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JAPAN PERSPECTIVES

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September 3, 2014

Redefining Self-Defense

The Abe Cabinet's Interpretation of Article 9

Masahiro Akiyama

Prime Minister Shinzo Abe's efforts to expand the scope of self-defense activities permitted by the Japanese Constitution have met with resistance from some members of his own coalition. Tokyo Foundation President and Senior Fellow Masahiro Akiyama discusses the July cabinet decision to revise the interpretation of Article 9 and the hurdles Japan must clear to expand the role of the Self-Defense Forces to make a proactive contribution to peace.

* * *

One of the most hotly debated issues in Japanese politics today—and in Japanese society as a whole—is Japan's right to engage in collective self-defense—the use of military force in defense of a friend or ally. Why is there so much fuss over an inherent right that all nations are recognized as having under the United Nations Charter? The answer lies in Japan's “pacifist” Constitution, promulgated under Allied Occupation following World War II. At issue specifically is Article 9, which reads as follows in the official English version:

Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes.

In order to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized.

On the face of it, this would appear to prohibit the very capacity to wage a military defense, whether collectively or individually. Yet in fact Japan maintains sophisticated land, sea, and air capability in the form of the Self-Defense Forces. Why, one might ask, are the SDF even legal under Japan's Constitution?

Masahiro Akiyama *President and Senior Fellow, Tokyo Foundation.*

Practical Limits of Pacifism

In response to questions regarding the legitimacy of the SDF, legal and other experts note that the text (in Japanese) states that land, sea, and air forces will never be maintained *for the purposes stated in the preceding paragraph*—that is, as war potential or a means of settling international disputes. The government has thus taken the view that the Constitution does not forbid self-defense in the event of an armed attack on the nation, noting that it would be unreasonable to interpret Article 9 as denying Japan the wherewithal to defend its own people from threats to their peace, particularly in the light of the Preamble and Article 13, which proclaim the “right to live in peace, liberty and the pursuit of happiness.”

On this basis, the government has stood by the fundamental position that Ja-

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pan has the constitutional right to maintain armed forces, but only the minimum necessary for self-defense. In addition, it has followed a highly restrictive interpretation of “the minimum necessary for self-defense” that permitted the use of force only if the nation was under imminent “armed attack”—meaning an organized and sustained attack by the military forces of a foreign nation.

Over the years, the government has sought to clarify the limits on Japan’s defense capabilities and actions under Article 9 through statements in the Diet and legal opinions drawn up by the Cabinet Legislation Bureau. In terms of weapons capability, the “minimum necessary for self-defense” ruled out predominantly offensive systems, such as long-range missiles and strategic bombers and assault aircraft carriers. In terms of operations, the overseas deployment of SDF troops has been prohibited, the SDF’s use of weapons strictly limited, and great care taken to avoid any form of security cooperation that could give the appearance of integral involvement in the use of force by another country.

In addition, the government’s interpretation of Article 9 had been that although engaging in collective self-defense was prohibited, Japan nonetheless had an inherent *right* to do so. Succeeding cabinets have adhered to this admittedly rather abstruse argument, originally formulated by the Cabinet Legislation Bureau.

Seeds of Change

Meanwhile, the regional and global security environment was changing dramatically, fueling concerns that Japan was losing the ability respond effectively to the exigencies of regional and global security under the existing interpretation of Article 9.

Prime Minister Abe took preliminary steps during his first term in office toward the lifting of the ban on collective self-defense, along with other constraints on defense operations that he considered outdated. In 2007, Abe formed the Advisory Panel on Reconstruction of the Legal Basis for Security from a group of like-minded experts. The panel was charged with deliberating the legitimacy of military action in four basic hypothetical cases—scenarios that in themselves shed considerable light on the evolving international situation. They were (1) defense of US naval vessels on the high seas; (2) interception of ballistic missiles that might be heading toward the United States; (3) use of weapons in international peacekeeping operations; and (4) logistic support for the operations of other countries in international peacekeeping operations by the United Nations, etc.

In its report, issued in June 2008, the panel concluded that the government should revise its interpretation of the Constitution to permit Japan to exercise the right of collective self-defense (the first and second cases above) and participate in peacekeeping operations categorized as collective security measures under UN auspices (third and fourth cases) and recommended that it introduce new legislation to permit action in all four cases. By that time, however, Abe had stepped down for reasons of health. His successor, Yasuo Fukuda, chose not to act on the recommendations, and the issue lay dormant until Abe returned to power in December 2012.

Resuming the Crusade

In February 2013, two months after his return, Abe reconvened the Advisory Panel on Reconstruction of the Legal Basis for Security.

The panel's final report, released in May 2014, stresses the dramatic and ongoing changes in defense technology and Japan's security environment. It reiterates the conclusion of the 2008 report that it has "become difficult to respond appropriately to important issues that arise under the contemporary security environment" under the existing interpretation of Article 9.

However, the latest recommendations go beyond the four cases set forth in the 2008 report, extending to situations involving the protection of Japanese nationals

overseas, cooperation in international policing, and response to security incidents or situations that fall short of a full-scale armed attack.

On July 1, 2014, the Abe government took the next step by announcing and explaining its intent to pursue executive and legislative action based on the panel's recommendations in a resolution titled "Cabinet Decision on Development of Seamless Security Legislation to Ensure Japan's Survival and Protect its People." The title makes no reference to "collective self-defense" *per se*, nor does the text itself highlight the concept. One reason is that the decision pertains more broadly to the optimization of SDF operations, but another is that the concept of collective self-defense has become a lightning rod for opposition, not only among the general public but also within the New Komeito Party, the junior partner in the coalition led by Abe's Liberal Democratic Party. As we shall see, the cabinet's new interpretation neatly skirts the issue of the legality of collective self-defense under Article 9.

The July 2014 cabinet decision sets forth the government's reinterpretation of Article 9 in relation to a variety of hypothetical security situations, broadly grouped under the headings of (1) response to an infringement that does not amount to an armed attack, (2) further contributions to the peace and stability of the international community, and (3) measures for self-defense permitted under Article 9 of the Constitution.

Under the first heading, "response to an infringement that does not amount to an armed attack," the government stresses the need to ensure an adequate response and seamless cooperation between responsible agencies (Coast Guard, police, SDF) in the event of "gray zone" situations that threaten Japan's territorial integrity but fall short of an act of war.

As an example, it cites a scenario in which armed fishing boats attempt to occupy a remote island of Japan—a reference to recent activities around the Senkaku Islands. The cabinet calls for joint exercises to prepare for such situations, as well as reforms to streamline procedures for the issuance of a maritime-security-operation or defense-mobilization order involving SDF units to enable a swift and seamless response in coordination with the Japan Coast Guard and other responsible police forces.

With regard to the protection of US naval vessels, the government intends to draw up legislation that would allow the "very passive and limited" use of military weapons by the SDF to defend US military units in the event that they should come under attack—in a situation that threatens to escalate into an armed conflict—while engaged in activities that contribute to the defense of Japan, including joint exercises.

The second heading is "use of weapons associated with international peace

cooperation activities.” In this section, the government stresses the need to facilitate more active and unhindered SDF support for UN-sanctioned peacekeeping operations as part of Japan’s “proactive contribution to peace.” It points out that situations arise in which Japan is called on to provide support for non-Japanese armed forces involved in the legitimate use of force in a UN PKO.

Whereas previous cabinets have limited Japan’s role to “rear area support” to avoid any appearance of “integral” involvement in the use of force, the current government takes the view that such support can legitimately be provided anywhere other than an active combat zone. The decision also substantially expands the SDF’s right to use weapons during peacekeeping operations. Under the cabinet’s new interpretation, SDF personnel may take on a more active role in PKOs by using weapons when responding to requests for emergency support from units that have come under attack (situations referred to as *kaketsuke keigo*) or “in defense of the mandate,” in the language of UN peacekeeping.

The decision also sanctions the use of weapons by the SDF as needed to rescue Japanese nationals overseas.

Skirting Collective Self-Defense

The third section is titled Measures for Self-Defense Permitted under Article 9 of the Constitution. It begins by summing up the longstanding interpretation of Article 9 as permitting the use of the minimum necessary force to deal with “imminent unlawful situations” that fundamentally violate “the people’s right to life, liberty, and the pursuit of happiness.” While embracing this logic, it makes the case for including within such situations certain armed attacks directed against “a foreign country that is in a close relationship with Japan,” rather than limiting them to direct armed attacks against Japan, as previous administrations have done.

The decision notes that such actions may fall under the definition of “collective self-defense” as defined by international law, and that international law sanctions such action. But it sidesteps this issue by avoiding any explicit reinterpretation of Article 9 to include collective self-defense. Instead, it expands the scope of actions that qualify as self-defense.

This may seem like an arcane distinction, but it can make a real difference in practical terms. While the right of collective self-defense is generally interpreted to mean the right to use force against any country that attacks an ally, the July 2014 cabinet decision clarifies that such actions are permitted only when they are taken as measures for self-defense which are inevitable for ensuring Japan’s own survival and protecting its people—in other words for defending Japan. In this way, the Abe

administration has made the defense of an ally consistent with the longstanding government interpretation of the Constitution.

Wanted: A Framework for Peacetime Defense

The recent cabinet decision, while touching on the issue of collective self-defense, is devoted predominantly to other issues, including the scope of SDF participation in activities categorized as UN collective security measures, secondary actions to collective self-defense, participation in other overseas operations, and peacetime measures. Nonetheless, most of the public debate remains focused on “collective self-defense” (*shudanteki jieiken*) as a kind of catch-all for SDF activities that fall outside the narrow limits imposed by previous governments.

But the truth is that Japan’s right of collective self-defense discussed above—just like its right of individual self-defense—is severely limited and permitted only in the event of an armed attack on the nation or on another nation with which Japan has close ties. Under Japanese law, then, actions in self-defense may be taken only *after* the issuance of a defense-mobilization order in response to an armed attack under the provisions of the Self-Defense Forces Law. The security problem we are facing now, however, is a difficulty occurring during peacetime.

In the Tokyo Foundation policy proposal “Maritime Security and the Right of Self-Defense in Peacetime,” issued in November 2013, we stress the need to create an institutional framework for self-defense in “gray zone” situations during peacetime—before a situation escalates into an armed conflict. We have called on the government to identify issues that need to be cleared and establish a clear decision-making structure. This, we think, requires a more flexible interpretation of an “imminent armed attack.”

The Abe government is to be commended for identifying the need for a seamless response to violations or infringements that “do not amount to armed attacks.” However, in its discussion of security in surrounding areas, including remote islands, it fails to consider the essential issue of self-defense in peacetime. The protection of remote islands—perhaps the most pressing security issue facing Japan today—is not a law enforcement issue but one of national defense. I strongly urge the government to heed the Tokyo Foundation recommendation as it turns to the task of drawing up legislation for a new security era.

June 19, 2014

Japan's "Proactive Contribution to Peace"

A Mere Political Label?

Akiko Fukushima

The centerpiece of Japan's first National Security Strategy, announced in December 2013, was a pledge to make a more proactive contribution to international peace. In an article reprinted here from the May/June 2014 issue of Economy, Culture & History JAPAN SPOTLIGHT Bimonthly, Senior Fellow Akiko Fukushima places the concept in historical context, noting that it is a natural response to a transformed security environment and an extension of the security and international cooperation policies Japan has already been implementing in recent years.

* * *

On Dec. 17, 2013, the Japanese government announced its first-ever National Security Strategy (NSS) calling on the country to make a “proactive contribution to peace” based on international cooperation. The strategy has prompted questions from the media both at home and abroad about the strategy’s real intentions and its vision. Questions have been raised, in particular, about the phrase “proactive contribution to peace.” What does the phrase mean? Is it a mere political label? What sort of path will Japan embark upon under this banner, and is this a cover for Japan’s return to pre-World War II militarism and a rejection of postwar pacifism? This article will try to answer some of these questions.

Why Now?

Foreign scholars and policymakers have long criticized Japan for lacking a security strategy and, for that matter, strategic thinking in its security and foreign policy,

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making Japanese policy unpredictable and unaccountable. Some have even argued that with the ongoing shift in the balance of power, Japan could disappear from the radar screen of international relations unless it shows where it stands with a clear strategy. The NSS is a response to such criticism.

Basic Policy on National Defense

Japan did announce a national defense policy—the Basic Policy on National Defense—on May 20, 1957, and this has guided Japan’s defense policy to date. But it is a very short statement of only half a page, stipulating that the “objective of national defense is to prevent direct and indirect aggression, but once invaded, to repel such aggression, and thereby to safeguard the independence and peace of Japan based on democracy.” The policy cites four specific policies to achieve this objective, namely (1) supporting the United Nations, (2) nurturing patriotism, (3) building up national defense capabilities necessary for self-defense, and (4) maintaining security relations with the United States until the UN becomes capable of maintaining international security.

After World War II, Japan adopted a policy of aligning its security and foreign policy with the position of the UN under the so-called UN-centered diplomacy. The UN did not function the way Japan anticipated due to the East-West divide of the Cold War, however, prompting the country to turn to its alliance with the US as the cornerstone of its security policy. Today, more than 50 years since the adoption of the Basic Policy on National Defense, Japan confronts new challenges and a vastly transformed security environment. Thus there is an urgent need to update its basic policy to adapt to the prevailing situation.

Changing Security Challenges

Over the past 50-plus years, challenges to Japanese security have evolved beyond the defense of territorial integrity. Security challenges have diversified to include terrorism, piracy, cyber attacks, energy resources, space, climate change, pandemics, failed states, international crime networks, and the illegal trafficking of arms and narcotics, to name just a few. These challenges, such as cyber attacks, are hard to predict. In a globalized world, moreover, Japan’s security has become indivisible from that of other countries. Terrorists from far-away failed states may target Japan, and Japanese nationals may become victims of attacks thousands of miles from home. For example, Japanese nationals were killed in Algeria in January 2013 when the plant where they were working was attacked by a group allegedly affli-

ated with Al-Qaeda in the Islamic Maghreb. This showed that peace and stability in countries as geographically distant as Algeria have an impact on Japan's security. Needless to say, piracy in the Gulf of Aden, which is a vital shipping lane, also affects Japanese trade.

The indivisibility, unpredictability, and diversification of security threats demand a more sophisticated, comprehensive, and integrated response. A long-term strategy is required, rather than ad hoc approaches to individual incidents.

Worsening Security Environment around Japan

Secondly, the security environment in areas around Japan has changed dramatically. In Northeast Asia, there are countries with large-scale military forces, and those either already possessing nuclear weapons or continuing with nuclear development. Recently, one of Japan's neighbors has been asserting its position in the East and South China Sea by rapidly expanding and intensifying its activities in the seas and airspace around Japan, including by intruding into Japan's territorial waters and air space. As *Military Balance 2014* observed, defense spending in East Asia has expanded rapidly against rising tensions in the region. The shares of the region's increase in real defense outlays in 2013 were 46% for China, 5.7% for Japan, 5.2% for South Korea, and 40% for other countries—split roughly equally between Southeast Asia and South Asia.

The Japanese government must do all it can to deter any aggression in its neighborhood and make diplomatic efforts to enhance cooperation with its neighbors to prevent a crisis from occurring.

Avoiding Misunderstanding

In an age of complex and intertwined security challenges, many countries, such as the US (since 1987), Britain (since 2013), Australia (since 2013), and South Korea (since 2009), have announced respective national security strategies. This is probably because they feel the need to explain their long-term security strategies both at home and abroad to avoid misunderstanding. Given the changes in the security environment, it is essential for governments to explain in advance how they plan to maintain peace and stability and to protect their citizens, both during peacetime and in contingencies. Long-term security strategies must also be explained to other countries to avoid unfounded misunderstanding on specific policies and to promote bilateral as well as multilateral cooperation.

In an age in which the security strategy of one country will have a large bearing

on that of others, and as security challenges become increasingly transnational, international and regional cooperation will be crucial in ensuring an effective response. Such are the factors that have prompted Japan, too, to announce its NSS.

What Is a “Proactive Contribution to Peace”?

Background

Japan has been criticized for not doing enough for international peace and security, even being accused of “free riding.” The question of whether it can participate in UN collective security activities has been left unanswered since Japan’s accession to the UN in 1957.

In his letter of application for UN membership, dated June 16, 1952, submitted to UN Secretary General Trygve Lie, Japanese Foreign Minister Katsuo Okazaki wrote: “I, . . . having been duly authorized by the Japanese Government, state that the Government of Japan hereby accepts the obligations contained in the Charter of the United Nations, and undertakes to honour them, by all means at its disposal, from the day when Japan becomes a Member of the United Nations.”

The unspoken meaning of this phrase “by all means at its disposal” was that Japan would fulfill its UN obligations so long as they did not violate the Japanese Constitution. The question that remained was the means Japan could actually use, for Article 9 of the Constitution stipulates that “aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes. In order to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized.”

The question of whether or not “by all means at its disposal” was a demarcation of its obligations and whether or not Japan can send its Self-Defense Forces on UN missions has been debated in the Diet since then. Soon after its accession to the UN on July 30, 1958, Secretary General Dag Hammarskjöld asked the Japanese government to send 10 SDF officers as military observers to reinforce the United Nations Observer Group in Lebanon. Although the mission was to monitor a ceasefire and did not involve combat, the Japanese government declined the UN request because the mission might involve activities that were outside of the scope of existing domestic laws, including the Self-Defense Forces Law.

During the 1990–91 Gulf War, when Japan was accused of not doing enough despite its very substantial monetary contributions, it was likened to a cash dis-

penser, disbursing cash in piecemeal fashion without working up much of a sweat. In response to such criticism, the Diet subsequently passed the International Peace Cooperation Law (the so-called PKO Law) stipulating five strict conditions under which the SDF could be dispatched. Three of the conditions—the existence of a ceasefire agreement, consent of the parties for deployment, and impartiality—are the same as the UN's PKO principles. Japan added two more, namely, (1) should any of the above three conditions not be met, the government of Japan may withdraw its contingent, and (2) the use of weapons shall be limited to the minimum necessary to protect the lives of personnel. These stipulations were intended to make sure that the dispatch was not unconstitutional. Since the law came into force in 1992, Japan has sent SDF personnel to places such as Cambodia, the Golan Heights, and Timor-Leste. Japan is currently participating in a UN peace-building mission in South Sudan.

The current official interpretation of the Constitution is that “Japan has the right of collective self-defense, as stated in the UN Charter, but cannot exercise it.” This interpretation has constrained Japan's security role so far. Nevertheless, over the years Japan has been contributing to international peace, security, and prosperity through other means, including development assistance, capacity building assistance, and disaster relief, in addition to peace-keeping and peace-building activities.

What Does “Proactive Contribution to Peace” Mean?

As a basic concept, the NSS calls for Japan's proactive contribution to peace based on international cooperation. I wrote a policy recommendation on proactive contribution to peace over a decade ago in March 2001 in a National Institute for Research Advancement (NIRA) Research Report entitled, “Japan's Proactive Peace and Security Strategies.” I translated the concept as “proactive peace and security strategies” rather than a “proactive contribution to peace.” In the report I argued that:

Looking toward the 21st century, we Japanese need to make efforts to establish our identities as “Japan living in the global village,” based on the recognition that the existence of Japan is inevitably linked with other parts of the world. Undeniably, Japan's traditional peace and security strategies after the end of World War II in which we declared “not to become an aggressor,” “not to possess nuclear weapons” and “not to export weapons” have contributed to world peace in no small measure. However, in the future, it is desirable to develop “proactive peace and security strategies,” where “Japan will proactively do something for world peace,” rather than reactive peace and security strategies.

Thus I placed “proactive contribution to peace” on the other end of the spectrum from the reactive and passive pacifism of postwar Japan. After World War II, as I noted above, Japan was cautious in playing a security role while it reconstructed and developed its war-ravaged economy. Japan wanted to remove its militarist image and wanted to portray itself as a peace-loving nation. In its public diplomacy, Japan avoided any image of militarism, even to the extent of not introducing traditional Kabuki and Noh plays in which samurai are portrayed. Also, Japan did not promote Japanese language education overseas—normally an important element of cultural diplomacy—until the 1970s because Japan’s prewar language education was strongly linked to military expansionism. Instead, Japan turned to the tea ceremony and flower arrangement to transmit a peaceful image of the country.

In the postwar period, it was sufficient for Japan to avoid talk of security issues to demonstrate its peaceful stance. And other countries did not expect Japan to play a significant role in defense and security, either. Today, however, in the face of the broadening, increasingly transnational nature of security issues, Japan can no longer ensure its own peace by doing nothing unless told. The international community, likewise, cannot afford to have the world’s third-largest economic power remain passive and reactive on security issues. We need to become more proactive in securing peace both at home and abroad. The basic principle of promoting peace has not changed, but we need to be more proactive.

In 2009 the Japan Forum on International Relations published a report entitled “Positive Pacifism and the Future of the Japan-US Alliance” which in its Japanese edition used the same phrase I had earlier proposed but used a different phrase—“positive pacifism”—for its English translation.

These were the ideas that eventually gave rise to the concept of a “proactive contribution to peace.”

Proactive Contributions Thus Far

Without using the label, though, Japan has already been proactive in its contributions to peace. One such example is the dispatch of Japanese SDF personnel and civilians on UN peacekeeping and peace-building missions. In recent years, Japanese nationals have participated in and even led UN missions in Cambodia, Timor-Leste, Bosnia-Herzegovina, and elsewhere and have also served as the UN High Commissioner for Refugees.

The unanswered questions about Japan’s participation in UN PKO missions still remain, however. When I was in South Sudan in July 2013, Hilde Johnson, the

UN Special Representative of the Secretary General, complained to me that the SDF cannot be deployed to dangerous zones, while Koreans are dispatched to unstable areas such as Jonglei. She hastily added, however, that she appreciates the high discipline of the Japanese contingent. This question is currently being debated by the Advisory Council on the Collective Right to Self-Defense, and a decision should subsequently be made by the government.

The second example of Japan's proactive contributions to peace is the efforts made to mainstream and seek the implementation of the notion of human security. Since the speech by Prime Minister Keizo Obuchi in December 1998 announcing assistance for people hit by the Asian monetary crisis, Japan has promoted the broadly interpreted notion of human security embracing both freedom from fear (in such manifestations as conflict, terrorism, landmines, small arms, and human trafficking) and freedom from want (including currency crises, natural disasters, environmental degradation, infectious diseases, and poverty).

Some UN member states interpret the notion narrowly, focusing on the freedom from fear, while others view the concept as more broadly encompassing freedom from want. There are some who oppose the notion altogether, moreover, worried that "human security" might be used as a pretext to interfere in the domestic affairs of other countries with coercive measures. Concern has particularly been voiced over the notion of "responsibility to protect" which allows intervention with force in the event of massive genocide or other extreme cases.

Japan has led the discussions on human security, seeking a convergence of the various interpretations and eradication of concerns. Japan has tried to mainstream it by having a paragraph on human security inserted in the 2005 Outcome Document—the first mention in an official General Assembly document—and subsequently through the adoption of a common understanding of human security in UN Resolution 66/290. The resolution interpreted human security as embracing the right of people to live in freedom and dignity, free from want—that is, poverty and despair—and freedom from fear.

Japan has also advanced human security through official development assistance (ODA) to fragile states. This is corroborated in the August 2003 revision of the ODA Charter, which states that development should be approached from "the perspective of human security," toward which end the protection and empowerment of individuals are important. Then in February 2005, Japan's Medium-Term Policy on Official Development Assistance identified human security as a pillar of the nation's ODA policy. This underscores the need for a human-centered approach and empowerment of local people—a thrust that has been embraced by the Japan International Cooperation Agency.

The United Nations Trust Fund for Human Security (UNTFHS) is the main avenue through which Japan has promoted the concept of human security. The Japanese government has continued contributing to the fund, donating a total sum of ¥42.8 billion (\$390 million), as of October 2013.

While initially the sole donor, Japan has persuaded other UN member states supporting the concept to contribute to the fund. In response, Slovenia has contributed \$47,000 and Thailand \$60,000 since 2007, and in 2010 Greece gave \$150,000 and Mexico \$5,000. As of October 2013, the UNTFHS has funded 210 projects in 85 countries.

Although the UNTFHS was initially regarded as just another aspect of Japanese ODA, the Advisory Board on Human Security revised its guidelines in January 2005 to mainstream projects that include a wider range of interconnected regions and areas and in which multiple international organizations and NGOs participate with the intention of integrating humanitarian and development assistance by strengthening people's capacity and seamlessly implementing assistance in the transitional period between conflict and peace.

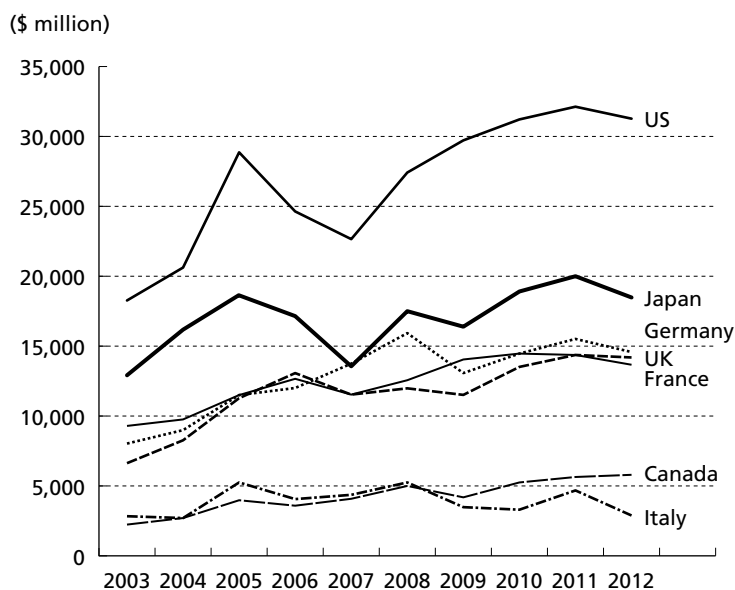
The *Rapid Assessment of the United Nations Trust Fund for Human Security*, published by Universalis in May 2013, reports that the human security approach at the project level has filled unaddressed areas; empowered stakeholders; is a valuable tool in promoting the three pillars of the United Nations—development, human rights, and peace and security—and overall has had a beneficial impact.

The third example of Japan's proactive contributions, related to the second, as the *Chart* shows, is its ODA disbursements. While assistance was initially offered to other countries in Asia, it is now provided worldwide, including Africa, contributing to the stability of the region. Japan not only assists conflict-ridden countries but also their neighbors, which could be affected by an influx of refugees or terrorists from failed states. Security and development are closely inter-related. When security is unstable and conflicts recur, the fruits of development could be wiped out. When a region remains undeveloped after conflict, local residents will not be at peace and may be unable to build a resilient society. Despite criticisms of the securitization of development, there is a nexus between security and development.

The NSS specifically mentions that "Japan has garnered high recognition by the international community, by its proactive contribution to global development in the world through utilizing ODA. Addressing development issues contributes to the enhancement of the global security environment and it is necessary for Japan to strengthen its efforts as a part of 'Proactive Contribution to Peace' based on the principle of international cooperation."

Chart

ODA Disbursement by Major Donors



Source: OECD/DAC and Japan's Ministry of Foreign Affairs.

The fourth example is that the Japanese Ministry of Defense since 2011 has been providing capacity building assistance to other Asian countries in nontraditional security areas, including training for humanitarian assistance/disaster relief; non-combatant evacuation operations; training of coast guards for piracy control; training in peacekeeping operations focusing on infrastructure; and defense medicine. Such training and assistance would allow countries to utilize their own resources in dealing with crisis situations and can also deepen cooperation between Japan and the recipient countries, contributing to regional stability. Japan is also collaborating with Australia and others in capacity building assistance.

Japan has thus already been making proactive contributions to peace, and it intends to do more in the years to come. Japan has not suddenly shifted from a reactive to a proactive approach with the Dec. 17, 2013, announcement of the NSS. The strategy also emphasizes contributions through international cooperation, as security challenges are becoming more transnational. It calls for collaboration with other countries in the region and in the international community in domains ranging from cyberspace and terrorism to maritime security.

Japan's Role in Promoting Peace & Stability

Japan's "proactive contribution to peace based on international cooperation" is therefore not a mere political label or a cover for militarization. The NSS will enable Japan to be more strategic in implementing its contributions. The revised National Defense Program Guidelines, announced on the same day, reflects this thrust.

The NSS notes that Japanese security strategy is to be based on both defense and diplomacy and that Japan needs a whole-government approach under the leadership of the newly created National Security Council (NSC). Given the diversification of security threats today, Japan must develop additional strategies and concrete plans to clearly map out what it intends to do regarding issues such as cyber attacks, maritime security, poverty, pandemics and health, and natural disasters. In facing these security threats, one has to take both hard and soft security approaches in a comprehensive manner in order to build a resilient society.

Combined with the upcoming revision of the ODA Charter and changes in the interpretation of Japan's right of collective self-defense and collective security, Japan has a chance to truly become a proactive contributor to peace based on international cooperation. The real questions are what Japan actually implements and how other countries respond through closer collaboration for peace, stability, and resilience.

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August 20, 2014

Ukraine: How Far Can It Go?

Paul J. Saunders

Perhaps the biggest question surrounding the ongoing crisis in Ukraine is how far it might go. Will Russia provide more assistance to rebels in eastern Ukraine or even intervene directly in the fighting there? Will the United States and other governments apply additional economic sanctions on Russia and apply further pressure on others to punish or isolate Moscow? And will the Kremlin respond outside Ukraine, through economic, political or other steps to retaliate? While a negotiated de-escalation is still possible, the likely answers to these questions are becoming increasingly disturbing.

No Incentives for a Settlement

The fundamental problem in the Ukraine dispute is the lack of incentives to de-escalate—on any side. This is most obvious with respect to Ukraine’s pro-Russian separatists, who are under heavy pressure on the battlefield and have been losing ground in recent weeks. After a brief post-election cease-fire during which he offered a settlement on terms the militants would have had great difficulty accepting, President Petro Poroshenko has renounced negotiations with the militants.

This essentially forces them to choose between death or injury in combat while hoping for additional Russian help, on one hand, and death or imprisonment by Ukrainian authorities combined with very difficult lives for their surviving families and supporters, on the other. The Russian government’s conduct so far provides some grounds for hope that more help will be forthcoming. So long as this is the case, the rebels are likely to keep fighting.

The Ukrainian government likewise has every incentive to continue its current offensive. Most importantly, Ukraine’s troops have been successful so far in taking back significant territory from the rebel forces and look close to their immediate

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Pro-Russian protesters in Lenin Square, Donetsk, March 8, 2014.

goal of cutting off the narrowing corridor between rebel groups in Donetsk and Lugansk. At the same time, despite mounting civilian casualties—recently estimated at about 800 killed and over 2,100 wounded since April by the United Nations—Washington and Brussels have tacitly encouraged Kiev’s offensive and have slowly but steadily hardened their positions toward Moscow, particularly since the downing of Malaysian Airlines flight MH-17.

On top of this, US and European officials have warned strongly against any further Russian involvement in eastern Ukraine. For example, America’s Ambassador to the United Nations, Samantha Power, recently declared that sending Russian forces into eastern Ukraine would be “completely unacceptable” and that it would be “viewed as an invasion of Ukraine” even if the Kremlin said that its mission was humanitarian assistance. [<http://www.bbc.com/news/world-europe-28715467>] Statements like this allow Ukrainian officials to be confident that they will have Western assistance (though probably not Western troops, at least initially) in resisting any possible direct military action by Russia. This encourages Ukraine to do whatever it takes to crush the rebels.

The problem for Kiev is that Russia has every incentive to escalate too. Politically, President Vladimir Putin has invested too much of his personal reputation in supporting the separatists—abandoning them could be costly and potentially destabilizing. As a result, Putin cannot allow Ukraine to defeat the rebels. The more likely this looks, the more Putin will have to consider either sharply increasing his support for them or, alternatively, intervening in Ukraine.

US and European leaders hope that their threatened “sectoral sanctions” against Russia’s financial, energy, technology and other segments of the Russian economy will deter Kremlin escalation, but their policy so far may actually have the opposite result, for two reasons. First, President Barack Obama and European leaders have said specifically and repeatedly that they will not fight a war with Russia over Ukraine. This removes the strongest possible deterrent—the danger that Russia could face war with much stronger opponents.

Second, many in Russia’s foreign policy elite think that if Russia abandons the separatists, Washington and Brussels will not simply accept this outcome and re-

turn to the pre-crisis status quo. On the contrary, they think that any Russian concessions would produce greater Western demands—perhaps for Crimea’s return, for example—with no real hope to escape economic sanctions. So from Moscow, the cost of escalation is low and the benefit of de-escalation is low.

American and European officials appear to see a Ukrainian victory on the battlefield as the most attractive outcome, since it would remove political pressure in the United States and some parts of the European Union for deeper involvement while avoiding politically unattractive negotiations with Moscow and the separatists. Negotiations would inherently require concessions to succeed, of course, and no Western politician wants to support “rewarding Russian aggression,” a likely criticism of any viable settlement.

This is why Washington, Brussels and European capitals will likely continue backing Kiev’s attempt at a total military victory—including stronger and stronger threats to discourage any additional Russian support for the separatists. If Russia provides further help to the rebels, Western governments may in turn impose wider economic sanctions. (And Russia will probably respond with its own stiffer sanctions—its recent agricultural import ban was a clear warning, and Prime Minister Dmitry Medvedev has now suggested that Moscow could block Western airlines from overflying its territory [<http://www.nbcnews.com/storyline/ukraine-plane-crash/mh17-sanctions-retaliation-russia-may-force-airlines-reroute-n173111>].)

The dynamics currently driving the Ukraine crisis are increasingly troubling because none of the parties appears genuinely interested in a diplomatic solution. Absent that, the conflict could become far more dangerous than it already is.

Paths to Wider Conflict

Imagine the following series of events. Fearing a separatist defeat, Moscow encourages large numbers of Russian volunteers (including possibly entire Russian army units who have removed their uniforms) to cross the border with sophisticated weapons, such as mobile surface-to-surface missiles to attack Ukrainian airbases supporting airstrikes on rebel positions. With this help, the rebels stop Ukrainian advances and recapture some key towns. Western governments publicly describe this as a Russian invasion of Ukraine, impose severe economic sanctions, and start to provide arms to Ukraine. The United States sends unarmed drones into Ukraine to help Kiev locate and target the missile launchers and to provide other intelligence. Separatists shoot down a drone and supply video to Russia’s state television channels, further inflaming the Russian public.

In response, Russia cuts off not only Western commercial flights but also NATO

air access to Afghanistan through its airspace, and security forces detain a handful of Western journalists in Moscow on accusations of espionage or of disseminating anti-Russian propaganda. Having already lost access to Western capital markets and investment, the Kremlin nationalizes businesses fully or partially owned by foreign companies based in countries imposing sanctions on Russia and expels their senior Western executives.

Russian commandos posing as separatists infiltrate central or western Ukraine with man-portable surface-to-air missiles and destroy a NATO cargo plane delivering weapons, killing the American crew, intending to deliver a signal to Washington to stay out. Russia disavows responsibility for the incident, but its officials argue that arms shipments are a legitimate military target and criticize US interference in Ukraine. The American media brand Putin as a “murderer,” and the US Congress passes a resolution declaring the incident an act of war.

Is this particular series of events a likely one? Probably not. Nevertheless, it illustrates starkly where confrontation over Ukraine could lead. Even if neither the United States nor Russia wants or expects a direct military conflict, predictable decisions that leaders in both countries may have to face could gradually but relentlessly produce that result. Top officials on all sides should consider their assumptions and their options extremely carefully. The crisis in Ukraine could get much worse.

August 26, 2014

Abenomics 2014

Expanded Content, More Uncertainty

Katsuyuki Yakushiji

The revised New Growth Strategy released in June has brought the “third arrow” of Abenomics into sharper focus, revealing an ambitious program for sustained economic growth. But the structural reforms proposed this time around face serious opposition from industry lobbies and vested interests. Katsuyuki Yakushiji sums up the plan and discusses the challenges—internal and external—the prime minister must overcome to achieve his economic goals.

* * *

In June 2014 Prime Minister Shinzo Abe released two new documents fleshing out his administration’s policies for fiscal reform and economic revitalization: “Basic Policies for Economic and Fiscal Management and Reform 2014” and the revised “New Economic Growth Strategy.” In general, the market gave the plans a thumbs up for clarity and specificity, at least compared with last year’s Growth Strategy. Yet their content has received surprisingly little attention in the media.

One major reason is the preponderance of policies oriented to long-term growth, as opposed to fast results. This is a good sign. It means that Abe’s economic program is done proving itself through flashy pump-priming measures and can devote its attention to low-key policies that emphasize patience and persistence. But the latest structural changes he has proposed are likely to prove much harder to accomplish, owing both to their longer timeframe and to powerful opposition from vested interests.

The Critical Third Arrow

Basic Policies for Economic and Fiscal Management and Reform is compiled an-

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nually by the Council on Economy and Fiscal Policy—chaired by the prime minister—and approved by cabinet resolution. It was first drawn up in 2001 under Prime Minister Jun'ichiro Koizumi as a way of strengthening the prime minister's control over the budget process through general guidelines for allocations in the fiscal year to come.



The New Economic Growth Strategy is the current administration's plan to bring about sustained private-sector investment and growth via a wide range of structural policies, including deregulation, labor reforms, and measures to prop up local economies. It is the third, and arguably the most important, "arrow" in the three-pronged economic program known as Abenomics.

The first two arrows, "aggressive monetary policy" (quantitative easing) and "flexible fiscal policy" (targeted stimulus), have largely hit their mark, allowing Abe to trumpet his cabinet's economic achievements since it came to power near the end of 2012. At the June 24 press conference announcing the two new policy documents, the prime minister touted the successes of Abenomics, citing a 2% increase in wages among large corporations (according to a survey by the Japanese Trade Union Confederation), along with survey results indicating upward wage movement among 60% of the smaller companies polled.

But the short-term efficacy of this monetary and fiscal expansion, while welcome, is not sufficient to put the economy on a long-term growth trajectory, and Abe is well aware that the real challenge lies ahead. "We cannot yet say that the winds of economic recovery have reached every corner of Japan," he acknowledged. The new policies approved by the Diet are designed to support the "virtuous circle" that the first two arrows set in motion and ensure that people in every community in every part of the country will feel the tangible benefits of the recovery. "This," he declared, "is the essential mission of Abenomics. Everything hangs on the New Growth Strategy."

Ambitious Structural Reforms

The 2014 Basic Policies and New Growth Strategy reinforce and complement one

another to the extent that they are virtually inseparable. Their collective content can be summed up as follows.

The key economic challenges facing Japan today, we are informed, are (1) countering the negative economic impact of the consumption tax hike that went into effect in April; (2) achieving economic growth fueled by private-sector demand; (3) reforming institutions and systems to lay the foundations for sustainable long-term growth and vitality (including steps to stem population decline); and (4) achieving fiscal consolidation without sacrificing economic vitality.

With the exception of the first, none of these items is new. They are all issues that previous administrations have attempted to tackle, but with little success thus far.

The specific policy measures the government proposes to meet these challenges are many and varied. To make Japan-based companies globally more competitive, it seeks to lower the effective corporate tax rate from around 35%—quite high by international standards—to less than 30% over a period of several years. To reduce energy costs, it plans to restart the nation's nuclear power reactors, all of which have been idle since September 2013. On the labor front, it pledges to boost the capacity of daycare and afterschool facilities to make it easier for women to enter the labor force and calls for immigration reform to bring more foreign workers into the country, albeit on a temporary basis. In the agriculture sector, it is calling for changes to the farm coop (JA) system, including measures to guarantee the independence of local coops, in hopes of breaking the powerful farm lobby's resistance to long-overdue agricultural reforms.

Defusing Two Time Bombs

At the same time, the ruling Liberal Democratic Party cannot afford to ignore its rural base, especially with local elections scheduled for the spring of 2015. Among the policies set forth this past June are measures designed to stem the ongoing migration of young people from the regions to Tokyo and support small and medium-sized businesses outside the capital region.

Another priority is defusing Japan's demographic time bomb. Japan has the oldest population and one of the lowest birthrates in the world. The population is shrinking and is projected to drop from slightly over 120 million today to 97 million in 2050 and 86 million in 2060, unless the fertility rate rises substantially. The Basic Policies calls for a wide array of reforms designed to keep the population at around 100 million for another 50 years.

Meanwhile, Japan must find a way to avert a fiscal crisis. The administration

has reiterated its international pledge to cut the primary deficit to half of the 2010 level by fiscal 2015 and to eliminate it by 2020. While the former target appears reachable, primary balance is still a distant dream. Long-term fiscal sustainability will clearly require major cuts in social security spending, which account for about one-third of the budget, through wholesale reform of the national pension and healthcare systems. Unfortunately, the administration has yet to offer any concrete plans for social security reform.

Looming Battles

For the most part, the ideas presented in the Basic Policies and New Growth Strategy are neither new nor particularly controversial from a policymaking standpoint. But many of them take on “bedrock regulations” and other sacred cows that powerful industrial lobbies have successfully defended for decades. If the administration follows through on them, it will be a groundbreaking accomplishment.

The main question is whether Abe can succeed where so many have failed. Before the government can implement corporate tax cuts, changes in labor and immigration laws, or farm reform, it must draft the pertinent bills and shepherd them through the Diet. At each step along the way, it will have to contend with fierce resistance from industry, interest groups, and their allies in the ruling party. Abe will have to stay in power for quite a long time if he wants to give such legislation a fighting chance.

Moreover, even if the bills become law, it will be years before the reforms can bring about the kind of restructuring needed for sustained economic growth. Of the process charts that the government has published to provide a time frame for the New Growth Strategy, most extend all the way to 2017. Achieving these ambitious reforms along with the fiscal retrenchment that must accompany them will require years of determined and skilled implementation by the government in power.

Setting Internal and External Priorities

In the meantime, developments in the Asia-Pacific and around the world could deal further setbacks to the Japanese economy. One wild card is the outcome of negotiations for the Trans-Pacific Partnership. If the US-led talks break down or hit an impasse, the domestic economy will suffer. The conflicts that continue to break out around the Middle East are another cause for worry. With the nation’s nuclear power plants off line, Japan has become more dependent than ever on thermal

power generation and has been obliged to import fossil fuels at prices above the international average. If prices jump even higher as a result of political instability in the Middle East, the impact on the Japanese economy could be devastating.

Japan's frosty relations with China and South Korea provide further grounds for concern. The Japanese economy has grown increasingly dependent on trade and investment with its closest neighbors, but the chill in diplomatic relations is preventing Japan from taking this economic interaction to the next level. Although Abe has made overtures, these moves have yet to yield substantive results. If the status quo continues, this too will have an impact on the Japanese economy.

In short, to succeed in his bid to restore vitality and sustainability to the Japanese economy, Abe will have to juggle internal and external exigencies, skillfully steering Japan's foreign policy even as he pushes ahead with ambitious domestic reforms. And he has only so much time in which to produce results.

While Abe has devoted much energy to the task of revising the cabinet's interpretation of the Constitution to open the door to Japan's participation in collective self-defense operations overseas, his attention, with autumn approaching, is likely to increasingly focus on the "third arrow" of Abenomics and the urgent diplomatic issues on which its success—and Japan's future—hinges.

August 6, 2014

Rethinking Personal Tax Exemptions to Mobilize Women's Power

Shigeki Morinobu

Replacing the spousal exemption for personal income tax can correct systemic biases with regard to family work patterns and encourage women's fuller participation in the labor force, thus unleashing the power of "womenomics," argues Senior Fellow Shigeki Morinobu. The article below is Chapter 4 of the Tokyo Foundation policy proposal on "Expanding the Tax Base for a Sustainable Social Security System," issued in Japanese in May 2014. A summary of the proposal follows the article.

* * *

One of the key policy objectives articulated in the "Japan Is Back" economic revitalization strategy released by the administration of Prime Minister Shinzo Abe in June 2013 is to create the conditions for fuller participation by women in Japanese society. In this connection, the government promises to "explore tax and social security policy options with a neutral impact on people's choice of work patterns" as part of its commitment to "create an environment where men and women can strike a balance between work and child rearing."

The following is an examination of the impact of income tax policies on women's labor-force participation, with particular attention on the spousal exemption, and recommendations for reform.

Rationale for the Spousal Exemption

The current focus of debate over Japan's tax policy and women's labor force participation is the exemption for spouses. Given that the exemption costs the govern-

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ment some ¥600 billion in annual revenue through a narrowing of the tax base, it should be carefully scrutinized to determine if it has any meaning in today's tax system.

Ever since Carl Shoup supervised the reform of Japan's tax system in the late 1940s, the Japanese income tax has been built around individual-based taxation. At the same time, the system has incorporated various deductions and exemptions for householders in an effort to adjust the tax burden according to family circumstances. One of these tax breaks is the spousal exemption.

The spousal exemption deducts ¥380,000 from the taxable income of a married taxpayer (in practice, the husband) whose spouse earns no more than the stipulated maximum (¥1.03 million for wage earners), in effect providing preferential tax treatment for households with full-time homemakers. Originally established as a "dependency" deduction, this tax break was established as a discrete exemption in 1961 on the grounds that a spouse should not be treated as a dependent, since a husband and wife are both contributing to the sustainment of the household.

In December 1961, the government's Tax Commission offered two basic justifications for the exemption. First, it stressed the need to provide tax relief for men married to full-time homemakers on the grounds that the wife incurred additional costs, adversely affecting the husband's ability to pay. Second, it emphasized the value of the full-time homemaker's housekeeping and child-rearing duties and sought to recognize the "helpmate's contribution" to her husband's earning power.

More recently, supporters have put forth a third rationale, arguing that preferential treatment for full-time homemakers is one way to encourage couples to have more children at a time when Japan's birthrate has sunk to an unprecedented low.

Criticism of the Spousal Exemption

Opponents of the exemption have challenged the validity of these arguments as follows.

With regard to the first justification, some have criticized the assumption that marriage negatively affects a man's ability to pay taxes, calling it a holdover of the pre-1961 concept of the spouse as a dependent. Indeed, it has been argued that the domestic labor performed by the homemaker actually enhances the husband's ability to pay, since it generates "imputed income" that escapes taxation.¹

¹ See Yasuo Tanaka, "Shotoku kojo no konnichiteki igi—jinteki kojo no arikata o chushin to shite" (The Role of Income Tax Deductions Today—Focus on Personal Exemptions),

With regard to the second justification, while acknowledging the contribution of the full-time homemaker to the husband's earning power, critics contend that it is unfair for the tax system to give preferential treatment to full-time homemakers, since working wives often bear the burden of housework and childrearing as well. They also make the point that, if the domestic labor of the wife allows the husband to earn more, that means the "helpmate's contribution" is already being rewarded financially, and there is no need for preferential tax treatment.

As concerns the third justification, that the spousal exemption can help stem the decline in the fertility rate, opponents have countered the exemption favors full-time homemakers with or without children. It should also be noted that the experience of other industrial countries over the past few decades challenges the assumption that greater labor-force participation correlates with lower fertility; indeed, as we discuss below, the opposite appears to be the case.

In addition, arguments have been advanced from the perspective of equity. Under the current tax code, most wage earners are entitled to a ¥650,000 employment income deduction as well as the standard ¥380,000 basic exemption. This means that the spouse can earn up to ¥1.03 million tax free. Yet the husband can still claim the ¥380,000 spousal exemption, resulting in a double exemption for the couple. In Figure 1, the shaded area represents this double exemption.

The spousal exemption has also been criticized as a policy that benefits the wealthy disproportionately, since the percentage of households claiming the exemption is larger among higher-income households.

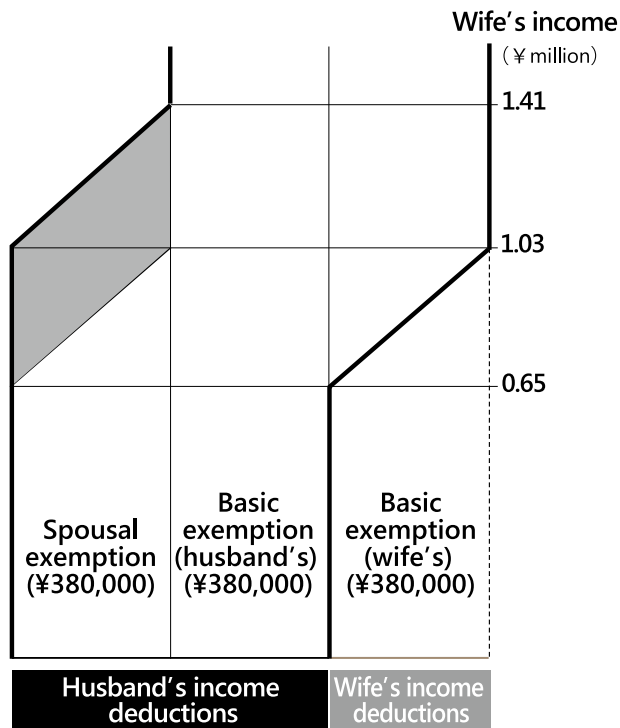
As women enter the labor force in increasing numbers, however, the main focus of debate has shifted from the husband's tax burden to the impact of a full-time homemaker's tax break on women's employment. Opponents of the break argue first of all that it fails the test of neutrality with regard to women's work patterns and earnings. Increasingly, moreover, critics are blaming the spousal exemption for maintaining a psychological ¥1.03 ceiling on women's income (in the minds of employers and employees alike), thus perpetuating employment inequities that have been long since legally abolished.

Women's Employment and the Fertility Rate

Defenders of the exemption have long focused on Japan's low birthrate and dwin-

Zeimu Daigaku Ronso (National Tax College Treatises) 48 (June 2005), National Tax College (National Tax Agency), <https://www.nta.go.jp/ntc/kenkyu/ronsou/48/tanaka/ronsou.pdf>.

Figure 1. Income Deductions under the Current Personal-Exemption System

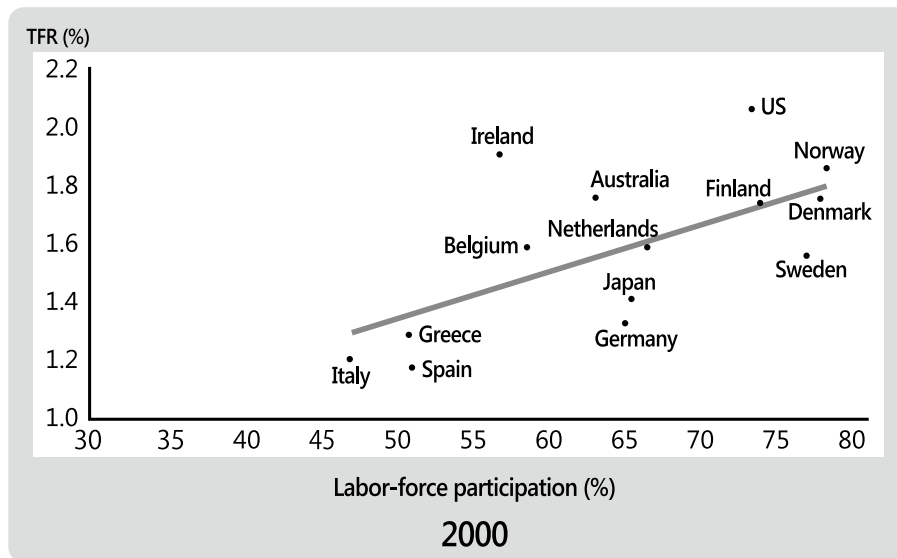
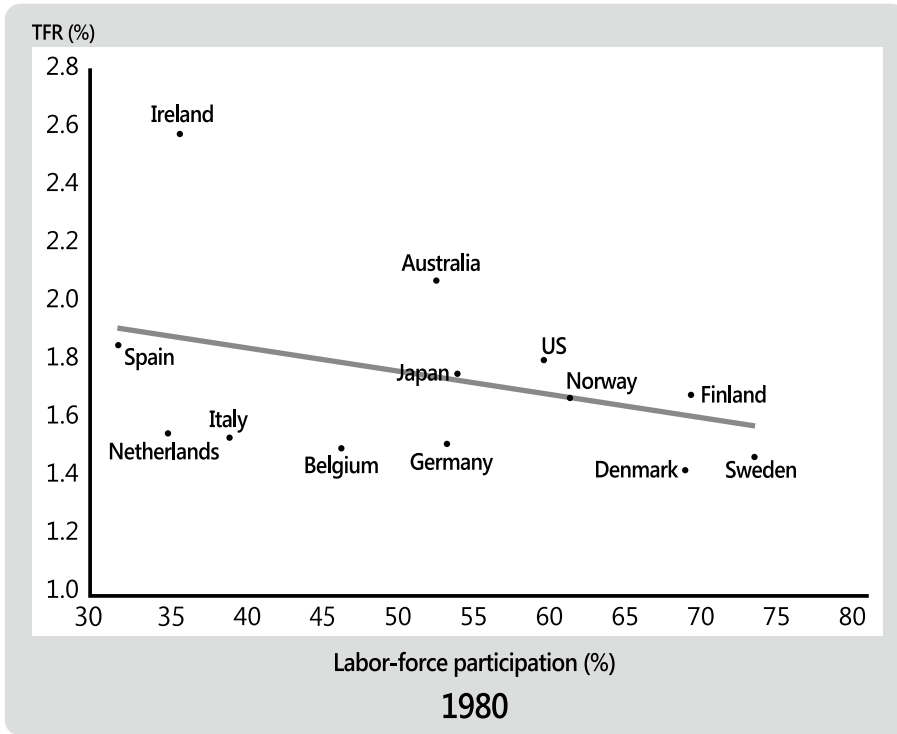


ding population as rationales for preserving the deduction. Their argument is that tax relief for households with full-time homemakers should have the effect of boosting the fertility rate. Interestingly, however, data from other industrialized countries point in the opposite direction.

Figure 2 shows the correlation between the total fertility rate (vertical axis) and women's labor-force participation (horizontal axis) among various member states of the Organization for Economic Cooperation and Development. The graph for 1980 does in fact show an overall negative correlation between TFR and labor-force participation; in other words, the larger the proportion of women participating in the labor force, the lower the fertility rate, generally speaking. However, the graph for 2000 exhibits the opposite trend—a positive correlation. After 1980 the overall situation among OECD countries clearly changed until, two decades later, higher rates of female labor-force participation were associated with higher TFR. The most likely explanation for this change is the adoption of public and corporate policies supporting women's employment, together with changes in the husband's role within the family.

Significantly, Japan stands apart from this trend. Here women's labor-force

Figure 2. Women's Labor-Force Participation and Total Fertility by OECD Country



Source: Compiled by the author from OECD and other data.

participation rate rose moderately between 1980 and 2000, while the fertility rate dropped. But the example of other industrialized countries should teach us that, given sound public policy, it is possible to boost the fertility rate while increasing women's labor-force participation.

Individual- or Family-Based Taxation?

An inquiry into Japan's spousal exemption raises the more general question of whether income taxes should be assessed on the basis of individual or household income. In truth, both systems have their pluses and minuses, and it is difficult to argue that either offers a decisive advantage over the other.

Given the economic interdependence of family members and their tendency to function together as a single consuming unit, it makes sense to look at family income as a whole when gauging ability to pay. The problem with family-based taxation is that it almost invariably incorporates a bias vis-à-vis taxpayers' marital status by taxing individuals at different levels depending on whether they are married or single. It can also raise serious fairness questions regarding the taxation of single-income versus dual-income couples.

Assuming a progressive (graduated) tax-rate schedule, an income tax based on household income (joint taxation) preserves an equal tax burden among families with the same income. However, it typically results in a "marriage penalty" in that two earners who marry and continue to work will end up paying more in taxes than they did when they were single because their aggregated income puts them in a higher tax bracket.

To avoid or mitigate the penalty, many family-based systems use "income splitting" to compute taxes. Under this method, the couple's incomes are combined and then divided in two, and the tax rate is applied on the basis of this average. This can lead to a "marriage bonus," particularly if one of the spouses earns considerably more than the other.

Since the tax benefits of income splitting increase as the gap between the two couple's incomes widens, though, this system can be criticized as favoring single-earner households. Family-based taxation can also drastically reduce a married woman's incentive to enter the labor market, since any additional income she earns will be taxed at a rate determined by the household's aggregate income.

If our goal is to improve the tax system's neutrality vis-à-vis family work patterns so as to encourage women's participation in the labor force, in keeping with the government's growth strategy, then shifting to a system of this sort would be counterproductive. It would also be highly problematic from the standpoint of

equity, since income splitting yields greater tax benefits for higher-income households, while those in the lower income brackets gain little or nothing.

Japan used family-based taxation prior to World War II, but after the war it adopted the recommendations of the Shoup mission and made the individual the basic tax unit. However, the individual-based system engenders problems as well, such as the practice of reallocating assets to other family members to avoid taxes on income from a family business, not to mention the questionable equity of requiring one-earner families to pay more in taxes than two-earner families with the same income.

From an international perspective, most major industrialized countries incorporate aspects of both individual- and family-based taxation. In the United States, married couples can file either jointly or separately, and exemptions for spouses are included under personal exemptions, which include standard deductions for the individual taxpayer, the spouse, and each dependent. Britain shifted from family- to individual-based taxation in 1990 and eliminated the spousal exemption in 2000. In Germany, married couples can choose either individual or joint taxation (income splitting method), and there is no exemption for spouses. France uses a “family quotient” income-splitting system to adjust the tax rate to the size of the family (combining all family income, dividing it by the number of family units, applying the appropriate tax rate, and then multiplying the result by the number of family units), with no special exemptions for spouses.

As the foregoing suggests, whether an individual-based or family-based system is more conducive to ensuring the equity of a progressive income tax is not an easy question to answer. However, among the world’s industrialized countries, the overall trend has been toward individual-based taxation, as exemplified by Britain’s 1990 reform. Today 25 of the OECD’s 29 member states use individual-based taxation in some form. I see no compelling reason for Japan to abandon its current system in favor of mandatory or elective joint taxation. Moreover, given the increasing diversity in individual and family lifestyles, individual-based taxation is probably the more rational choice.

From Spouse to Family Exemption

To return to Japan’s spousal exemption, then, any new policy the government adopts must do three things: preserve the basic principle of individual-based taxation, ensure neutrality with respect to family work patterns, and strive for maximum equity on a household basis.

Thus far, discussion has centered on two basic proposals: (1) eliminating the

spousal exemption and using the recovered revenue to create a comprehensive childcare support system (for example, tax credits for dependent children, a child allowance, and an expansion in the number of day-care centers); and (2) replacing the spousal exemption with a more generous basic exemption applicable to all taxpayers, thus eliminating the bias against working spouses.

The first proposal has its roots in the 2002 reform recommendations of the government's Tax Commission, which called for eliminating exemptions for spouses and dependents and instituting a tax credit for dependent children. The commission's reasoning was that, unlike an income deduction, "a tax credit can be applied equally, regardless of income level." As a drawback, however, the report notes that adopting such a measure would involve "combining income exemptions and tax credits, which would make the system more complicated." (In 2010, the Tokyo Foundation issued a set of specific recommendations centered on the adoption of a refundable child tax credit in place of current exemptions for spouses and dependents.)

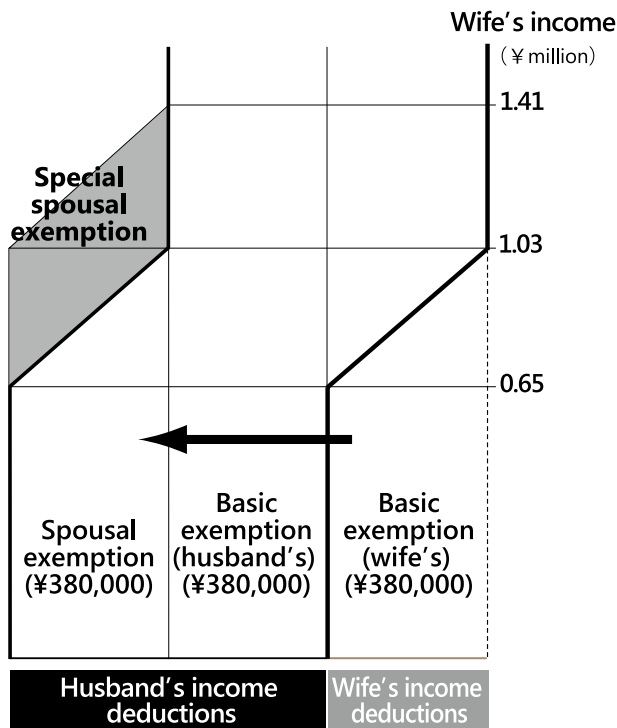
The second proposal, expanding the basic exemption to replace the spouse exemption, would have relatively little impact by itself, assuming that the exemption would apply to all taxpayers and that the change would be revenue neutral. In that case, the increase in the basic exemption would have to be exceedingly small, and the efficacy of the reform would be minimal.

A third alternative would be a "transferable basic exemption" to replace the current system of spousal and basic exemptions. This would do away with the double exemption mentioned previously, while at the same time eliminating the ¥1.03 million barrier that has discouraged fuller labor-force participation by women. Under this system, every individual would be entitled to deduct a standard amount from their income as a basic personal exemption. A married couple would thus be entitled to two exemptions, regardless of their employment status or income. In cases where the wife earned less than the basic exemption, the husband could deduct the unused portion of her exemption from his own income. This can be called the "family exemption."

Figure 3 compares the outcomes of this system of personal exemptions with the current system. In this chart, the shaded portion represents the deductions that would be eliminated under the proposal.

Note that this system falls short of achieving complete neutrality with regard to women's employment choices since it would yield no change in the tax-exempt amount for households with women earning less than ¥650,000 or more than ¥1.41 million. However, it would reduce the psychological impact of the ¥1.03 million threshold, mitigate the financial penalties experienced by Japanese couples

Figure 3. Income Deductions Under a Transferable Family Exemption System



when the wife enters the labor market, and eliminate the inequity of the double exemption.

Under this system, the tax burden would increase in households with women earning between ¥650,000 and ¥1.41 million, since the husband would be able to apply only the unused portion of the woman’s basic exemption rather than the larger spousal exemption and special spousal exemption (when the wife earns between ¥380,000 and ¥760,000). However, a simultaneous expansion of the government’s childcare support system (requiring an increase in spending) could serve to mitigate the impact, since many of the households affected would be families with children.

Deducting Childcare Expenses

The government’s new growth strategy pledges to “pursue policies to further improve the work-life balance and consider measures to alleviate the financial burden incurred by such services as babysitting and housekeeping.”

Because babysitters and housekeepers are unregulated in Japan and are under no obligation to register their businesses or report their activity, no system cur-

rently exists for integrating such services into government policy. However, beginning in fiscal 2015, babysitting will be classified as “visiting childcare services” (childcare provided in the home of the child) and will be eligible for support under the new child and childcare assistance program. In addition to such welfare benefits, the government should expand assistance and incentives for those employers that offer babysitting or housekeeping allowances to employees.

Providing tax deductions or tax credits to offset babysitting and housekeeping costs is doubtless desirable from the standpoint of alleviating such expenses for women working outside the home. But tax designers must be armed with strong economic data before establishing a permanent deduction dedicated specifically to that purpose. With this in mind, we recommend further studies to assess the effects of tax relief targeted to babysitting and housekeeping costs from the standpoint of neutrality.

In the meantime, since babysitting costs can take a variety of forms, the best option for tax relief is probably to include such expenditures under “deductions for specific expenses.”

Tax reforms carried out in 2011 expanded the use of the “specific expense” (itemized) deduction while establishing an upper income limit for the standard employment income deduction. Cognizant of growing diversity in labor and employment patterns, the Tax Commission moved to lower the floor for itemized deductions and expand the scope of qualifying expenses. As a consequence, the list of deductible expenses now includes the costs of acquiring the legal qualifications needed to practice such professions as law, public accounting, and tax accounting. The list also contains such “necessary job expenses” as purchases of publications, clothing, and entertainment expenses. Including babysitting and housekeeping costs under “necessary job expenses” would allow the government to provide tax relief for working wives without making any permanent structural changes to the tax system and would minimize complications from the standpoint of tax enforcement.

* * *

Summary of Policy Proposals

Expanding the Tax Base for a Sustainable Social Security System

1. The importance of reexamining the tax base

Among the world’s industrialized countries, Japan derives a relatively small portion

of its total tax revenue from personal income taxes. One reason is that Japan's tax code limits the income tax base by providing for various income deductions, including the standard "employment income deduction" and deductions for social insurance premiums. Moreover, because income from public pension plans is partially exempt from taxation, the tax base continues to shrink as society ages and the number of people receiving pension benefits soars. Expanding the tax base by identifying potential revenue sources that currently escape taxation can serve to boost tax revenues while at the same time enhancing the redistributive function of the tax system, thus helping to address growing economic disparities. In this way it can contribute to the development of a fair and effective tax system.



partially exempt from taxation, the tax base continues to shrink as society ages and the number of people receiving pension benefits soars. Expanding the tax base by identifying potential revenue sources that currently escape taxation can serve to boost tax revenues while at the same time enhancing the redistributive function of the tax system, thus helping to address growing economic disparities. In this way it can contribute to the development of a fair and effective tax system.

2. Instituting a social solidarity tax

Japan's social insurance system has a double function—to provide insurance coverage and to redistribute economic resources. Inasmuch as it is, in effect, a tax on wages, the redistributive component of social insurance (to finance healthcare for the elderly and to make up for the lack of pension contributions from dependent spouses and the unenrolled) should be financed with a new "social solidarity tax" levied on individual income. This would eliminate employer contributions to social insurance programs, preventing a rise in labor costs and dampening the incentive to replace regular employees with contract, part-time, and other nonregular workers.

3. Rethinking taxes on public pensions

The public pension scheme currently allows for multiple tax breaks. Contributions are tax deductible, the interest accruing on contributions is tax exempt, and pension income is partially exempt as well. For many receiving pension benefits, the net effect of the applicable deductions and exemptions is zero tax liability. Without any substantive change in the pension and tax systems, current and future workers will be obliged to pay for some ¥500 trillion in unfunded liabilities stemming from past commitments. Paying their share of taxes on pension income is one way current beneficiaries can ease the burden of future generations and contribute to the vitality of the Japanese economy.

4. Replacing the spousal exemption with a family exemption

The government is currently deliberating tax and social security reforms that would correct systemic biases with regard to family work patterns as part of its commitment to encourage women's active participation in the labor force. The current spousal exemption—a tax break for households with full-time homemakers that results in about ¥600 billion a year in lost tax revenues—has come under scrutiny. To restore the tax system's neutrality with regard to family work patterns, Japan should replace the current spousal exemption with a transferable basic exemption (or “family exemption”) designed to maximize fairness with regard to each household's ability to pay.

5. Correcting the inequity of tax-free pension benefits

Survivors benefits paid to the immediate family of deceased pension enrollees are currently exempt from taxation. While there is an obvious need to address the needs of young survivors, exempting elderly beneficiaries while at the same time requiring them to pay taxes on old-age pensions is difficult to justify from the standpoint of fairness. Benefits received by elderly survivors should therefore be taxed at the same rate as other pension benefits.

6. Broadening the tax base can mitigate economic inequality

Broadening the tax base means reducing and eliminating deductions and loopholes so as to collect taxes from those who have thus far avoided paying them. Based on the experience of other countries, we believe that the reduction of loopholes and exemptions to broaden the tax base, if carried out in combination with redistributive policies, can help to mitigate the economic inequality that has emerged as a growing concern in recent years.

May 27, 2014

Moving the ROE “Mountain”

A Framework for Capital Market Reform

Keiichiro Kobayashi

Despite a slew of corporate governance reforms undertaken over the past two decades, Japanese companies remain extraordinarily immune to shareholder pressure. Keiichiro Kobayashi argues that reforms must begin targeting the investors in order to transform and revitalize Japan’s business culture.

* * *

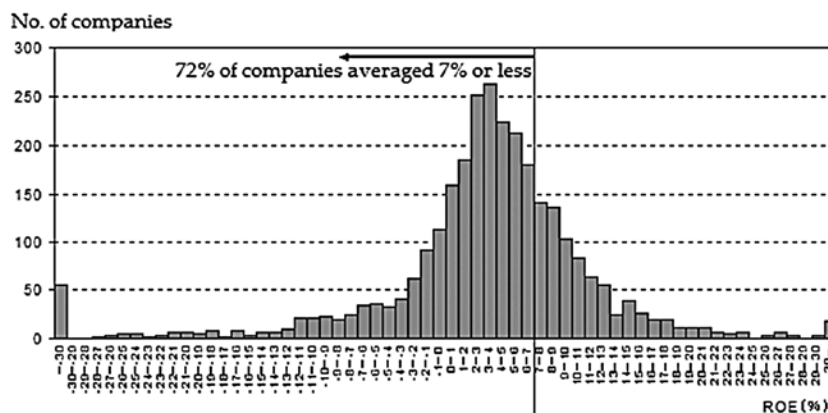
About two years ago, I assembled a group of financial experts to identify the problems in Japan’s equity market and propose directions for reform. We named our group the Yama o Ugokasu Kenkyukai (Yamaken) or “Moving the Mountain” Study Group. The name, explained in greater detail below, reflects our perception of the task facing policymakers if they wish to revitalize the Japanese economy through meaningful capital market reforms.

The need for reform is clear. Despite recent improvements, Japanese companies in the Topix index averaged a return on equity (ROE) of only 6% during the 10 years from 2004 through 2013, as compared with 12.6% for the companies in the MSCI World Index. If we focus not on the mean value but on the mode—that is, the ROE levels occurring with the highest frequency—the difference is even more striking. Figure 1 illustrates the frequency distribution of ROE values among listed Japanese firms.

The peak in this histogram represents the ROE range most frequently seen among Japanese companies: roughly 3%, as compared with a global figure of 13%. In other words, to place Japan’s equity market on an equal footing with that of other countries, we need to move this “mountain” a full 10 points to the right—

Keiichiro Kobayashi Senior Fellow, Tokyo Foundation; Professor, Faculty of Economics, Keio University; Faculty Fellow, Research Institute of Economy, Trade, and Industry; Research Director, Canon Institute for Global Studies.

Frequency Distribution of ROE in Japan (10-year average)



Source: Yasunori Nakagami, *Bloomberg*.

hence the name of our study group. Convinced that moving this mountain would require a wholesale restructuring of corporate governance through multi-level reforms, the group spent two years deliberating the kinds of policies that could help bring about such a transformation.

Toward a Shareholder-Centered Model

In the 1970s, corporate financing in Japan was basically controlled by a handful of large banks that maintained close, long-term relationships with their corporate clients. In their dual role as shareholders and creditors, these “main banks,” as they are known, imposed a considerable measure of long-term discipline on corporate governance.

In fact, the average ROE of Japanese corporations during this period was roughly comparable to that of US companies. In the booming 1980s, however, Japanese corporations were able to raise cash by tapping into inflated asset prices, and the banks ceased to perform their traditional role. The ROE of Japanese companies began to plunge around this time, and even today—20 years after the collapse of the asset bubble—it remains far below the global average.

This suggests that a major factor behind the low ROE of Japanese corporations is the loss of discipline formerly imposed by the main bank system. To restore discipline and boost ROE, Japan needs to complete the transition from a bank-centered model of corporate governance—embodied in the now-dysfunctional main bank system—to a shareholder-centered model.

To achieve this, it is not sufficient to focus reform efforts on the corporations alone. What we need are consistent, integrated reforms along the entire investment chain, injecting greater vitality at three stages: (1) the institutional investors, such as pension funds and life insurance companies, that hold assets to be invested; (2) the asset management companies that invest funds on their behalf; and (3) the private companies in whose stock a portion of those funds are invested.

At stage 3, the key goal is to encourage a greater awareness of the cost of capital in corporate management. This is also the goal of the corporate governance reforms Japan has implemented over the past two decades with a view to boosting the vitality and competitiveness of Japanese business. To achieve this, reforms are needed for stage 2—the asset management companies (AMCs) that invest in these corporations on behalf of institutional investors.

The goal here is to get professional investors more actively engaged in the management of investee companies so as to contribute to their long-term growth. As things stand now, Japanese AMCs exert almost no influence over corporate management. Asset managers in Japan focus their efforts either on passive index-based investing, in which case they have no shareholder role in individual businesses, or on quick profits from short-term trading, meaning they have almost no interest in businesses' long-term growth.

There is a need to change this culture and to encourage the kind of investor engagement that can impose discipline on corporate management, much the way banks did during the heyday of the main bank system. This requires leveraging their position as shareholders and providing management with timely and constructive ideas for reform—ideas that management would welcome and value.

Institutional investors (stage 1) have a key role to play as well. In addition to seeking maximum long-term performance from their investments, they have a social responsibility to help inject vitality into the asset management industry through the kinds of long-term investor agreements that encourage engagement-oriented investment.

Japan's Aberrant Asset Managers

Japanese economists and policymakers have been talking about corporate governance reform for decades now. The problem is that hardly anyone has bothered to address the other half of the equation, namely, institutional investors and the asset managers that invest on their behalf—or, if the issue has been raised, no one has paid much attention. It seems to me that the reason the corporate governance reforms of the past 20 years have yielded so few tangible results is that efforts have

not extended to institutional investors and AMCs. If we want to see real progress in Japanese corporate governance, we need to take a comprehensive, integrated approach that deals simultaneously with the corporations, the institutional investors, and the AMCs together as closely interacting players in the investment chain.

It is no secret that Japan's asset management business has serious and deep-rooted problems. Surely one reason returns on Japanese equities have stagnated at half the global average is the passive behavior of Japan's asset managers, who do little more than pour their clients' assets into the most popular index-linked funds, knowing that their clients will be satisfied as long as their returns keep pace with the domestic market overall. This situation minimizes incentives to boost corporate ROE.

Of course, each company's ROE is basically a function of its productivity, but pressure from the asset management industry can have a major impact on companies' productivity. Japan's lagging ROE is a testimony to the relatively backward practices of our asset management industry. The relationship between Japanese investors and investees has settled into an insular form of stagnation that may be regarded as a manifestation of Japan's "Galapagos syndrome."

Our group believes that the only way to alter the hidebound behavior of institutional investors and AMCs in Japan is to modify the market environment and governance structures that encourage it. Since it is beyond the purview of this article to cover all the policy ideas discussed within our study group, I will limit myself to offering three examples of the kinds of proposals that could play a pivotal role in the reform of Japan's capital markets.

Proposal 1: Supporting Emerging Managers

One way to help Japanese AMCs' break free of their herd mentality and passive approach to investing is to encourage market entry by newcomers. Although Japan's asset management industry has relatively few institutional barriers to entry, even the most able newcomers face daunting obstacles owing to the reluctance of institutional investors to entrust their funds to a company with no previous record of performance.

This problem could be addressed by a kind of "affirmative action" system under which institutional investors would be required to allocate a certain portion of their assets (for example, 1%) to up-and-coming AMCs, or "emerging managers." Many US states have adopted such quotas for their public pension funds via so-called emerging manager programs. A well-known example is CalPERS, the California State Employees' Retirement System. CalPERS pioneered the emerging manager concept in 1999 with the launch of a \$3 billion Global Equity Manager

Development Program, and it has been increasing the quota ever since. Similarly, the State Employees' Retirement System of Illinois is required by law to utilize emerging managers for approximately 10% of its equity portfolio. In 2012, this amounted to about \$720 million.

In the United States, emerging manager programs of this sort were originally adopted with the political aim of supporting minority-owned investment firms, but they are now regarded as a tool for boosting overall performance by augmenting the contribution of small, up-and-coming management companies that can respond flexibly to changing market conditions. In Japan, this kind of affirmative action could perform an important public policy function. By mandating the utilization of AMC's that would otherwise find it virtually impossible to attract institutional investors, such a program would serve the laudable purpose of injecting vitality into Japan's hidebound and stagnating asset management industry.

Proposal 2: Promoting Engaged Investment

To encourage these emerging managers to adopt an engagement-oriented approach, we also need to ensure that they have assets allocated for long-term investment.

Start-ups in this industry face especially steep hurdles when it comes to long-term investing, as Japanese institutional investors are extremely reluctant—more so than their Western counterparts—to entrust their assets to untested AMC's over longer investment horizons. This places stiff constraints on the investment strategies of emerging asset managers. If entrusted with funds under a three-year agreement, an AMC can develop its own strategies for long-term asset building. As a long-term corporate shareholder, it can engage with management to encourage positive changes that increase the value of its shares. When limited to short-term investment, however, they fall into the habit of short-term trading and never develop the capacity to for anything beyond a passive, short-term investor relationship. This vicious circle needs to be broken.

We believe that nurturing AMC's oriented to long-term investment is an important key to reform of the Japanese economic system. Assuming that this is a worthwhile public endeavor, it makes sense, as a matter of public policy, to make long-term funds available to fledgling AMC's. One way to do this would be to institute a requirement that public institutional investors (the Government Pension Investment Fund, Japan Post Bank, etc.) entrust a certain minimum share of their investment assets to emerging managers under long-term asset-management agreements (three years or more). Another possibility would be for public institutional investors (such as the Innovation Network Corporation) to invest directly in these fledg-

ling AMCs, thereby providing them with sufficient capitalization to embark on long-term investing.

Proposal 3: Creating an Investors' Lobby

Finally, we believe it is essential for the investment industry to come together to formulate its own long-term vision and become actively involved in the rule-making process (including statutory regulation and the establishment of a framework for dialogue with investee corporations) if it is to make the transition to engaged, long-term investing.

Japan does have the Investment Trusts Association, but this is a passive entity devoted to industry self-regulation under existing Japanese law. To my knowledge, this country has no active, independent trade group that can advocate for the industry on laws and statutory regulations and lead the way on reform of business practices. To fill this gap, we recommend establishing a loose trade association built around a nonprofit organization and open to professional investors across the business spectrum. The functions of such a group—which we shall tentatively name the Investors' Forum—might be as follows.

1. Ascertaining the views of the professional investment community on laws and regulations governing its activities and lobbying the government on its behalf through proposals, opinion papers, etc.
2. Developing standards for engagement with investees and representing the professional investment community in wide-ranging dialogue with business.
3. Acting as a counterpart to professional investor associations overseas; cultivating contacts and exchange with overseas associations to learn about best practices of overseas investment professionals and promote their adoption in Japan.

Conclusion

The goal should be to create a market environment conducive to long-term improvement in corporate productivity. To change the market environment, it is necessary to change the behavior of the institutional investors and asset management firms that account for the lion's share of equity investment. The Japanese economic system must be reformed as a whole to promote the shift to a shareholder-centered model, in which investors assume the role formerly played by the main banks and become actively engaged in the business policies of investee firms to promote their long-term growth and development.

ECONOMY & TRADE

The proposals outlined here are but a sampling of the kinds of concrete policies needed to effect this shift. Further study is needed to develop a comprehensive, consistent policy package aimed at each stage in the investment chain: institutional investors, asset managers, and corporations. The future of the Japanese economy depends on it.

September 8, 2014

Overview of CSR in Japan

Ideals, Intentions and Realities at Advanced Companies

Tokyo Foundation

Addressing Social Issues That Government Alone Cannot Resolve

Up to now people in Japan have tended to think of it mainly as the government's job to deal with matters like the environment, human rights, women's advancement, and poverty. But now the situation has become more complex. For example, when we consider the factors seen as contributing to poverty, including unemployment, dysfunctional families, and lack of education, it is apparent that the Ministry of Health, Labor, and Welfare, which is responsible for government policy in this field, cannot resolve the issues on its own; it is also essential to have cooperation from businesses and communities in order to create jobs. And in the case of large-scale disasters like the Great East Japan Earthquake of March 2011, the impact affects every aspect of people's lives and cannot be addressed solely within the framework of public administration.

There are limits on the capability of government organs to deal with the public issues that we face. In order to cope with these issues, which are diversifying and developing a complex web of interconnections, we must call on the resources of society as a whole in support of the public realm.

Every social problem is in fact an amalgam of diverse individual woes, and its solution must involve all-out efforts not just by the government but by all sectors and strata of society, including businesses and citizens, based on a sense of their respective responsibilities. In particular, heightened expectations are being directed at the corporate sector, with its organizational strengths and funding clout.

"Landmine" Issues That Threaten Inattentive Japanese Companies

Meanwhile, with the progress of economic globalization, the impact of corporate business activities is rapidly expanding in scale. And corporate responsibility, which was traditionally seen as applying to a relatively narrow range, notably the interests of companies' shareholders and consumers, has extended to encompass the

environment, jobs, and human rights in regions far removed from their home countries.

Japanese corporations, responding to the shrinkage of their domestic market and taking advantage of the strength of the yen, have stepped up the pace and scale of their overseas mergers and acquisitions. As a result of this M&A activity, they are both procuring supplies and selling products in more countries, and they must simultaneously manage organizations in locations with different operating climates. This international expansion of their operations is accompanied by the expansion of the risks they face, a point that was highlighted back in the 1990s when Nike came under attack for the alleged use of child labor by suppliers in Southeast Asia.

Hideto Kawakita, who heads the nonprofit International Institute for Human, Organization, and the Earth (IIHOE), notes that the social issues that citizens view as important differ from country to country, citing the results of a survey of readers of environmental and social reports conducted by the NTT Group. For example, according to this survey, the share of people citing “protection of human rights” as a form of social responsibility that corporations should address is much higher in other countries—Britain, Germany, China, and Malaysia—than in Japan.

What this suggests is that a Japanese company whose management takes a Japanese view of human rights may find itself unable to deal with the risk of suddenly being sued at one of its overseas affiliates on the other side of the globe for violating human rights. So there is a strong need for Japanese corporations to address social issues from a public-interest perspective, not just to meet their social obligations but also to manage the risks of doing business globally. In other words, they must practice corporate social responsibility (CSR) to avoid stepping on “landmines” around the world.

Rising Expectations for Private-Sector Involvement

Though we hear much talk about the need for CSR, in practice the activities of Japanese firms in this connection tend to be limited to introductions of their “good deeds” and contributions to charity and documents drawn up to meet international CSR reporting standards. As matters stand, society cannot readily see the great potential that companies have as participants in efforts to address public issues, and companies cannot readily generate synergy through the sharing of know-how and the conduct of joint endeavors in this area. It is a shame to let these potential benefits go to waste.

CSR activities ought to allow companies to draw on their own problem-solving strengths and take the initiative in addressing social issues, thereby giving a com-

petitive advantage in terms of business management as well, such as by letting them grasp new business opportunities, enhance their technologies and services, and recruit and develop superior human resources.

We believe that it should be possible to tap the strengths of Japan's corporate sector in a strategic manner. The question is what is required in order to break away from rigid reliance on the government, which faces severe fiscal constraints, and get the private sector more involved, making it possible for corporations to change society for the better.

To address this question, the Tokyo Foundation launched a CSR survey of about 2,000 companies around Japan, including listed corporations, major unlisted companies, and major foreign affiliates, seeking to investigate the relationship between Japan's companies and social issues.

Five Common Points in Japanese CSR Efforts

Our survey contained numerous questions concerning companies' thinking about social issues. These seem to have caused considerable confusion among the respondents, who made comments like, "We've never been asked how we define social issues," and, "We don't know how to respond, since the question is not related to the CSR guidelines." These responses suggest that Japanese companies are not accustomed to considering social issues from an autonomous perspective.

Below we cite five common points that emerged from the survey.

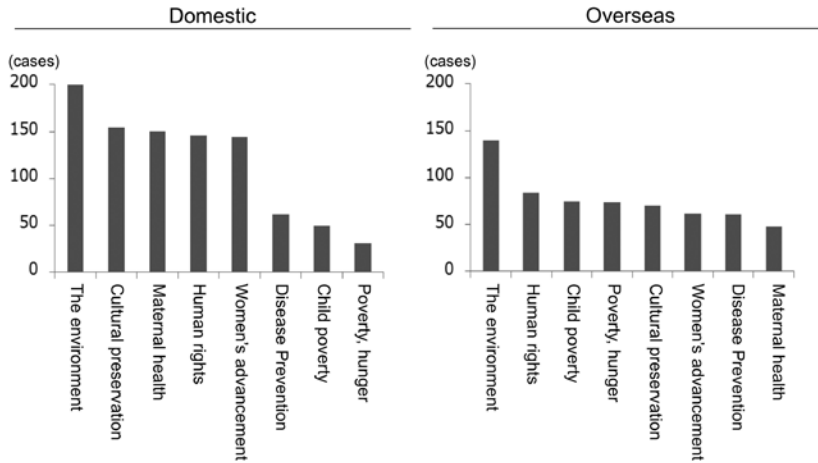
- 1. Domestically, many companies are undertaking efforts in the areas of the environment, human rights, and women's advancement, but few are addressing the issue of poverty. Overseas, the top area they are addressing is the environment.*
- 2. Environment-related efforts approach the ideal in terms of being integrated with business operations, but efforts in the areas of human rights and women's advancement are mainly directed at people inside the company.*

First of all, what specific types of social issues are Japanese companies addressing through their CSR activities? Many are involved in initiatives relating to environmental protection, respect for domestic human rights, and women's advancement within Japan. But their human-rights-related activities are generally undertaken in the context of legal compliance and corporate governance, involving employee education and similar efforts aimed at preventing sexual harassment, power harassment, discriminatory behavior, and other abuses within the company. And their efforts for women's advancement aim to make it easier for women to be dynami-

Figure 1

Many pursue environmental, human rights, and (domestic) women's issues but few address (domestic) poverty

CSR Initiatives Taken by Issue*



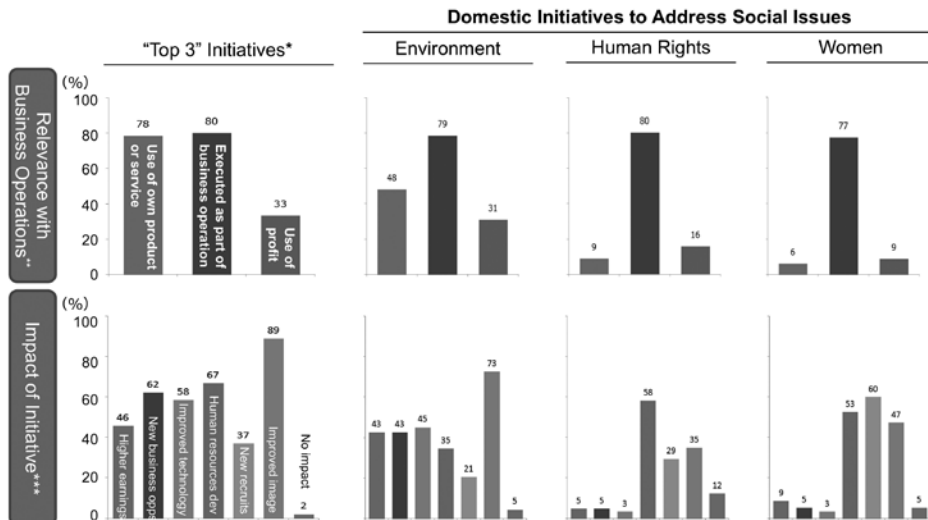
* Responses to the question, "For which social issues are you taking concrete steps to help resolve?" The tallies are for issues for which respondents chose "We have an independent program, offer donations, have employees participating in, or take other concrete steps to address the issue."

Source: Compiled by the Tokyo Foundation based on CSR Survey results (n=218).

Figure 2

Environment-related efforts approach the integration ideal, but those for human rights and women's advancement are mainly in-house initiatives

The Gap between Ideal and Reality



* The three most successful CSR initiatives, as cited by the company.

** Percentage choosing responses (in multiple-response format) to the question, "How is the CSR initiative relevant to your business operations?"

*** Percentage choosing responses (in multiple-response format) to the question, "How did the CSR initiative enhance your business strength?"

Source: Compiled by the Tokyo Foundation based on the results of the CSR Corporate Survey (n=218).

cally engaged within the company and thereby to improve the company's image (see Figures 1 and 2).

The most commonly cited areas in which companies view their domestic CSR activities as having produced good results are (1) environmental protection, (2) cultural preservation, including efforts to keep local festivals going and to pass on traditional culture to the next generation, and (3) maternal health, including improved maternity leave programs. Outside of Japan, environment-related efforts are by far the most commonly cited as successful.

3. Companies are aiming to integrate their CSR activities and their business operations, but they have yet to approach this ideal.

Focusing on the CSR initiatives that companies viewed as successful, the companies were asked how these initiatives were relevant to their business operations and how they enhanced the company's strength.

In terms of relevance, the most common replies were that the initiatives had allowed companies to make good use of their own products or services and that it had been possible to incorporate them into the company's business processes. In terms of enhancing the company's strength, the respondents cited a wide range of benefits, including improvement of the company's image, development of human resources, new business opportunities, enhanced technologies, and increased earnings (see Figure 3). The ideal for companies is to "integrate" their CSR activities and their business operations, achieving business success while producing a positive impact in addressing social issues.

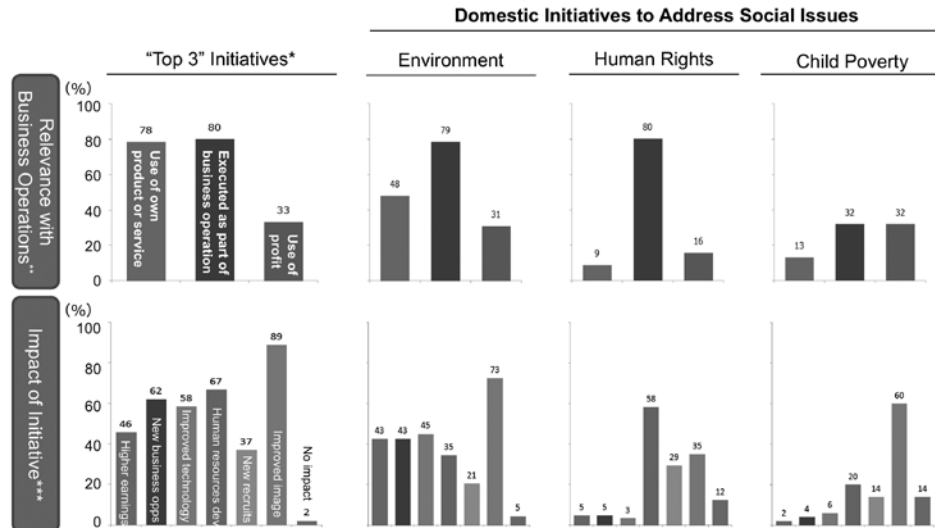
When it comes to environment-related initiatives, an area in which Japanese companies are strong, they have been able to approach this ideal in many cases. But in other areas the ideal is proving harder to realize. Consider, for example, the area of human rights, which, as noted above, is one where Japanese companies face strong demands overseas. So far they have undertaken few initiatives in this connection outside of Japan. And the steps they have taken within Japan are largely related to their legal compliance efforts, such as paying attention to human rights in their business processes and adding this subject to their employee training programs; they have not reached the point of actively working for social change through their business activities.

The issue of human rights has traditionally been something of a taboo topic within Japan, and so it has been difficult for companies to address it. But we are now in an age when the US Department of State is regularly issuing reports on human rights concerns in countries around the world, including Japan, and so

Figure 3

Firms seek “integration” of business operations and CSR but have yet to approach ideal

The Gap between Ideal and Reality



* The three most successful CSR initiatives, as cited by the company.
 ** Percentage choosing responses (in multiple-response format) to the question, "How is the CSR initiative relevant to your business operations?"
 *** Percentage choosing responses (in multiple-response format) to the question, "How did the CSR initiative enhance your business strength?"
 Source: Compiled by the Tokyo Foundation based on the results of the CSR Corporate Survey (n=218).

Japanese companies can no longer keep up this posture of neglect. In this connection, the efforts by Takeda Pharmaceutical and Dentsu that we introduce below are pioneering initiatives that address this issue both from the business side and as a CSR concern.

In any case, the results of the survey reveal that, while many corporations are pursuing the integration of CSR and their business operations as their ideal, it is a difficult matter to realize this ideal in connection with specific issues. Before we consider the reasons for this difficulty, let us first look more closely at the concept of “integration” itself.

Two Yardsticks: Contributions to Resolving Social Issues and Contributions to Business Operations

In the business world, approaches like product portfolio management rely on a pair of yardsticks, namely, market growth and market share. In CSR as well, there are two independent yardsticks that play a key role in integrating contributions to resolving social issues and contributions to business operations: (1) importance for corporate management and business operations and (2) importance in

terms of benefits for society—in other words, importance in terms of the public interest.

In order to achieve the desired integration of CSR and business operations, it is essential to aim for activities that will maximize both the contribution to resolving social issues and the contribution to business operations. But our survey revealed that this is hard to achieve in practice.

4. There is a greater emphasis on taking action to implement CSR than on deliberating how best to address social issues.

Corporations naturally devote much attention to the contribution of activities to their business operations. But their focus tends to blur when it comes to contributions to resolving social issues. This aspect is generally left up to the judgment of individual employees based on their own values and conscience, and often there is no deliberate coordination among employees in this connection.

So the CSR reports from Japanese corporations often feature snapshots of executives and employees taking part in volunteer activities, along with blurbs reporting on these efforts. In other words, they tend to be catalogs of “good deeds” by people from the company. Of course, one cannot complain about good deeds, but it is extremely rare to see CSR reports that actively present an integrated view of the social issues that the company sees in its own area of business and the actions it is taking to address them.

This state of affairs can also be seen in the findings of our survey. In Figure 4 we show an issue-by-issue breakdown of the answers to two questions: “How much interest do you have in resolving the following social issues?” and “Which of the following issues are you taking concrete initiatives to resolve?” The results of this breakdown are interesting. For many issues, the number of companies that have taken concrete action is higher than the number that have held repeated meetings to discuss the matter. When it comes to business management, a company would never skip the deliberation process, including advance studies, but in the case of CSR they move straight to implementation.

Of course there are some areas, such as the environment, in which Japanese companies are proficient and have been active for many years. For issues like these, it is quite conceivable that companies completed their deliberations at an earlier stage and were already at the implementation stage at the time of our survey. But overall the results seem to indicate a strong bias toward action. This is also seen in the areas of poverty and human rights, which are fields in which companies will be expected to do more in the future.

Figure 4

Greater Emphasis on Taking Action Than Deliberating How Best to Address Social Issues

Cases Deliberated* vs. Actions Taken by Issue**

	Deliberation > Action			Deliberation ≈ Action***			Deliberation < Action		
	Issue	Cases deliberated	Actions taken	Issue	Cases deliberated	Actions taken	Issue	Cases deliberated	Actions taken
In Japan***	None			Women	149	144	Poverty	20	31
				Maternal health	154	150	Child poverty	36	50
				Other	133	132	Culture	129	154
				Environment	193	200	Human rights	132	146
				Public health	57	62			
Overseas***	None			Women	63	62	Poverty	59	74
				Other	79	78	Maternal health	38	48
				Human rights	81	84	Culture	58	70
				Environment	134	140	Child poverty	64	75
							Public health	52	61

* The number of issues for which respondents chose "More than one meeting has been held to discuss the issue, and concrete deliberations are being conducted" to the question, "How much interest do you have in resolving the following social issues?" The other choices were "There is an awareness of the issue, but concrete deliberations have not been conducted" and "No thought has been given to this issue."

** The number of issues for which respondents chose "Concrete initiatives have been taken to address the issue, such as an independent program, donations, and participation of employees" to the question, "For which of the following issues are you taking concrete initiatives toward their resolution?"

*** ≈ (approximately equal) refers to issues for which the difference between "cases deliberated" and "actions taken" was less than ±10%. Issues and figures in red are when "Deliberation < Action." Figures "In Japan" and "Overseas" are averages of all social issues deliberated or acted on.

Source: Compiled by the Tokyo Foundation based on the results of the CSR Corporate Survey (n=218).

What we see here is a stress on doing good deeds, whatever they might be, and producing results. It is possible that the process of deliberating why particular actions are appropriate for the company to undertake at a particular time is being neglected. It may not be fair to suggest that companies are merely taking actions so that they can fill up the pages of their CSR reports, but the fact that not a single social issue was the object of more cases deliberated than of actions taken would seem to indicate that, when it comes to CSR, companies are not undertaking the sort of advance deliberation and analysis based on a long-term perspective that they practice in their business operations. An emphasis on action sounds good, but it is actually detrimental if it means that companies are taking a "stapler" approach to CSR: merely putting together sheaves of documents cataloging the good deeds they have done for society on an unsystematic basis.

The Case for Guidelines-Based Integration

How can companies switch from their current "stapler" approach to an approach that emphasizes deliberation as the way to integrate CSR with their business activ-

ities on a systematic basis? One way for companies to consider what issues to address with concrete action in a more comprehensive and effective manner is through the use of guidelines.

One of the major sets of guidelines for CSR activities is the ISO 26000 standard, which groups social issues to be resolved into “core subjects” based on the perspectives of all stakeholders and breaks these down into detailed lists of issues. For example, one of the core subjects is human rights, under which eight issues are listed; it is recommended that companies decide on appropriate initiatives of their own to deal with each of them.

- (1) *Due diligence*: Check for violations of human rights within the organization proper and in related organizations (client organizations); if violations are found, correct them.
- (2) *Human rights risk situations*: Special care should be taken in situations where governments are corrupt and with business relationships that are not protected by law, since violations of human rights can easily be overlooked.
- (3) *Avoidance of complicity*: Avoid the earning of improper profits from human rights violations, including profits earned through the organization’s complicity in such violations and through violations by others.
- (4) *Resolving grievances*: Resolve grievances by establishing systems that make it possible to notify the organization when human rights have been violated.
- (5) *Discrimination and vulnerable groups*: Prohibit direct or indirect discrimination against all those connected with the organization, and give special consideration to providing equal opportunities and respecting the rights of vulnerable groups whose members are liable to be placed at a disadvantage.
- (6) *Civil and political rights*: Respect people’s rights to live with dignity as human beings and as members of society, including their freedom of speech and expression and freedom to participate in politics.
- (7) *Economic, social and cultural rights*: Respect people’s rights to pursue lives of happiness and of good mental and physical health.
- (8) *Fundamental principles and rights at work*: Respect the fundamental rights at work identified by the International Labor Organization (ILO), including freedom of association, the right to collective bargaining, elimination of forced labor, abolition of child labor, and elimination of discrimination.

By referring to this set of guidelines organized by core subjects and issues, companies can shift from a collection of ad hoc “good deeds” aimed at promoting respect for human rights to a more systematic program, mapping the connections between

the ISO 26000 core subjects and issues and their own business operations and identifying the areas in which their efforts have been lacking up to now.

Japanese companies face major risks if they try to extend their operations to places like Europe and Southeast Asia—where, as we noted above, people have high expectations regarding respect for human rights—without reconsidering their existing mind-sets and equipping themselves with concrete images and methods to address the relevant issues. If they adopt a more systematic approach and follow established guidelines, they will be able to conduct dialogue with customers and various other stakeholders in the countries where they are operating, including local government bodies, residents, and employees. This will make it possible for them to ascertain their stakeholders' expectations and deliberate on the importance of the expected actions for their own business operations (see Figure 5). This approach goes beyond the realm of CSR and links up directly with the company's business risk management.

5. Having a department dedicated to CSR can make a big difference.

In the light of what we have considered so far, we can see that it is vitally important for corporate management that the company has a department dedicated to CSR so as to consider all of the company's initiatives to address social issues as a portfolio of programs and seek to integrate these activities with business operations. The results of our CSR survey indicated this clearly.

As shown in Figure 6, we found a clear correlation between the level of interest that companies show in resolving social issues and the presence or absence of a department dedicated to CSR. Quite naturally, an attempt to deliberate a social issue in concrete terms requires study, vision, and consideration of the impact of actions by the company on society and on the company's business operations. Though individual employees may have a good values, knowledge, and enthusiasm, it is impossible to expect them to grasp the interrelations between social issues and business operations in their entirety through their own efforts alone. Just as in the case of developing a new line of business, it is necessary to handle the matter as a team effort involving full-time staffers and an organizational unit dedicated to this task.

Here, though, we encounter another tricky issue, namely, the position of the CSR department within the corporate organizational structure.

The Tendency for CSR Departments to Become Isolated

In tandem with the CSR survey, members of the Tokyo Foundation CSR project

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team conducted individual interviews with people at over 40 companies. The results of these interviews revealed that CSR still tends to “belong” to specific individuals. We found two patterns: one where CSR relies on the strong involvement of a senior executive and one where it relies on the persistent efforts of the responsible department.

In just about every company where a CSR department exists, it lacks organizational clout and has few employees. Since the number of the department’s employees is small relative to the weight and scope of its responsibilities, the ability to get things done depends largely on the enthusiasm of the individual employees. So the CSR activities end up “belonging” to these individuals.

If a top executive like the president or chairman of the board is strongly committed to CSR, it can have a strong impact on the company as a whole, and the work can be fulfilling. But it is rare for both patterns of “belonging” to coexist in a single company. And in any case, operations that rely on the power of individuals lack sustainability.

Why are CSR operations liable to end up belonging to individuals? The underlying reason is that the time frame for corporate management from a CSR perspective is different from that for business-cycle management. A CSR department is looking at social issues that cannot be resolved quickly, and so its sense of time is not the same as that of other departments scrambling to deliver results on a quarterly basis. This difference between long-term and short-term outlooks often results in the isolation of the CSR department from the rest of the company.

Since CSR departments address themselves mainly not to the company’s employees and customers but to society as a whole on various levels, including citizens and governments, they tend to develop long-term mind-sets. From the standpoint of executives and people in other departments working under medium-term management plans with spans of two or three years, the ideas set forth by the CSR department are liable to sound like pretty thoughts lacking urgency.

Meanwhile, the older generation of executive officers and senior employees are liable to misunderstand the significance of CSR. Many executives still equate CSR with corporate philanthropy and the idea of “contributing to society,” thinking that it is something that is good to do but not essential. But in order for a company to avoid stepping on “landmines” as it undertakes international operations, it must conduct risk management based on the knowledge assembled by the CSR department concerning potentially dangerous issues. So CSR goes beyond the realm of corporate philanthropy and other voluntary contributions to society.

Above, we noted the risk that a Japanese company may suddenly find itself

being sued at one of its overseas affiliates on the other side of the globe for violating human rights. In order to avoid this sort of risk and reconfirm the company's social raison d'être, it is essential to adopt the long-term perspective of CSR as part of the business process—it is essential, in other words to integrate CSR and business operations.

One hopeful phenomenon in this connection is the generational shift in the way people view their relationship with society. Japanese corporate employees who are currently in their forties or over tend to be highly focused on their own companies and relatively lacking in interest in external phenomena. By contrast, those in their thirties or under tend to seek their personal sense of worth not from their performance within the company but from their involvement with society. In other words, younger employees are more open to the world beyond their own company and seek to interact with it naturally. Tapping the power of this younger generation may make it possible for corporations to change society.

Where Are the Corporations That Can Change Society?

The results of our survey and interviews have given us a picture of the kind of corporations that can change society, the types of ideas they are implementing, and the sources of their motivation. We found three points characteristic of such corporations: (1) They are thinking and acting over a long time frame in integrating their efforts to help resolve social issues and their own business operations. (2) They are keeping up efforts to tap their own corporate strengths in working to resolve social issues. (3) They have established concrete systems to channel their strengths for this purpose.

In closing, let us introduce the case of six Japanese corporations that have been constructing relationships with society by appropriately identifying and tapping their own strengths.

1. Sompo Japan Insurance Inc.: Focusing on dialogue

In order to identify the strengths that are required in order to integrate contributions to resolving social issues with its own business operations, Sompo Japan, has been earnestly conducting dialogue with outside stakeholders. This ongoing dialogue has been clarifying what society expects of the company and which of the company's strengths should be tapped in order to meet these expectations. The capabilities that this company has displayed in a distinctive, highly visible manner both around the world and within Japan, notably in the areas hit by the March

2011 Great East Japan Earthquake, actually exist—perhaps less visibly—within many other Japanese corporations.

2. Itochu Corporation: A bottom-up approach

Itochu has been drawing on its corporate culture of conducting operations based on the awareness and motivation of its individual employees. Though the results may seem to lack overall coherence, the company has built ties with society in a manner befitting a trading company. The bottom-up approach it has been taking, relying on input from the front lines of its operations extending around the globe, is also effective for risk management.

3. Takeda Pharmaceutical Company Limited: Global partnerships

Takeda has gone global in order to compete successfully with the world's other giant pharmaceutical companies. Through the partnerships it has established around the world, it is striving to respond to society's expectations and demands by "creating and sustaining corporate value"—in other words, by activating the positive and offsetting the negative.

4. Kirin Company, Limited: Unification with brand strategy

In 2013 Kirin consolidated its beer, wine, and nonalcoholic beverage operations into a single integrated beverage business within Japan. Its approach to CSR differs from those of the three companies cited above, focusing on "visualizing" the integration of CSR with the organization and with specific business strategies. In its quest to lengthen the lives of its products in Japan, the country with the world's most demanding consumers, the company has found the answer in the integration of CSR with its brand strategies, aiming to create shared value for society and the company through its business operations.

5. Dentsu Inc.: A "lab" model

Advertising and public-relations giant Dentsu promotes employee initiative through "labs"—small groups of employees from different sections of the company, whose joint activities are recognized as part of the employees' jobs. These labs, made up of people who are professionals at expressing and delivering messages, can turn an issue like human rights into something with a different sort of potential. Dentsu,

while nurturing the sort of thinking and posture that form the foundation of moves to create a society embodying diversity, has also achieved solid integration of these efforts with its own business operations. Dentsu's lab activities, which attract individuals and have the potential to change society, offer a new model of organization.

6. Akebono Brake Industry Co., Ltd.: Continuation

Akebono, which boasts a large share of the global market for automobile brakes, has been undertaking CSR activities over a longer time span than any other company considered in this overview. It has been making contributions in the field of education for 50 years, and though these activities may seem to have no direct connection with its business operations, they have had an impact in connection with other social issues and have in fact had a positive effect on the company's business. Akebono's initiatives also offer good hints for addressing issues like diversity and inclusion, which have become important concerns for contemporary corporate management.

September 8, 2014

Turning Social Challenges into the Company's Strengths

Akebono Brake Industry

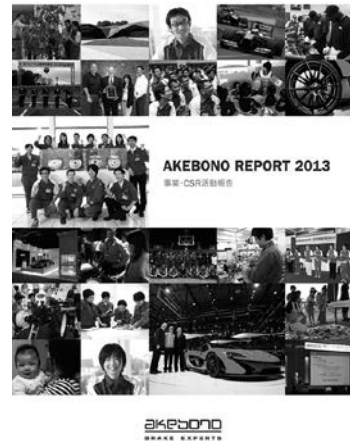
Tokyo Foundation

When you read the integrated business and CSR activities report published by Akebono Brake Industry, you quickly notice something interesting: the large number of employee photos featured on its pages, compared to the reports of other companies. The cover of the 2013 *Akebono Report* is a good example, and so is that of the 2011 report: All photos are of Akebono employees working around the globe.

There are more employee photos inside. Akebono's corporate mission is printed on the inside front cover: "Through 'friction and vibration, their control and analysis,' we are determined to protect, grow and support every individual life." Underneath this text is a picture of a group of Akebono employees, who are quoted on what the company's corporate mission means to them personally. The juxtaposition of universal, crystallized principles and personal messages from employees who daily put the corporate mission into practice gives a clear idea of the kind of company Akebono is and what it means to work there.

Akebono's company ethos comes through strongly, too, in the report's three feature stories.

The first is on the "New Midterm Business Plan," the second is on "Product Development toward 2020," and the third on "Developments since the Great East Japan Earthquake." The second article details how the company intends to turn its products and production methods into global standards and to become more competitive by adding enhanced product features (which the company calls "topping") to meet local market needs. The article features 12 young engineers who are respon-



Cover of Akebono Report 2013.

sible for developing Akebono’s unique technology. Through the filter of these employees’ eyes—with specific references to their involvement in daily tasks—they explain what the company’s goals are and describe what needs to be done going forward in an approachable way.

Fostering Pride

But why are so many employees featured in the report? And why do they explain all this in their own words?

An answer to these questions requires a look back at the company’s history. Akebono manufactures brakes for automobiles and trains. It boasts an impressive share of the global market and is an example of Japanese manufacturing prowess.

“Brake” is the term for a device that stops a car by using friction to convert kinetic energy to heat energy. Brakes have an important role in protecting human lives. We cannot escape the fact, however, that from a consumer’s perspective they are rather uninteresting. People have heard of Japanese automakers like Toyota, Nissan, Honda, Mazda, Mitsubishi, and so forth, but not many could name a brake company.

In fact, Akebono employees are the same. They cannot buy their own company’s products, and neither do they know whether the cars they see on the road are using an Akebono brake or not. A lot of hard work goes into making these products and parts, but when the fruits of such labor are not readily visible, having pride in one’s company and its products can be difficult.

Akebono conducts surveys of its various stakeholders to learn what they think of the company and its products. Through this process, it has discovered that automakers and other business partners highly value the company’s products—even more so than its own employees.

The company’s target for 2020 is to increase its share of the global OEM disc brake pad market to 30%. Its current share is 18%, so this is an ambitious goal. Only an exceptional company could set its sights so high. But even for Akebono, there might be more room in enhancing the pride employees feel about their company.



Comments by Akebono employees.

A CSR Report for Employees to Read

At Akebono, the Corporate Branding Management Office plays a coordinating role in advancing company-wide CSR activities. Branding is something that adds value in the eyes of customers and is considered a central part of business strategy for consumer product companies. But branding management is seldom an important consideration for B2B companies.

At Akebono, though, branding is aimed at fostering pride in employees, and it is toward this goal that the company exerts its branding efforts. Generally speaking, companies direct their CSR and other annual reports at their various stakeholders. But the *Akebono Report* is created with the idea that employees would be among its most important readers. It is intended as a guide to help employees identify closely with the company and act accordingly.

The following comes from the conclusion of the “Top Message” section of the report, written by Akebono Brake Industry President and CEO Hisataka Nobumoto: “Brakes are not merely car parts; they are indispensable automobile components that ensure safe and smooth driving. We encourage all who work at Akebono Group companies to take great pride in the fact that they deliver safety and security to people throughout society through the production of superior brake products. By recognizing the contribution of the significant contribution they make to society, we hope to stimulate the kind of proactive thinking and response to challenges that provide both personal fulfillment and corporate success. Launched in 2005, corporate brand management is one initiative promoted in line with this aim. Guided by the idea that every associate should be an advocate of the Akebono brand in their day-to-day operations, we will achieve greater recognition for our company among all our stakeholders.”

Perhaps the most enthusiastic readers of CSR reports in recent years have been students looking for the “right” company to join after graduation. Since they are likely to stay with an employer for many years, they no doubt look at companies from a long-term perspective, and they read the reports to find out about the companies’ engagement with society. This is also the reason that, as soon as they join the company, they are less likely to read their own company’s report, as they become less interested in the long term than with addressing immediate concerns.

As is described in the Top Message, the *Akebono Report* is intended to stimulate among employees “proactive thinking and response to challenges that provide both personal fulfillment and corporate success.” Already, about 60% of Akebono’s consolidated sales are generated outside Japan, and about 60% of group employees work outside the country. Maintaining a manufacturing base in Japan will not be

easy from the viewpoint of maintaining global competitiveness. But if the company can make full use of employees' latent strengths, it can not only achieve the goal of increasing global market share, as mentioned above, but also create a company that is truly ready to meet the challenges of globalization. That is why it emphasizes the importance of fostering employees' pride in the company and its products.

The company calls its employees "human assets," rather than resources, and a training center has been built in Japan to nurture such assets from around the world. Akebono employees are trained to think not just about their own workplace but also about the company's operations as a whole, how their work is connected to the work of the company, where the company is headed over the long term, and what their role should be in this evolution. The *Akebono Report* is designed to encourage such thinking.

It is not unusual for companies to think about how their CSR report would be read by their various stakeholders, but in reaching out to too many different readers, they may lose sight of their primary focus. Such companies can draw valuable hints from the single-minded attention Akebono gives to fostering pride among its employees, prompting them to take a broad and long-term view and encouraging them to identify areas for improvement."

Findings of a Post-Disaster Employee Survey

The emphasis on fostering pride among employees was evident in Akebono's response to the March 2011 earthquake and tsunami in northeastern Japan. The Akebono Group has four production sites in the areas that were affected. The worst damage was suffered by a subsidiary producing brake linings and other components: Akebono Brake Fukushima Manufacturing, based in the town of Koori, Fukushima Prefecture. Thanks to the hard work of Fukushima Manufacturing's employees, the company was ready to resume production by March 21, just 10 days after the disaster. Akebono's corporate culture showed through most clearly, though, in what they did next. The company surveyed its employees on "what they felt" during and "what they learned" from the disaster. By May 27 they received 239 completed surveys in which respondents said they were impressed by "employee cohesion, teamwork, and solidarity," "the company's concern for its employees," and "the gratitude of residents, customers, and business partners in disaster-hit areas."

The process of recovering from the disaster and Akebono's experience with the Thailand floods later in 2011 provided an opportunity for the company to rethink its supply chain. It moved to ascertain how many companies worldwide were ac-

tually capable of supplying the raw materials and parts it needed and to examine the effectiveness of its risk management policy with regard to sources. Akebono not only reconfirmed the substitutability of its suppliers but, in reexamining its supply chain, has also begun to rethink its entire approach to manufacturing.

This experience also convinced President Nobumoto of the high potential of Akebono's employees. "If all our employees can do their part working towards a single goal," he noted, "we can do great things. In fact, there's nothing we can't do. What we need to consider, however, is why we typically don't achieve that potential." This is a message that Nobumoto often repeats to his employees. So in addition to instilling pride, management is asking employees to set their sights higher and have a broader perspective so they can realize their full potential. This may be said to be the essence of Akebono's management philosophy.

Fifty Years of Providing Scholarships

One of the biggest factors behind Fukushima Manufacturing's swift recovery was a group of scholarship students working there, as became evident from the employee survey taken after the disaster. These students are on the Akebono Vocational Scholarship Program and work at Fukushima Manufacturing while attending junior college to complete a three-year occupational course, such as in kindergarten teaching, nursery school work, and nutritional science.

Akebono has been operating this program since 1964—for exactly half a century. It was launched by the previous president who himself received a government scholarship to attend a university abroad and who wanted to offer a way for young people to support themselves by working while continuing to study. The company provides work and housing to young people who, for financial or other reasons, are otherwise unable to go on to university or vocational school. All the scholarship recipients spend three years living together in a dormitory while working shifts at Akebono plants. The students pay for their education from their wages and earn a degree or other qualification through hard work. To date, more than 3,000 students have benefited from the program, including some who are the second generation in their family to do so. They are called *hosensei* (nursery school students), since many of them go on to work at nurseries.

The *hosensei* spend their mornings working and study from afternoon until evening. At Fukushima Manufacturing, they have had a significant impact on company morale. The full-time workers have been heartened by the progress students make during the three years there and how hard they try, and this has prompted the employees to take a fresh look at themselves and to make new discoveries.

Seeing the *hosensei* working so hard, they, too, approach their job with greater seriousness and sense of responsibility. Compared to other Akebono production sites, the level of cooperation among Fukushima Manufacturing workers is quite high, such as when changing shifts.

Indeed, many Akebono employees note that they are not the ones supporting the *hosensei*; rather, it is the students who are helping and teaching them. The Vocational Scholarship Program was originally implemented at production sites across Japan, but Fukushima is the only facility where the program currently remains. Successful applicants come from all over northeastern Japan, and most return home after they graduate. These young women work as they study, live together for three years with fellow *hosensei*, and acquire strong interpersonal skills that are highly valued by employers. They now live all over northeastern Japan, working as nursery school staff, child nutritionists, and kindergarten teachers.



The April 2011 graduation ceremony held at Akebono Global Headquarters.

These students also made a huge contribution to the restart of operations following the March 2011 disaster, but the graduation ceremony at their university, which was planned for March 17, had to be cancelled. Akebono thus organized a special ceremony for the graduating *hosensei* at its Global Head Office in Tokyo on April 10. Thanks to the assistance of a kimono rental company and beauty salon, all students were provided with traditional formal wear and were beautifully coiffured for the ceremony, attended by President Nobumoto and other senior Akebono managers.

At a glance, the scholarship program looks like a one-way street, with the company supporting the students. And because it requires substantial financial resources, some have suggested over its 50-year history that maybe it was time to bring it to a close. But the truth is that the program has had a very positive impact on Akebono's corporate culture. The company and its employees have gained much from interacting and working with the students on a daily basis. In that regard, the program has created value to both the company and society at large.

President Nobumoto's message to the 2013 graduates, titled "Setting Out on a Journey of Creation," offers an idea of how important the students are to Akebono.

Benefitting from Unexpected Connections

There is one special-purpose Akebono subsidiary that promotes employment for people with special needs—Akebono 123. It was established in September 2013, becoming the first such company to be set up by a manufacturer in Saitama Prefecture.

The employment rate of disabled people in the Akebono Group as a whole is 2.28%. This is already higher than the statutory rate in Japan of 1.8%, but the rate at Akebono Brake Industry and Akebono 123 combined is 3.88%. The average employment rate of disabled people in Japan as a whole is 1.76%, and the corresponding rate for companies with more than 1,000 employees is 1.98%. Less than half of all private companies in Japan, at 47.7%, meet the legally mandated em-

“Setting Out on a Journey of Creation”

Hisataka Nobumoto

President and CEO, Akebono Brake Industry Co., Ltd.

For three years you have devoted yourself to study and work, forming friendships in the midst of difficult times. Now you have received your graduation certificate. I offer you my sincere congratulations.

Around the time you joined the Akebono Group, we were expanding into the North American and Asian markets and doubling the size of our operations. We were engaged in a growth-focused restructuring of our Group operations at home and abroad, prompted by issues that became apparent after our sudden expansion. And right after you joined Akebono, the Great East Japan Earthquake struck, hurling not only our company but the whole of Japan into turmoil. In the midst of that, as the Akebono Group pulled together toward recovery and reconstruction, you devoted yourselves wholeheartedly to restarting production, even at the risk of your personal safety.

I am deeply moved by memories of how much strength you gave the entire Group.

LET’Z¹ was held soon after the initial period of recovery and when we

¹ LET’Z is an employee general meeting to discuss the company’s future that is vol-

ployment rate of people with disabilities, so the rate at Akebono Brake and Akebono 123 can be said to be quite high.

The large number of associates with special needs working at Akebono 123 is not the only thing that makes the company special. It has achieved growth by expanding the range of work that these associates can do and training them according to their various disabilities and personalities. It has a quality-focused personnel policy based on carefully allocating work according to each employee's aptitude.

On its establishment in 2003 the company was initially tasked with providing cleaning services for other firms in the Akebono Group and has since gradually expanded its work. During the next 10 years the company's staff has grown from 5 to 25.

were beginning to regain some calm. The Fukushima *taiko* drumming group moved us afresh with its wonderful teamwork and exuberance. I received these comments from those attending the meeting: "The audience and drummers became one," "I had a taste of what it really means to work together," "The audience listened attentively to both the drumming and the reports on our business situation."

Through the drummers' powerful performance and the awareness of their role in the group, they showed us the importance of working together in harmony as a team. You gave us fresh energy and vitality.

No one could have predicted that so many difficulties would occur during such a short period. And of course, no one would have wished these things to happen. Nevertheless, this experience has given us strength and helped us grow as human beings.

Please be grateful to your parents, friends, and all who have helped you so far. Take the confidence you have gained from overcoming these hardships and use it in the new life you create for yourself in new surroundings. Work hard, and I wish you the best of luck in your future endeavors.

untarily attended. It is planned by a cross-company project team with 10 or so members and often opens with a performance by a Fukushima *taiko* drumming team made up mainly of *hosensei*. The 2013 event was held on November 19 and was attended by approximately 800 workers.

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In 2008, its sixth year of operation, Akebono 123 was awarded a chance to become part of Akebono's production process for the first time when it began the packaging of repair kits for brake parts. A special production line for Akebono 123 was set up inside an Akebono Brake plant, where employees have been working alongside their Group colleagues. Akebono 123 workers have won many prizes at technical skills competitions, and the company—viewed as a model employer of people with special needs—is now asked to run workshops at schools and other facilities for the disabled.

This has been achieved thanks to the attention given to each employee's needs by Akebono 123 President Koji Saito and the instructors hired to guide workers' activities. They carefully consider each worker's characteristics, how best their skills can be developed, what tasks they should be assigned, what support they may need, and how their long-term career prospects may be improved. The management staff is dedicated to helping each and every employee find job satisfaction and a role to play in society.

One remarkable thing about this personnel management policy is that all instructors are graduates of Akebono's Vocational Scholarship Program. These alumni returned to their hometowns to work at a kindergarten or nursery, and many have married and have children of their own. A number of them whose children have grown up learned of an opportunity to give something back to Akebono—a company that enabled them to continue their education despite difficult personal circumstances—and their former colleagues, and so they accepted an offer to work at Akebono 123 as instructors, making use of the skills they acquired while raising their children.

The Way Forward

In many ways, the scholarship students and Akebono 123 instructors represent the company's ideal "human assets." They are proud of their work, their colleagues, and their company. They are skilled at spotting areas for improvement and work daily to solve them. They are the kind of workers about whom President Nobumoto spoke in his Top Message.

The scholarship program launched 50 years ago and the special-purpose subsidiary for people with disabilities set up 10 years ago were aimed at fulfilling Akebono's responsibilities to society. Little did the company's senior managers know at the time that these two projects would eventually wind up setting an example for the rest of the company to follow.

In offering a helping hand to students in financial difficulties and in creating

job opportunities for people with special needs over the years, Akebono has unexpectedly acquired valuable know-how on a key management issue: the effective development of human “assets.”

CSR is not just about addressing social issues. Donations to charitable organizations alone will have little positive impact on a company’s operations. And encouraging employees to engage in volunteer activities will not necessarily prompt them to think deeply about how their work is linked to society at large. CSR activities that have little relevance to a company’s main line of work will be considered a luxury and are unlikely to be sustained over the long term.

What we learn from Akebono’s example is the importance of a company’s awareness of its role in society and its relationship with its employees. Rather than overreach and attempt something unsustainable, it has chosen to engage with society over the long term. This is one approach to more fully integrating CSR into the core aspects of a company’s business.

September 2, 2014

Corporate Social Responsibility

Potential and Challenges

David J. Vogel

In this brief essay, I would like to discuss the growth of CSR first more generally and then in Japan, provide some suggestions to enable firms to improve the effectiveness of their CSR efforts, and offer some general reflects as to what CSR can and cannot accomplish.

The Growth of CSR

In recent decades, public expectations of business have steadily increased. While investors still expect firms to maximize profits, the public has become increasingly aware of the importance of the social and environmental impact of businesses. Firms are now expected to make every reasonable effort to reduce their negative externalities—or such harms as pollution that they cause while pursuing their business activities—and to increase their positive externalities, or their impact on addressing important social and environmental problems, such as poverty reduction.

The expansion of economic globalization has created a political backlash: Many citizens regard its benefits as insufficient and its social and environmental costs too great. It has been associated with increased inequality, economic insecurity, human rights abuses, and environmental degradation. In addition, many governments, particularly in developing countries, appear either unable or unwilling to control the conduct of global firms and their complex global supply and distribution networks. This has created a marked imbalance between the power of large global firms and national government regulations: The former frequently appears to be overwhelming or undermining the latter. CSR has emerged as a way to fill in this “governance gap,” or to create a public domain between states and markets.

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There is considerable evidence that business norms have changed: CSR is now widely regarded as a legitimate dimension of global corporate decision making. Survey evidence reveals that CSR has become a more important priority for managers and that its importance and legitimacy have steadily increased. Evidence of the increased importance of CSR includes:

- A substantial increase in the number of global firms that produce annual reports on their CSR activities.
- A substantial increase in the number of global firms that have a CSR program.
- A substantial increase in the number of CSR reports that are independently audited.
- A steady increase in the number of corporate codes of conduct. Industry codes now exist for firms in virtually every global sector including chemicals, finance, mining and minerals, tea and coffee, toys, textiles, diamonds, sporting goods, and electronics. These codes have established standards for responsible corporate behavior, primarily with respect to employee rights, working conditions, and environmental impact. Some are governed by the firms themselves, while others, such as Fair Trade International and the Forest Stewardship Council, involve partnerships with nongovernmental organizations. In some sectors, such as forestry and clothing, there are multiple industry codes.
- An increase in the number of countries whose home companies have embraced CSR. Thus the United Nations Global Compact now has more than 7,000 corporate signatures from 130 countries. Likewise the Equator Principles, which established social and environmental criteria for project finance, have become a global standard, endorsed by nearly every bank that engages in this kind of lending.
- An increase in the number of social or ethical investment funds or indices; they now exist in virtually every capital market. In short, CSR has become globalized.

CSR in Japan

Since it was originally developed as a Western concept, primarily in the United States and Britain, CSR came relatively late to Japan. The year 2003 is often referred to as CSR *gannen*—or the first year of the “CSR era.” It is clear, however, from the results of the Tokyo Foundation’s CSR Survey, as well as other sources, that major Japanese firms have now embraced global CSR norms and practices. For example:

- 75% of major Japanese firms have CSR committees.
- 88% of the largest Japanese firms issue reports on their CSR activities.

- More firms in Japan have been certified as ISO 14000 compliant than in any other country. (ISO 14000 is an environmental process standard which is used by many large firms, especially in Western Europe, to select their suppliers.)
- Japan is home to more socially or ethically responsible investment funds than any other Asian country.
- 132 Japanese firms have subscribed to the United Nations Global Compact.
- Keizai Doyukai has issued several reports on CSR practices in Japan while Keidanren has issued a Charter of Corporate Behavior.

Improving CSR Performance

While there has been a considerable growth of CSR, both globally and in Japan, many firms are still struggling to better manage their CSR policies and practices. What, then, can firms do to improve their CSR performance?

It is important to recognize that notwithstanding the importance of the 10 principles of the UN Global Compact and the widespread embrace of ISO 26000, a comprehensive CSR guideline, it is clearly *not* the case that “one size fits all.” Rather it is critical that companies tailor their CSR practices to their own distinctive business operations and core competence. Clearly, the CSR agenda of a financial institution will differ from that of an oil company or a clothing manufacturer. But even within the same industry, a firm’s CSR strategies are likely to vary, depending, for example, on such factors as the location of their business operations, strategies, size, and financial performance. Thus the challenge for every firm is to formulate their *own* CSR strategies.

How then should a firm go about developing its CSR strategies? The following is not meant to list action items in order of importance but rather in sequence: they are intended to enable managers to further develop their CSR initiatives.

One way to begin is to focus on the defensive aspects of CSR. These involve the reputation or, in some cases, the financial risks faced by a firm by being perceived as *not* sufficiently responsible. Firms need to identify and anticipate their CSR-related business risks. What aspects of your firm’s operations might result in it becoming the focus of a media exposé or an attack by an NGO? Who is likely to criticize your firm and for what reasons? What damage to your firm are they likely to cause? In other words, how, where, and for what is your business likely to be vulnerable?

Investments in CSR can be usefully understood as a form of reputation risk insurance. An important goal of a firm’s CSR initiatives should be to reduce the likelihood that its reputation will be damaged. In this context, managers should

carefully monitor similar firms that are currently being criticized, since this may provide them with advance notice of the challenges their firm will be facing.

Another useful proactive strategy is to develop informal relationships with reporters, investigators, and activist groups, as these can help you anticipate future media and NGO activities. Finally, a firm's CSR's strategies should be linked to its approaches for dealing with crisis management in general. Firms need to develop advance procedures for responding to CSR-related crises. The key objective should be to avoid being surprised or caught unaware.

A second approach for developing a CSR strategy is to carefully and comprehensively assess your firm's social and environmental impact. If an important dimension of CSR involves reducing a firm's negative externalities, then it is vitally important that a firm's managers first learn and understand what they are. This is not only an important exercise but a challenging one: It requires a firm to engage in a comprehensive life cycle analysis of its products or services that includes a focus on where and how they are sourced, how they are transported, how they are processed, how they are sold, how they are consumed, and how they are disposed of.

This exercise is particularly important for a firm that wishes to reduce its negative environmental impact or its "carbon footprint." Many firms have found such assessments extremely valuable as they have uncovered dimensions of the social or environment impacts of their supply and distribution chains about which they were previously unaware. Such an exercise can then inform a firm's CSR agenda by highlighting areas which it then has the potential to change.

The third exercise that should inform a firm's CSR strategy involves thinking very broadly about the social and environmental problems faced by society in general or in the countries where it does business. After identifying these problems, the next step is to figure out what role your firm might be able to play in addressing or ameliorating one or more of them. This important exercise requires you to think beyond your company to the broader society in which it is embedded. It may turn out that there is little overlap between many of these problems or ills and your business operations, in which case, there is little or nothing for your firm to do. Alternatively, it might well be the case that your firm has some unique competences that overlap the social or environmental problems you have identified and which your firm can then play a role in addressing.

The fourth approach to developing a CSR strategy is to examine it from the perspective of your business operations. Given your business goals and strategies, in what ways can CSR help you achieve them? It might be the case, for example, that you need to attract better trained and highly motivated employees. Or you might be interested in extending your business operations into another country,

either by making it a part of your supply chain or as a source of new customers. There might be an important constituency whose support your business needs. How can CSR assist you in achieving these business objectives?

Each of these four steps—identifying your CSR risks, identifying your overall CSR impact, identifying the broader social problems that need addressing, and identifying which business objectives CSR can assist you in meeting—are designed to accomplish a similar goal: their purpose is to help your firm establish its CSR agenda, to assist it in deciding its CSR priorities. Thus the more a proposed CSR initiative can reduce a reputation risk, reduce a negative externality, address a pressing social need, and assist in the achievement of the firm’s business objectives, the more it makes sense for a firm to pursue it.

Taking Specific Steps

After formulating your CSR priorities, the next challenge is to determine what specifically your firm should do. It is important to think creatively and broadly about this, for there are many ways in which a firm can improve its CSR performance and thus net its positive social impact. These include philanthropy—the most traditional form of CSR—permitting or encouraging employees to actively participate in various community initiatives, changing your product mix, changing the criteria by which you select contractors or suppliers, improving the monitoring of your supply chain, and improving the environmental efficiency of your own operations.

In undertaking these efforts, managers need to think beyond their own organization. The large and growing number of industry codes represents an important resource for companies. Many of these codes have already developed specific standards for corporate conduct as well as specific strategies and policies for implementing them. These codes also provide important sources of information for industry “best practices.”

Another possible advantage of participating in an industry code is that their formation and in some cases their governance frequently involves the participation of nongovernmental or activist organizations—precisely those constituencies whose activities and priorities may represent a reputation risk for your firm. In this context, an important way for a firm to leverage its core competences is to directly partner with nongovernmental, nonprofit organizations. These partnerships need to be carefully managed, but there is considerable evidence that cross-sector partnerships can provide a firm with significant benefits: They can often result in better results than a company can achieve on its own.

Many firms experience shortcomings in their CSR programs because they are

insufficiently clear about their goals. You need to clearly define what you hope to accomplish by your CSR initiatives and then develop clear metrics or measurements for these goals. These metrics are an extremely important business tool: they signal what CSR commitments are important to your firm and enable you to clearly assess the progress you have made in meeting them. They also represent an important way of communicating to the public about what you want to and can accomplish, and how well you are achieving the goals you have set for yourself. Moreover, developing clear CSR goals and publicly reporting on your progress in meeting them represents a critical—even essential—vehicle for establishing the legitimacy of your CSR initiatives.

Such objectives should not be written in stone. On the contrary, they should be periodically reviewed. It might be the case that you need to revise them either upward or downward or abandon some and/or add others.

In fact, the process of reviewing or possibly revising your firm's CSR objectives is also very important. It provides a way of making sure they are realistic and achievable. Alternatively it may alert you to shortcomings in your CSR performance which you can then address.

Finally, firms need to think comprehensively, strategically, and creatively about the business benefits of CSR. In some cases, the business benefits of CSR can readily be measured. They may, for example, help to develop new markets for your existing products and services or even lead to new or revised products or services. Likewise, they may improve the efficiency of your operations by reducing energy use. (One reason why environmental initiatives have become so popular among firms is that they often result in reduced operating costs, which can be readily measured.) But more typically, measuring the business benefits of CSR is much more difficult.

But the fact that some of the business benefits of CSR may be difficult to quantify does not make them unimportant; they may still be valuable. The hard-to-measure benefits of CSR can include a better corporate reputation, improved employee morale or the reputation risks to which your firm was not exposed. It is also important not to overlook the personal value of a firm's CSR efforts to its senior managers. Employing a firm's resources to help ameliorate pressing social or environmental problems can be appropriately viewed as a form of nonwage compensation for senior managers: they enable them to broaden the contribution of their firm beyond creating shareholder value.

CSR and the Market for Virtue

Both the accomplishments and shortcomings of CSR fundamentally stem from the

same factor: the strengths and limitations of the business benefits of corporate social responsibility. There is a “market for virtue”: There are business benefits for acting more responsibly. They include a better corporate reputation, improved employee morale, better relations with stakeholders, more efficient use of resources, and more effective and innovative marketing.

Moreover to the extent that CSR is viewed as a form of public relations risk insurance, then investments in it certainly make business sense—even if these benefits are not always easier to measure. It is these benefits that explain why so many global firms have expanded their CSR programs and initiatives.

But while the good news is that more responsible firms do not perform any worse financially than less responsible ones, the discouraging news is that *neither do they perform any better*. The reason is that the relative importance of CSR to a typical firm’s profit margins, return on investment, or market share is often modest. The financial impact of a firm’s CSR efforts or the lack thereof is typically overshadowed by other competitive events, pressures, and opportunities. This, in turn, reduces the amount of resources many firms may be able or willing to devote to improving its CSR performance. There certainly is potential for firms to improve their effectiveness of their CSR efforts, but we must also recognize the extent to which a highly competitive global marketplace constrains those efforts.

We need both to acknowledge and applaud all that CSR has accomplished while at the same time also recognizing its limitations. Many important global problems, such as reducing corruption or coping with the risks of global climate change, are simply beyond the scope of profit-seeking firms to effectively ameliorate. They can only be adequately addressed with the support and cooperation of governments.

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Toward a New Era of Global CSR by Japanese Companies

Toru Naito

Developing countries around the world are grappling with a multitude of challenges, from poverty and environmental destruction to conflict and human rights abuses. International organizations, national governments, aid agencies, and nonprofit or nongovernmental organizations have been working for years to address these problems through a variety of programs and initiatives. But until recently, private industry's participation in these problem-solving efforts was indirect at best and was generally limited to business activities carried out under contract with governments or development agencies, such as construction of infrastructure or the supply of materials or equipment.

In recent years, however, the impact of global business on the developing world has reached unprecedented levels. Accelerating economic growth has made developing countries highly attractive to such corporations, whether as consumer markets or as bases of production. Today, the industrialized world pours far more capital into developing countries through private investment than through official development assistance. Where such business operations spring up, their impact on people's lives can extend far beyond simple economics.

These circumstances have fueled a growing belief, exemplified in the United Nations Global Compact (UNGC), that corporations must behave as responsible members of civil society and work proactively in support of the environment, good labor practices, and human rights. At the same time, the past few decades have witnessed the global rise of "base of the pyramid" (BoP) businesses specifically oriented to improving conditions for people with the lowest income levels in the world. We are embarking on a new era of corporate social responsibility in which businesses are expected to make a direct contribution to the resolution of global problems.

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Japanese Companies' Timid Response

What sort of overseas initiatives have Japanese businesses taken in response to these new expectations? Unfortunately, surveys suggest that only a small fraction of Japanese companies' CSR budgets are devoted to international cooperation. In the 2012 Keidanren Survey on Corporate Philanthropic Activities in Fiscal 2012, completed by 397 companies, only 2.0% of reported CSR expenditures fell under the category of "international exchange and cooperation." Out of the survey's 14 activity areas, international cooperation ranked ninth, following education, culture and the arts, academic and research programs, health and sports, the environment, assistance to disaster-stricken areas, local community activities, and social welfare.

Is this simply a reflection of Japanese citizens' attitudes toward problems facing people in other parts of the world? While it is difficult to draw a meaningful statistical comparison between corporate philanthropy and the attitudes of private citizens, we can gain some idea of the general level of public concern with international development issues from a 2010 survey by Intage, Inc. The report *Social Overview (Basic NPO Marketing Data Report)* offers an analysis of Japanese citizens' interest and involvement in various social issues based on a nationwide survey of more than 170,000 subjects aged 15–69.

In this survey, assistance to developing countries ranked sixth among 20 issues, after environmental protection, energy conservation and recycling, disaster relief, welfare services for people with disabilities, and healthcare, in which respondents reported being personally involved within the past year. It came out ahead of education, social welfare, and culture and the arts—all of which ranked higher than international cooperation in the aforementioned Keidanren survey. If we use the general public's interest and involvement as a yardstick, corporate efforts in this field said to be coming up short.

The Tokyo Foundation's 2013 Survey on Corporate Social Responsibility (sample: 218 companies) collected fairly detailed comparative data on Japanese CSR programs carried out within Japan and overseas, broken down into nine basic categories (human rights, poverty/hunger, infant mortality/maternal health, childhood poverty, women's status, prevention of infectious diseases, the environment, preservation of regional and national culture, and other activities). The results shed light on the dominant character of Japanese CSR initiatives in other parts of the world.

The survey found that, while most Japanese corporations plan and administer domestic CSR initiatives independently in response to specific challenges and issues, their overseas philanthropy generally take the form of financial or in-kind

donations to NGOs or NPOs. Asked how the company itself benefited from its CSR program, most respondents reported that their domestic initiatives (mostly developed and administered independently) benefited the corporation internally, by contributing to employee education and workforce development and by building technical know-how. But when assessing the value of their overseas programs, they pointed only to the public-relations benefit of a good corporate image.

Taken together, these survey data suggest that Japanese companies are insufficiently engaged in social issues in other parts of the world, particularly in comparison to the level of interest among Japanese private citizens. They also show that, when Japanese companies do engage in overseas CSR, the overwhelming emphasis is on financial and in-kind donations to other organizations, with the result that its value to the donor is limited to PR benefits.

Representative Examples of Global CSR by Japanese Corporations

Let us now examine some specific initiatives illustrating four favorite Japanese approaches in developing countries.

AFFORESTATION PROJECTS Among the most popular forms of overseas CSR by Japanese corporations, particularly those operating overseas, is support for local environmental programs. Environmental initiatives comprise the bulk of overseas CSR activities reported by companies responding to the aforementioned Tokyo Foundation survey, and afforestation projects figure prominently in this category. The following are some noted examples.

Toyota Motor Corp. has been engaged for 10 years in a project to stem desertification in China, a key market for the Japanese auto industry. Komatsu (mining and construction equipment), Sumitomo Forestry, and several major paper manufacturers are also carrying out tree-planting programs overseas.

It is particularly common for Japanese companies involved in logging as part of their core business to contribute to the renewal of forest resources through such programs. Afforestation projects are an effective way to enhance a company's global image as a friend of the environment, and their outcomes are visible and easily gauged, making them popular with corporate insiders and consumers alike. The projects themselves are generally administered by Japanese or local NGOs or public agencies, with the corporation providing the funding. This makes such philanthropy easy to implement from the corporation's standpoint. Tree-planting programs may also yield economic benefits for corporations, since they can be converted to carbon credits under the Kyoto Protocol emissions trading scheme.

COMPETITIVE GRANTS AND FELLOWSHIPS Another popular approach to overseas corporate philanthropy is to solicit applications for funding from individuals or grassroots groups oriented to social change. In fact, several Japanese companies have made an important contribution to Japanese international cooperation through ongoing programs of this sort. For more than 30 years, the Duskin Ainowa Foundation, established by Duskin Co. (cleaning products and services), has worked to foster leadership among young people with disabilities by sponsoring overseas training for disabled Japanese citizens and offering training in Japan to disabled persons from elsewhere the Asia-Pacific region. This program has helped build international trust and understanding, and it laid the groundwork for many of the overseas programs currently administered by Japanese organizations for the disabled. The Ajinomoto International Cooperation Network for Nutrition and Health (AIN), established by Ajinomoto (food and chemicals), awards funding for nutrition-related projects, selected from applications submitted by NGOs and NPOs. This program, which has continued for more than 10 years, provided the impetus and know-how for many of the overseas health and nutrition programs launched by Japanese NGOs in recent years.

“CAUSE MARKETING” IN PARTNERSHIP WITH INTERNATIONAL AGENCIES AND NGOS Cause-related marketing, in which a portion of the proceeds from consumer purchases goes to support a designated social cause, is on the rise among Japanese producers and distributors of consumer goods. This is a particularly effective variation on the theme of donating funds to support activities by public agencies, one which makes the most of the growing interest in assistance for developing countries among ordinary Japanese citizens.

One noteworthy example of this model is the Volvic “Drink 1, Give 10” (or “1L for 10L”) campaign, carried out in Japan by beverage giant Kirin in partnership with UNICEF (United Nations Children’s Fund). Through this program Kirin has raised funds to provide clean and safe drinking water for people in Mali over the course of five years while drumming up Japanese sales for Volvic mineral water. It deserves special mention as an example of CSR that yields economic and PR benefits while contributing tangibly to the lives of people in the developing world. Other examples of Japanese cause marketing in partnership with UNICEF are the “1,000 Toilets” project in Timor-Leste, sponsored by Oji Nepia (tissue paper), and the “Wash a Million Hands” project in Uganda, sponsored by Saraya (personal hygiene products). Other companies are carrying out similar programs in cooperation with Japanese NGOs. Morinaga (chocolate and confectionery) is using a portion of its profits to help the nonprofits ACE (Action against Child Exploita-

tion) fight child labor and Plan Japan support children in Africa through its “1 Chocolate for 1 Smile” campaign.

FAIR TRADE The fair trade movement, which promotes fair compensation and decent living conditions for producers in developing countries, was introduced into Japan about 20 years ago. At first the market for fair trade goods was small, with only a handful of NGOs and fair trade organizations importing goods from participating cooperatives. But awareness of the fair trade movement and its products has spread along with public concern over social issues. Today quite a few big corporations have signed on to the fair-trade movement.

The trend has spread particularly rapidly in the food and retail sectors thanks largely to the active involvement of two major players, Zensho and Aeon. Assisting developing countries through the sale of their products is a good way for such businesses to leverage their marketing know-how for the betterment of humanity, and it is also an effective way of conveying their social responsibility to customers. For this reason, the trend is likely to continue.

Expectations Going Forward

How, then, can Japanese businesses beef up their efforts to address social ills around the globe, and what role can public agencies and NGOs play in the process?

LEVERAGING CORPORATE KNOW-HOW, TECHNOLOGY, AND HUMAN RESOURCES Japanese government and industry have been working cooperatively to expand Japan’s economic presence overseas in recent years, and we can expect more and more companies to incorporate overseas sourcing, production, and marketing in their business strategies. Meanwhile, the private sector’s potential contribution to development assistance has emerged as a major topic in discussions about options for assistance after 2015, the target year for the United Nations Millennium Development Goals. The expert panel set up by the Japanese government in March 2014 to update Japan’s ODA Charter has also highlighted the role of private investment and corporate philanthropy in international development.

Much of this discussion has focused on the potential economic benefits of foreign direct investment and BoP business ventures. But businesses can also play an important role in improving social conditions overseas through CSR initiatives. Unfortunately, Japanese companies’ expenditures on international cooperation and development have not kept pace with the public’s interest and involvement, as we have seen. What can be done to close the gap?

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Clearly, Japanese businesses operating overseas need to invest more in CSR activities geared to specific problems in the locales where they do business. In doing so, moreover, they need to do more than contribute money; they must find ways to mobilize their corporate know-how, technology, and human resources.

In the wake of the Great East Japan Earthquake of 2011, a number of Japanese businesses won kudos by mobilizing their own special resources for effect relief programs. Fujitsu created a database to help match victims to relief organizations and services. The Google Person Finder gathered and posted information about the status of individuals in affected areas. And Honda provided access to local traffic data in disaster areas gathered through its bi-directional onboard navigation system. Each of these initiatives reflects a determination to find a way of contributing that capitalizes on the company's strengths. If Japanese businesses would apply the same approach overseas and apply their special know-how to the issues facing developing nations, they could usher in a whole new era of innovative and effective overseas assistance.

GREATER CONCERN FOR THE ENVIRONMENT, HUMAN RIGHTS, LABOR Japanese businesses overseas are all too frequently the subject of controversies stemming from a lax attitude toward the environment, human rights, labor conditions, and legal compliance in the host country. Japanese companies are frequently cited for legal and ethical violations by international advocacy groups, to say nothing of complaints from the local community, and their overseas record is incomparably worse than their performance within Japan. This is a grave matter not only from the standpoint of social responsibility but also from the perspective of business risk management, and it needs to be addressed seriously as such.

In this connection, it is important to remember that global businesses today are being held accountable not only for their own business activities overseas but also for those of subcontractors to whom they outsource production, as well as businesses that supply materials and components. A top sporting goods company came under intense pressure to step up oversight when an international NGO revealed that its overseas subcontractors were using child labor. Western clothing brands have been called to account for substandard labor conditions among their overseas suppliers in the wake of tragedies that killed hundreds of garment workers in the Bangladesh. From society's standpoint, big global corporations bear the greatest responsibility because they have the greatest power and influence. This is something Japanese companies need to keep in mind.

A group of leading Japanese CSR experts recently issued a paper titled "Principles of CSR and CSV." The paper cautions against the growing tendency among

Japanese business leaders to emphasize the concept of “creating shared value” over that of corporate social responsibility in defining the role of corporations in society. The authors of the report seek to shift the focus back industry’s responsibility vis-à-vis its impact on society, as set forth in ISO 26000 (international standards on social responsibility), which emphasizes continuous improvement to minimize a business’s negative impact on the environment and society.

This paper suggests ways in which public agencies and NGOs can help promote CSR among Japanese corporations. They need to take the initiative, as by organizing seminars and other events to inform and educate Japanese businesses about such guidelines as ISO 26000J and the UN Human Rights Norms for Business, and to familiarize business managers with some of the ethical problems and controversies that have arisen in connection with overseas operations and transactions. Government agencies providing support for overseas investment should draw up and publish exacting standards for corporate social responsibility, along with specific guidelines pertaining to child labor and other human-rights concerns. In addition, Japanese NGOs should develop their expertise in areas like environmental protection and human rights so that they can offer CSR monitoring and consulting services to companies that seek such support.

SOCIAL ENTREPRENEURS AS MODELS AND PARTNERS Social entrepreneurs around the world have spearheaded a business-centered approach to social activism that has begun to bear fruit. One of the best-known social entrepreneurship programs is the microfinance service run by the American organization Kiva. Kiva uses the Internet to directly connect small-scale lenders in the industrial world with small entrepreneurs in developing countries. More than 1 million people have used the website to extend loans of \$25 or more, yielding upwards of \$500 million in total investments. Similarly, the US nonprofit organization Kopernik (co-founded by a Japanese national) uses the Internet to solicit funds from individuals and corporations in order to supply people in remote communities with products that improve their lives through innovative but inexpensive technology. To date Kopernik has supplied some 30,000 products to people in 16 countries. Both undertakings take advantage of Internet technology to connect donors and recipients across national borders. They exemplify a new business model that holds the promise of continuity and expansion.

Entrepreneurial approaches to social problems in the developing world are taking hold in Japan as well. One example is Motherhouse, which sells high-quality handbags produced entirely in Bangladesh with local materials, in the process providing training and decent jobs to help lift Bangladeshis from poverty. Another

is Hasuna, a jewelry maker that encourages values-based buying behavior by offering ethical products using environmentally friendly and human rights conscious materials from developing countries. Andu Amet is a purveyor of upscale bags and other accessories made in Ethiopia from Ethiopian high-quality sheepskin. Cross Fields and Very50 are “business-model nonprofits” that provide businesses and individuals with opportunities to train and address social needs in developing countries. Another example is Granma, a Japanese company that provides local support services for Japanese businesses seeking to launch social ventures or BoP businesses in developing Asian countries.

Of course, social entrepreneurs are not concentrated in the industrial world. To the contrary, the majority of social enterprises are local businesses launched in developing countries with the aim of providing the goods and services needed to solve regional problems and improve people’s lives. Such businesses often face higher financial hurdles at the launch and expansion phases than conventional companies oriented to maximizing profits. They also have an acute need for operational know-how and information on comparable undertakings in the region and around the world.

Ashoka was the earliest organization to recognize the potential of social entrepreneurship, and it has had a profound impact on social enterprises and the people connected with them. Using the rigorous criteria it developed independently, Ashoka has selected an elite group of social entrepreneurs called Ashoka Fellows, who receive ongoing support from the foundation and form an influential global network. Another pioneering organization is the US-based Acumen, which raises capital to invest in social businesses around the world. In Japan, Arun is an innovative investment firm that is dedicated to financing social enterprises in Cambodia and other developing countries.

Japanese corporations should pay close attention to these social entrepreneurs and pursue possibilities for collaboration with them. While the benefits of programs by aid organizations and NGOs have a tendency to vanish once the project comes to an end, social entrepreneurship offers the promise of expanding benefits to society through independent, sustainable economic activity.

Furthermore, since social entrepreneurship shares many of the basic management principles followed by conventional businesses, corporations may be well positioned to assess the viability and potential of a social venture from a business standpoint and contribute their own business skills and know-how to the undertaking. In addition, Japanese corporations can learn from the innovations of successful social enterprises and incorporate those approaches into their own CSR programs in developing countries.

Some Japanese corporations are already beginning to offer financial assistance to local social entrepreneurs and the organizations and networks that support them. For example, All Nippon Airways recently established a grant program for Ashoka Fellows. The new Benesse Social Investment Facility, launched by Japanese education giant Benesse, has already invested funds in an Indian education company. If this kind of assistance and cooperation spreads, it could usher in a whole new era in social activism.

TAPPING EXTERNAL KNOW-HOW When planning overseas CSR programs, Japanese corporations have a tendency to choose a general development issue and then donate cash or supplies to an NGO or aid organization working in that area. This simplifies things for the corporation, but it precludes the kind of assistance that leverages that business's unique strengths. It also makes it difficult for a company to reap the internal benefits of corporate philanthropy with respect to the development of human resources and technical expertise. One key step to boosting the efficacy of Japanese overseas CSR is for companies to begin putting their own people on the ground and tackling social problems directly.

That said, it is scarcely practical for a group of employees with no prior experience in a country to march in, assess the needs of the local inhabitants, and design and implement an effective program to match. Corporations need to build new platforms, tapping the skills of employees with overseas experience and forging partnerships with local NGOs and social enterprises. Ricoh, a major manufacturer of copiers and other imaging solutions, recruited employees with international cooperation experience for a project team that is now working on-site with an Indian social enterprise to develop plans for a local BoP business.

Meanwhile, a number of government agencies and NGOs have instituted programs to provide corporate employees with experience in developing countries. JETRO (Japan External Trade Organization) dispatches young interns to work in public and private organizations in developing countries under a government program to foster "international readiness" in the Japanese workforce. The Japan International Cooperation Agency provides corporate employees opportunities for overseas experience and training through its new Private Sector Coordination Volunteer System. The nonprofit organization Cross Fields runs an International Corporate Volunteering program, under which corporate employees put their professional skills to work overseas helping NGOs and social enterprises address social needs.

Through overseas experience in the area of international cooperation, people gain a unique understanding of local culture and society and an ability to function

independently in foreign countries. These qualities are of great value to corporations that are expanding their operations overseas or developing global CSR programs. According to JICA, inquiries from companies seeking to hire Japan Overseas Cooperation Volunteers alumni have quadrupled in the past two years. Daichi Konuma, co-founder and CEO of Cross Fields, and Hiroko Samejima, founder of Andu Amet, are both former JOCV volunteers. As corporate demand for personnel with international know-how continues to grow, NGOs can play a key role by pursuing cooperative human-resource programs consistent with their own mission.

From a long-term perspective, school education has a central role to play in the development of human resources capable of functioning in the global arena. With the help of funding from MEXT (Ministry of Education, Culture, Sports, Science, and Technology), under the Project for Promotion of Global Human Resource Development, many Japanese universities have recently launched study-abroad programs focusing on international development in cooperation with JICA and various NGOs. A MEXT program instituted in the 2014 academic year is providing funding for global education pilot programs at about 50 model high schools. While some Japanese schools have provided a limited amount classroom instruction about developing societies and international cooperation under such topics as international understanding and development, there is clearly a need for more extensive and widespread educational programs to promote understanding of global problems and educate people to fulfill their global social responsibility.

PROMOTING CROSS-SECTOR NETWORKING Earlier we looked at survey results showing that Japanese businesses place a relatively low priority on CSR programs in developing countries compared with the level of interest in the population at large. To a large degree, this failure may stem from insufficient knowledge regarding the situation in developing countries. Corporate officers may worry that they will be unable to explain such programs to shareholders or find qualified personnel to plan and implement them. If we want businesses to invest in more effective global CSR programs, then public agencies and NGOs involved in overseas development need to provide those companies with information on local conditions and problems, share examples of best practices in overseas corporate philanthropy, and offer concrete proposals for company-friendly CSR partnerships.

The nonprofit organization JANIC (Japan NGO Center for International Cooperation) has set up a Network for Promotion of NGO-Corporate Cooperation. Member NGOs and corporations are invited to participate in a variety of networking programs, including symposiums that explore successful NGO-corporate partnerships and task forces devoted to formulating guidelines for collaboration. Such

opportunities for cross-sector networking—preferably including government aid agencies as well as businesses and nonprofits—have an important role to play going forward.

One good way to promote practical, project-oriented partnerships would be to organize forums dedicated to specific areas, such as environment, water, healthcare, education, and human rights, where people from business could meet with representatives of government, academia, and the nonprofit sector to discuss the issues and consider how they can be part of the solution.

July 31, 2014

Recycling and Economic Growth in China's Interior

Kenji Someno

A potential solution to China's environmental woes may be the development of "venous" industries that retrieve secondary materials for reuse by the "arterial" sector in a circular economy. Research Fellow Kenji Someno visited recycling facilities in the fast-growing inland regions of China to learn of the progress being made to formalize what had until quite recently been marginal aspects of the Chinese economy.

* * *

In many Asian countries, an economy is considered to consist not only of "arterial industries" that produce and market goods for the formal market but also secondary "venous industries" that recover used or discarded products, components, and materials—which in themselves have little or no market value—and turn them back into reusable resources.

Creating a Circular Economy

The two are intimately related, with changes in the former having an impact on the latter. Economic growth in China has proceeded at breakneck pace, before measures to deal with its environmental fallout could be put in place. Such headlong development is one reason for the serious air, water, and soil pollution that China has been experiencing in recent years. Said another way, rampant pollution is a telltale sign that venous industries in China have remained largely undeveloped compared to arterial ones.

Until quite recently China's venous activities remained at the most basic level, being largely restricted to the production of fertilizer from human and animal

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waste and straw from the stalks of rice plants in rural communities. Even arterial supplies were unstable until the rationing system administered by the All-China Federation of Supply and Marketing Cooperatives and other firms was abolished in the early 1990s. Most venous initiatives used the same distribution channels as arterial ones, only in reverse. So the All-China Federation of Supply and Marketing Cooperatives was responsible both for providing materials and commodities and recovering the used and waste products after consumption.

From the early 1990s, the rapid development of the arterial economy resulted in venous resources of all kinds, including discarded household appliances and electronic devices, scrap metal, and waste plastics. What was done with these materials? Because China lacked the technology, information, and social systems for recycling, the informal sector comprising farmers and other small-scale operators who had previously recycled things like straw, cans, and bottles now took to recycling the new materials in the same way, working by hand, with little thought for minimizing pollution. Such an unsophisticated approach caused few problems in the past, but when they began handling appliances containing heavy metals and chemicals—piling them up in vacant lots, dismantling them haphazardly, and using toxic solutions to extract components—the result was serious environmental pollution.

Priority on Securing Resources

In Japan, social frameworks for waste disposal were already well developed by the Edo Period (1603–1868). This was partly for hygienic reasons, given the country's hot and humid climate. Not long after the country adopted a modern legal system, the Meiji government enacted the Waste Sanitation Law in 1900. Thus the basic systems, infrastructure, and human resources to support the venous economy were already in place by the early stages of Japan's modernization, and the country was comparatively well prepared to cope with the large volumes of industrial waste generated as the arterial economy flourished during the postwar, high-growth years. For the most part, Japan's venous industries have developed in step with the growth of the country's arterial sector.

China, too, has begun waking up to the need to create a recycling-oriented, circular economy, similar to the initiatives being advanced in countries like Germany and Japan, particularly since the turn of the millennium with the spectacular growth of its arterial industries. China, though, has been driven less by concerns about the environment than the desire to secure resources, and it sees venous companies as the leading players in an environmental sector that is expected to drive China's economic growth in the years to come.

One manifestation of this policy has been the development of urban mining. In May 2010 China's National Development and Reform Commission and the Ministry of Finance announced a plan to develop pilot urban mining facilities in 30 cities within five years—with financial assistance being provided by the central and regional governments—to obtain reusable resources from junked electrical and electronic appliances. Seven newly developed industrial parks were identified as the first group of such facilities: Tianying Recycling Economic Park in Jieshou, Anhui; Ziya Circular Economy Industrial Park in Tianjin; Jintian Industrial Park in Ningbo, Zhejiang; Miluo Industrial Park in Hunan; Huaqing Circular Economy Park in Qingyan, Guangdong; Jinmai Industrial Park in Qingdao; and the Southwest Resource Recycling Industrial Park in Sichuan. The target is for the seven to recycle 1.9 million tons of copper, 800,000 tons of aluminum, 350,000 tons of lead, and 1.8 million tons of plastic by 2015. Another 15 sites have already been earmarked for phase two of the urban mining initiative.

Changes in the Interior

Industrial zones to reclaim materials from industrial waste have been developed since around 2000, in advance of the pilot urban mining facilities. One Japanese city that has been cooperating with these efforts, notably in Tianjin and Qingdao, is Kitakyushu, famous for its “Eco-town” recycling project. China is also advancing circular economy projects in Ziya, Tianjin; Caofeidian, Tangshan, and Zhuanghe, Dalian, and has proposed the joint development of these parks with Japan and South Korea. In addition to these government-led developments, there are a number of informal-sector initiatives that are now recycling substantial amounts of e-waste, such as in the Guiyuzhen district of Shantou, Guangdong.

These recycling efforts are all along the coast, which may be inevitable given that venous industries spring up in areas of vigorous arterial activity. But in recent years, as the pace of economic growth has begun to slow in China's coastal cities, there are increasing hopes of growth and development in the western part of the country. The table below compares the gross regional products of the coastal and inland regions over a five-year period from 2008 to 2012. The country as a whole grew by 163% over the period, with only Tianjin and Jiangsu outperforming the average among the coastal cities. All six provincial-level inland cities, by contrast, grew by 180% or more. It has been argued that the scale of production is much smaller in the inland areas and that most of the growth in these regions has come from public works spending. The growth figures should thus be read with a grain of salt, but they do reflect the government's strong will to develop the western

part of the country and indicate that these efforts are achieving a degree of success.

Gross Regional Product of Major Coastal and Inland Cities

	Gross Regional Product (million yuan)		Growth rate 2008–12 (%)
	2008	2012	
Beijing	11,115	17,879	161
Tianjin	6,719	12,894	192
Shanghai	14,070	20,182	143
Jiangsu	30,982	54,058	174
Zhejiang	21,463	34,665	162
Guangdong	36,797	57,068	155
Hubei	11,329	22,250	196
Hunan	11,555	22,154	192
Chongqing	5,794	11,410	197
Sichuan	12,601	23,873	189
Guizhou	3,562	6,852	192
Yunnan	5,692	10,309	181
China total	316,030	516,282	163

Source: *China Statistics Yearbook (2013)*.

As I have noted, the development of the venous economy follows that of the arterial economy. If this proposition is correct, there should be nascent signs of an emerging venous sector in western China. To get a firsthand look I visited the Niupengzi district of Neijiang, Sichuan, where the Southwest Resource Recycling Industrial Park is being developed.

Old and New Ways of Recycling

Neijiang is a major distribution hub in southwestern China, a city of some 4.3 million located 150 km from Chengdu, the provincial capital, and 140 km west of Chongqing. The new recycling park is being built in Niu-



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pengzi, a village some 10 km from central Neijiang. Driving along Route 321—the main road running through Niupengzi—one notices stacks of junk piled up outside of people’s homes. This continues for several kilometers: there are mounds of trash and waste materials of every kind, from dust-coated TV sets and refrigerators to piles of scrap metal and plastic. The answer to this riddle was that for more than 30 years, this was the site of the Neijiang Refuse Collection and Recycling Market, the largest of its kind in the southwest.



The market specializes in plastic waste, of which it handles more than 600,000 tons—worth over 5 billion yuan (approximately US\$8 million)—a year, or one third of the national total. I stepped out of the car and spoke with an elderly woman by the roadside, asking her how long this town has looked this way. She told me that the amount of refuse flowing into

the region suddenly began to grow in the early 1990s, around the time that economic growth started to accelerate as a result of Beijing’s reform policies.

In front of the house across the street was a heap of waste vinyl. In the courtyard inside, three elderly men were using machines that looked as old as they were to crush and clean the discarded material. The workplace was the epitome of small-scale manual labor—a cottage-industry approach to recycling. There were no facilities to treat the wastewater, which seemed to be simply flowing into the gutter.

A similar approach to recycling can be seen in the Guiyuzhen district of Shantou, Guangdong, but because the e-waste they handle poses a much higher threat of contamination, this method has resulted in serious pollution problems. Local children have been found with high levels of mercury in their blood. By comparison, the situation in Niupengzi seems less threatening, since the bulk of the work involves recycling plastic. Being on the coast, moreover, Guiyuzhen also recycles imported products from Japan, Europe, and the Americas, while Niupengzi mostly processes materials trucked in from Chengdu and other cities in the country’s southwest.

As I walked around Niupengzi I



came across typically Chinese scenes of people sitting in front of their houses playing mahjong or cards. Almost everyone, though, was elderly. A donkey loaded with bricks ambled slowly to a site where a new house was being built. Except for the occasional traffic jam caused by the trucks bringing in new waste, there was none of the bustle one might expect in a market doing 5 billion yuan of business each year.

The Sichuan Recycling Park

I continued down the national highway past yet more piles of scrap until I came to a T-junction where I turned off onto a smaller road. I was immediately greeted by a sight quite different from anything I had seen in Niupengzi. In front of me were lines of spanking new cafeterias and shops, with crowds of busy-looking young people in work clothes on the street. At the end of the road was an immense complex: the Sichuan Southwest Resource Recycling Industrial Park.



On September 22, 2008, the Neijiang municipal government and China Recycling Development Co., the largest resource recycling company in the country, reached agreement on the construction of the Southwest Recycling base, and on November 14 they signed a contract calling for an initial investment of 3.4 billion yuan to develop a recycling park spanning 3.3 square kilometers to function

as the core facility for the recycling base.

The base is a colossal project that will make it the largest recycling center in the southwest, comprising a market covering some 53.3 km² and another area for the deep processing of recycled resources covering 26.7 km². The core recycling park is being built in three phases over five years and is scheduled for completion in 2015. The first phase focused on an area covering 53 hectares and investment of 912 million yuan to develop facilities for retrieving and sorting scrap materials, trading, processing, distribution and shipping, anti-pollution measures, waste management training, scientific and technological research and development, and public services. Phase two involved the construction of a 26.5 ha deep processing area at a cost of 515 million yuan. And phase three, covering 253 ha and costing 2 billion yuan, will expand the park's resource-retrieval and deep-processing capabilities.

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While China Recycling Development, which is developing the site, is not one of the 113 state enterprises belonging to the State-owned Assets Supervision and Administration Commission of the State Council, it is nevertheless China's top recycling company that was founded with State Council backing in May 1989.



In addition to its facilities in Neijiang, the company has bases all over the country, including Qingyuan, Guangdong Province; Luoyang, Henan Province; Changzhou, Jiangsu Province; Linyi, Shandong Province; Lingwu, Yinchuan in the Ningxia Hui Autonomous Region; Tangshan, Hebei Province; Xian, Shaanxi Province; and facilities in Heilongjiang and Jiangxi Provinces.

There are other major recycling firms in China, but most of these operate in only one or at most a few provinces. One reason is the difficulty of obtaining recycling permits, which are issued on a provincial basis and only in small numbers. The fact that CRD has been able to expand its operations nationwide is proof that it has full state approval.

The first phase of construction at the Sichuan Recycling Park began on October 18, 2009. At the time, Tang Limin, the Communist Party chairman for Neijiang, announced that with this project, "We will bid farewell to our history of ill-disciplined development, characterized by high pollution and minimal added value, and move onto the stage of specialized, concentrated, industrial management development." On March 9, 2011, the Neijiang government and CRD signed an investment agreement in Beijing for the second phase of the project. First phase construction was completed on June 5 that year, and the park officially opened for operations, as 120 companies moved in. Work subsequently began on phase two.

When the project was launched in 2009, there were 1,142 recycling companies in the area, employing 7,344 people and processing some 1.5 million tons of waste plastic and other materials a year. The local market, as mentioned above, was worth around 5 billion yuan a year. Because the work was done almost entirely by small companies in the informal sector, though, tax revenue was limited, and pollution was a serious problem. Neijiang no doubt hoped to formalize the sector by inviting one of China's leading companies to the city. Plans call for the recycling park in Niupengzi to recycle 1.85 million tons of resources a year from 2 million electrical and electronic devices and 50,000 scrapped automobiles. This, it is hoped,

should generate sales of 10 billion yuan and profits of 200 million yuan, creating 1.9 billion yuan in tax revenue and jobs for 20,000 people.

As I drove into the recycling park I saw an impressive row of buildings on the left. Belonging to the CRD, they were offices, recycling facilities, and storehouses for venous resources. This was a modern, large-scale facility that was worlds apart from the village's small-scale cottage industries.

Moving further into the site and turning to the right, I came across neatly segmented yards of various recycling firms. Seeing this I understood the reason for the lack of activity in the village—most venous businesses with any financial clout had already moved in to the park, leaving only the smallest businesses operating outside.

Those that had moved into the park, though, were not recycling the waste materials themselves but taking them to the adjacent CRD facilities or selling them to other recycling companies. This arrangement has enabled local workers to keep their jobs while preventing environmental contamination by transferring the actual task of recycling to companies in the formal sector.



A Win-Win Situation?

In summer 2012 I visited Yutian County in the city of Tangshan, site of another CRD factory. Like Niupengzi, this had been a major collection point for used plastic and tires where local farmers living around the factory undertook recycling on an informal basis. The factory manager told me that CRD was persuading these part-time recyclers to focus on collection and leave the task of recycling to CRD to prevent contamination. I was also told that CRD had initiated a training program with a view to employing local farmers to work at its factory.

The Niupengzi project is adopting a similar approach. Inasmuch as the collection of materials is one of the most important things for the venous economy, CRD no doubt wished to tap Niupengzi's track record as a collection hub for waste plastic in setting up its recycling park there.

For the municipal government, too, the project has such benefits as helping to sustain and expand the local economy, boost tax revenue, and conserve the environment. As the project is the only urban mining base in Sichuan Province, support

has been coming from the provincial government as well. In March 2010 the Sichuan Development and Reform Commission named CRD a model enterprise for the development of a circular economy in Sichuan, and in August the same year, the Sichuan government issued the company a recycling permit for the appliances collected under a national subsidy program to encourage replacement buying for aging appliances. As a company with state backing, CRD is supported at the local level as well through the issuance of permits and licenses. It has consequently seen its profits rise, while regional governments have benefitted from a boost in tax revenue and job opportunities, as well as a cleaner environment.

It looks like an obvious win-win situation.

If there is a fly in the ointment, it is the fact that despite all the advantages it receives through preferential government policies, CRD's sales for the year ended October 2010 was just 375.97 million yuan. And although the company paid 63.34 million yuan in value-added taxes that year, at the same time the national government paid 77.22 million yuan in subsidies to the Sichuan Southwest Renewable Resources Industrial Park project.

As a general rule, it is difficult for companies in the venous economy to make a profit from the sale of recycled materials alone, so they need to obtain income from supplementary sources. In Japan, this might be the fee charged for the disposal of industrial waste, while in China it may be subsidies like those currently provided for the recycling of household appliances. For companies in the formal sector that can be expected to undertake recycling with due consideration for the environment, profits in the markets where informal operations remain are likely to be quite low. The elimination of the informal sector is thus of primary importance, not only for reasons of environmental protection but in order to ensure the sustainability of companies in the venous sector.

The third phase of construction on the Southwest Resource Recycling Industrial Park calls for investment on a scale far beyond that required for the first two phases. This raises questions about whether such investments are warranted considering the low anticipated income. Arterial industries, meanwhile, are continuing to grow in western China; in June 2012 the Sichuan branch of CRD signed a cooperation agreement with Korea's SK Group and Suning Appliance, a Chinese electronics retailer. How confident, though, are local governments and CRD itself that the venous economy will see corresponding growth? This is a question that will bear close watching.

May 26, 2014

Closer US-China Ties Test Abe's "Smart Diplomacy"

Takashi Sekiyama

US criticism of Abe's December visit to Yasukuni Shrine elicited a chorus of objections from Japanese politicians, most insisting that the prime minister has been misunderstood. Takashi Sekiyama sees the incident and its aftermath as a sign that Japan has much to learn about "smart diplomacy" in an era of rapidly growing Chinese influence.

* * *

U S President Barack Obama visited Japan from April 23 to 25, being welcomed as a state guest at Tokyo's strong request. This in itself expresses the importance Washington places on its relations with Japan. The joint statement confirmed, moreover, that America's commitment to defend its ally under the Japan-US Treaty of Mutual Cooperation and Security extends to the Senkaku Islands, which Beijing also claims. These facts would seem to suggest that the US government has strongly endorsed Tokyo's position in its confrontation with Beijing.

The reality, however, is not so straightforward. Although hardly reported in Japan, the United States and China have nurtured a very close relationship. This year marks the 35th anniversary of the normalization of diplomatic ties between the United States and the People's Republic of China, and in recent years the US and Chinese heads of state, cognizant of increasing economic interdependence between their nations, have maintained close contact on a wide range of issues, keeping diplomatic relations on a solid footing.

Meanwhile, ties between Tokyo and Beijing—already badly frayed—deteriorated further in the wake of Prime Minister Shinzo Abe's visit to Yasukuni Shrine last December. This paper offers a brief overview of the US-China relationship and explores its implications for Japanese diplomacy.

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US-China Relations Since 1979

For more than three decades following the birth of the People's Republic of China, the US government withheld diplomatic recognition from the Communist regime in Beijing, treating the Republic of China in Taiwan as the legitimate government of China. The United States and China set to work normalizing relations following

US President Richard Nixon's historic visit to Beijing in 1972, and in January 1979, Washington severed diplomatic ties with the ROC and finally shifted its recognition to the People's Republic of China.

In a statement dated January 1 marking the 35th anniversary of US-PRC diplomatic ties, Chinese Minister of Foreign Affairs Wang Yi acknowledged past differences while stressing high hopes for the future. "China-US relations in the past 35 years have achieved historic growth despite ups

and downs," he wrote. "Looking ahead, we are fully confident in the future of our relations." At a press briefing on January 2, US Department of State Deputy Spokesperson Marie Harf responded by saying, "We remain committed . . . to building a stable, reliable, and continuous relationship with China on the military-to-military side, diplomatic side, economic side, and we welcome the rise of a peaceful and prosperous China that plays a constructive role in the region."

US-China relations have deepened over the past 35 years. In the 1980s, during the Cold War, the relationship rested largely on the common strategic goal of containing the Soviet Union. In the 1990s, following the Tiananmen Square incident, it entered a period of tension and turbulence. Since the start of the twenty-first century, however, the two nations have been cultivating ever-closer economic, diplomatic, and person-to-person ties.

On the economic front, the volume of bilateral trade has grown about 200-fold over the past three and a half decades, from less than \$2.5 billion in 1979 to over \$500 billion in 2013. Today the United States is China's biggest export market, China is America's leading source of imports, and the two countries are one another's top trading partners.



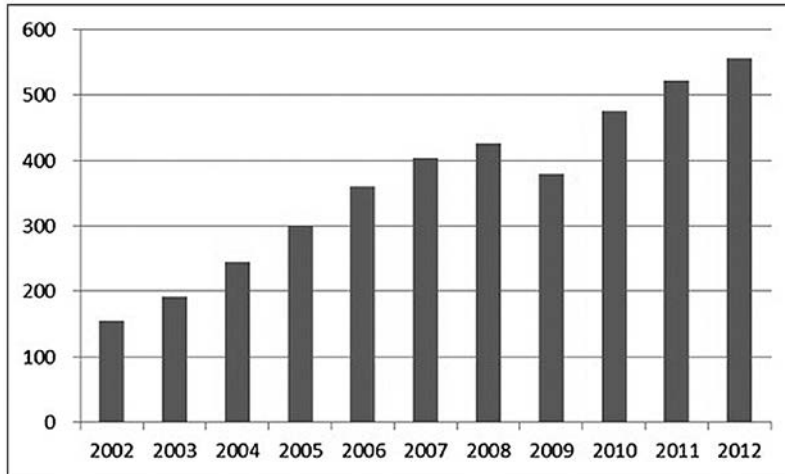
President Obama and Prime Minister Abe hold a joint press conference at Akasaka Palace in Tokyo, April 24, 2014.

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Figure 1. Value of US-China Trade, 2002–12

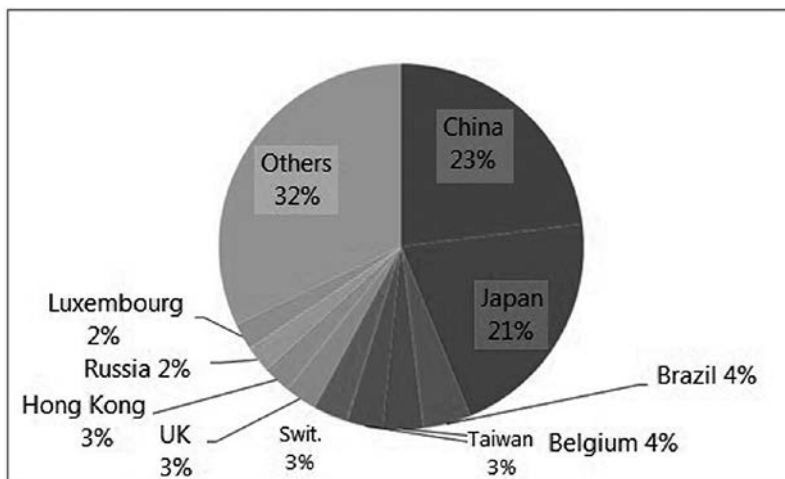
(\$US billion)



Source: World Trade Organization, *International Trade Statistics 2013 (US figures)*.

China is also the world's largest foreign holder of US government debt—a distinction it has held since it overtook Japan in September 2008 at the peak of the financial crisis. Today China holds approximately one-fourth of all foreign-held US Treasury securities.

**Figure 2. Major Foreign Holders of US Treasury Securities
(as of end of November 2013)**



Source: US Department of the Treasury.

Not surprisingly, travel between the two countries has skyrocketed as well. From a few thousand visitors in 1979, the number of people traveling between the United States and China has soared to about 4 million (2013).

On the political front, diplomatic ties have improved dramatically of late. Top US and Chinese leaders have met for bilateral summit talks 14 times over the past five years. In 2013 alone, Presidents Barack Obama and Xi Jinping met twice to reaffirm their nations' cooperative ties. By contrast, Xi has yet to agree to a summit meeting with Prime Minister Abe, who came to office in December 2012.

Washington's focus on improving ties with China predates the advent of the Obama administration, and it crosses party lines. Under the Republican administration of George W. Bush, the United States and China stepped up high-level dialogue under the frameworks of the Senior Dialogue (six meetings between August 2005 and December 2008) and the Strategic Economic Dialogue (five meetings between December 2006 and December 2008).

Since Obama took office, these discussions have continued under the framework of the US-China Strategic and Economic Dialogue. Although the Democratic Party may be the party of international cooperation, the current US emphasis on stronger ties with China is clearly a bipartisan phenomenon.

Building a "New Type" of Bilateral Relationship

During their summit talks last June, President Xi reiterated his proposal for building a "new type of great-power relations"—a cooperative, nonconfrontational relationship based on mutual benefit and respect, as contrasted with the tension and antagonism that persisted between Washington and Moscow and between Beijing and Moscow during the Cold War. President Obama echoed that call.

Of course, Beijing's top political priority is domestic policy, not foreign relations. In recent years, such festering problems as corruption and abuse by local public officials, unemployment among migrant workers, and poor employment prospects for college graduates have fueled growing discontent in Chinese society. Ethnic conflict and separatism are on the rise in regions like Tibet and Xinjiang. Protests and acts of violence have become grown common and widespread throughout China.

The most pressing challenge facing the country's leaders today is coping with these mounting problems while keeping the economy on track. To do this, Beijing needs to focus like a laser on the domestic situation, and this means maintaining a smooth, cooperative relationship with the United States, China's biggest trading partner and a pivotal regional player.

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The Obama administration, which has trumpeted a pivot toward Asia in its foreign policy, is no less determined to maintain constructive ties with Beijing. The top political priority for the Obama administration remains the domestic economy, which has yet to post a strong recovery in the wake of the Lehman crisis. The White House views export growth as a key to reducing domestic unemployment, and it is eyeing China as the country with the greatest potential for absorbing those exports.

In fact, the United States and China have a host of common and overlapping concerns as the world's first and second largest economies and permanent members of the UN Security Council. Among the topics Vice President Joe Biden and Xi covered during some four hours of wide-ranging talks in December 2013 were the Chinese economy, Taiwan, Tibet, US-China economic ties, North Korea, Iraq, and Syria.

Given these realities, we can expect the trend toward bilateral cooperation—particularly in the economic sphere—to continue for the foreseeable future. In terms of intergovernmental cooperation, we can look forward to progress on climate change, energy, and food and drug safety, areas on which the two sides reached basic agreements during Biden's visit. In the private sector, foreign investment should pick up substantially once the two governments finalize the bilateral investment treaty now under negotiation.

In addition, despite a general tendency to regard the Trans-Pacific Partnership as a tool for containing China, participation in the TPP is the next major item on Beijing's international trade agenda after the bilateral trade treaty, according to one high-ranking Chinese economist. Premier Li Keqiang stated in September 2013, at the China-ASEAN Business and Investment Summit, that Beijing was willing to consider a range of regional frameworks, including the TPP, and China's Ministry of Commerce later confirmed that it was deliberating the possibility of joining in the free-trade initiative. Washington has sent positive signals as well; during his visit to Japan in May 2013, Under Secretary of Commerce Francisco Sanchez stated that the United States would welcome China's participation in the TPP.

To be sure, both the investment treaty and the TPP must overcome major hurdles, but there is no question that both countries are making a concerted effort at the government and private levels to strengthen bilateral ties.

Of course, this is not to suggest that the US-China relationship is one of complete mutual trust and satisfaction. Washington continues to voice concern over the Chinese government's suppression of free speech and other human rights abuses, its lack of transparency with regard to continuing increases in military spending, cyber-spying on US corporations and government agencies, and other issues. Even

in the economic sphere, where bilateral ties are relatively untroubled, China's chronic trade surplus with the United States (surpassing \$300 billion) and its frequent violations of intellectual property rights remain a source of friction.

Beijing, for its part, continues to demand that Washington refrain from interfering in matters affecting China's "core interests," including Taiwan, Tibet, and territorial disputes in the South China Sea and East China Sea. While Xi's foreign policy is oriented to maintaining the stable international environment his regime needs to focus on domestic issues, he has also made it clear that he will not compromise where China's core interests are concerned. On the economic front, the Chinese government remains frustrated by American restrictions on high-tech exports to China and on Chinese investment in the United States.

Still, the statement by Foreign Minister Wang cited above and the US response express a mutual determination to maintain a constructive relationship notwithstanding acknowledged differences. While disagreements will no doubt continue to crop up from time to time, both governments have embraced a basic policy of working to resolve such issues through dialogue.

The Specter of Conflict in East Asia

The real shadow hanging over US-China relations today, in fact, is not the bilateral issues noted above but the deteriorating regional situation in East Asia, which threatens to entangle the United States. Territorial claims in the South China Sea have generated friction between China and Vietnam, the Philippines, Brunei, and Malaysia. But even more troublesome from the US perspective may be the escalating territorial dispute between China and Japan, a key American ally. Given the high priority Washington places on cooperative ties with Beijing, Tokyo's efforts to bring US pressure to bear over the Senkaku dispute have placed the Obama administration in an increasingly difficult position.

The US government has articulated its displeasure with any kind of unilateral action that threatens the stability of the Asia-Pacific region. At the same time, the last thing Washington wants now, given its interest in stronger ties with Asia's fast-growing economies, is to throw a monkey wrench into US-China relations. And the United States certainly has nothing to gain from becoming enmeshed in an escalating dispute between Japan and China.

This ambivalence came through clearly in Washington's reaction to Beijing's establishment of a vast air defense identification zone (ADIZ) and its requirement that any aircraft flying through the zone submit its flight plan to Chinese authorities. In a December 4 press conference following Beijing's announcement, Secretary

of Defense Chuck Hagel went no further than to call the “unilateral” policy “destabilizing” to the region, complaining that Beijing had not consulted the United States in advance. Although Washington has refused to submit flight plans for US military aircraft, it has also declined to join with Tokyo in demanding that Beijing rescind the new policy.

All of this helps explain Washington’s reaction to Abe’s visit to Yasukuni Shrine in late December last year. A press release issued on December 26 by the US Embassy in Tokyo publicly scolded the prime minister, saying, “The United States is disappointed that Japan’s leadership has taken an action that will exacerbate tensions with Japan’s neighbors.” In short, Washington treated Abe’s visit to the shrine much as it did Beijing’s establishment of the East China Sea ADIZ—as an action to be deplored on account of its potential to destabilize the region.

Some Japanese leaders have dismissed such objections, countering that the prime minister has every right to honor the spirits of the fallen and should not be deterred by foreign criticism. The author personally sees nothing objectionable in the prime minister’s paying tribute to the war dead while at the same time renewing the Japanese government’s commitment to peace. But there is no denying that, by making a gesture guaranteed to further alienate China and South Korea at a time of troubled relations with both countries, the Japanese government has undercut its own foreign and security policy.

A Test of Japanese Diplomacy

Over the past few years, China has pursued policies and actions that show a determination to change the status quo in the East China and South China Seas. Diplomatically, Japan needs to respond to such behavior by marshaling international opinion in its own favor and showing the world that China is unilaterally destabilizing the region. Unfortunately, Abe’s nationalistic views, as suggested by his Yasukuni visit, have created the impression among Western nations that Japan is also helping to undermine the region’s stability.

On the security front, the Japanese government must take action to ensure that the Self-Defense Forces and the Japan-US alliance serve as an effective deterrent to any possible military challenge from China. Moreover, at a time when fiscal constraints are forcing the United States to trim its military budget, Washington is counting on Japan to assume a greater security role in the Asia-Pacific region.

With these challenges in mind, the Japanese and US governments are discussing the first upgrade to the Guidelines for Japan-US Defense Cooperation in 17 years with the aim of reaching a final agreement within the year. Unfortunately, with

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Japan-China relations as strained as they are today, any move by the United States to upgrade defense cooperation with Japan is likely to fuel mistrust and anti-American feelings among the Chinese. In short, Abe's Yasukuni visit has compromised Washington's ability to pursue constructive revision of the Guidelines. This is scarcely advantageous to Japan's national security.

Since January this year, top Japanese government officials and ruling-party politicians, including Deputy Foreign Minister Nobuo Kishi and former Foreign Minister Hirofumi Nakasone, have been traveling to Washington in an effort to convince US leaders that Prime Minister Abe's motive in visiting Yasukuni Shrine was not to provoke Japan's neighbors but to renew the Japanese government's commitment to peace. Most of the people they have spoken to have responded that, while they appreciate the prime minister's motives as explained to them, the problem from Washington's viewpoint is not Abe's motives but the all too predictable result of his visit. Given the backlash from the Chinese and South Koreans, no amount of explanation regarding the prime minister's good intentions is likely to assuage Washington's "disappointment."

Other reactions from the ruling party have been even less helpful. LDP lawmaker Koichi Hagiuda, special advisor to Prime Minister Abe, responded sharply to the US Embassy's press release, arguing that only the Democratic Obama administration would issue such a statement. "We never had to put up with such fault-finding under the Republicans," complained Hagiuda. Washington's emphasis on ties with China and stability in East Asia, though, reflects a strong bipartisan consensus, as we have seen. It would seem to be the Japanese, rather than the Americans, who are misreading the other side's motives.

Of course, one visit to Yasukuni Shrine is not sufficient to destroy the ties of mutual trust and cooperation that Japan and the United States have developed over the years. But Tokyo's current course is a dangerous one. At a time when not only Washington but also the vast majority of European and Asian governments are keen to maintain stable ties with Beijing, Japan risks isolating itself by needlessly antagonizing the Chinese and then seeking validation from the international community.

Our relationship with China is a complex one, holding within it potential for conflict as well as for great mutual benefit. As such, it must be managed holistically, with close attention to each aspect. It demands the kind of "smart diplomacy" that can secure the economic benefits of friendly ties while guarding against security risks through calm, measured cooperation with other countries that share our concerns. This is the test facing Japan in an era of ever-stronger US-China relations, and it will take all the diplomatic skills our government can muster to meet that challenge.

July 22, 2014

Economic Opportunities Outweigh Risks in China

Kiyoyuki Seguchi

Japanese companies doing business in China have enjoyed a strong rebound in sales over the past year, after protests and boycotts sent sales plummeting in the fall of 2012. Kiyoyuki Seguchi reviews their success and warns that businesses that shy away from China on the grounds of risk are jeopardizing their own survival in the global marketplace.

* * *

With diplomatic relations between Japan and China relations at their lowest point since the normalization of ties more than four decades ago, the influx of Japanese businesses into the Chinese market has slowed. But firms that previously took the time and effort to adapt to China's business environment and establish a foothold in the local market are reaping rich rewards. Their experience offers important lessons for Japanese business in today's global economy.

Business as Usual

More than a year and a half has passed since tensions flared over the Japanese government's purchase of the Senkaku Islands in September 2012, but relations between Tokyo and Beijing remain as chilly as ever. A glimmer of hope appeared in the late summer and fall of 2013, when Prime Minister Shinzo Abe passed up two opportunities to visit Yasukuni Shrine, viewed by the Chinese as a symbol of Imperial Japanese aggression. But that November, Beijing put an end to speculation about an imminent rapprochement with its announcement of a vast East China Sea air defense identification zone covering the Senkakus. And with Abe's Yasukuni visit the following month, the relationship appeared doomed to continue on its frigid course

Kiyoyuki Seguchi *Research Director, Canon Institute for Global Studies.*

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The anti-Japanese protests and boycotts that broke out in China in the fall of 2012 dealt a significant short-term blow to Japanese business activity in China, with sales plummeting in all sectors. But the effect petered out fairly quickly. As early as December 2012, sales had recovered in all major sectors except autos, government procurement, and tourism. By April 2013, auto sales were almost back to year-before levels. By the end of June, Japanese companies were able to bid on Chinese government contracts again, and July sales figures of Chinese travel agencies showed a rebound in group tours to Japan.

In October last year, Japanese manufacturers of automobiles, industrial robots, and farm equipment, among other products, posted record-breaking sales on the Chinese market. In the following, let us examine these trends a little more closely.



© DNC

The guardian lion at the entrance of the Forbidden City, Beijing.

Sales

Japan's big three automakers (Toyota, Nissan, and Honda) made impressive gains in China from September 2013 on. In November, sales of new Nissans and Hondas nearly doubled from the previous year, while Toyota posted year-on-year growth of 40%. Together, Japanese automobiles claimed a 19.2% share of China's new-car market that month, overtaking German cars (15.6%) to reclaim their top position among foreign brands. Sales of auto parts have mirrored this recovery in finished-auto sales.

Meanwhile, demand for Japanese factory automation systems has been soaring, as manufacturers in China scramble to cope with rapidly rising labor costs. In the summer of 2013, Yasukawa Electric launched operations at a brand-new robot manufacturing plant in Changzhou, and Kawasaki Heavy Industries plans to produce robots at a new plant in Suzhou beginning in April 2015. Mitsubishi Electric has also posted rapid growth in Chinese sales of factory automation systems, and Epson's plans to shift robot production from Nagano to its Shenzhen facility testify to a growing emphasis on the Chinese FA market.

Nor is the good news limited to cars and robots. Daikin Industries, for example, is riding a surge in Chinese demand for air conditioners. With sales for the period from April to September 2013 up 45% from the year before, Daikin plans to add 2,000 more sales outlets in China, increasing the total to 14,000.

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In the food sector, Saizeriya, an Italian-style family restaurant chain with about 150 restaurants in China, intends to increase that number to 400 over the next three years. Other companies eyeing ongoing expansion in their China operations include Yoshinoya, a fast-food chain specializing in *gyudon* (“beef bowl”); Muji (Ryohin Keikaku), known for its extensive line of design-conscious, no-frills consumer products; Seven & I Holdings, parent company of Japan’s 7-Eleven chain; and instant-noodle giant Nissin Foods, which plans to build three additional plants in China between now and 2016.

Direct Investment

Underlying the fundamental health of Japanese business in China is the high level of foreign direct investment from Japan, which continues to lead the world in FDI to China. Between January and November 2013, FDI flows to China from Japan totaled about \$6.7 billion, outpacing those from the United States (\$3.1 billion), South Korea (\$2.9 billion), and Germany (\$2.0 billion).

At the same time, FDI from Japan increased at a slower rate—2.3%—than that from the United States or South Korea (both up 8.6%), not to mention Germany (up 43.7%). This represents a sharp drop compared with the previous year’s growth of 16.1% or the 55.0% increase recorded the year before that.

For the most part, this slowdown reflects the reluctance by Japanese companies to launch operations in China in the wake of the 2012 protests, which resulted in boycotts and incidents of vandalism. Companies that had already enjoyed a measure of success on the Chinese market have kept their wits about them, pursuing profits from a smart growth strategy, even while keeping an eye on the risks involved. The rest, however, have been scared off by the gloom-and-doom atmosphere of biased media reports. This gap has been apparent for some time, but it has grown all the more conspicuous since the government purchase of the Senkaku Islands.

Looking Ahead

Japan’s direct investment in China is expected to continue to grow over the next few years, judging by the ambitious investment plans Japan’s major banks have been receiving from client companies. The reason is simple: a burgeoning consumer base that continues to expand at a rate exceeding GDP growth.

Demand for Japanese goods and services typically soars in cities where the per capita GDP has topped \$10,000. By computing the total population of Chinese

cities that have achieved this average income level, one can roughly estimate the number of Chinese consumers in the market for Japanese goods and services. In 2010, that number was approximately 100 million. By 2013 it had grown to around 300 million, and in 2020 it is expected to reach between 700 and 800 million.

Two basic factors are driving the surge in China's (dollar-denominated) per capita GDP: the rapid rate of real economic growth and the appreciation of the renminbi. The currencies of other emerging markets, such as India, Brazil, and Indonesia, have declined in value owing to a deteriorating current account balance. But China has maintained a sizable trade surplus ever since 2005, and as a result its currency has continued to appreciate. This, combined with rapid economic growth, has pushed up per capita GDP in dollar terms.

China's economic growth is expected to remain brisk until around 2020, buoyed by continuing urbanization and infrastructure investment. And barring an unexpected drop in the competitiveness of Chinese exports, the renminbi should continue to appreciate. This means that per capita GDP will keep rising, making it likely that the market for Japanese goods and services will continue to grow.

Surviving in the Global Economy

As previously mentioned, Japanese businesses tend toward two general extremes. At the heart of this gap are disparities in companies' capacity to localize, which in turn determines their ability to succeed in today's global economy.

Japanese companies that have successfully localized their Chinese business operations, recruiting talented Chinese managers to lead their local affiliates or subsidiaries, have deftly navigated China's business environment, with its special risks, and boosted their performance year by year. The key is organizational support from the main office predicated on close communication and mutual trust between the parent company and its local affiliate.

On the other hand, many Japanese businesses have spent years trying to penetrate the Chinese market with very little to show for it. The reason is that they have failed to meet the challenge of localization head-on by tapping capable Chinese executives and delegating genuine authority to them. Meanwhile, those companies that have remained on the sidelines until now are at an ever-increasing disadvantage. Lacking access to reliable local information sources, they allow themselves to be deterred by biased reporting in the Japanese and Western media and hang back until their window of opportunity has closed.

The fact is that the risks traditionally associated with doing business in China—problems recovering payment and protecting intellectual property—are receding in

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importance. From a long-term viewpoint, the biggest risk for major Japanese firms is losing their presence in the Chinese domestic market. Given the size of this market and the huge potential for profit that it offers, firms that cannot compete in the Chinese market are likely face at a significant decline in global stature and corporate value relative to rivals who can make a go of it.

Small and medium-sized firms competing in niche markets may well be able to survive on the strength of their share of the Japanese market and overseas markets other than China. But for major Japanese corporations facing intense global competition from Japanese and foreign rivals, failure to compete on the Chinese market will mean failure to compete in the world. This is the real “China risk” for businesses today. Japanese corporate executives must remember that the best defense is a good offense. If they want to survive in the global economy, they cannot afford to shy away from the Chinese market.

July 8, 2014

Toward a New Japan-Taiwan Business Alliance

Baatar

The rapid removal of barriers to trade and investment between Taiwan and China augurs a new age of cross-strait economic integration. The author examines this changing environment and the unique economic opportunities it offers for Japanese businesses able to navigate the unique triangular relationship between Japan, Taiwan, and China.

* * *

Although Tokyo severed formal diplomatic ties with Taipei when it normalized relations with the People's Republic of China in 1972, Japan and Taiwan have continued to cultivate close economic, cultural, and people-to-people ties in the nongovernmental sphere. The two countries have a fundamentally strong bilateral relationship, buttressed not only by economic interaction but also by deep historical roots and a shared commitment to such values as democracy and human rights.

Given this relationship, it is only natural that Japanese and Taiwanese businesses would enter into a variety of partnerships and cross-border strategic alliances. Moreover, the role of such cooperation has expanded greatly in recent years as Japan has shifted production overseas and turned its attention to emerging Asian markets. Today, Japan and Taiwan have more to gain than ever from a new type of business alliance built on a complementary, symbiotic relationship.

In the following, I assess recent trends in bilateral trade, investment, and people-to-people interchange and explore the possibilities for building new business alliances grounded in the close ties already existing between Japanese and Taiwanese companies.

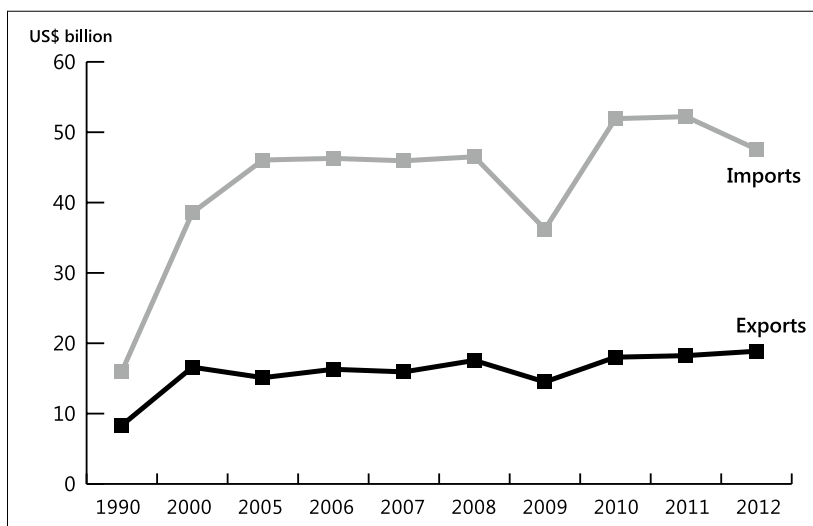
Baatar Associate Professor, Tama University.

Japan-Taiwan Ties by the Numbers

With the exception of 2009, when the global recession precipitated a sharp decline in commerce, the total value of trade between Japan and Taiwan has either risen or held essentially steady every year since 1990. The 2012 figure of US \$66.5 billion (\$18.9 billion in Taiwanese exports to Japan; \$47.6 billion in Japanese exports to Taiwan) was only slightly below the historical high of \$70 billion recorded the year before. Japan is Taiwan’s second-largest trading partner, and Taiwan is Japan’s fifth-largest. According to trade statistics published by Taiwan’s Ministry of Finance, Japan was the world’s fourth-largest importer of Taiwanese goods in 2012 (after China, Hong Kong, the United States, and Singapore), accounting for 6.3% of the total value of Taiwan’s exports. In the same year Japanese products accounted for 17.6% of Taiwan’s imports, the top share for the second year running.

Japanese investment in Taiwan has grown rapidly since the conclusion of the Economic Cooperation Framework Agreement (ECFA) between China and Taiwan in 2010, jumping from 266 cases totaling \$240 million in 2009 to 619 transactions totaling \$410 million in 2012. A major boost came with the signing of an investment pact between Japan and Taiwan in 2011. That year, Japanese firms invested a total of US \$440 million through 441 transactions, the largest numbers ever. This is another sign of increasing economic interdependence between Japan and Taiwan.

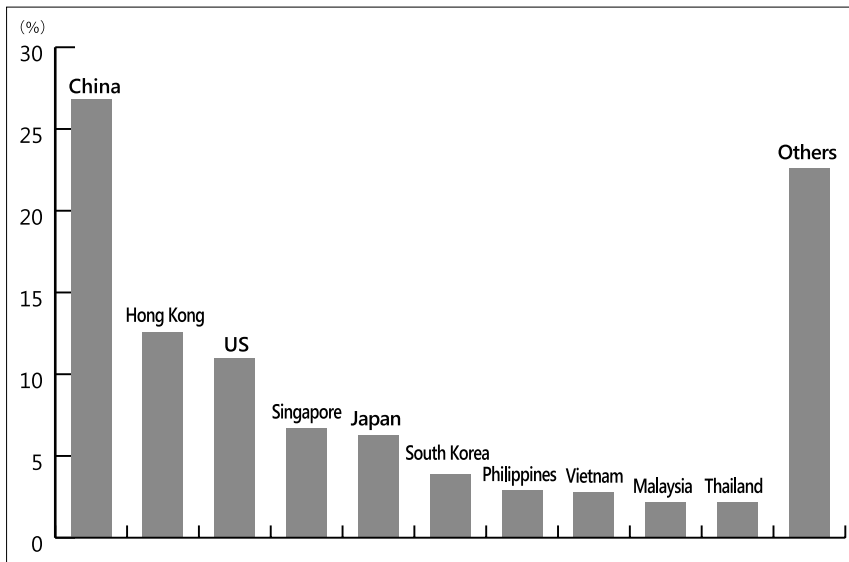
Figure 1. Value of Taiwan’s Trade with Japan



Source: Department of Statistics, Ministry of Finance, Taiwan.

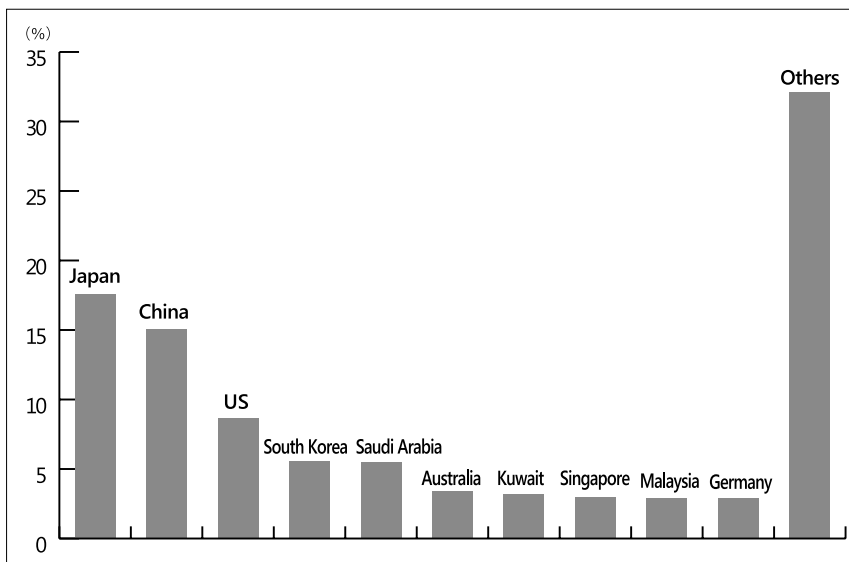
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Figure 2. Taiwan's Exports to Top Trade Partners as Percentage of Total (2012)



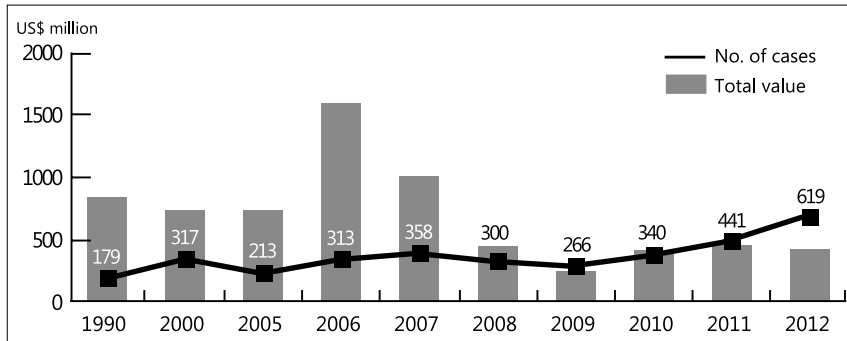
Source: Department of Statistics, Ministry of Finance, Taiwan.

Figure 3. Taiwan's Imports from Top Trade Partners as Percentage of Total (2012)



Source: Department of Statistics, Ministry of Finance, Taiwan.

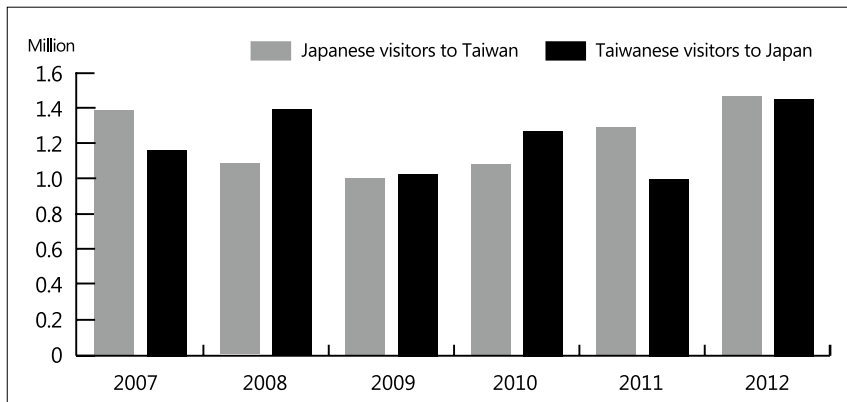
Figure 4. Japanese Investment in Taiwan



Source: Investment Commission, Ministry of Economic Affairs, Taiwan.

Note: Figures are on approval basis.

Figure 5. Travel between Japan and Taiwan



Sources: Japan Tourism Agency; Tourism Bureau, Taiwan.

Taiwanese investment in Japan seems to have entered a new phase as well. In 2012, Hon Hai Precision Industry (the world’s largest electronics manufacturing service company) began negotiating with Japan’s Sharp to buy a major stake in the consumer electronics manufacturer. And in July 2013, CTBC, one of Taiwan’s top financial institutions, reached a buyout agreement with the major shareholders of the midsize Tokyo Star Bank. If the deal goes through, it will be the first takeover of a Japanese bank by an overseas-based institution. CTBC has also been busy signing cooperative agreements with other regional banks around Japan with the apparent goal of building a new business model centered on financing for Japanese firms that want to expand into other parts of Asia.

With closer economic ties has come a surge in people-to-people interchange. Travel between Japan and Taiwan have been on an overall uptrend in the past five years despite the impact of the global recession in 2009 and the Great East Japan Earthquake in 2011.

Tourism between the two countries received an important boost from the conclusion of a bilateral open skies agreement in November 2011. Since then, airline routes have opened up between Taipei and such regional Japanese cities as Kagoshima, Shizuoka, and Toyama, and visits in both directions have soared. In 2012, according to statistics from the Japan Tourism Agency and Taiwan's Tourism Bureau, 1.43 million tourists visited Japan from Taiwan, the second-largest number by country. Likewise, Japan accounted for the second-largest number of visitors to Taiwan, with 1.47 million tourists. The result was the largest two-way flow of visitors ever.

Taken together, the ongoing increase in trade, the improved investment climate, and the surge in people-to-people links between Japan and Taiwan make a compelling argument that the two countries are entering a new phase in bilateral relations.

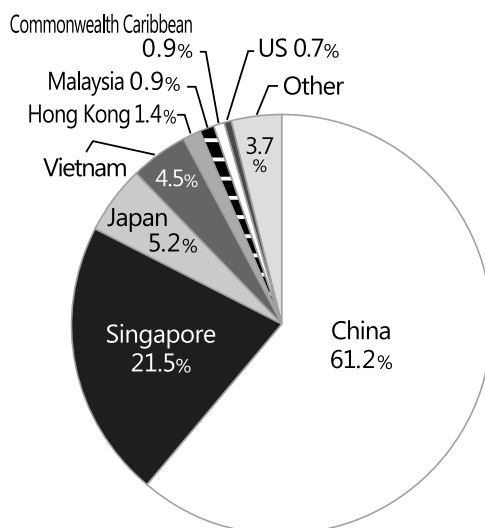
Moves toward Cross-Strait Integration

A key factor behind the increase in economic interaction between Japan and Taiwan is the trend toward economic integration between Taiwan and mainland China.

Taiwanese firms have been expanding into mainland China since the 1990s, when Taipei relaxed restrictions on investment in the PRC. Since then, Taiwanese businesses are estimated to have made roughly 80,000 investments in China totaling somewhere between US \$100 billion and \$150 billion. In a list of China's biggest exporting firms of 2010, published in 2011 by the Chinese government's General Administration of Customs, 13 of the top 20 companies were based in Taiwan. Making the most of China's industrial agglomeration and the extensive networks linking Taiwanese companies, these firms have emerged as major players in the Chinese market, making an important contribution to the China's economic development.

Foreign investment by Taiwanese firms in China accelerated after President Ma Ying-jeou came to office in May 2008. As part of his policy of reconciliation with Beijing, Ma dramatically loosened restrictions on investment by Taiwanese high-tech firms in China. In 2010, capital flows to China accounted for more than 80% of all foreign investment by Taiwanese businesses. Although diversification reduced that share to 60% in 2012 (according to Taiwan's Investment Commission), China remains far and away Taiwan's favorite target for foreign investment.

Figure 6. Taiwan’s Top Foreign Investment Destinations as Percentage of Total (2012)



Source: Investment Commission, Ministry of Economic Affairs, Taiwan.

The rate of cross-strait people-to-people exchange jumped when Taiwan lifted its ban on Chinese tour groups in 2008. In 2010, China sent more tourists to Taiwan—1.63 million—than any other country, overtaking Japan to claim the top spot for the first time. The number rose to 1.78 million in 2011 and 2.59 million in 2012 in the wake of a decision by Taipei to admit individual tourists from 26 mainland Chinese cities between June 2011 and August 2013. Meanwhile, the number of Chinese employed by Taiwanese-owned businesses in China surpassed 12 million, and the number of Taiwanese citizens working in mainland China hit 1 million (3 million including family members). These figures indicate a new burst of economic and interpersonal interaction accompanying recent improvements in cross-strait relations.

The most important development in cross-strait economic integration was the June 2010 conclusion of the Economic Cooperation Framework Agreement, a preferential trade agreement between China and Taiwan that came into effect in September 2010.

The ECFA consists of a wide range of measures for economic liberalization and cooperation grouped under four major headings: trade and investment, economic cooperation, early harvest (accelerated tariff reduction), and other provisions (dispute settlement, etc.).

Under the “early harvest” program, both sides committed themselves to phas-

ing out tariffs on specified products beginning in January 2011. China agreed to lift tariffs on 557 goods and liberalize investment in 11 service industries, while Taiwan pledged to lift tariffs on 267 goods and liberalize investment in 9 service sectors. The Taiwanese products covered by China's tariff reductions amounted to about \$13.8 billion worth of imports in 2009, or 16.1% of the total. The Chinese products covered accounted for about \$2.9 billion the same year, or 10.5% of the total value of Chinese imports into Taiwan. By January 2013, tariffs on the specified products had been eliminated entirely.

In this way the government in Taipei has actively pursued economic cooperation with China in a bid to avoid the marginalization of the Taiwanese economy amid moves toward regional integration—particularly the China-ASEAN FTA that came into effect in 2010. It is also hopeful that the ECFA will pave the way for bilateral agreements with other major trading partners, such as Japan, the United States, and Singapore, while strengthening the competitiveness of Taiwanese business in the region and enhancing Taiwan's position in the regional economy.

More recently, Taiwan and China concluded an agreement for the protection and promotion of bilateral investment and an arrangement for customs cooperation at the eighth round of top-level talks between Taiwan's Straits Exchange Foundation (chaired by Lin Join-sane) and China's Association for Relations Across the Taiwan Straits (then chaired by Chen Yunlin), held in Taipei in August 2012. The SEF and the ARAT are quasi-official organizations charged with negotiating technical and economic agreements between Taiwan and China.

In the period spanning June 30, 2009, when Taiwan relaxed its restrictions on Chinese capital inflows, and the end of 2012, investment by Chinese businesses in Taiwan hit the \$500 million mark. Much of this activity occurred in 2012, when China's Bank of Communications and Bank of China both opened their first Taiwan branches. In 2012, the number of investments from China rose 35% to 138, while their total value jumped 650% to \$328 million. With the signing of a bilateral agreement on trade in services in June 2013, the expansion of economic ties between China and Taiwan can be expected to continue full throttle.

Another significant development is the Taiwanese government's decision to allow Chinese businesses and their engineers to operate in Taiwan's new "free economic pilot zones" under the same conditions as other foreign firms and employees. Taiwan has long prohibited Chinese entities from acquiring a controlling stake in Taiwanese IT businesses out of security concerns, but in the new FEPZs, launched in August 2013, these restrictions have been relaxed. For the first time, a Chinese firm will be able to take a controlling stake in a joint venture with a Taiwanese company in such key areas as semiconductors and liquid crystal displays.

One of Taipei's key objectives in liberalizing trade and investment with China in this manner is clearly to facilitate Taiwan's participation in trade agreements with other countries. In early July 2013, Taiwan and New Zealand concluded a de facto FTA, the first such agreement between Taipei and a government with whom it does not have diplomatic ties. In response, China's Foreign Ministry commented that it had no objection to "nongovernmental business and cultural exchanges" between Taiwan and other countries, signaling Beijing's acceptance of such pacts, which it has opposed in the past. The agreement with New Zealand was succeeded by a similar pact with Singapore, and Taipei has expressed interest in an economic partnership with Japan as well. It has also indicated that it hopes to participate in the two regional free trade frameworks currently under negotiation: the Trans-Pacific Partnership, currently consisting of 12 nations, including the United States and Japan; and the Regional Comprehensive Economic Partnership, involving 16 countries spanning Asia and Oceania, including Japan, China, and South Korea.

The trend toward integration of the Chinese and Taiwanese economies can be expected to continue, aided by the ever-expanding activity of Taiwanese business in China. Japanese business leaders and analysts are watching the trend with great interest, since integration promises a whole new range of possibilities for alliances between Japanese and Taiwanese business.

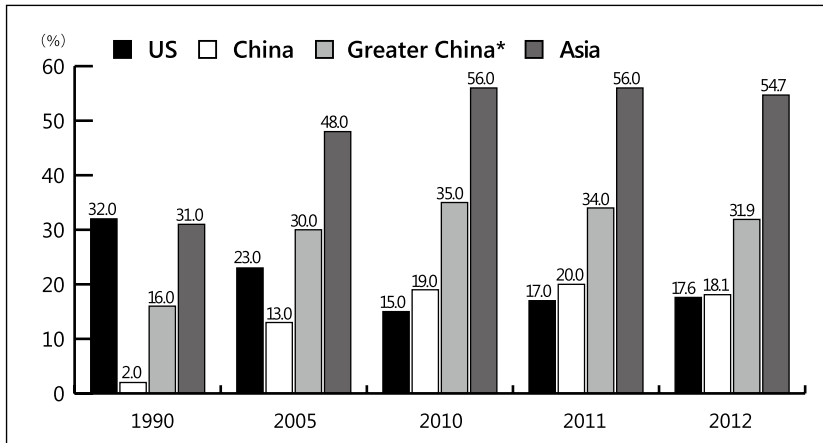
A Half-Century of Business Partnerships

Japanese businesses have been forging cross-border partnerships with Taiwanese firms for decades now, though the form these tie-ups take has evolved with the times and the changing needs of both countries. From the mid-1960s through the 1970s, Japanese manufacturers looked to Taiwan as a base for the assembly of manufactured exports. The period spanning the 1980s and the early 1990s saw the rise of cross-border partnerships in third countries. From the mid-1990s to the mid-2000s, Japanese corporations began developing stronger complementary relationships with Taiwanese industry as their operations expanded into other Asian countries.

The structure of Japanese trade has changed dramatically since the 1990s, with the focus veering sharply away from the United States and toward Asia. Between 1990 and 2012, the share of Japanese exports bound for the United States fell from 32% in 1990 to 17.6% in 2012, while Asia's portion rose from 31% to 54.7%. During the same period, China's share of Japanese exports soared from 2% to 18.1%; and exports to Greater China (China, Hong Kong, and Taiwan), meanwhile, rose from 16% to 31.9%

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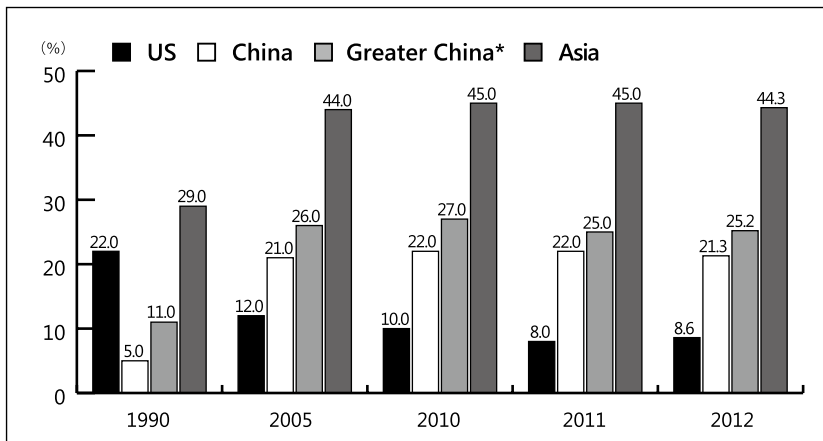
Figure 7. Japan's Exports to Major Trade Partners as Percentage of Total (2012)



*China, Hong Kong, and Taiwan

Source: Trade Statistics, Japan Ministry of Finance.

Figure 8. Japan's Imports from Top Trade Partners as Percentage of Total (2012)



*China, Hong Kong, and Taiwan

Source: Trade Statistics, Japan Ministry of Finance.

Much the same trend can be seen in Japan's imports. From 1990 to 2012, the share from the United States fell sharply, from 22% to 8.6%, while the contribution of Asian goods rose from 29% to 44.3%. Here, too, China's share grew dramatically, from 5% to 21.3%, and Greater China's ratio jumped from 11% to 25.2%.

China has emerged as an economic powerhouse that supports the global econ-

omy not merely with its labor force but also with its huge and rapidly developing market, and now the progressive integration of the Chinese and Taiwanese economies is further transforming the international economic landscape. Japanese businesses need to adapt by forging new and stronger business alliances with Taiwanese firms already well established in China. Taiwan can be their gateway to the Chinese market by making maximum use of the ECFA to facilitate their expansion. In addition, they should begin to think of Taiwan, Hong Kong, and even Singapore as belonging to a single Greater Chinese economic zone.

Penetrating the Chinese market through Taiwan can be facilitated by forging partnerships with Taiwanese businesses. Today several circumstances are conspiring to encourage the growth of such cross-border ties. One is the conclusion of the ECFA, which seeks to integrate the Chinese and Taiwanese economies and create a free trade zone. Another is the development of increasingly complementary relationships between Japanese and Taiwanese business. The Taiwanese government is also actively promoting Japan-Taiwan cross-border alliances. And last but not least is the affinity so many Taiwanese feel toward the Japanese people; indeed, in a 2010 public opinion survey carried out by the Interchange Association, which represents the government of Taiwan in Japan, 52% of respondents chose Japan as their favorite country.

Leveraging Both Sides' Strengths

To operate effectively in the Chinese market, the partners in a Japan-Taiwan business alliance must establish a complementary relationship that makes the most of each side's relative strengths. Let us examine what Japanese and Taiwanese businesses can bring to the table when it comes to doing business in China.

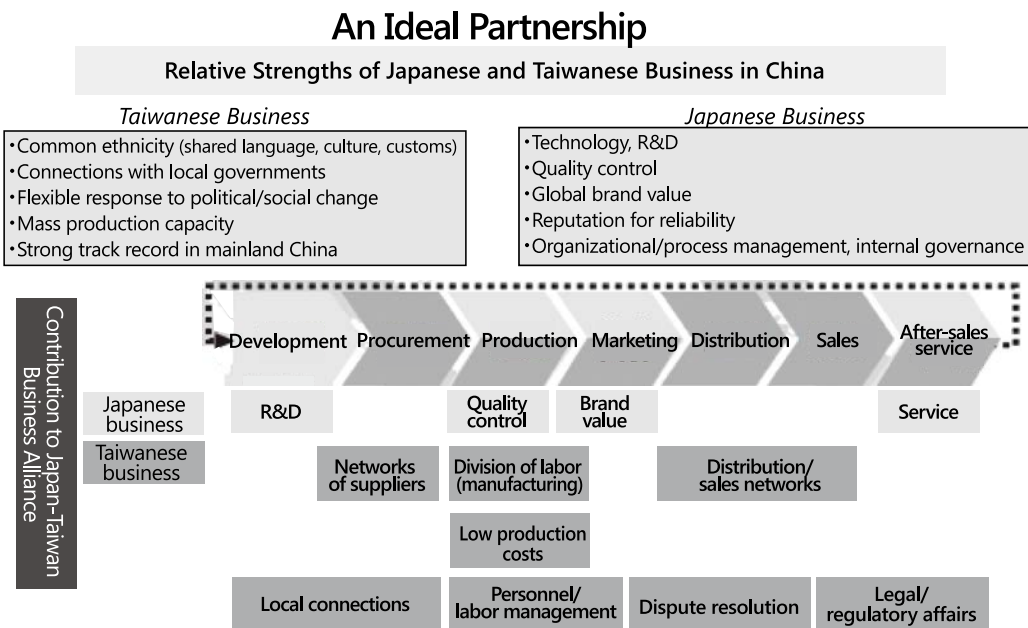
Chief among the advantages Taiwanese business enjoys are its global value chain; its affinity toward Japan; its networks of interpersonal relationships and ability to negotiate in a Chinese milieu (including connections with local governments); its relatively advanced industrial technology and fast, low-cost mass-production systems; its ability to tailor its products to the needs of the local market; an impressive track record of achievement in China; the ability to respond flexibly to political and social change; and the ethnicity (language, culture, customs) it largely shares with the mainland Chinese.

Japan, meanwhile, brings its technological know-how and capacity development and innovation; top-notch quality control; brand recognition and value on a global level; an international reputation for reliability; and advanced organizational management, process management, and internal governance systems.

The key to successful business alliances between Japanese and Taiwanese firms is a rational division of labor that leverages the relative advantages of each side at various stages, from research and product development to procurement, production, marketing, distribution, sales, and after-sales service, as illustrated in Figure 9. Simply put, this means building an integrated regional value chain that brings Japanese technology and product design to the emerging Asian markets—China’s in particular—using materials and parts sourced from Taiwan, test-marketing on the Taiwanese market, and tapping the business networks of Taiwanese companies operating overseas.

The liberalization of trade and investment between China and Taiwan offers a wealth of opportunities for Japanese businesses with Taiwan connections. Those that have been providing products and services for the Taiwanese market can make use of the know-how, business partnerships, and human resources they have acquired in the process to secure a role for themselves in the cross-strait development projects that are expected to emerge as liberalization of China-Taiwan trade and investment progresses, thereby accelerating their expansion into China. Corporations that have partnered with Taiwanese companies in the manufacture of products for global export, whether through joint development or outsourcing of components, will be able to secure a cost advantage over the competition by selling

Figure 9. Japan-Taiwan Business Alliance



products on the Chinese market that have been assembled in China. Japanese businesses with corporate clients in Taiwan may now find it strategically advantageous, given the favorable winds generated by the ECFA, to use Taiwan as a base for development and export.

With a few exceptions, small and midsize Japanese businesses have made relatively little progress expanding overseas, owing to limited resources and the risks of launching business operations in an unfamiliar environment. But given the rapid improvement in cross-strait relations in recent years, these smaller businesses may find they can acquire the resources they need to penetrate the Chinese and other emerging markets by forming business alliances with Taiwanese counterparts, making the most of each side's strengths and compensating for one another's weaknesses.

Of course, any Japanese business considering such an alliance needs to draw up an individualized blueprint tailored to its own sector and business strategy, with the lessons of previous partnerships in mind. The choice of a partner is also critical, as the success of any business alliance depends on finding a good fit in terms of mutual trust, the potential for a mutually complementary relationship, and the ability to embrace a common vision at all levels of management.

Conclusion

In Taiwan's January 2012 presidential election, incumbent President Ma Ying-jeou of the Kuomintang, with Wu Den-yih as his running mate, fended off a challenge from the opposition to secure a second term. Setting forth his policy agenda for the next four years, Ma stressed his administration's ongoing commitment to preserving the political status quo in the Taiwan-China relationship based on the "three no's" (no unification, no independence, no use of force). At the same time, he pledged to continue his policy of reconciliation centered on stronger economic ties by pushing for early negotiations oriented to further liberalization, including tariff reductions, under the ECFA.

On the Chinese side, at the 18th National Congress of the Communist Party of China in November 2012, party leaders called on Taiwan to join in discussions for a peace agreement (activity report by then General Secretary Hu Jintao) and voiced Beijing's intent to wrap up follow-up talks for tariff reductions and deregulation under the ECFA by the end of 2013 (press conference by then Minister of Commerce Chen Deming).

This was a time of rising tensions between Japan, China, and Taiwan over the Senkaku Islands (referred to as the Diaoyu Islands in China and the Diaoyutai

Archipelago in Taiwan). In August 2012, President Ma proposed an East China Sea Peace Initiative to preserve peace and stability through economic cooperation aimed at sustainable marine development for the mutual benefit of all three parties. Urging all sides to refrain from escalating the conflict and to commit themselves to a peaceful resolution, he called for the adoption of an East China Sea “code of conduct” based on a trilateral consensus and the creation of a formal mechanism for joint development of resources in the East China Sea.

Ma has described Taiwan’s relationship with Japan as a “special partnership” that he wishes to maintain and has pledged not to side with Beijing against Tokyo over the Senkakus. On April 10, 2013, Japan and Taiwan concluded a fisheries agreement, which went into effect a month later. On November 5, 2013, the Taiwanese and Japanese negotiating authorities signed five documents agreeing to boost cooperation on electronic commerce, patent priority claims, pharmaceutical regulations, railways, and maritime search and rescue. On November 28, they signed a memorandum of understanding on financial supervision aimed at maintaining the health of the financial system through exchanges of information between financial authorities.

These developments have set the stage for further progress in the development of Japan-Taiwan relations. In such an environment, partnerships between Japanese and Taiwanese industry can function not only to maintain strong bilateral ties at the private level but also to help stabilize political and diplomatic relations in the region.

In our age of globalization, the economic dynamism of China and other emerging markets is the engine that powers the global economy. Japanese businesses need to understand which way the wind is blowing and actively explore the possibilities for tapping into Asia’s emerging markets by leveraging its deep ties with Taiwanese industry to build a new type of cross-border business alliance.

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Working with Nigeria's Change Makers

(1) Leadership Training in New York

Suzuka Kobayakawa

In September 2013 Suzuka Kobayakawa began her 12-month fellowship under the Tokyo Foundation–Acumen Global Fellows Program. In her first report, she details her experiences during the initial training phase in New York before going to work at Pagatech, an innovative startup delivering universal access to financial services in Nigeria.

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Life in the “Real World”

It was mid-September when I landed at JFK Airport, full of anticipation and excitement. With me were two suitcases containing everything I would need for the year ahead, which I would spend in New York and Nigeria. I took a taxi at the airport and headed to my new home in Brooklyn.

On the way, many thoughts swirled through my mind. I knew the kind of people the Acumen program attracts, and just thinking about meeting them during my training in New York thrilled me: They were determined to stand with the poor, prepared to listen to unheard voices. They valued generosity, accountability, humility, audacity, and integrity. They listened to others and respected their views. I felt sure I was going to learn a lot from



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them, and hopefully I could offer something for them as well. How far would we be able to grow?

When I arrived in Brooklyn, I signed the lease papers, and the agent handed me the key. I opened the door to find a number of fellows waiting to give me a friendly welcome: my new roommates, with whom I would spend every waking moment for the next two months.

There were 12 global fellows this year from 11 countries. We'd been in touch several times by phone and email before coming to the States. At some stage someone suggested the idea of renting an apartment together; eventually, seven people signed up and agreed to share a nine-room house. Until now we had only met online. Now we were about to embark on a life together in the real world. So, we took to calling our new home the "Real World House."

Training Begins

The Acumen office is located inside the Google Building in Manhattan. Whenever I enter a building like this I find myself looking up at the list of tenants and musing about the people who work there. It must be a carry-over from my days in sales, I guess. I observed people as they hurried past, trying to figure things out about them from their facial expressions, the way they dressed, and the things they talked about.



Brooklyn Bridge Park, a 10-minute drive from the "Real World House."

What kind of approach would be effective if I were trying to seal a deal with these people, I wondered. My reverie was interrupted when a man I had never seen before suddenly walked up to me and greeted me with a smile. "Hey! You're Suzuka, right? You used to work in Nepal? Welcome to Acumen!"

I was quite taken aback to be addressed by name by someone I'd never met before. How did he know who I was? He laughed and told me he had looked at the bios of this year's fellows on the Acumen webpage and committed a little bit about their backgrounds to memory. This wasn't the only time I was impressed by people at Acumen. The positive impression was reinforced again and again in the hours that followed.

Everyone I met in the office knocked me out: their inspiring presence, their

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beautiful manners, their stellar backgrounds. They all seemed to be such great listeners and observers of people. I was struck by how considerate they were, by their communication skills, and by the sense of fulfillment that seemed to emanate from inside them. I also got to meet Jacqueline Novogratz, Acumen's founder. I had longed to meet her ever since I read her memoir, *The Blue Sweater*. Everybody was simply brilliant.

The next month shot by. Our days were packed with activity: We met the previous year's fellows and listened to their experiences and advice, we got tips from TED speakers on how to get our stories across. In between, I grabbed every free moment I could to catch up on my reading for the next session. And then there were the probing sessions at the leadership workshop, kicking off with a grueling period of introspective silence that seemed like it would never end.

During our financial training, when we dealt with cash flows and balance sheets totaling millions of dollars, we went through a moral imagination exercise in which we were sent off with just five dollars and a subway ticket to experience the life of New York's poor. In another exercise on human-centered design, we took to the subway in wheelchairs and blindfolds, trying to come up with feasible ideas for a public transportation system more accessible to handicapped people.

Self-Exposure

After just two weeks, we were all settled into our new environment and knew one another quite well. It was during the third week, just after the long periods of silent



Participating in a training course in finance with other global fellows.

reflection at the leadership workshop, when one of the other fellows remarked to me: "The things you talk about often seem to hinge on the idea of strength and weakness." It is certainly true that I have often wished for more strength and that I tend to think of weakness and lack of power as fearful things. I'm not talking only about physical strength. I mean other types of strength as well: economic and political power, knowledge, net-

works, emotional strength, kindness, and generosity.

I have always worked hard to make myself stronger and to overcome weaknesses and vulnerabilities. However, the Acumen training was centered on the idea

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that we should reveal ourselves to one another as we really are, weaknesses and all. It made me feel uncomfortable.

My fear of being vulnerable dates back to that impressionable period in early adolescence when I was an avid reader, reading whatever came to hand. Some of the books I read dealt with cruel themes: things like war and conflict, poverty, violence, injustice, and discrimination.

There were terrible descriptions of a baby being tossed into the air and impaled on a bayonet and of child victims of human trafficking. The revelation that there were still parts of the world where a girl my age could be stripped of her dignity and forced to suffer unbearable pain shocked me to my core. I could barely believe what I was reading.

Throughout human history, those who suffered were always women, children, and others in positions of weakness. For me, weakness was something to be feared and avoided at all costs. This idea was stamped on my consciousness from my early teens. A frightening encounter with a sexual pervert during puberty only reinforced the idea that as a girl I had been born on the side of the “weak.”

To overcome my fear, I took up martial arts. I got a black belt, gulping down protein drinks and building up muscles and eventually bringing home trophies and prizes from various tournaments.

Having grown up with values like these, there was no way I could expose my vulnerabilities in front people I had only just met—especially when they all had such glittering backgrounds. If anything, the idea made me feel more defensive than ever. I believed that I was well aware of my own weakness and was doing a decent job of dealing with them. It was because I knew my weaknesses so well that I worked hard to make up for them. I even had a number of “calculated weaknesses” that I didn’t mind letting people see in order to break down the distance between us. Wasn’t that enough?

I couldn’t accept the idea of telling others about my hidden inferior complexes: my cowardice, shallowness, inadequacies, selfishness, and lack of confidence. I worried that they would be disappointed if they found out, so I protected myself and tried to make sure that no one ever knew.

The other fellows often asked deep, probing questions, though. They were probably trying to get to know the real me. I should have been grateful. They were so sensitive and observant that they must have noticed there was more to me than I was letting on. Besides, we had plenty of time to deep dive into our inner selves. In the Acumen office we worked together, discussing issues until business closed, and in the Real World House we cooked together and sat up talking till late. Trying to articulate the subtle ins and outs of your inner self is difficult in any language.

Having to do it in English, which wasn't my mother tongue, made it even harder. It wasn't easy to explain the different values and different ways of thinking that had been shaped by experience without touching on my vulnerability. I just smiled and hoped others wouldn't see through me.

The effort exhausted my already tired brain, worn out after the Acumen training during the day. I would collapse into bed and fall asleep over my reading assignments and preparations for the next day. The next thing I knew, it was morning. And so it went on.

What Is Leadership?

I suppose everyone has their own idea of what a leader is and what leadership entails. For me, a leader is someone who can unlock the potential in others and by so doing boost the performance and happiness of the whole group; someone who can correctly grasp the situation and make the best decisions based on the evidence; who can respect and bring together different positions and opinions, diverse philosophies, and values.

A leader is someone with the power to move things forward through inspiring speeches, someone with a rich knowledge and understanding of the world, who is trustworthy and in control, with an extensive network of contacts; someone who is attractive as a human being.

My "factors for an ideal leader" did not include any weak points. Therefore, my weaknesses, I felt, were exactly what I didn't need. I worked much harder on building my financial, operational, and other hard skills than on opening myself up and exposing my vulnerabilities to others.

I felt vindicated in my approach when one of the facilitators remarked one day: "Ideas of leadership are just illusions. Leadership is about taking action." When I look back on it now, I think the message we were meant to take from this was that it is important not to be trapped by fixed and traditional ideas of leadership; you need to make sure that the action you're taking is really adaptive to the circumstances. But at the time I interpreted it to suit my own ideas: "Don't waste time discussing concepts and ideas; it's action that counts."

If you want to change something, I thought, actions work better than words. And so I worked on building my strengths and conquering my weak points instead of talking about it. I recoiled from the idea of revealing the weaknesses I knew existed inside me, and tried to keep it hidden. It was only when we entered the second half of our training that my refusal to acknowledge my weaknesses started to cause me problems.

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