

Chairman: May I now call upon Mr. Charles Stevens, attorney from Coudert Brothers New York and he is also teaching at Columbia University. He will speak on "Japanese Investment in Singapore — Legal Aspects".

JAPANESE INVESTMENT IN SINGAPORE — LEGAL ASPECTS

by

CHARLES STEVENS

Historical Investment Patterns

Until this summer's flurry of activity surrounding the visits of Prime Ministers Lee and Fukuda to Japan and Singapore, respectively, and Prime Minister Fukuda's visit to the ASEAN Summit Conference in Kuala Lumpur, the pattern of Japanese investment in Singapore had not differed remarkably from that of other industrialized countries, such as the United States.

Singapore Economic Development Board statistics¹ show that as of July 31, 1976 approximately 50 per cent of the fifty-three Japanese investment projects at that time and 50 per cent of the fifty-eight American investment projects at that time were relatively small investments where the gross fixed assets of each investment (excluding land) were worth S\$5,000,000 or less. In the case of both Japanese investments and American investments, the next largest grouping of investments in terms of numbers of investment projects was in the S\$5,000,000-S\$20,000,000 range, with nineteen Japanese projects (26 per cent of all projects) and twenty American projects (25 per cent of all projects) in this range. In 1976 the investment pattern of Japan and the United States differed significantly only in the three large American refinery projects (Amoco, Mobil, and Exxon), each of which has gross fixed assets (excluding land) of over S\$150,000,000. In 1976 Japan had no similar huge investment projects, but this situation has, of course, recently been radically changed by the inauguration of the Japan-Singapore Petrochemicals Co. US\$800,000,000 joint venture between a Japanese investment company led by Sumitomo Chemical Co. Ltd. and the Singapore Government.

In terms of industries invested in, both Japanese and American investments show heavy concentration in a number of the same industries, including electronics, precision tools, and plywood. Special Japanese investment interest in Singapore is evidenced in the shipbuilding industry, with three projects all in the S\$51,000,000-S\$150,000,000 range. This shipbuilding interest probably corresponds to the special American investment interest in the oil service industry.

Since 1973 Japan has been the leading foreign investor of new money in Singapore, although its share of foreign direct investments (until the new petrochemical joint venture) has remained about 14 per cent. According to the Japanese Chamber of Commerce in Singa-

¹ *Major International Companies Manufacturing in Singapore* (Singapore Economic Development Board 1976).

pore,² Japanese-affiliated companies in Singapore in 1976 had gross sales of US\$2,090,000,000 and were responsible for US\$1,130,000,000 or 8.7 per cent of Singapore's exports. Japanese-affiliated companies employed 20,300 persons, including approximately 4,000 Japanese. The percentage of Japanese employees has been increasing, from 5.6 per cent in 1973, to 6.0 per cent in 1974 and 6.4 per cent in 1975. In Japanese-affiliated companies Singaporeans held 40 per cent of the board positions, 36 per cent of top management positions, 54 per cent of middle management positions and 86 per cent of clerical position.

The motive for Japanese manufacturing investment in Singapore, at least until the recent petrochemical project, seems to have been a desire to market in Southeast Asia goods manufactured in Singapore. This desire was motivated at least partly by a desire to use lower labour costs in Singapore to regain competitive advantage for those products which can no longer be produced cheaply enough in Japan to permit Southeast Asian sales. Despite the continuing imbalance in Japan's favour, it would seem that there was relatively little interest in marketing goods manufactured in Singapore in Japan, as opposed to marketing in Singapore's own regional market.

Nikkei Business, an influential Japanese business magazine, recently rated Singapore "A" (on a scale of "AA" to "D") for foreign investment of the "market-oriented type" (such as automobile, household electric appliances, textiles, foodstuffs and housing industries) and "C" for foreign investments of the "resources and processing type" (such as non-steel, non-ferrous metal smelting, oil refinery and petrochemical industries).³ In the market-oriented category Singapore shared the "A" rating with the Republic of Korea and Hong Kong in Asia and with many advanced Western European countries. In the "resources and processing" category it ranked lowest in Asia except for Pakistan, which had a "D" rating and Hong Kong, which shared a "C" rating, but Singapore's very low rating might be discounted since it rests heavily on a very low rating for "resources availability", which ignores Singapore's geographical advantages for crude oil refining and the petrochemical industry. In the ratings Singapore scored relatively high on political stability, labour situation, investing conditions, and external relations.

Japanese Governmental Incentives

The Japanese Government offers very real economic incentives for investment in Asian countries. The incentives are of two basic kinds:

- (a) those which provide for the accumulation of income in tax free reserves for a period of five years; and
- (b) those which provide for certain exclusions from income of profits derived from the licensing of technology.

In the case of the incentive provided by tax-free reserves, over a period of five years a Japanese company may place in a reserve an amount equal to up to 30 per cent of the amount paid by such com-

² Reported in *The Japan Economic Journal*, August 13, 1977 at p. 13.

³ The rating is reported in detail in English in *The Japan Economic Journal*, August 16, 1977 at p. 11.

pany for the newly issued shares either of a non-Japanese Asian company or of a Japanese company which is principally engaged in the business of investing funds.⁴ The income placed in reserve need not be related to income derived from the Asian investment project. The reserve is accumulated for five taxable years and in the next five taxable years is taken back into the taxable income of the Japanese company in equal amounts per year. Since the income is eventually taxed, the system is not one of tax holiday, tax credit, permanent exclusion or deduction from taxable income. Rather it is one of income tax deferral. Similar provisions exist for the making of loans to companies in Asia and for the acquisition of the issued and outstanding stock of a non-Japanese Asian company.

In regard to the licensing incentive, a Japanese company which licenses a patent or know-how to a company doing business in a non-Japanese Asian country may exclude from its taxable income up to 55 per cent of the income derived from the licensing of such technology or up to 50 per cent of the Japanese company's entire income (from whatever sources), whichever is less. This exclusion is more straightforward and "classical" in an income tax sense than the reserve, and the exclusion is a permanent exclusion from income.

Both the capital investment incentive and the technology incentive are granted by a special law, and are available only until March 31, 1978, but similar laws have been re-enacted over a number of years and this system, or one like it, is likely to stay in effect.

The Future of Japanese Investment in Singapore

The future of Japanese investment in Singapore will have two aspects: Japanese investment in Singapore itself and Japanese investment in ASEAN development projects. In his August visit Prime Minister Fukuda completed Japan's commitment to the US\$800,000,000 petrochemical joint venture between a Japanese investment company led by Sumitomo Chemical Company, Ltd. and the Singapore Government. In his visit Prime Minister Fukuda also promised Japanese corporation in surveys for a Japan-Singapore Technology Training Center and in establishing a Science Center in Singapore.

All three of these projects follow Japanese investment patterns in other areas. The Sumitomo Chemical investment company is of the type which can take advantage of the Japanese tax incentives outlined above. As an investment company participated in by many Japanese companies, it is following a format used by the Japanese Government, both domestically and internationally, to consolidate investment capital and to spread the risk of investment in any new, Government-promoted investment area. For instance, in creating Japan's own petrochemical industry in the 1950s many Japanese companies, often members of the same group, were encouraged by the Government to pool investment in the new petrochemical companies. Similarly, in oil exploration and development outside of Japan, many companies, with Government encouragement, have pooled their capital

4 To qualify for tax-free reserve status the Japanese investment company may not be listed on any stock exchange in Japan, and the Ministry of International Trade and Industry must determine that the activities of the Japanese investment company will contribute to the promotion of foreign investment.

in large investment companies led by trading companies and others with experience in the oil business.

Often particular investment consortiums are given particular, almost semi-diplomatic responsibility for fostering economic relations with particular countries. For instance, in oil exploration and development, consortiums led by Sumitomo Shoji Kaisha, Ltd. have responsibility for Iraq and Oman, whereas other groups have responsibility for Iran. It is likely, therefore, that Sumitomo Chemical will have an increasingly important semi-diplomatic role between Singapore and Japan as the petrochemical complex is built and comes on-stream.

The proposals for a Japan-Singapore Technological Center and a Science Center parallel recent efforts by the Ministry of International Trade and Industry to establish a system for technological research cooperation with developing countries. The first of the big research projects planned is a Y1,000,000,000 project on sea water desalination with Saudi Arabia. In fiscal year 1979 (beginning April 1, 1979) the Ministry hopes to work on a solar heat generation project with Iraq. With Singapore's concentration of intellectual resources and its central role in the region, large scale technological cooperation with Japan in appropriate fields would seem very likely.

There are indications that Japanese banks are now breaking away from their traditional term lending patterns and will be willing to grant loans directly to development projects created in less developed countries, without their traditional insistence on guaranties by Japanese suppliers to the projects or other collateral which has tied past loans to the purchase of Japanese goods and services. The first of these loans has been made in Brazil in the Nibrasco iron ore project, but the Nibrasco loan can be expected to be a model for Japanese project financing in other developing countries, including Singapore.

No discussion of Japanese investment in Singapore would be complete without mention of Japan's commitment to "consider favourably" granting US\$1,000,000,000 in aid to ASEAN's five industrial projects on "concessional" terms and in "various" forms when the projects are proved "feasible". This aid will presumably benefit Singapore's projected diesel engine plant and will also greatly bolster the development of the region.

In summary, Japan has always played an important role as a foreign investor in Singapore, but with the inauguration of the petrochemical joint venture, its role as a concessionary financier of ASEAN, and the increased long term lending role of its banks and other financial institutions, Japan's role as the key foreign investor in Singapore would seem to be well-established. It remains to be seen whether Singapore and Japan can live comfortably in the new relationship.

DISCUSSION

Myint Soe: *This question is directed to the last sentence of Mr. Stevens' paper. That it remains to be seen whether Singapore and Japan can live comfortably in their new relationship. Reading between the lines, I think you probably are thinking of certain circumstances under which the new relationship might become uncomfortable. Could you enlighten us?*

Charles Stevens: *I think one immediate problem is the one I pointed out and that is what are the details of huge projects such as the petrochemical project and are the Japanese truly committed in the sense that you understand it. I think more importantly is the long term problem for the University perhaps, and that is, what is the state of your Japanese studies here? You have a long tradition of relationship with the United Kingdom. You have many years of relationship with the United States and you share English as a language but it strikes me that people from Japan and Singapore don't really know each other very well. How many people here enrol in Japanese courses? What is the state of your study of Japanese culture, history and economics? I think that certainly you are going to have to learn about Japan because Japan is very interested in Singapore and is making a real contribution here. So I think this is a general cultural problem of knowing more about Japan and starting to orientate Singapore a bit more towards Japan. Certainly the American government has been promoting Japan's interest in this region and I think perhaps intending that Japan will supplant America's responsibility for the area in terms of economic investment. My impression is that culturally perhaps you are not ready for that yet. That was my uneasiness.*

Lai Kew Chai: *Mr. Stevens. Can you please tell us in specific terms some of the legislative provisions in Japan which a Japanese investor will have to comply with before he can invest in Singapore.*

Charles Stevens: *Every foreign investment by a Japanese company which is more than US\$200,000 has to be approved by the Japanese government. So every foreign investment must be reviewed by the government and whether the review is strict or not strict depends upon how the government values the investment. Now this review is justified by what are called foreign exchange laws but the laws of course are no longer needed for foreign exchange control with Japan's degree of balance of payments surplus. In fact, it is a kind of government guidance on foreign economic policy which is being exercised. So that is the primary process. It is a very long consultative process with the government whereby the government will review an application in draft form and suggest changes such as some restructuring or arrangement, and then approve it after the suggestions. That is a direct investment. The other type would be these new projects financing I mentioned.*

Patrick Teo: *This question is directed to Professor Tan. We all know that Singapore continues to campaign for foreign investment. We also know that many local companies, large and small, as well as private individuals have considerable idle capital seeking investment media. Some of these companies are genuinely interested in investing in Singapore where the incentives offered reduce investment risks and improve payback periods. Many of these potential investors are in a quandary as to what they would like best to do, without the capacity for research and the perspective of investment opportunities etc. One alternative which appears to me apparent is to seek a collaboration with foreign companies who can contribute products, technology and markets. Also in such a collaboration or joint venture, real technology transfer from the foreign to the local counterpart at all management levels is achieved. Where the foreign investment is*

total and local participation is by way of employment, the technology and management transfer is at best, middle level and even at that, somewhat muted. What we need is a corporating body, and the EDB is best placed to perform this function to bring foreign and local entrepreneurs together, and obviously, this has to be done gently.

I am going back to the discussion that James Chia brought up on foreign exchange control. This might throw some light on the matter. As we know the advent of the Asian Dollar Market and Asia bonds which have been floated in this area have given a lot of people intellectual provocation, especially in respect of remuneration for services where the use of the bond which is a freely negotiable instrument and untraceable because of its "bearer" designation are often used as payment for services rendered which can then be transmitted anywhere in the world; the only condition is that a stock exchange exist in order that the bonds can be sold and kept in an account. The beauty is that it is completely untraceable.

Augustine Tan: *I think you are referring to the possibility of having more joint ventures. If you talk to the EDB they will tell you that they have tried their best to match local businessmen with foreign partners. But I think there are certain inherent difficulties involved in joint ventures. There have been ventures in which the local partner has found himself fleeced by the foreign partner especially when the control of the operations and where the technological aspects are not known to the local partner. Transfer pricing is one good way by which you can be milked of all your profits plus your capital invested if you are not careful. The other consideration is that if we were very rigid in terms of requiring companies to have a certain ratio of local participation as some countries do, in the end we may scare away the foreign investment which is very much needed here. So the policy has been not to lay down any legal guidelines, any legal constraints in terms of such business relationships but to leave them wide open. If two partners wish to get together or if there is a foreign firm looking for a local partner, the EDB will do its best to find a local partner. I think the problem of excess Singapore capital is one which is tied in with entrepreneurship. You mentioned technology and excess of capital; however, the question of the entrepreneurship is every much part of the problem. If you look at our total savings and investment figures in Singapore you will find that a considerable part of our savings is invested abroad. It is invested in companies like rubber plantations, tin mines, timber concessions, small scale light manufacture and so on, for the simple reason that people invest their money in lines that they are familiar with or in which they have expertise. In my view, if you have a million dollars to invest and I ask you "why don't you build a factory in Jurong?", you will say, "I don't know anything about factories." So if you don't know anything about manufacturing, you put it in POSB or fixed deposit or at the very most, buy a house for investment. But this is the problem and in fact if you look at our official reserves we have plenty of money that could be invested. But suppose you tell the government: "Set up a corporation. Why don't you set up more industries." Well, if you set up industries that are not viable it is going to be worse than nothing. And who is going to take charge of those industries? Civil servants or people co-opted from the private sector? Here again, you run into this problem of entrepreneurship, technology, management,*

and markets. So it is not a simple problem. There was reference earlier to the fact that we don't have an investment code here. Now, I know something about what is done in other countries, particularly in Southeast Asia. They lay down such rigid investment codes to protect certain sectors from the foreign investor to create certain preserves exclusively for local investments. I think a lot of local vested interest had a hand in the drafting of those codes. The result is that those countries have very few new investments forthcoming because the local entrepreneurship is lacking. They tie up so many areas that they strangle their own economic growth. So we have had no investment code written as such into laws for this very simple reason and, if I may just reflect upon the legislation which was discussed by Mr. Khoo, you will find that the evolution was in response to changing economic circumstances. In 1968, for example, we had very heavy unemployment and the prospect of British withdrawal; hence the labour legislation amendments were brought in. And by 1970 we had reached virtually full employment. The Economic Expansion Incentives (Relief from Income Tax) Act was amended accordingly. 1975 presented a different situation. Consequently, we liberalised our investment incentives.

Brij Soin: I just have a brief comment on Mr. Stevens' incentives that are provided to Japanese investors in Singapore. This is regarding incentives that are given to Japanese employees who come here. They have incentives, obviously given by the employer, but these have the full backing of the Government. These cover the taxes overseas Japanese pay in Singapore which are fully recoverable from the employer with the consent of the Japanese government. The other one is that they get part of their salary or part of their remuneration paid in Japan into an account there by the employer in Japan and not by the employer in Singapore. This is part of the arrangement for sending out employees overseas. And the third important one is that they are paid golf expenses or they can join any golf club in Singapore. This can be up to a \$20,000 entrance fee. In addition costs of everything from A-Z where golf is concerned is paid for either by the employer in Singapore or by the employer in Japan. Now the second point I want to make is that in these figures of 20,400 Singaporeans that are being employed by the Japanese here does the figure include golf caddies because I believe that that at least 250 Japanese are playing golf every week and employing Singapore caddies.

Charles Stevens: I might also say that the claim in Japan has caused immense problems in the United States under our own equal employment opportunity and labour laws because a number of American employers have challenged the additional compensation being paid to Japanese executives for equal work in Japan in law suits being brought in our States. I don't know if that has happened in Singapore or not?

Robert Beckman: How do the Japanese government and companies view the problem of the need for investment guarantees and then if you could make a short comment of their general attitudes towards dispute settlement in comparison to Western countries.

Charles Stevens: Frankly, I don't know what their attitude is about investment guarantees. On dispute settlement they are an

Eastern culture that values conciliation; they don't favour litigation; they don't favour arbitration as such because in an arbitration you have one side winning and one side losing. So that almost any effort will be made to see that the litigation is avoided. But how the relationship affects investments, I suppose is the attitude that we take. It will either be a paternal one or a sort of social one between co-equals. But the idea of a legal relationship will not be very much present in the minds of the Japanese investor.

Chairman: This is the final phase of our 2 day seminar. We have three presentations, one a paper by Mr. Lee Bian Tian and two oral presentations.

SOME ASPECTS OF AN INVESTMENT GUARANTEE IN SINGAPORE

by

LEE BIAN TIAN

An investment guarantee may perhaps be defined as a guarantee granted by one State to another State usually in exchange for a similar guarantee against certain political or non-commercial risks particularly expropriation and prohibition or restrictions against repatriation of capital and earnings in respect of investments of nationals of either State made or to be made in the territory of the other State. Singapore's first agreement relating to an investment guarantee was entered into on 25th March, 1966, with the United States of America. This was followed by agreements with Canada on 30th July 1971, the Netherlands on 16th May, 1972, the Federal Republic of Germany on 3rd October, 1973, the United Kingdom on 22nd July, 1975, and with France on 8th September, 1975. It would appear that these agreements only emerged recently because a deliberate policy to foster the growth of new industries in Singapore was only first initiated in or about 1959. Apparently the idea behind these agreements was primarily to provide an added incentive to non-nationals to make direct investments in Singapore.

2 Before 1966, the 1959 agreement relating to an investment guarantee between the USA and the then Federation of Malaya was extended on 24th June, 1965, to the whole of Malaysia (of which Singapore then formed part) by an exchange of notes of that date between the USA and Malaysia. After separation on 9th August, 1965, the 1959 Agreement continued to apply between the USA and Singapore by agreement between them and by virtue of section 13 of Annex B to the Separation Agreement. It had since been superseded by the investment guarantee agreement of 1966.

3 To be eligible for approval as guaranteed investments under the terms of an investment guarantee agreement entered into by Singapore (IGA), investments must be investments of nationals of the other State party to it. An IGA does not automatically apply to investments in Singapore of nationals of the other State party to it. It applies to a particular investment only if specifically so approved in