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# Corporate values and responsibilities



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Corporations' social roles and the questions of their values and responsibilities are the topics of the day increasingly discussed at various fora. What triggered such onslaught of discussions was the incident of frauds and false accounting uncovered at Enron, which allegedly exposed the shortcomings of US style capital management that aimed to maximize shareholder earnings. In contrast, European corporations are more inclined to build a system on a rational that aims to attain sustainable development through synergy between society and corporations as entities existing within the boundary of a society.

In Japan, the debates of corporate social role or social responsibility have undergone some changes over time. First, at the times of post-War restoration and rapid economic growth that followed, corporations were expected to expand production capacities thereby to provide more employment opportunities, and eventually to become a driving force of economic growth that could lead to improved standard of living.

In 1970's and 1980's after the high economic growth period, people started to seek qualitative fulfillment of their lives rather than quantitative expansion, and at the same time severely criticized corporations for their role in causing pollutions, such as the cases of Minamata Disease and Itai-Itai Disease, and selling unsafe products.

During the so-called bubble economy, corporations made a rush to the pursuit of profits in a manner almost like a money worshiper, and frantically sought speculative investments on stocks and real estates to the extent of corporate crimes involving management executives.

In 1990's and in this 21<sup>st</sup> Century, there has been a call for management reform to respond to economic globalization and revolutionary information technology development. At the same time, there have been growing interests on the responses toward global environmental conservation. What are expected of corporations have changed to involve the roles as a driving force for information technology revolution, as an entity to coordinate between the interests of shareholders and stakeholders, to conserve natural environment, and to respect

basic human rights.

I believe that the corporate social roles can be summarized to three aspects. First of all, corporations need to pursue business profits. In order to ensure shareholder's and stakeholders' benefits, and to build internal reserves, management executives of corporations must improve corporate profitability. For this purpose, corporations need to utilize IT to build more sophisticated strategy plan, and to improve efficiencies in clenching demands, developing products, managing production operation, procuring materials and equipment, distributing and transporting commodities, and providing customer services.

In these days, more corporations undertake management reforms such as the introduction of outside directors, separation of functions between board directors and executives, carrying out a companies-within-a-corporation system, while exerting efforts to develop ties, mergers, take-over, outsourcing, etc. Other important tools to secure profitability include new technology development and risk management.

Secondly, CSR is to contribute to the realization of human values. On one hand it is to realize the values of customers. Those customers in highly developed consumption society seek values such as culture, education, health, environment, safety and security. Corporations must respond to such consumer values.

On the other hand, it can be to realize the values sought by employees. Employees want to receive proper assessment of their works, while pursuing the sense of participation in corporate activities. They also seek values such as the fulfillment of their daily lives, no discrimination between sexes, sense of social contribution, and self-improvement.

Thirdly, it is to maintain the social values. Such CSR activities can lead to the maintenance of social order and enhancement of sustainability. Such aspect of CSR may include the compliance with laws and regulations, ensuring the transparency through information disclosure, the promotion of Mecenat activities and contribution to a regional society.

Particularly needed is CSR in global environmental protection. The destruction of global environment is advancing at an alarming rate to endanger the very existence of humans. So, corporations are promoting their self-assessment and voluntary actions in the field of environmental protection, such as the acquisition of ISO 14000 series, incorporation of environmental accounting, and preparation of environmental reports, in addition to more traditional voluntary measures of energy saving and carbon dioxide emissions reduction. Some companies even start to actively implement CSR investment for the greening of material and equipment procurement, and of financial and capital markets.

As seen here, how to practice corporate values and responsibilities can eventually lead to the entity's sustainable development with enhanced images of corporate brands, while providing the benefit of risk shrinkage and attracting the best human resource. The corporations must consider the reform of corporate governance and the practices of corporate social responsibilities as investment rather than cost.

In these days, we find a certain movement among international organizations and in Europe toward the standardization of such reforms. If Japan is to miss the bandwagon, it will be left behind in a disadvantageous position. Japan must engage in in-depth discussion on corporate values and responsibility, and provide input from its ways of corporate governance and social responsibilities developed through unique business environment and cultures, thereby actively participating in such international processes.

# **Activity Plan for the Fiscal Year 2004**

## **Research Studies**

We will organize a research committee for each of following themes and conduct research and survey.

- (i) Sustainable Socio-economic System and Corporate Social Responsibilities
- (ii) Harmony between Trade and Environment
- (iii) Transition to Multi-cultural Symbiotic Society
- (iv) Roles of Public and Private Sectors toward the Construction of Supply Chain Management(SCM) in East Asia
- (v) Building a Recycling Network in Asia

## **Complementary Survey**

- (i) Actual Status of SCM in East Asian Economies
- (ii) Education and Awareness Building on CSR at European Universities and Research Institutes
- (iii) Corporate Sociability Assessment Processes at the Assessment Organizations in Europe and USA

# Activity Results in 2003FY

## 1. Sustainable Socio-economic System and Corporate Social Responsibilities

### Chapter 1 Thinking about CSR

The first chapter shows an outline of our basic ideas and theoretical framework on this report. In our country, corporate social responsibility (CSR) has come to be an important management subject and has drawn unprecedentedly much attention in recent years. From the perspective of the stakeholders (employee, labor union, investor, consumer, environment, community, etc.), this report analyses the problems in each domain, and shows an indicator of a new corporate society. CSR is a concept that companies fulfill accountability to their stakeholders by integrating social and environmental concerns in their business operations.

CSR does not remain in philanthropic activities, compliance and risk management. It is called for reflecting upon the way of everyday business activities itself. The total corporate value is evaluated by not only the financial index but the social and environmental index. In order to become a socially responsible corporation, it is important that the corporations should be supported by the stakeholders and to build relationships of trust with them.

The following three points are considered in this chapter ; expected CSR, current situation in Japan, and required policy of corporation.

### Chapter 2 CSR and Stakeholders

The stakeholder concept is useful to understand CSR. Stakeholders represent society, so corporate social responsibility means that corporation is responsible to their stakeholders. Stakeholders may be affected by the decisions and actions of corporation, and stakeholders may affect the decisions and actions of corporation. Thus, stakeholders have interaction with corporation.

Main stakeholders for Japanese corporations were banks and other corporations that belonged same KEIRETU, corporate group, and employees who were employed for “lifetime”.

But these relationship changes, for recent depression influence the structure of Japanese corporate society. NPO are growing up in Japan, and someone affect corporations.

Stakeholder management is important for CSR. Some corporations carry on a dialogue

between their stakeholders and enter into partnership with stakeholders. They recognize the stakeholder view is necessary for business success.

### Chapter 3 Labour and CSR

It is an important factor of CSR for the both labour and management to conclude and comply with their labour agreement on the job security of employees (union members) and maintenance and improvement of working conditions.

In recent years, as corporate activities are advanced across national borders and uncontrollable issues by governments and trade unions have started to happen, the need to monitor the behavior of multi-national companies through setting up codes of conduct has increased, some international institutes establish rules or guidelines on corporate behavior of multinationals, and some of global trade unions have agreements with specific companies on code of conduct.

On the other hands, in Japan, the ratio of corporate codes of conduct which have article on labour is small. The level of trade unions' commitment to monitoring of CSR is also low. A considerable number of Japanese enterprise-based unions are deeply involved, in substance, with decision-making process and sharing of information in their companies. Under such a matured industrial relations, there is a possibility that the commitment of trade unions to CSR to be raised ever than before. As for monitoring, it is also possible for trade unions to collect information and to find problems through their network. This could be helpful to early solution in the event of that a problem arises.

Taking advantage of the above characteristics, it is necessary to focus more on labour and enhance the level of commitment of trade unions in CSR.

### Chapter 4 Working Women and CSR

Not a family but an individual is the basic unit of economy. In Japan, however, it is quite difficult for women or female workforce to become a stakeholder in SRI. The reality of women's work life in Japan is that: women "enter workforce at 22 years old, around 50% of them leave the initial work place within three years, get no promotion, even remained and worked hard for about 10 years, quit the job, get married and bear children at 29 years old, return to work as a temporary worker at 35 years old, after reaching a certain stage of child bearing, find some affordability at 45 years old but not enough to purchase investment funds, and become a domestic and neighboring helper at 55 years old. Especially, the low wage of a temporary worker is an immediate problem that calls for early correction.

Presently, the lifetime wage of women, who quits the work then returns as a temporary worker,

is about one-fifth of those who continue to work as a full-time employee. The “Women and Work Research Center” has set the independent standards to assess company activities, with an aim to establish a “Working Women Fund.”

In their activities, the issue of temporary workers, which is unique to Japan, becomes a bottleneck for internationalizing their standards.

## Chapter 5 Agenda around the issue of Human Rights and the Corporate Social Responsibilities

The issue of human rights is one of the areas that has not progressed as far as the most of the development of activities with regards to the Corporate Social Responsibilities (CSR) in Japan. Even Nippon Keidanren’s Charter of Corporate Behavior and the recent white paper on CSR management by Keizai Doyukai allocate only a few lines for human rights issues.

For Japanese corporate enterprises to develop relevant activities for human rights and the CSR, the work should be carried out at first to set concrete agendas to be addressed, by putting in order relationships between different human rights agenda and various forms of business while promoting awareness on comprehensive human rights. In the course of that work, while in accordance with various international principles and legal framework, it will be important to breakdown ‘human rights’ into different categories of rights and also to identify what types of corporate enterprises exist in order to analyze relations between these categories of rights and each type of business.

At the same time, ideas should be developed on what kind of policies and measures could be effective for enabling an environment in establishing human rights and the CSR, such as the introduction of legislation on anti-discrimination in the field of labor issues or the introduction and active promotion of bids standards, which are conscious of human rights, for corporate enterprises by government agencies.

## Chapter 6 Consumers and CSR

“Consumer issues” concerning the threats to the life, health and assets of consumers are old but also new issues. In recent years, we have seen fewer actions of big company which directly threaten the life or health of consumers. However, consumers seeking advice of public organizations are steadily increasing, which call for the further development of legislation to protect consumers. In the past, the response to a consumer claim used to repeat the process of: the occurrences of consumer injuries; development into a social problem; case-by-case legislation for consumer protection; and the calming down of the situation.

The policies for appropriateness of company activities to serve consumers and supporting



consumers are improving though still insufficient. Also companies are required to voluntarily develop the system of consumer claim response. For the policy proposals in this field, the research is to outline the questions of: what kind of a system a business entity should develop in the fields directly related to consumers, such as product safety and consumer services; and how the current situation of information disclosure is; and what items should be disclosed.

## Chapter7 CSR and People-friendly "Accessible Design"

In principle, no corporations intend to provide products and services that do not accommodate people with vast differences in ages, disabilities, languages, and so forth. However, if we are to ask whether "all the products and services" are made in a way usable or easy-to-use for the disabled or elderly, the answer will definitely be "no."

Compared with 20 years ago, however, the concept of "everyone is the customer and the user" seems to have taken root among public service entities since the enactment of the Barrier-free Transport Law and what called the Heartful Building Law. The private sector, also, seems ready to strive for further advancement in this respect, compared with 20 years ago. Efforts have been made to reduce inconveniences, and to set up unified standards among industry associations. Corporations start to pursue the needs of the disabled and elderly, for whom they have hardly taken note as consumers in the past.

On the other hand, the "market principle" is the very key for the activities of private corporations, so the efforts are "still ongoing in search" for the way to address issues in various fields. It may not be made public but not too few corporate managers would likely question "why companies with the purpose of making profits should conduct semi-volunteering projects?"

In response to such corporate managers, this chapter will review the "provision of people-friendly products and services," which in the past used to be considered as a special service to be dealt with individually, as a part of "CSR" along with "environmental protection" and "employment."

## Chapter 8 SRI and Evaluation of Corporate Value

Socially Responsible Investment is attracting attention as a promoter of CSR.

SRI is said to have begun the US in 1920s, by Christian churches who avoided investing in 'sin stocks' such as tobacco, alcohol and weapon. In the 1990s', when environmental management began to gain support from business communities, assessing business's environmental management has been regarded as indispensable in evaluating corporate

value, and positive connection between CSR and corporate value began to have been noticed. In the last ten years, SRI asset is growing rapidly in the western world. In the US, the total SRI asset grew 3.4fold, and in Netherland, 15times from 1995 to 2003. In the UK, total SRI asset expanded 10times from 1997 to 2001. These SRI have social screens, such as negative screens that omits sins stocks, and positive screens which picks up best in class company within each industry regarding each CSR criteria such as environmental management, human rights and labor issues.

It is now becoming well known that CSR has positive relation with long-term corporate value. However it is still a challenge to evaluate monetary value of CSR for the short-term and recently some research has been published, estimating climate risk.

In the near future, evaluating CSR impact on corporate value will be an important concern not only for SRI investors but corporations with high CSR practices.

## Chapter 9 CSR and Community

Recently in a market society, a business corporation is expected to tackle the social problems in the community by philanthropic activity in collaboration with NPO/NGOs. Corporate community activity in Japan has been conventionally understood as “returning profits to society” , or “doing good secretly” . However, recently community support activity is positively evaluated by Socially Responsible Investment (SRI) , which has grown rapidly since the second half of the 1990’s. In the West, the new flow of “Strategic Philanthropy” and “Cause-Related-Marketing” (CRM) has been popular in the corporate community activity since 1980’s. These strategies are based on the way of thinking of utilizing the company’s limited resources efficiently, and utilizing their expertise and experience of the business in the community activities. It is important for a company to reconfirm the mission, communicate with NPO/NGOs and build a collaborative relationship with them in doing the community activity. Moreover, building the intermediate support organization which functions as an information center and a coordinator with a company and NPO/NGO is a hot issue.

## Chapter 10 Japanese Institutional Investors Promoting the Development of Socially Responsible Investment

In the recent asset management society, we often find topics related to socially responsible investment (SRI). The concept of SRI contains 2 aspects i.e. social screening and shareholder advocacy. In relation to the screening aspect, it is expected in the Japanese SRI that the positive screening method based on the “triple bottom lines” will be in the mainstream. In this type of screening we are not necessarily concerned with the consistency with fiducially

responsibility, which has often been questioned overseas in case of the negative screening.

With regard to the shareholder advocacy, the essence of SRI is expected to prevail through the incorporation of social or environmental elements into voting standards for shareholders. In both of these aspects, the institutional investors in Japan are playing a very important role in developing socially responsible investment by providing SRI related financial products. We do believe that the Japanese SRI market will steadily grow as the number of investment institutions providing SRI funds increases. We also expect that the aspect of shareholder advocacy will have a strong influence on the Japanese corporate governance that hasn't paid as much attention to environmental or social elements as in foreign-based corporations' cases.

## Chapter 11 CSR as an Emerging Critical Element to Companies' Sustainability in the Global Marketplace

Interest in CSR (Corporate Social Responsibility) is rising globally. One of the major reasons for this growing interest is the pace of economic globalization, to which some attribute negative social and environmental impacts, particularly on developing countries. Accelerating diversification of corporate stakeholders is another reason for the rising interest in CSR.

For example, NGO power and influence over sustainability and human rights are growing around the world. People are increasingly concerned about the environment, health and safety, and about allegations-- and evidence -- of corporate misconduct and injustice.

Intensive media coverage and development of the Internet draw even more attention to these issues. As a result of all these factors, much attention is being given to voluntary CSR codes and standards, to the related interests and actions of governments, and to SRI index evaluations that promote CSR management and practices.

However, the most influential factor is supply chain risk management. Leading multinational companies are now applying CSR practices to their supply chains in order to ensure the ongoing success of their business. In order for Japanese companies to avoid risk and sustain their positions in the global marketplace, it is critical that they introduce, practice and enforce CSR management. This diligence must extend to self-disclosure regarding their supply chains and business partners around the world.

## Chapter 12 CSR-Related Initiatives led by Japan Association of Corporate Executives

Since its establishment, Keizai Doyukai, or Japan Association of Corporate Executives, has been one of the pioneers in the area of "Corporate Social Responsibility." In 2003, it issued the 15<sup>th</sup> Corporate White Paper, which was widely received as a result of serious discussion on CSR among corporate managers. Their argument was based on their convictions of what

an ideal society should pursue.

In the White Paper, the aspirations of top management are considered the driving force of CSR. Furthermore, the pursuit of CSR is recognized not as cost but as an investment. It places importance on fundamental questions such as why a company exists. In addition, it proposes a Corporate Evaluation Standard as a tool for driving CSR efforts.

The results of the self-assessment by the Corporate Evaluation Standard show how Corporate Japan addresses CSR. Efforts in creating a CSR-adherent system are making progress. Particularly, manufacturers and large corporations lead environmental efforts. Major challenges for the future include empowering female employees and ensuring effective governance.

A lack of active dialogue between corporate managers and stakeholders could be indicative of why CSR has not taken root in Japan despite Doyukai's previous proposal. Doyukai should engage in such dialogue in its future activities.

### Chapter 13 Initiatives by the Nippon Keidanren and the CBCC to Promote CSR in Japan

Japan Business Federation (Nippon Keidanren) and its affiliated organization; the Council for Better Corporate Citizenship (the CBCC) has long been promoting Corporate Social Responsibility (CSR) in Japan.

Nippon Keidanren first established "Charter of Corporate Behavior" in 1991, it revised the Charter in 1996 and published the Implementation Guidelines for the Charter. In 2002, Nippon Keidanren published the third revision of the Charter, requesting its member corporations to establish and maintain a system for promoting ethical corporate conduct within corporations. In October of 2003, Nippon Keidanren established a Sub-Committee on Socially Responsible Management to discuss the Japanese corporate views on CSR and issues facing Japanese Corporations.

The CBCC, through the activities of its Study Group on CSR and the Working Group on the ISO CSR standardization, studies the trend of Global CSR and it engages in networking activities with the leading CSR organizations overseas. The Nippon Keidanren and the CBCC believes that in promoting CSR, it is essential to respect corporate autonomy and voluntary initiatives, given the diverse nature of CSR.

### Chapter 14 Current Issues and Future Perspectives of CSR in Japan

Each sector of Japan addressing CSR will face the following four issues in the future:

(1) Development of, and the support for, NPO/NGO : Need to develop NPO/NGO that can study and assess the activities of businesses and government from an independent viewpoint,

and recommend policy proposals. Also required is the presence of intermediate support organizations that can develop the alliance between NPO/NGO and businesses-

(2) Increase CSR studies and develop CSR education system at universities : In our corporate society, most people have shown less interests in CSR, and fewer researchers studied “business and society” as a research subject. Now researchers are expected to develop management systems and education programs in cooperation with businesses and NGOs, while presenting policy proposals.

(3) Recognition of a role of the government : The government needs to base CSR for its industrial policies through coordination among ministries and agencies. Moreover, it is necessary to enhance CSR not only by regulatory measures, but also by preferential policy and tax measures.

(4) Establishment of a multi-stakeholder forum : Need to develop a system in which businesses and economic entities study CSR in cooperation with the government and NGOs. In practice, it is necessary to set up a multi-stakeholder forum where economic entities, government sector (ministries and agencies), NGOs related to environmental, consumer, and social issues, labor unions and other stakeholders participate and discuss CSR.

## **2. China after its Accession to WTO, its Effects on Japan, and Japan’s Response**

In terms of macro-economic viewpoint, China is likely to continue its strong and steady growth and expansion, but lurking ahead is a glimpse of problems, such as overheating economy (investment fever, bad debts, impending bubble collapse, etc.), and currency situation (possible revaluation or floating of Renminbin, and foreign currency reserve issue). As the government enforces more efficiency-oriented policies, their adverse effects are seeping through the country, led by the ever-widening income gap between urban and rural population, and rising unemployment due to migration en masse from villages to cities. Now, even the central government of China seems to feel wary and starts to adopt policies to restrain economy (for soft-landing), and introduce measures to rectify income gap.

“China as a threat” used to be Japanese perception of Japan-China economic relationship, but now there is a sense of “China as a driving force.” Indeed, a large part of recent economic recovery of Japan owes to the strength of their exports to China. The rapidity of China’s growth, however, may put the economy off balance, as seen in the recent price hikes from the deficiency in raw materials, and a widening demand-supply gap, which may eventually cloud

their economic well-being in the future. From the business point of view, to maneuver corporate management to adapt to such rapid change has become increasingly difficult. China has emerged as the “world’s factories,” taking advantage of their lower labor costs. Now, the most important issue in view of corporate management is how to develop a marketing strategy to incorporate the Chinese market, which has vast demand potentials due to their large population.

The Committee, composed of almost same members as the fiscal 2002, reviewed Chinese economy as a whole from macroscopic viewpoint and their business environment from microscopic perspective. For this fiscal 2003, the Committee conducted studies focused on more concrete issues including the opportunities and risks of corporate strategy. The Committee activities included: inviting corporate executives to speak of their successes in the penetration of Chinese market; and studying businesses in China based on case studies, so to deepen the understanding of their market.

In brief, the best way for the corporations advancing into China to make the most of business opportunities would be to focus on “localization,” especially localized employment, and “governance.”

The biggest risks will include how to “secure collection of payment,” and to protect “intellectual property rights.” Of course, if no risk, no opportunities. Thus, the secret of a success in China can be found within a company itself, and the best and only way is to deepen the understanding of China.

The issues of Chinese economy are no longer the issues of one country. The extent of their implications has expanded to Asia, Europe, USA, and other areas covering almost entire world. In terms of the prospects of Japanese economy, however, one should keep in mind the very basics of international relationships, i.e. to seek mutual development in cooperation with every region or country, and not only with one country, for example, China. That is what Japan needs to aim for. The Committee sincerely hopes that the report will provide recommendations to aid the companies’ challenge in building such win-win relationships. Lastly, the Committee will like to thank the Chair Seki and all those members actively participated in the discussions under the guidance of the Chair.

### **3. A Global Strategy for Japan's Eco-Business**

Excessive competition within Japanese companies and increasingly fierce competition among Japanese, Korean, and other local companies have lowered the profitability of the Japanese business.

Speaking of business types, the Japanese business has been centered on hardware, with its weaker basis to compete in software-oriented business. Thus, with its strong tendency to rely on public funds including yen loans, they have fell into high-cost and over-spec business structure. It has less ability to transmit information, conduct research overseas, and manage risks. While the United States and European countries have been taking some strategic approach to dominate the East Asian market, Japan has not yet established a sufficient mechanism to coordinate and mobilize extensive efforts in such broad area of research, survey, promotion of technology transfer, supports in establishing infrastructure, human resources development and financial development in a cross-sectoral manner.

Based on national circumstances in differing degrees of development, we need to accomplish improved profitability by contriving quality products tailored to local needs, localizing, and offering goods with high customer satisfaction. Also, it is important to share a vision and strategic significance of entire technical assistances to East Asia. Furthermore, we would need to gain credence and establish trust from each country by proposing an entire solution for systemic software exporting in both upstream and downstream.

In tandem with universities and aid agencies and with the involvement of local experts, information should be obtained through field surveys and policy support relevant to environment in order to develop human resources who have the know-how in environmental service sector. Exporting our IT-based environmental marketing tools, business models to reduce negative impacts on environment and eco-conscious life style models, among other things, would contribute to the international community in reducing environmental impacts in the developing countries while improving their quality of life. At the same time, we should keep in mind that corporate green initiatives, drastic overhaul of their managerial policies, and the philosophy of the management could accelerate the pace of that change.

Environmental cooperation is an integral component in fostering close partnerships with other countries. It would be expected to further promote market development for exporting companies by identifying our aid policies in line with national interests. As far as aid is concerned, the needs on the part of Japanese companies should be taken into account in order to develop businesses. To that end, institutional limitations should be removed for them to take a leading role in JI/CDM area. Also, our current "recipients' request-based" assistance

should be transformed into the “Japanese government’s proposal-based.”

Financial sector would also play a significant role to promote corporate eco-consciousness by assessing corporate efforts to conserve environment. Moreover, it is important for us to intensively transmit information at all levels so that developing countries could see our specialty environmental technologies more clearly. Now is the time for our country to review the total strategy by shifting its approach of partial optimization into total optimization.

## **4. Harmonization of Trade and Environment**

The research committee on harmonization of trade and environment held five meetings under the chairmanship of Prof. Mitsutsune Yamaguchi (Dept of Economics, Keio University). It has identified potential challenges and organized relevant information with regard to the conflicts between multilateral environmental agreements, inter alia, the relationship between the UNFCCC/ Kyoto Protocol and the WTO rules that have significant impact on businesses, in an attempt to avoid potential friction in the process of policy implementation.

Specifically, it has first analyzed interpretative transition in terms of GATT Article III and XX and Technical Barriers to Trade (TBT) in the WTO agreement and revealed some global trend and WTO’s treatment in harmonizing trade and environment. Then, it has analyzed more specific cases such as the tax system to prevent global warming proposed by the Central Environmental Council (Joint B/O Group of Comprehensive Policy/Global Environment/Anti-Global Warming Tax System Review Committee), the conflict between the Kyoto Mechanism including CDM/JI and WTO agreements, and the EU Emission Trading Scheme (EU-ETS) to be launched in 2005. Moreover, it has deepened understanding on the position of the developing nations who have greater impact on the international negotiation to address global warming. Furthermore, committee members conducted surveys on overseas literature and attended an international symposium at Kagawa University, to grasp the latest trend. All of the research results are compiled in a captioned report in Japanese.

Our major analytical findings are as follows:

- Change in the interpretation of environment-related clauses in WTO

As stipulated in the preamble of the Agreement establishing the World Trade Organization, it seeks to preserve and protect environment and thus deemed to put more emphasis on environmental factor than before. That means it no longer aspires for ensuring free trade alone.

GATT Article 3 is intended to protect anticipations for equal competitive terms for both domestic products and imported goods and thus not deemed to have impacts on trade. With



that, environmental measures are prone to be measured merely by the treatment of domestic/import goods of a same kind rather than their purpose to protect environment.

On the other hand, TBT Agreements tend to allow standards if they conform to international standards, especially ones that are designed to conserve environment. However, they tend to disallow setting standards on production inputs (i.e. greenhouse gas emissions at the production process).

In such cases as mentioned above, environmental measures that would have impacts on trade are to be justified by GATT Article XX. The Article rules out some trade-related aspects of environmental policies which may result in significant trade effects as general exceptions to be allowed in WTO in the event that they serve “to protect human, animal or plant life or health” (Article 20-b) and to relate to “the conservation of exhaustible natural resources” (Article 20-g) and “not constitute unjustifiable discrimination between countries”. (Article 20/chapeau) In fact, few cases were recently allowed after numerous disputes. Nevertheless, the chapeau still has murky areas and the trade-relevant measures based on the Kyoto Protocol would not necessarily be allowed even if the GATT Article XX is used.

- Taxation System to Address Global Warming

As a measure to avert negative impacts on international competitiveness arising from taxation, two approaches can be considered. Namely, 1) border tax -adjustment on imported and export goods; 2) tax reduction or exemption on steel and other sectors that would be vulnerable to taxes.

Regarding the tax adjustment on imported goods, there is a wide gap between taxable goods (Top line, upstream sector) and the actual operational level (end products). It is expected that accurate calculation of how much fossil fuel is used in the end product would be extremely difficult and resulting tax adjustment would be likewise. Meanwhile, tax adjustment for exported goods is also subject to accurate calculation of tax burden. Not to mention the difficulty in calculation, the existence of subsidies for the exempt sector makes it harder because the subsidy might be regarded as export subsidy unless treated otherwise.

Tax reduction or exemption might be effective tool. But since the subsidy method has a risk of infringement in the event that the subsidy is provided for the exempted sector, the combination of uniform taxation and subsidies that do not exceed the amount of tax burden might be a better solution.

- Emission Trading and Others

Our committee confirmed that emission credits under the Kyoto Mechanism are not within the scope of either goods or services defined in the WTO agreements.

The European Union Greenhouse Gas Emission Trading Scheme, or EU-ETS, could invite incentives for EU members to purchase goods or technology inside the EU to help contribute to reduce emission, if it takes on the character of CDM/JI in EU area. However, that would be

taken as conflicting with GATT Article III paragraph 4.

A key to solve the trade and environment issue in WTO would be to make efforts to remove persistent distrust that has long prevailed in both developing and developed nations as well as multinational companies.

Amid the current economic structure, “harmonizing trade and environment” is a critical issue which would be most likely to surface at once when the Kyoto Protocol takes into effect and the business and the international community have to implement measures in reality. It is hoped that the research would be continued in order to offer useful strategic information for the business community by gathering more specific information on case studies.

## **5. Corporate Environment Performance Assessment**

To gauge corporate efforts to address environmental issues, ISO 14000 series and Environmental Performance Indicator (EPI), above all, have taken hold. Corporations who are prepared with their environmental reports based on these guidelines have rapidly grown in number.

In addition, a global initiative to assess environmental efforts with various environmental rating tools has become more active, as represented by Nihon Keizai Shimbun’s “Environmental Management Assessment” and the Sustainable Management Rating Institute’s “Mita Model” in Japan, and environmental ratings by Innovest, Dow Jones and others in Europe and the U.S. Nevertheless, it seems these ratings tend to look at only a small part of corporate environmental activities. Thus, it might be said these evaluations are not quite comprehensive.

Therefore, we have launched a research project in 2002. We started first in 2002 by identifying existing environmental performance indices and making comparative analysis to find out what are common or unique areas among them, with an aim to explore ways to offer a better comprehensive assessment. In 2003, we examined measures to encourage small and medium-sized businesses that comprise most part of the Japanese business community to work on environmental policies, based on the study of the previous year.

The research was originally aimed at establishing a set of criteria to help make fairer assessment. However, our review policy had to be changed to the above-mentioned one, as the work was expected to be very difficult with all different assessment categories depending on the size of companies and job categories as well as different categories required by stakeholders. During the review process, we have identified current challenges in “environmental performance indicators” and “environmental reporting guidelines”, among other things. Also, by hearing actual ways where companies have addressed the issue, we

could find what stood as a challenge to extend the eco-initiative to small and medium-sized companies. We think some of the solutions would be; to review the guidelines to make them more user-friendly, and to ask business green leaders to inform small and medium-sized companies of their efforts in order for them to recognize advanced environmental measures, relevant costs and resulting benefits. This report compiles papers written by our committee members and the Chairman to help solve these challenges from their own point of view. We hope it will serve as a starting point for all companies to take environmental measures more vigorously.

## **6. Industrial Responses toward More Competitive Tourism**

Expecting to grow into a huge market, tourism industry is likely to enter the age of global competition in 21<sup>st</sup> Century. To attract large number of visitors with various purposes such as sightseeing will result in a new source of income that can vitalize economies of a nation, city, or rural area. How each nation or region addresses business opportunities in this market will make a large difference in economic vitality.

Under such situation, various organizations such as Nihon Keidanren and Keizai Doyukai submitted policy proposals in the last several years on the way of the sightseeing and tourism industry in Japan. The Government itself advocated the “Visit Japan Campaign” with an aim to attract 10 million visitors from abroad by 2010, to make Japan as “Tourism-oriented Country.”

As it is still early days from the start of tourism promotion measures, there still remain many issues that require further addressing and studying.

Because of this, GISPRI set up a Research Committee on “Industrial Responses toward More Competitive Tourism” in fiscal 2003, and studied the issue to identify factors that could determine a nation’s or region’s competitiveness in attracting visitors, and examined the possible measures to strengthen such competitiveness with a focus on the way of industrial response.

As emphasized in the aforementioned study, tourism industry is entering a new phase, in which conventional ideas and methodologies would no longer be applicable, but where the governments, industries, and residents must truly make efforts to develop mutual collaboration. We hope that the result of this Research Committee will provide an effective guide for the future development in tourism promotion and to the progress of tourism industry as a whole.

## **7. Corporate Social Responsibility by Machine-industry Companies in Europe**

This study focuses on Europe, which has a good reputation for its advanced approach to corporate social responsibility (CSR). It assesses the status quo, and considers why European companies are so more active than other regions by the following steps. First, European companies are compared with those in Japan, the United States and other regions. Comparisons are also made between different European countries. Second, three theoretical models (institutionalism, resource dependency and information diffusion) are shown to explain regional differences in the performance on CSR. The third step examines nine machine-industry companies in Northern Europe, which apparently exhibit particularly high CSR performance, to see what they carry out as CSR activities, how they conceive CSR and how their performance is characterized. The research is conducted not only by the investigation into corporate reports but also by the interviews with those directly engaged in CSR activities. The conclusion points out that CSR-consistent values, norms and perceptions have traditionally existed in Europe, that European companies tend to hold stronger and broader approach to stakeholder relations, and that wide network is being established to help many companies share and diffuse relevant information. All those factors contribute to the advancement of CSR performance in Europe.

## **8. Assessment of NPOs as collaboration partner with businesses and local governments**

NPOs are expected to improve qualities of their provision of values to the society through cooperative and mutual complementary collaboration activities with businesses and local governments.

Businesses and local governments, in turn, will likely raise motivation to actively implement collaboration with NPOs. However, there have not been many cases, in which the collaboration between them achieved the original goal. Especially limited were the cases of collaboration implemented with a view to provide values favorable to beneficiaries, and to produce positive effects on the future projects and activities of NPOs.

Under this recognition, the Committee focused on the cases of collaboration implemented with full awareness of its significance. The analysis of these cases highlighted key factors for bringing successes to collaboration, as follows:

What synergistic effects to be expected: Mutual acknowledgement of strengths and weaknesses of collaboration partners. Will they be able to clearly indicate the reasons of partner selection?

Mutual recognition of basic principles for implementing collaboration: equity; respect each other's autonomy; promote organizational independence, improve mutual understanding; share objectives; and disclosure.

Building mutual and versatile personal relationships between relevant organizations: Persistent dependence on personal relationships may hamper the mutuality and objectivity of projects. Building multilevel relationships with shared common values will improve stability in service provision

Development of a flow chart for collaboration implementation: Idea and concepts will not actually execute projects. Concrete process control methods should be adopted.

Awareness of collaboration at the planning stage of projects, and practical actions based on such awareness: To develop mutual understanding from the planning stage will lead to true collaboration.

Development of middle term strategy to secure the continuity of services: It is essential to mutually confirm the goal and schedule for the completion of projects.

System to assess results and the implementation of periodical assessment: Simple execution of projects will not necessarily provide accumulation of benefits. Recognizing what issues to improve will make it possible to modify the course of project implementation, resulting in the better success rates of next projects.

Above factors are conditions for successes in collaboration. These are not the attributes of partner organizations, but the issue of their awareness and attitudes in addressing collaboration. Although the success in one collaboration project will provide valuable accumulation of benefits to all partners involved, whether businesses, local governments, and NPOs, it will not guarantee the successes of next collaboration projects. To continue the successful execution of collaboration, all project partners must have the same level of awareness, understanding and practicability, encouraging further development of better NPO partners.

## **9. Survey on P&M to Address Global Warming**

With a view to considering policies and measures for our country in achieving the commitment of the Kyoto Protocol as well as to contributing to successful future international negotiations, we have conducted a survey in following areas: 1) the trend in international negotiations on climate change, 2) ten new EU members' political stances toward Kyoto Mechanism, 3) potential approach of China whose GHG emission has been remarkably increasing along with its economic development.

## **10. P&M to Address Global Warming**

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## **11. International Meetings including the IPCC**

The Intergovernmental Panel on Climate Change (IPCC) has set 2007 as the year to finalize its Fourth Assessment Report (AR4) and laid down its outline at the twenty-first session of the IPCC in November 2003. In order to involve industry experts into the process, IPCC Working Group III included "energy supply," "transportation and its infrastructure" and "industry" to be covered as respective chapters in the report and decided to organize the Expert Meeting on Industrial Technology Development, Transfer and Diffusion" in Tokyo in September 2004. Moreover, to communicate such relevant input to the business community in Japan, we have organized "domestic liaison meetings to prepare for AR4" twice, where the government's commitment on the IPCC and the results of scoping meetings were reported.

## **12. International Meetings including the Framework Convention on Climate Change**

We have conducted a research on the international trend centering on the UNFCCC and the Kyoto Protocol. With Russia yet to ratify, Kyoto Protocol has not yet entered into effect. Thus, there was less political enthusiasm in both of the eighteenth session of the subsidiary bodies and the ninth session of the Conference of the Parties (COP), where most discussions generally focused on administrative matters. Although most parties remained to reiterate their conventional statements and no major progress was observed, the rule on sink CDM was successfully adopted as scheduled.

## **13. Research to Explore Potential Introduction of Environmental Technologies through China Council Programs**

We have conducted a research on the socioeconomic and institutional situation in China to examine future introduction of Japan's environmental technology through China Council and "the Task Force on Circular Economy and Cleaner Production" (CE&CPTF) and presented the result at the plenary session of the "China Council for International Cooperation on Environment and Development" (CCICED). China has been faced with severe environmental pollution with its rapid economic development. With the result of the research, we have compiled a report on Japan's potential contribution to China in establishing a circular society.

## **14. The Risk Management in Electricity Production Industry**

The research aims to explore both merits and demerits caused by deregulation in the energy production sector as well as to identify potential risks that could give significant impact on the management of the exchange market or designing derivatives. In this year, we have summarized what merits and demerits would the deregulation entail from the viewpoint of individual companies and aggregate national economy with a time-line perspective.

## **15. How an international consensus has been formed to prevent global warming**

The survey was conducted to explore how the international framework would work after the first commitment period of the Kyoto Protocol to address global warming. To this end, “the Committee on Issues Involving Participation of Developing Countries” was formed and has conducted a research on past international negotiations, overall trend and burden sharing, combing through vast literature. Through the research, we have gained some insights on the following; how to develop a workable international scheme; responsibility and equity; timeline; goal-setting approach; a mechanism to establish an international consensus; how to ensure incentives for commitment; a basic approach to ensure compliance scheme.

## **16. Promoting Kyoto Mechanism**

The survey was conducted to examine and valuate what would stand as legal/accounting/tax issues to facilitate Kyoto Mechanism in Japan. To this end, two committees were set up in order to study issues from legal perspective and from accounting/tax perspective, respectively. The former focuses on legal characteristic of emission credits and the national registry, while the latter addresses on accounting treatment of the credits set by the International Accounting Standards Board and on accounting and taxation in the event of credit acquisition through Clean Development Mechanism and other projects. They have compiled a paper for the sixth Special Meeting on Market Mechanism in the Industrial Structure Council held in September 2004, thereby contributing to the development of domestic infrastructure to encourage Kyoto Mechanism.

## **17. Relationship between World Trade Organization and Multilateral Environmental Agreements and Their Trend**

The Objectives of the research were to study the relationships between WTO agreements and MEAs, the domestic measures that would have impacts on trade, and the future trends of these matters. The research has covered the WTO environment-related disputes and deliberations in the CTE, in addition to environmental protection measures that were not



submitted to the WTO but were in review for implementation. One of the findings was that the measures implemented with a view to complying with the MEAs with trade restriction clauses could face limitations of justifying in using extended interpretation of GATT XX but that they could be supported by the GATT XXV para.5. In case that the measures including environmental standards were implemented to fulfill the objective of the MEAs without any trade restriction clause, the TBT agreement could be applied for justification.

## **18. Global Climate Change and Energy**

Global Climate and Energy Project, or G-CEP, was designed based on the result of the WBCSD “Sustainable Mobility Project.” In order to help bring a meaningful result, this project aims to examine G-CEP’s research guideline, approaches and themes and extend support. For this reason, we have reviewed the SMP’s findings and successfully identified what issues would lie ahead for Japan and other Asian countries and how to address those issues. Based on the result, future agenda and direction were examined for G-CEP.

## **19. China Council for International Cooperation on Environment and Development**

China Council was the non-governmental international council organization established in 1992, which discussed the sustainable development strategy to incorporate environmental concerns, and presented policy-proposals to the leaders of the Chinese Government. Our Research Institute has participated in their activities since the establishment. China Council’s third phase (2002-2006) activities started from the fiscal 2002, and GISPRI has taken part in the “Circular Economy and Cleaner Production Taskforce.” The Taskforce held a plenary at Guiyang City in August, 2003, and prepared the report on the building of circular society in China, which was presented to the Chinese Government as policy proposals at the China Council Plenary held in October, 2003.

## **20. Japan-US Joint Taskforce on the Achievement of Harmony between Trade and Environment**

The project aims to realize the harmony between sustainable development and environmental conservation, included in the WTO's Doha Ministerial Declaration. The project members, consisted of experts and researchers of Japan and US, developed policy proposals for presentation at the side event of WTO's Fifty Ministerial Meeting, distributing them in CD-ROMs etc. GISPRI reported on the human resource development activities in developing countries, which would be essential for the harmony between trade and environment.

The 14<sup>th</sup> GISPRI Symposium

## “How to build a new Japan-China economic relationship”

On February 5, 2004, Thursday, GISPRI held the captioned Symposium at the International Conference Hall of 11<sup>th</sup> Fl. Keidanren Kaikan (Ote-Machi, Chiyoda-Ku, Tokyo), with the support of the Ministry of Economy, Trade and Industry, Nippon Keidanren, and Japan-China Economic Association.

Opened with the special lecture given by the Honorable Wu Dawei, Chinese Ambassador to Japan, the Symposium featured two sessions with five panelists each. Stated below is the outline of the proceedings.

### 1. Special Lecture: “Current Chinese economy and society and their prospects for the future”

**The Honorable Wu Dawei, Chinese Ambassador to Japan**



#### 【Summary of the lecture】

Since the policies to reform and opening to the outside world were introduced in 1978, China has achieved outstanding progress in the development of a modernized society, maintained sustainable economic development, and improved social productivity and gross national power. Today, China has completed its initial phase of developing a socialist market economy system, while introducing the various forms of property ownerships, and firmly establishing an economy opening to the outside world. Its economy has seen significant improvement in both the quality and profitability. Its economic growth rate is 9.1 %, GDP is 1.4 trillion dollars (about 150 trillion yen, which is the 6<sup>th</sup> in the world), gross

import/export amount is 851.2 billion dollars (5<sup>th</sup> in the world), and foreign exchange reserve is 403.3 billion dollars (2<sup>nd</sup> in the world). China is number one in the world for the production of coal, iron and steel, color TVs, and cement. Three mega-projects (the Western China project: electric power supply to the Eastern China; another Western China project: natural gas supply to the Eastern China, and the Southern China project: water supply to the Northern China) have been fully introduced, and smoothly executed.

The Chinese standard of living has experienced significant leap from the hardship living with clothing and food issues to the lives of greater affordability and affluence. Especially apparent is the improvement in their income level, life expectancy, education quality, material life and cultural life, as the per capita GDP exceeded 1,000 US\$. The consumption structure was shifted from the want of clothing and foods to the pursuance of better housing and transport conditions. The growths were especially significant in speedway construction, cellular phones, Internet, passenger cars, home ownerships, and oversea travels.

On the other hand, some problems are becoming apparent such as: the stagnant growth of farmers' income adding greater pressure for urban employment; overheated economic development of certain regions and industries making regional development off balance; prominence of paradoxes in resource bottlenecks; and the realization of environmental issues. To solve these problems, China has no choice but to rely on the further progress in reform and development and recently launched the concept of sustainable development to harmonize all aspects of development. The center pillars of this concept are to stabilize and properly coordinate policies, to integrate plans and programs; and to aim for the balanced development with consideration for all. To be specific, the concept calls for the improvement in the current dual social structure of urban and rural areas, better coordination among the Eastern, Central, and Western China, social progress and full development of human resources, harmonization between economic surroundings and resource environment, and the greater utilization of both domestic and international resources and markets.

The 16<sup>th</sup> Conference of the Chinese Communist Party adopted the "Grand Blue-print for fully developing an affluent society." The aim is to quadruple the GDP from 2000 level to reach 4 trillion dollars by year 2020 with per capita GDP exceeding 3,000\$. Based on the Deng Xiaoping Theory and three representative concepts, China shall resolutely promote the reform and opening policy with a focus on its economic development, sustain its policy on scientific advancement, and develop socialist market economy, socialist democracy, and advanced socialist culture, thereby promoting the overall development of economy, society and people.

In view of how much China achieved for the past 25 years, there is no doubt that it can attain the goal of fully developed prosperous society, in the end. The development of China will not only contribute to the peace and prosperity of the World, but also provide a new platform for international funds to take an active role. The viewpoint that China's

ever-continuing development is one of driving forces to move the world economy is correct. The broadening of a market and increase in business opportunities brought by the Chinese economic growth assuredly lead to developmental opportunities and actual benefits for Asia and the World. I fully believe that China can contribute anew for the peace and the development of the World as well as the further development of Asia.

The Yen loans from the Government of Japan played an important role in the modernization of China. The trade amount between two countries reached the highest level last year at 133.5 billion \$. For China, Japan has been the largest trade partner for 11 years in a row. It is my sincere hope that the economic cooperation and exchanges between China and Japan will expand further in the future and bring more happiness to the people of both nations.

## **2. 1<sup>st</sup> Session “Economic development of China and the future of Japan and Asia”**

Issue presenter Dr. C. H. Kwan, Senior Fellow, Research Institute of Economy, Trade and Industry

Coordinator Shinji Fukukawa, Senior Advisor, Dentsu Inc.

Panelists Dr. C. H. Kwan, Senior Fellow, Research Institute of Economy, Trade and Industry

Prof. Fukunari Kimura, Faculty of Economics, Keio University

Toshiya Tsugami, Senior Fellow, Research Institute of Economy, Trade and Industry

Yasushi Harada, Comprehensive Policy Researcher, Economic and Social Research Institute, Cabinet Office, Government of Japan

### **【Issues presented by Dr. Kwan】**

- The rise of China does not necessarily mean a challenge for Japan but actually an opportunity. Currently, the view of China as threats has been shifted to China as a driving force. Japan-China relationship is not the relationship of competition but that of mutual complement, in other words, the win-win relationship. The complementary relationship is where “China’s strength is Japan’s weakness and Japan’s strength is China’s weakness.” The share of US market, in which Japan competes with China, is about 20%. For Japan, the business opportunities lay where the Japanese products are stronger (such as R&D, major part manufacturing, distribution, brand-image products, and services).
- Why Japanese automobile industry relocates its production sites to China? Originally, it will be ideal to manufacture automobiles in Japan and export them to China, but there still exists the barrier of 25% tariff on automobile imports. What Japan needs is to enter

FTA with China as soon as possible. This will be useful as a measure to prevent the hollowing of manufacturing industry, as well.

- Problems concerning risks include exchange rate adjustment, the possible appreciation of Chinese Yuan (Renminbi), risks due to the cycle of economy, the possibility of inflation originated from China, and the overheating of economy.
- The inflating foreign exchange reserve of China will better be used for building national economy rather than to buy US bonds.
- In the 80% of the market, where Japan is not competing with China, the appreciation of Chinese Yuan does not necessarily mean good news, as it is better to have lower prices for Chinese products. Those benefiting from the Yuan appreciation will be only those 20% of the market in competition with Chinese products.
- The inflation rate in China is steadily increasing (3%), and the Chinese authorities are shifting toward tighter price policies. In the future, Chinese economy is likely to make a soft-landing.

Upon the above items raised by Mr. Kan, three panelists debated freely.

(Mr. Kimura)

- [In regards to the argument on the advantages of wage level gap,] It should be noted that the merits of transferring into China do not necessarily rest on the wage differences but also on the “service-link costs” (transportation fee, communication fee, etc) and the “aggregate benefits” (presence or absence of business partners). In case of direct investment into China, one must consider the “aggregate benefits” as well as “scale economy.” Before considering relocation, it is necessary to make an earnest review on the distribution of roles between Japan and China.
- [In regards to FTA with China] Theoretically, the case of automobile industry is as discussed above, but the issue is not that simple. Rather than the simple discussion on the tariff reduction, it is necessary to discuss the problem on how to let China improve its domestic policy-making environment. For this, the keys are what contents should be incorporated into FTA, and how to let China work on these contents. It is a tacit agreement between two countries to aim for the economic integration of the East Asia as a whole. Japan’s role is to subjectively consider the contents of economic integration. Japan has already started FTA negotiations with Korea, Thailand, Philippines, and Malaysia. The key points are what kind of contents should be incorporated to build more favorable business environment, and how to modify the domestic policies of each country. Japan should develop a prototype of FTA through negotiation with Korea and ASEAN countries, and then envisage the FTA negotiation with China. Hasty decision should be avoided. The partner countries of ongoing FTA negotiation are five nations including Mexico, and a few of them are likely to reach practical agreements within this year. In

case of FTA negotiation with China, the timing to review the possibility may arrive within two to three years from now, if not later. At that point, there should be a discussion on whether China would be really ready to follow the steps of forerunners.

(Tsugami)

- We have indeed entered the era of feeling complimentary relationship with China. Japanese exports to China and Chinese GDP already showed significant increases. Sooner or later, China is likely to surpass Japan in GDP amounts.
- As the risks in this rapidly growing China, there are “regional gaps” and “the disparity in wealth,” but Chinese authorities have rightly responded to the corrections of these issues, so there seems no need for any anxieties.
- One of the defining issues for China’s success or failure in the future would be the issue of “population movements.” China unified their dual registry system of rural and urban areas. This may provide the merit of securing labor force as hundreds of millions of people flow into urban areas, but substantially affects the environmental issues, employment/unemployment issues, and social environments, etc. The problem is: “Whether China can duly respond to such impacts?”
- Another problem is what will happen to the “restrictions on resource, energy and water.” As seen in the case of iron ore price hike, how price increases due to Chinese factors influence domestic and international markets? It may end up being useful for the mitigation of the North-South economic issues.
- In regards to the Chinese Yuan, Mr. Kang said that there might be differences in viewpoints of politics and economics, but such differences are natural. Whatever the issues are, there will be winners and there will be losers. The problem is how to provide for the victims in the dark. In fact, this may be the major and fundamental issues in FTA.

(Harada)

- I agree that Japan and China are in a win-win relationship, i.e. complimentary relationship rather than competitive relationship. Moreover, I do not believe that there will be any one big event to overturn this complimentary relationship to a competitive relationship overnight.
- It seems that China’s foreign currency reserve of 400 billion dollars, which is equivalent to about one third of 1.4 trillion dollars GDP, is too big. Their situation closely resembles that of Japan right before the Oil Crisis, which led to the appreciation of Yen. Moreover, to lend such huge foreign currency reserve to the US at lower interest rate of 1-2 % is a great loss for China, which maintains higher economic growth rate of 9%. If China is to invest these funds domestically, they must be able to achieve even higher growth.

- I hope that China will not repeat the mistake of Japan in the Yen appreciation. China is likely to make a soft-landing, but they need to study more from the cases of Japan's past mistakes.

(Fukukawa)

- It seems all four panelists agree that Japan and China are on the win-win relationship. Now, we would like to focus our discussion on three issues as the keys for the projection of Chinese economy in the future: "overheated economy"; "Yuan appreciation" and "FTA."

## 【Discussion】

### 1. Overheated economy

(Kimura)

- We cannot debate solely on economic indices such as price index, money supply, etc., but the Chinese economy is definitely not overheated.

(Tsugami)

- I believe it was somewhat overheated until the end of last year. Recently, however, they start to have practical tightening policies. The growth rate of 9.1% may actually be higher, so there is really a need to introduce the tightening policy.

(Harada)

- The problem is in employment, in other words, the issue related to the population shift between the regions within China. In addition, the bottlenecks in various resources may lead to disorder.

(Kwan)

- The appreciation of Yuan can be a measure to cool down the overheated economy. What I worry is the fact that the increase in bank loans to reduce the banks' bad debts ratio seem to flow into the real estate markets. Investment is the driving force of Chinese economy now, but they need to shift it to consumption. Their current consumption structure is distorted with only expensive items showing stronger sales, which reflect the uneven distribution of wealth resulted from the privatization of state-owned companies.

### 2. Yuan appreciation issue



(Kimura)

- Even if Yuan is to be appreciated, its impact on the balance of international accounts may be less than expected. In terms of Chinese export pattern, we find a shift from textile and clothing to machineries. These commodities have prices fixed on US dollars, so Yuan appreciation will not undermine their export competitiveness. Thorough review will be needed on this issue.

(Harada)

- Yuan appreciation is not likely to improve the current balance. It is better to use the foreign exchange reserve to invest domestically rather than to invest on lower return bonds.

(Tsugami)

- Real economy and finance/currency are two sides of the same coin. The issue of their currency should be addressed under the concept of regional integration and linkage along with the integration of real economy.

(Kwan)

- In a long term, it may be possible to think about one unified currency for Asia, but at present the gaps between Asian countries are wide in their developmental phases and industrial structures, so Asia region as a whole does not certainly come up to the required condition for creating the optimum currency sphere. For the short term, managed currency floatation system and the BBC method (band, basket, and crawling) may be better. Yuan is about 15-20% undervalued now, so it is better to appreciate Yuan gradually in the expanse of several years. China eventually needs to consider the liberalization of capital, but there is no need to hurry.

### 3. FTA Issue

(Kimura)

Order of concluding FTAs can be:

- With Mexico, the FTA negotiation is in its final stage, and likely to get a breakthrough.
- In case of Philippines and Malaysia, to reach actual agreement within this year or early next year will be sufficient.
- With Korea, the negotiation is rather difficult. The current situation calls for the gradual advancement of negotiation and the development of details through mutual consent over the entire year of 2005.

- The future discussion will involve whether to broaden FTA to the East Asia as a whole, or with ASEAN, and whether to envisage the involvement of China. For the next one or two years, however, Japan and China are not likely to be ready for such discussion.

#### Contents of the FTAs

- Removal of tariff is essential. Developing countries need to develop own industry by replacing imports, so cross-border efficiency improvement is wanted. Such are the cases for automobiles, home appliances, petrochemicals, iron and steel, and other industries.
- On the other hand, East Asia has developed international production/distribution network already, and become more export-oriented, so FTA for tariff removal alone will not be sufficient. The FTAs for this region need to incorporate the facilitation of trade and investment (including rules on investment), development of systems for intellectual property rights and standardization, introduction of dispute settlement procedures (especially for in-depth issues between private companies and states), and economic cooperation.
- With China, the potential contents of FTA include tariff removal and resolution for agricultural issues to be implemented over the span of ten years or so. As there are various contents and issues to be discussed for FTA with China, it will be desirable to incorporate above to help improve policy-making environment in China.

(Harada)

On the agricultural issue:

- The protection of domestic agriculture is what every country does. It may be better to resolve the issue by “protecting agriculture by the means of income compensation.”
- If a country is to launch some kind of basic guideline at first by the political leadership, it may facilitate the eventual resolution of this issue, while providing better impression to others.

(Tsugami)

- Upon the review of FTA between Japan and China, the main stream of thoughts is certainly the tariff removal, but tariff issue has lost its importance significantly during the past 20 years. In this new era, it is a mistake to focus only on tariff issue. For example, won't there be anything to do for “the migration of population”? For example to change visa policy drastically.
- In addition, the “issue of capital flow” finds more restrictions than trade. We must consider, for example, investing Japanese welfare funds in China to get better return.
- There may not be sufficient efforts or attitudes to go and get merits in China, rather than to expect and receive some merits from China. For example, Japan needs to exert more

efforts to recruit Chinese tourists to Japan. Without serious and disparate efforts to earn as many merits as possible, the balance book as a whole will go into the red.

**【Q&A from the floor】**

**Q-1:** Mr. Taniguchi, President of the Comprehensive Research Institute on Modern Chinese Studies, Waseda University

I think that both China and Japan find insufficient understanding among young students. What should we do? Also, at the Special Summit Meeting of Japan and ASEAN, Japan approaches ASEAN countries, but ignores China and Korea. China on the other hand does whatever it wishes with ASEAN. Is this the way to be?

A:

(Kwan)

Shouldn't Japan treat Chinese students studying in Japan better? It is the failure of Japanese diplomatic policy. Many students end up not being able to get employment in Japanese companies, and start work for European and American companies. Such a way will never allow Japan to bring competent human resources together. How to utilize those Chinese students educated in Japan, or the NEC policy (Nippon Educated Chinese) is an important theme for the Japanese companies' advance into China in the future.

(Kimura)

Insufficiency in communication may be the root of such problem. It is the same not only between Japan and China but also between Japan and Korea. The key is to have closer communication at various levels. Whether China/ASEAN or Japan/ASEAN, the contents are quite different, and both Japan and China are well aware of what should be done. I am optimistic.

**Q-2:** Mr. Ohkawa, Senior Advisor, Toray Industries, Inc.

The issues of Chinese Yuan and FTA are closely related to each other. While Yuan is maintained at the rate undervalued by 15-20%, to let trade liberalization, which is the aim of FTA, precede Yuan appreciation may present a problem. Will it be acceptable to proceed with trade liberalization under the regimes of labor distribution and complementary relationships between two countries, without discussing currency issue?

A:

(Kimura)

Although FTA and currency issue is closely related, it is technically possible to address them separately. Real problem is not the Yuan but the transfer of capitals. Technically it is possible to start trade liberalization while restraining capital transfer. In practice, however, it may certainly be a problem.

(Kwan)

I think it is acceptable to consider adapting the two-stage method. In the case of Japan, the so-called Nixon Shokku (shock) led to the shift toward the currency fluctuation system, while the liberalization of capital flow somewhat lagged behind. People here may be worrying about the issue of remitting profits earned in China to Japan, but such remittance is not the trade of capitals but the transaction of ordinary expenses. As China being the country under IMF Article 8, and a member of WTO, such transactions must have considerable freedom, and rather preferably treated, so there should not be much complaint.

(Kimura)

The FTAs of USA/Chile, and USA/Singapore basically prohibit the restriction on capital movement. I understand that there is no talk of incorporating such restriction on the FTAs Japan plans to make.

### **3. Second Session “New business models for the advancement toward Chinese market”**

Issue Presentation: Prof. Kenji Hattori, Faculty of Modern Chinese Studies, Aichi University

Coordinator: Yasuhiro Goto, Columnist/Editorial Writer, Nihon Keizai Shimbun Inc.

Panelists: Taizo Kayata, Executive Officer, President, Overseas Marketing, Construction & Mining Equipment Marketing Division, Komatsu Ltd.  
Dr. Jian Min Jin, Research Fellow, Economic Research Center, Fujitsu Research Institute  
Prof. Kenji Hattori, Faculty of Modern Chinese Studies, Aichi University  
Yoshinori Yasumi, President, CEO, Unika Co., Ltd.

#### **【Presenting issues (Kenji Hattori)】**

- The management viewpoint is to fill the gap between macro economy and actual works. I would like to introduce to you the thoughts of Japanese company people working hard at the work sites.

- The problems in Japanese companies' business activities in China include following three points: (1) no feedback from the work site (importance of work site, location, and actual commodities); (2) no long-term strategy; and (3) the lack of a stance to address Chinese market with the full awareness of advantages and disadvantages of own companies.
- At present the status of China is rising as a vast market, but their companies lack international competitiveness (industrial competitiveness, export competitiveness, technologies, and brand images). The pillar for China's continuous growth will be to develop and earn independence of private entities, on the assumption that China is to recognize private ownerships and property rights. Economic relationship between Japan and China has entered a new era of "competition and coordination" from the earlier era of "stability". Also we must consider how to respond to their change of values from public-sector-oriented to private-sector oriented.
- There will be many business opportunities as the Chinese market continues to expand and become open, but the challenge for private entities is to establish the rights of domestic sales and sales in general, especially the right to trade. Certainly there are many risks arisen in the process of a regime change from controlled economy to market economy and from closed society to an open society.
- In the environment of four "nons" (irrational, unfair, insincere, and displeasure" as well as anti-Japan feeling, the localization will be the main pillar for investment strategy toward China. To be specific, the measures will include the training of Chinese managers, transfer of technologies (not the second-rated technologies), fund procurement (important to gather information), and marketing and sales (with distinct class distinctions, targetting riches, or selling goods exclusively specialized for a specific region).
- Another key point is "greater authority to a local entity". The relationship with a parent company in Japan should be clearly identified. For small to medium size companies, out-sourcing and cross-industry alliance need looking into.
- In terms of time, we must invest in China by seriously studying and focusing on everything from people, materials, money, information etc. for the moment, but for longer term put less importance on strategy and resort to optimism, as Mao Zedong said. of "heavy tactics and light strategies."
- In larger perspective, Japan and China need to become the central force of East-Asian Economic Community. At individual level, Japan needs to view China in its life-size, from dynamic, three-dimensional, and multi-layer viewpoints, with the spirit of "commerce and money-making first and friendship second."
- It is important to tackle Chinese market through own entities as a medium.

【Discussion】

## 1. About Chinese market

(Jin)

- The source of Chinese purchasing power is the uneven distribution of wealth accumulated on value-added base, among regions, people, and professions. (Disparity between the haves and have-nots.)
- As the consumption structure develops, the market will further expand in every field.

(Hattori)

- Even after the Beijing Olympics in 2008 and Shanghai Expo in 2010, China's growth will continue though losing momentum. Important thing is how to grasp the opportunity that exists today. It all depends on the management's attitude.

## 2. Introduction of a company and its current status

(Kayata)

- Construction machinery market continues its course of expansion. The keywords for business expansion are "speed" and "quality."
- The (Komatsu's) sales amount in China is about 6% of the whole company sales. The ratio of Chinese sales in overseas market is less than 10%. Its growth rate is 60-70%.
- Japanese shovels are superior products and technologies in the world. Chinese market takes up the used shovels from Japan. Japan and China are in a complimentary relationship in terms of market, production, and used products.

(Yasumi)

- Business of our company (Unika) is the production of drills for concretes (hole-drilling edged equipment). The industry is matured and started to shrink in Japan. We concluded that advancement into overseas markets is the only way for the company's future growth. Taking advantage of our company's competitive edge on "high quality" and "low price", the company advanced into the Chinese market. What used to be important there 10 years ago when we first entered the Chinese market was "less cost," but now the keywords are "efficiency" and "productivity."
- The concept is "if you can win the Chinese market, then you can win any other markets."
- The sales in China shares about 5% of the total sales. Those manufactured in China are sold to Japan, and then to Europe and USA. The growth rate of the Chinese market is 70%,

## 3. Issue of qualities

(Jin)

- The quality and technology levels of Japanese products are superior, but they alone may not ensure sales. (Such as the cases of Japanese home appliances, cellular phones, etc.) The development of products and technologies conforming to the needs of consumers and the Chinese market as well as the growth of a market itself can lead to business opportunities.

(Hattori)

- Nowadays consumers do not go for low quality inexpensive goods as they used to, but ask for higher quality products. In this sense, the bi-polarization of Chinese markets has begun in both consumption and supply. In other words, Chinese market is increasingly divided into two poles of “good and expensive” and “affordable.” In the future, the question will be how to attack this huge market of 1.3 billion people, which field to focus on, and whether to select spreading or aggregating.

#### 4. Production and sales risks and countermeasures

(Kayata)

- Production risks are not too hard to tackle compared with those of domestic sales.
- As long as one offers technological cooperation, there always are risks about pirating. Yet they can hardly copy the contents.
- Sales risks are actually the risks on “collecting payments.” Collection method is not by cash but by “installments.” As there is a secure system to collect debts through bank loans, trading is possible if there are information on, and proofs of, ID cards, copies of family register, and the work contents. We expect that there will be the development, transparency, and disclosure of customer and credit information.
- Until now, we put efforts to let consumers select Komatsu. In the future, it will become important for us to select consumers.
- What is important in debt collection is to manage the frontline of transaction. All the problems we find are localized at the site of transaction, including the moves and behavior of consumers, and the actions of our staff, managers, agencies, business partners etc. In this sense, risk management is equivalent to the frontline management.

(Yasumi)

- Regarding the issue of production, the management of production site is important in view of quality control. Sometimes even Japanese managers have difficulties. The biggest issues include the “education of local managers” and “training of employees.”
- Pirating of products is inevitable, as the wants of users have been divided into “good quality products” and “cheaper the better.”

- In terms of sales, the biggest problem is payment collection. Currently we request cash payment, but plan to shift gradually to credit sales.

(Hattori)

- Generally and universally speaking, what is important in addressing risks is to make everything open. Another important thing is to pressure administrative organizations rather than to threaten or to intimidate them.

(Jin)

- The risk issue is not the comparison of risks between Chinese and Japanese markets, but whether you are facing the same risk your competitors are facing. The issues of payment collection and technology leakage are alike. Important thing is to self-manage what is valuable to you.
- The problem of technology outflow is the problem of job hopping. How a Japanese company manages and controls Chinese or Japanese people in the Chinese market. Are you in the control of what the technologies are and what should be protected?
- Need to build systems, regulations, and methods for localization, risk hedging, risk management, and monitoring.

## 5. About alliance

(Hattori)

- It is difficult to make general and universally applicable comment, but we need to note that China is still a developing country, and a country of one-party rule by the communist party. We need to address irrational aspects under such conditions as well as the aspects of their wish to develop markets.
- Especially the domestic sales issue is a big problem. To be partnered with a Chinese company can be more important than to start production activities. While it is necessary for Japanese company to ascertain what kind of a company is your partner, Chinese companies are trying to place Japanese companies, too.

(Jin)

- There are three secrets of success in China. One is to well respond to the Chinese market through close observation and evaluation. (Sensitivity in responding and reacting to the market formation.) Two is to have a technology conforming to the consumer needs (for example, not a catalogue sales but technology development conforming to the demands of consumers). Three is the management (basically localization of management).



(Yasumi)

- We provided Spartan training for the “management education” of the local president, while inspiring employees as a whole to have “motivation.”
- In terms of alliance, we formed one cross-industry company among small and medium companies to enter the Chinese market. Unika has become a representative company to manage the local company (local name: Rimao). Each Japanese company is organized into each “division” in order to reduce costs, improve management efficiencies, and hedge risks by sharing certain business functions and processing expenditures as common costs.

(Kayata)

- The head of the local company is Chinese. He has been trained since his joining the company in Beijing 20 years ago. On top of training such personnel, important thing is that he has sufficient people to follow him. In other words, to develop an excellent individual, and let other local Chinese people motivated to strive on his footsteps.
- When we started to enter the Chinese market, the situation there did not allow for us to make alliance with other companies or entities, but today we try to do various efforts in winning the partnerships including the one with a university in Shandong Province.
- The basic principle of our company’s management is to optimally and fully utilize every resource in China (human resource, funds, know-how etc.) Whether a plant is located in China or not, it is necessary for the production site to do whatever possible for winning a global competition.

#### 【Q&A from the floor】

Q: (Mr. Shimano, Chief of Economic Research Department, Okasan, Economic Institute)

What will be the impacts of Yuan appreciation and the countermeasures to mitigate such impact?

A:

(Yasumi)

- As our company has more imports from China than exports to them, the Yuan appreciation will be a plus. In terms of investment from Japan, also, it is a plus as their values increase.

(Kayata)

- We steadfastly make reservation on foreign exchange rates. On another aspect, the Yuan appreciation raises costs for the Japanese company in China, but their asset value will increase. It depends on how they offset each other.

**【Final comments】**

(Hattori)

- It is important to view China through the eyes of own company or entity.
- Before judging or criticizing China (Chinese companies), it is important to address issues as the issues of own.

(Jin)

The most important is the localization. Localization does not necessarily mean to use Chinese people but to use people who have a thorough knowledge in the local market, and maintain sales capability. No need to be Chinese. We need to develop a market led by local markets. In such sense it is governance. How Japanese parent companies govern Chinese subsidiary company? How to motivate a local Chief Financial Officer? Current evaluation system may present problems. Make a commitment to the Chinese market, and provide incentive mechanism. Even Japanese can be well adapted to the job if qualified.



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