

Kawauchi, Junko; Shinohara, Takeshi; Yokozawa, Makoto

Conference Paper

Study on factors for evaluating the economic impact of data localization requirement policies on the IT industry

26th European Regional Conference of the International Telecommunications Society (ITS): "What Next for European Telecommunications?", Madrid, Spain, 24th-27th June, 2015

Provided in Cooperation with:

International Telecommunications Society (ITS)

Suggested Citation: Kawauchi, Junko; Shinohara, Takeshi; Yokozawa, Makoto (2015) : Study on factors for evaluating the economic impact of data localization requirement policies on the IT industry, 26th European Regional Conference of the International Telecommunications Society (ITS): "What Next for European Telecommunications?", Madrid, Spain, 24th-27th June, 2015, International Telecommunications Society (ITS), Calgary

This Version is available at:

<https://hdl.handle.net/10419/127154>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

“Study on factors for evaluating the economic impact of data localization requirement policies on the IT industry”

Author: Junko Kawauchi, Otemon Gakuin University
Co-Author: Takeshi Shinohara, Makoto Yokozawa

I. Introduction

In my last paper¹, I studied data localization requirement policies and their impact on the economies of some countries.

In Russia, a data localization requirement law has been enacted and will be enforced beginning Sept. 1, 2015. In Brazil, “Marco Civil da Internet,” a law to protect Internet users’ rights, was formally signed by the Brazilian president in April 2014. The clause requiring data localization was deleted, but Article 11 says this law should be respected whenever an Internet service is related to Brazilian citizens². In Korea, a regulation to restrict the cross-border transfer of data from financial institutions is under consideration³. Many countries around the globe started to consider adopting policies requiring data localization.

1 “Study on Data Localization Requirement Policies Around the World and Direction to Be Taken by Japan” by Junko Kawauchi, Otemon Gakuin University Graduate School Journal, March 2015

2 Marco Civil Internet Bill of Rights (English version), Art. 11. “In any operation of collection, storage, retention and treating of personal data or communications data by connection providers and internet applications providers where, at least, one of these acts takes place in the national territory, the Brazilian law must be mandatorily respected, including in regard the rights to privacy, to protection of personal data and to secrecy of private communications and of logs.”

3 Jonah Force Hill “THE GROWTH OF DATA LOCALIZATION POST-SNOWDEN: ANALYSIS AND RECOMMENDATIONS FOR U.S. POLICYMAKERS AND INDUSTRY LEADERS” Lawfare Research Paper Series July 21, 2014

<http://www.lawfareblog.com/wp-content/uploads/2014/07/Lawfare-Research-Paper-Series-Vol2No3.pdf>

The governments that have adopted policies requiring data localization insist that the objective is to protect the privacy and security of citizens. I discussed the credibility of claims those policies can protect the privacy and security of citizens.

I had a question after my study and discussion — if the Japanese government adopts a policy requiring data localization, will it have a negative impact on Japanese industry and the Japanese economy?

ECIPE Occasional Paper No. 3/2014 suggests that those policies will have a negative impact on the economy of the country implementing them⁴, and Vietnam will suffer the greatest damage, even greater than China. In other words, the data localization requirement policy in Vietnam will hinder local business and direct foreign investment to Vietnam.

On the other hand, the Japan Information Technology Service Industry Association (JISA), which is a trade organization of the IT software and services industry in Japan⁵, conducted a survey on global business trends in 2012 and 2014⁶. According to the survey result (Chart 1), Vietnam and Indonesia are recognized as more attractive future markets than China.

According to results of the Foreign Direct Investment Confidence Index 2015, published by A.T. Kearney, China held second place after the US for three consecutive years from 2013 to 2015⁷. Vietnam and Indonesia were not included in the rankings. This means China still a large and desirable foreign direct investment (hereafter “FDI”) market, and one that is much more focused than Vietnam's and Indonesia's. But JISA member companies answered that Vietnam and Indonesia have better prospects than China in the future.

4 “The Cost of Data Localization: Friendly Fire on Economic Recovery,” ECIPE Occasional Paper No.3/2014 by Matthisa Bauer, Hosuk Lee-Makiyama, Erik van der Marel, Bert Verschelde

5 www.jisa.or.jp

6 Global Business Survey conducted by JISA Global Business Committee in 2012 & 2014, <http://goglobal.jisa.or.jp/home//tabid/75/pdid/183/catid/5/Default.aspx>

7 <https://www.atkearney.com/research-studies/foreign-direct-investment-confidence-index/2015>

Chart 1. JISA Global Business Survey Result



We can also find inconsistent result in regard to legal and tax systems for FDI. According to the results of JISA Global Business Survey, government policies in Vietnam are not recognized as an obstacle to business, though the government policies in China have been recognized as a large obstacle⁸. This result is different from that of the ECIPE paper suggesting policies in Vietnam will be more harmful to the growth of the economy than those in China⁹.

In this paper, we will study various factors other than market environment (market size, growth prospects, etc.) and government policies including data localization requirements that influence investors' decisions on FDI destinations.

8 Global Business Survey conducted by JISA Global Business Committee in 2012 & 2014 <http://goglobal.jisa.or.jp/home//tabid/75/pdid/183/catid/5/Default.aspx>

9 "The Cost of Data Localization: Friendly Fire on Economic Recovery," ECIPE Occasional Paper No.3/2014 by Matthisa Bauer, Hosuk Lee-Makiyama, Erik van der Marel, Bert Vershelde

To this end, we conducted an online survey to find out how Japanese people decide FDI destinations, and what they think about Japan's neighboring countries – China, Vietnam and Indonesia – as FDI destinations.

Furthermore, we will analyze why the result of the survey are inconsistent with other resources, and explore the impact of national/individual preferences on the economy.

For the case of IT industry in Japan, subjective factors influenced stronger to investors than the objective factors such as market size, legal and tax systems and data localization requirement policies.

II. Survey Method

1. Survey title: Online survey on foreign direct investment or business development from Japan to Asia, including China, Vietnam and Indonesia
*Hereafter it will be called “Online survey on FDI from Japan to Asia”
2. Dates survey conducted: May 21-24, 2015
3. Objectives of the survey
 - 3.1 To investigate how Japanese people decide FDI destinations
 - 3.2 To find out how China, Vietnam and Indonesia are thought of as FDI destinations by Japanese people
 - 3.3 To analyze Japanese people’s feelings toward China, Vietnam and Indonesia
4. Targeted respondents: Japanese people who have experience engaging in FDI or business operations in Asia
5. Number of respondents: 300

III. Survey Results

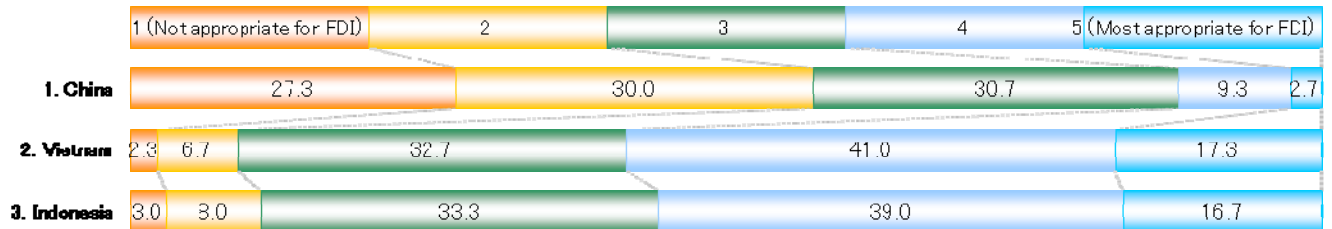
1. Evaluation of FDI destinations based on market size and growth prospects

Chart 2 shows the results of the question “How do you evaluate the three countries as FDI destinations based on their market size, future prospects for market grow and the strategy of your organization?”

As for China, more than half answered “not appropriate” or “not very appropriate” to invest, and only 12% answered “most appropriate” or “appropriate” FDI destination.

On the other hand, more than half answered that Vietnam and Indonesia are “most appropriate” or “appropriate” FDI destinations.

Chart 2 How do you evaluate the three countries as destination of FDI based on their market size, future prospect of the market growth and strategy of your organization?



Source: Online Survey on FDI from Japan to Asia

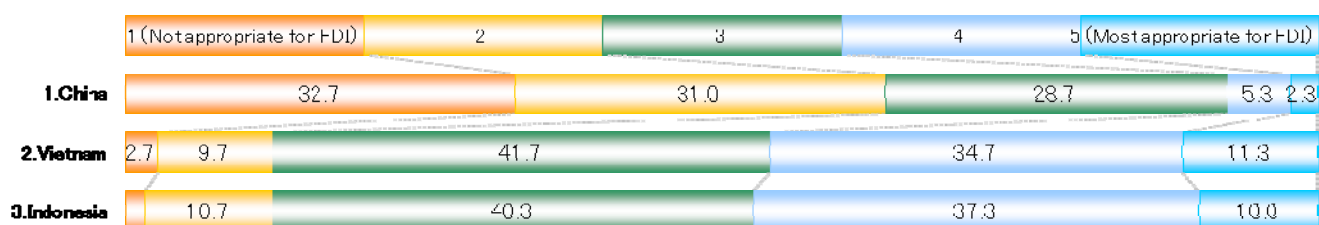
These results are not consistent with the general recognition that China has a large market to match its large country and population. As mentioned in the introduction, the Foreign Direct Investment Confidence Index 2015 results published by A.T. Kearney¹⁰ show China held the second highest position for three years, which is not consistent with this online survey result either.

10 <https://www.atkearney.com/research-studies/foreign-direct-investment-confidence-index/2015>

2. Legal and tax system for FDI

As for the legal and tax system including FDI incentives, China is also recognized as an inappropriate destination of FDI. Sixty-three point seven percent answered “Not appropriate” or “Not very appropriate,” and only 7.6% answered “Most appropriate” or “Appropriate” destination of FDI. As for Vietnam, 46% answered “Most appropriate” or “Appropriate” destination of FDI.

Chart 3. How do you evaluate the three countries as destination of FDI based on their legal/tax system including FDI incentives?



Source: Online Survey on FDI from Japan to Asia

ECIPE Occasional Paper No. 3/2014¹¹ suggests that data localization requirement policy in Vietnam will cause the greatest damage and hinder local business and FDI more seriously than will such policies in China. This, too, is inconsistent with the survey results.

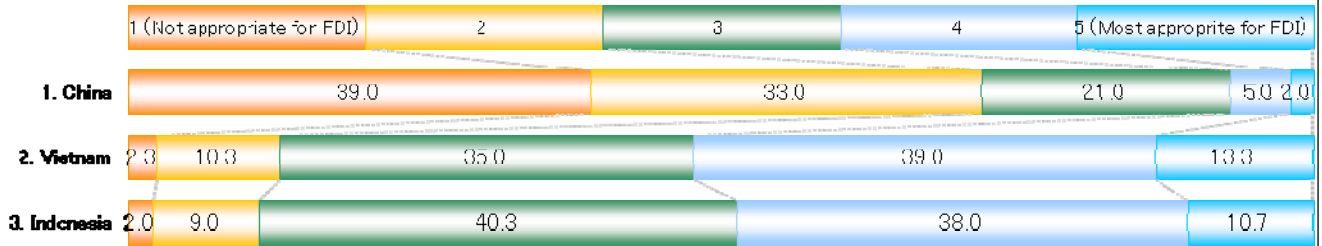
3. Risk of rising labor costs

It is often said that labor costs in China are rising steeply. According to the China Business Review, “Executives across China have been quick to mention rapidly increasing labor costs in recent years as one of their top concerns for their China operations.”¹² Chart 4 shows that the issue of rising labor costs in China is strongly recognized by respondents.

11 “The Cost of Data Localization: Friendly Fire on Economic Recovery,” ECIPE Occasional Paper No.3/2014 by Matthisa Bauer, Hosuk Lee-Makiyama, Erik van der Marel, Bert Verschelde

12 <http://www.chinabusinessreview.com/chinas-rising-costs/>

Chart 4. How do you evaluate the three countries as destination of FDI based on the risk of rising labor cost and securing human resources?



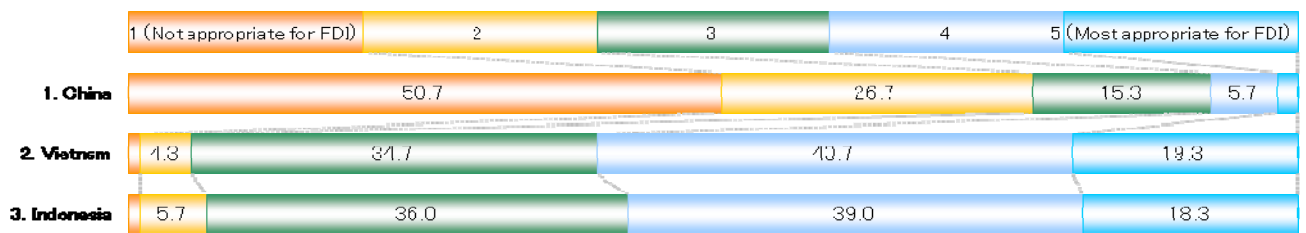
Source: Online Survey on FDI from Japan to Asia

4. Impact of historical, diplomatic, political and economic factors on FDI

As you see in charts 5 & 6, China is not recognized as an appropriate FDI destination when the historical, diplomatic, political and economic relationship between Japan and China is considered.

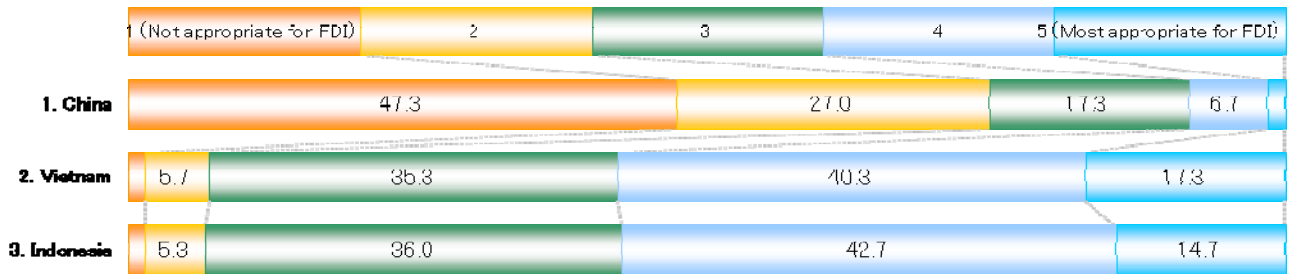
When historical incidents are considered, 76.7% answered that China is “Not appropriate” or “Not very appropriate,” though the rate in Vietnam is 5.3% and in Indonesia only 6.7%. This trend is the same for diplomatic, political and economic factors.

Chart 5. How do you evaluate the three countries as destination of FDI based on historical incidents and relationship between Japan and the country?



Source: Online Survey on FDI from Japan to Asia

Chart 6. How do you evaluate the three countries as destination of FDI based on the diplomatic, political, economic relationship between Japan and the country?

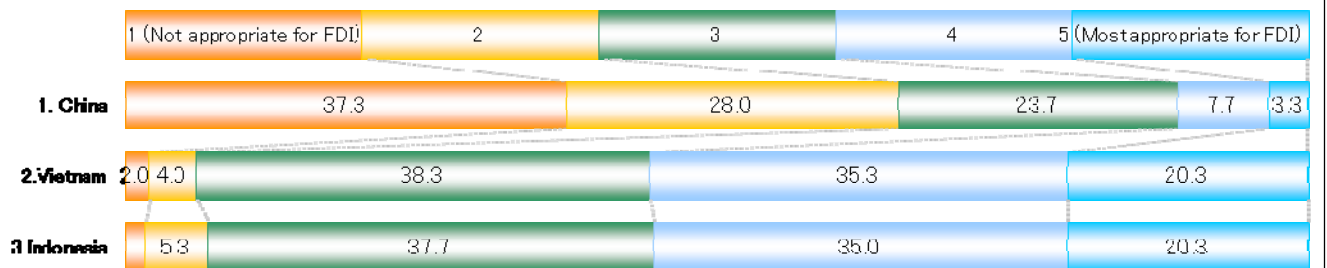


Source: Online Survey on FDI from Japan to Asia

5. Impact of personal preferences on FDI

Chart 7 shows the results of a survey asking respondents to evaluate the countries as destinations for FDI based on personal preference. Again, 65.3% evaluated China as inappropriate, while less than 7% evaluated Vietnam and Indonesia that way.

Chart 7. How do you evaluate the three countries as destination of FDI based on your personal preference?



Source: Online Survey on FDI from Japan to Asia

IV. Discussion

According to statistics on FDI from Japan to foreign countries published by the Japan External Trade Organization (JETRO), China was third after the US and UK in 2011, and it was second after the US in 2012¹³. In 2013 it was fourth after the US, the UK and Thailand¹⁴.

As seen in Chart 8, FDI to China was increasing year by year until 2012, after which it started to decrease. FDI to Vietnam and Indonesia are steadily increasing even in 2013, though the amount is not so large. As mentioned earlier, the Foreign Direct Investment Confidence Index 2015 result published by A.T. Kearney¹⁵ shows China held the second highest position from 2013 to 2015. However, FDI from Japan to China decreased a lot in 2013. Why?

We will discuss two important factors that strongly impacted this decrease in FDI to China.

1. A territorial dispute between Japan and China over the Senkaku Islands

One of the most important reasons why the FDI amount from Japan to China started to decrease in 2012 would be the territorial dispute between Japan and China over the Senkaku Islands, which escalated in September 2012.

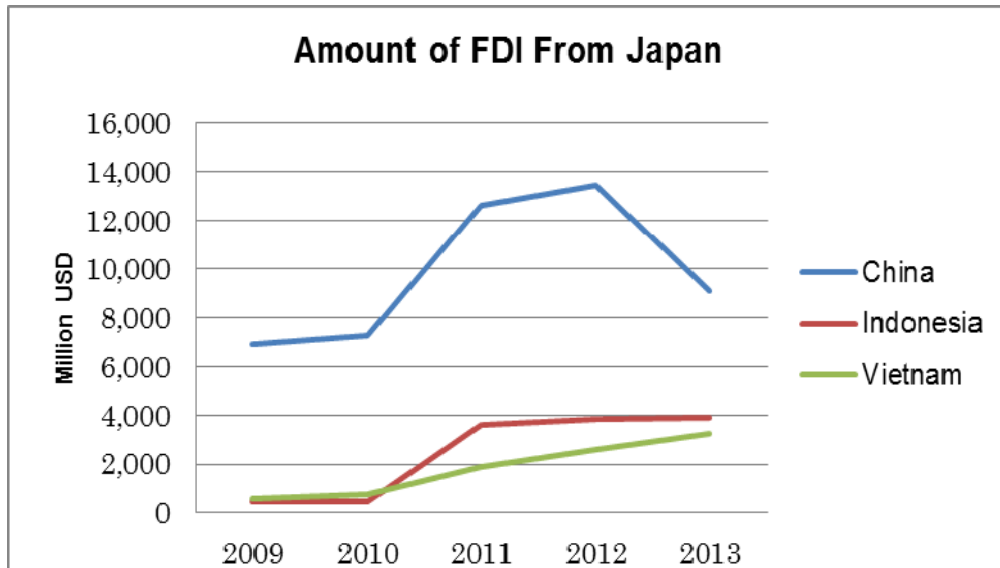
At that time, there were many demonstrations in China by Chinese people destroying Japanese retail shops and Japanese cars. Also many Chinese ships approached the Senkaku Islands to threaten the safety of Japanese fishing boats. Many images of Chinese people destroying Japanese retail shops and cars were on the TV news and many Japanese people were shocked by them. Many Japanese people felt anti-Chinese sentiment from those shocking images of destruction on TV.

13 <http://www.jetro.go.jp/world/japan/stats/fdi.html>

14 <http://www.jetro.go.jp/world/japan/stats/fdi.html>

15 <https://www.atkearney.com/research-studies/foreign-direct-investment-confidence-index/2015>

Chart 8

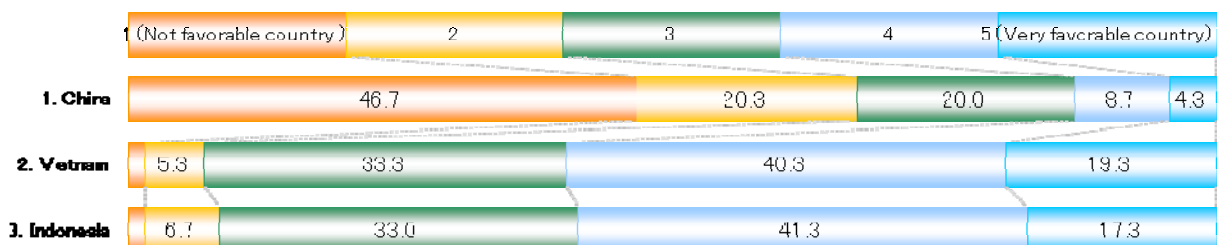


Source: Compiled from JETRO data on FDI from Japan

Chart 9 clearly shows how Japanese people feel about China – 67% answered “Not favorable” or “Not very favorable,” while only 13% answered “Very Favorable” or “Favorable.”

After the escalation of the Senkaku Islands dispute, many Japanese business people recognized that business with China has political/diplomatic risk and started to consider moving part of their FDI to other Asian countries including Vietnam and Indonesia. This strategy is called “China plus One.”

Chart 9. How is your impression on the three countries?



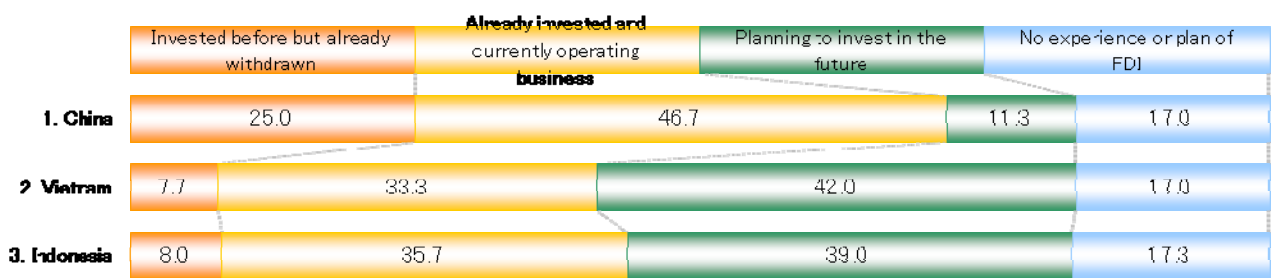
Source: Online Survey on FDI from Japan to Asia

2. Experience of difficulty of business in China

Another important reason why the FDI amount started to decrease is that many Japanese people have experienced FDI/business operations in China already, and have recognized its difficulty.

Chart 10 shows that 71.7% have already invested in China, and 25% have already withdrawn, which is much more than the comparable figures for investment in Vietnam and Indonesia. We can also find this from Chart 3, which we wrote earlier shows that the legal and tax system in China are not favorable for FDI.

Chart 10. Have you ever invested or are planning to invest in the future in these three countries?



Source: Online Survey on FDI from Japan to Asia

V. Conclusion

There are many factors that impact investors' decisions on FDI destinations. If only the size of the market is considered, Japanese investors should have continued to invest more in China. If only legal and tax systems that are not desirable for FDI are considered, Japanese investors should not have focused on Vietnam.

However, since the territorial dispute between Japan and China over the Senkaku islands escalated, many Japanese have had negative feelings toward China. This is one of the most important reasons why Japanese investors reduced their investment in China.

Also, many Japanese have invested or operated businesses in China already and found it difficult. This is another important reason why Japanese investors focused more on other countries including Vietnam and Indonesia.

To conclude, subjective factors including personal preferences, national feelings against a country and business experiences have a strong impact on investors' decisions on FDI destinations. In the case of Japan, those subjective factors have a stronger impact than objective factors including market size or legal and tax systems.

It is difficult to evaluate the economic impact on the IT industry only by looking at data localization requirement policies. Many other important factors need to be considered to evaluate its impact properly.