that will push down tariff peaks. In a final trade-off, I hope the EU and Japan will speak as one.

I don't set out this case on EU investment in Japan today to confront or demand. Rather I hope to convince you that a greater openness to EU investment is in Japan's interest as much as Europe's. I hope that gradually, over time, we can give a new equilibrium to our investment ties: one that better reflects our mutual interest in close economic relations, and our joint commitment to an open global economy. In the week of our annual summit it seems beyond question to me that our partnership is too big and important to have such an imbalance at its centre. Because I care about this relationship I want to set that right.

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