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INSIGHTS

into Japanese

CULTURE *and* POLITICS

Articles from the Tokyo Foundation Website

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A Taste of Japan

Japan's regions were once blessed with an abundance of their own traditional foods and handicrafts. Although globalization and a centralized distribution system have led to a more standardized landscape, there are still many remaining riches, waiting to be discovered.



The kaki, or Japanese persimmon, is one of the few fruits that are native to Japan. Until sugar production began in the early seventeenth century, dried kakis were the only form of sweetening, except for honey.



Freshly harvested wasabi roots are bright green.



Dried bonito is an important source of umami (savoriness) in Japanese cuisine.



Rice terraces are formed on sloping land.



Mage-wappa boxes made from cedar used to store lunch.



Decorative sashiko embroidery is hand-woven, stitch by stitch.

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December 13, 2010

Haiku: The Heart of Japan in 17 Syllables

By Mayuzumi, Madoka

Haiku poet Madoka Mayuzumi delivered a special lecture at the Fifteenth Symposium on Japanese Language Education in Europe, held in late August 2010 at the University of Bucharest in Romania. Mayuzumi, appointed by Japan's Agency of Cultural Affairs as a special advisor for cultural exchange, was invited to speak by the Tokyo Foundation, which provided assistance for the symposium and which has also been supporting Japanese language education at the University of Bucharest for many years through the Nippon Foundation Fund for Japanese Language Education Program.

Prior to the symposium, Mayuzumi also delivered a lecture for members of the general public at the university entitled "Haiku: The Heart of Japan in 17 Syllables." Over 100 Romanian students, cultural figures, and haiku enthusiasts attended the lecture and poetry reading. She also discussed haiku and Japanese culture with a smaller group following the lecture.

A haiku is the world's shortest poem consisting of just 17 syllables. Despite its succinct form, it contains the essence of Japanese people's aesthetics, view of nature, philosophy, thought, and sentiments. As a rule, haiku must have a *kigo* (a word connoting a season) and are rendered in three lines of 5, 7, and 5 syllables each. The *kigo* is a reflection of the Japanese people's sensitivity to the changing seasons, our love of nature, and our respect for form. These qualities are seen not just in haiku but in many other manifestations of Japan's traditional culture. Just what exactly is a haiku, and what is its place in modern Japanese society? Let me explain with references to things that are close to the hearts of Japanese people.

Encounter with Haiku

I first discovered the rich world of haiku when I read a poem by Hisajo Sugita, who was active in the first half of the twentieth century: *Hanagoromo / nuguya matuwaru / himo iroiro*. This can be translated as: "Unfastening the cords / Around my spring kimono /

Mayuzumi, Madoka *Haiku poet. Was appointed special advisor for cultural exchange by Japan's Agency of Cultural Affairs in 2010.*

One by one.” *Hanagoromo* is the kimono women traditionally wore to go cherry-blossom viewing.

The Japanese love cherry blossoms; in the past, women used to order a new kimono early each spring to wear to blossom-viewing events. These beautiful kimonos were called *hanagoromo*.

The haiku depicts a woman who has returned from such an event is now disrobing in her room at night. The many layers of a *hanagoromo*, including undergarments, are held together by various cords. She has removed the cords one by one, and the kimono is now scattered around her feet, still warm from being next to her skin. She stands unfettered in her room, outside of which stand cherry trees in full bloom.

The poem elegantly captures the sensuous beauty of this scene, but there is much more that Hisajo tried to convey. She was born in 1890, a time when publishing poems as a form of self-expression was not considered proper for a woman, and she was harshly criticized by her contemporaries. Her marriage, too, was unhappy, and her last days were spent in a mental hospital. She was a highly talented poet yet did not publish a single collection of her works during her lifetime. The cords around the woman’s feet in the haiku are a metaphor for the various social stigmas that kept women bound in her day. The true artistry of this poem is that while it is an expression of Hisajo’s inner sorrow and torment—which was no doubt shared by many women of her time—such sentiments are not conveyed bluntly but transformed into something more refined and beautiful. This, for me, is the true appeal of haiku.

By avoiding direct emotional expression, the author is cleansed of and is able to transcend those emotions. Our modern society has become full of words and explanations, so it was with great surprise and joy that I chanced upon such a condensed, refined, and simple poetic form. That is how I developed a deep love for haiku.

History of Haiku

The haiku was born in the late fifteenth century. It was originally part of a much longer poetic form called *renga*, which literally means “linked verse.” *Renga* were written by two or more persons by linking stanzas comprising lines of 5, 7, 5, 7, and 7 syllables each. Haiku are essentially the first three lines of this older form. Initially called *hokku* (literally, “first verse”), the haiku was elevated into a refined poetic style in the seventeenth

century by Matsuo Basho and renamed haiku by Shiki Masaoka at the end of the nineteenth century.

Today, haiku are written in many different languages around the world. European Council President Herman Von Rompuy is a noted lover and writer of haiku who just recently published a collection of his poems. Enthusiasts in France include former President Jacques Chirac and Prime Minister Dominique de Villepin.

The haiku-writing population in Japan is said to number 8 million to 10 million. Innumerable submissions are made each week to daily newspapers, weeklies, and other magazines that feature sections for haiku and similar short verses written by readers. These are not works by professional poets but by members of the general public. In a world where poetry as a literary art form is now waning—even new editions of Shakespeare's sonnets have print runs of only around 2,000 copies—the love of haiku, *tanka*, *senryu*, and other short poetic forms among the Japanese people still endures.

Haiku have also had a broad influence on other poetic genres and in many other countries. Soviet Russian film director Sergei Eisenstein is said to have gained hints for his theory of montage in cinema from the haiku form. And John Lennon reportedly drew inspiration from haiku when he wrote his hit song, "Imagine."

Haiku Conventions

Haiku, as a rule, have three lines of 5, 7, and 5 syllables each and contains a *kigo*, which indicates a season. This emphasis on a seasonal element is probably an outgrowth of the Japanese people's sensitivity to nature. Each country has its own areas of scenic beauty and a unique way of relating to nature. The Japanese approach is to become completely one with it.

For example, popular seasonal pastimes in Japan include cherry-blossom viewing, firefly viewing, and autumn-foliage viewing. These activities are referred to as *gari* in Japanese, which literally means to "hunt"; the purpose of these events is, of course, not to take home cherry or maple branches as spoils. The reference to *gari* indicates that you are not merely looking at beautiful scenes of nature from afar but stepping into their midst and appreciating them up close and on their own terms.

There are many seasonal *kigo* to describe mountains. In the spring, for instance, the hills are said to be "smiling." This refers to the warm, gentle stirrings of life, like the appear-

ance of shooting buds and blossoming flowers and the chirping of birds. In the summer, mountains “trickle”; with their new coat of green leaves, trees are so full of life that water seems to ooze from them.

In the fall, the mountains turn red and golden. Maples don a coat of bright red leaves, while other trees turn yellow or brown. This is as if the mountains have “adorned” themselves with blush makeup. When the trees drop their leaves in the winter and lie quietly, the mountains are said to be “sleeping.” By thus personifying nature, a very close affinity with it is created.

The “smiling” mountain in the spring seems to share with us the joy of having endured and overcome the cold, harsh winter. The Japanese people have traditionally been heavily influenced by changes in the seasons and have incorporated those changes in their lifestyles. In early spring, we await the first blossoming of flowers, and in the early summer we enjoy viewing the dance of fireflies in the evening. As the summer heat intensifies, we hang wind chimes by the window and listen to the breeze. Autumn is the time to appreciate the full moon, the fall colors, and the song of crickets. And winter brings pure, white snow. While appreciation of such seasonal changes has diminished in Tokyo and other modern cities, it is still an enduring part of everyday life in older parts of the country, like the ancient capital of Kyoto.

The *kigo* evolved from cultivating such close ties with nature. Seasons always come and go, even during times of social upheaval like warfare. The full moon appears each month, and cherries always blossom in the spring. The Japanese people have lived with these seasonal changes and shared the joys, sorrows, and concerns that the changes bring. The *kigo* encapsulates all these sentiments, our happiness, our pain, our tears, and even our values and aesthetics. It is the secret behind the haiku’s ability to make profound statements with just 17 sounds.

The 5-7-5 syllable format also gives haiku a distinctive rhythm. Traditional manifestations of Japanese culture, such as the noh theater, flower arrangement, and tea ceremony, all make use of conventionalized forms. Many people comment that haiku is already restricted by being so short and having fixed syllables and wonder why there is a need for a *kigo*. Ironically, it is the rigid structure and seasonal requirement that give poets the freedom to let their imagination run free.

Writing a poem can be likened to an Olympic event. One of the best-known Romanian athletes is Nadia Comaneci. If she stepped outside the 12-meter by 12-meter performing

area in the floor exercise, for instance, points would have been deducted from her score. If, on the other hand, she limited her movements to the center of the mat to avoid a penalty, her score would have been low. The highest points are given to exercises that use the entire floor, including along the perimeter. A gymnast's foot landing firmly just inside the perimeter after a flip along the diagonal is breathtaking and beautiful because of the tension created by the danger of falling out of bounds.

A haiku is like the 12-meter-square floor. It is because we must operate within the confines of a narrow, constricting poetic structure that we are compelled to give depth to our words. We must pare down and strip away all superfluous elements until all we have left is the bare essence; it is the tension created by the need to accommodate a prescribed shape that enhances the reverberating beauty of a poem.

Haiku as a Form of Greeting

Haiku is sometimes described as a form of greeting, much like "hello," "goodbye," and "thank you." A haiku is dedicated to the people—as well as birds, flowers, and other forms of life—that we happen to meet as our contemporaries. A haiku about cherry blossoms is a thank-you letter for having endured the long, harsh winter to delight us in the spring. In so doing, the fleeting pleasures provided by the sight of a cherry tree in full bloom can be eternalized in verse. Composing a haiku is an act of reciprocation for the wonders and delights that nature provides. The cherry blossoms that Basho wrote about three centuries ago are still as radiant as ever in the vase of his haiku.

Between the Lines

The Japanese people are sometimes thought of as being vague and unable to say "no." But this is not entirely accurate. It is not that we cannot say "no" but that we do not need to say it. It is simply hinted, and the hint is understood. People can read "between the lines" of short utterances and guess what the other person is trying to say. Japanese culture is thus a "sympathetic" one, and the ultimate manifestation of this phenomenon is the haiku. The succinct form of the haiku leaves plenty of space for what was left unsaid. There is an eloquence to this silence, and it is this quality that characterizes many aspects of Japanese culture.

Movement in the noh theater, for example, is regarded as being quite subdued, but, again, it is the stripping away of all nonessential motion that gives richness and depth to the intervals between each stage movement. Perhaps the same can also be said of food.

A chef that studied in France noted that if French cuisine uses 10 parts seasoning, Japanese dishes only use 5. A deliberate choice is made not to add too many flavors. This is not to say that Japanese food is bland; great effort is made in preparing the ingredients and adding “hidden” seasoning, but this is done in subtle ways that are not obvious. It is up to the diner to complete the gastronomical experience.

Similarly, in the Japanese art of flower arrangement, flowers do not fill up the entire space. The Sogetsu school of *ikebana*, where I used to study, utilizes the concepts of *shin*, *soe*, and *hikae* to prescribe the positions and angles of the stems. There is a broad opening between *soe* (second longest) and *hikae* (short) stems, which forms an integral part of the floral arrangement. In fact, one *ikebana* artist noted that the focus of attention when creating an arrangement was not the flowers themselves but the space between them.

I feel the same way when writing a haiku. While I am weaving together words to create a poem, I am at the same time weaving the spaces between them in my tapestry. And to gain a full appreciation of Japanese culture, it is essential that you not only *read* between the lines but also *smell* and *feel* the spaces and pauses, filling in the missing pieces on your own. Readers must draw from their own experience to reproduce the epiphany felt by the author in the spaces that have been left unfilled.

A haiku is thus a joint undertaking between the author and reader. It is often said that a haiku cannot be written that is richer or deeper than the person creating them. In a similar vein, a reader whose life experiences are limited will be unable to share in the richness or depth of the sentiments expressed.

It is between the lines—in the words that have been left unsaid—that the haiku communicates the poet’s deepest sentiments and thoughts. In the words of haiku master Basho, “What is left after everything there is to say has been said?” Words alone cannot describe the fullness of the human experience.

The Spirit of Haiku

Composing a haiku means giving a voice to the “other” appearing before our eyes and taking a slice of Earth’s life. By so doing, we ourselves tap into the cosmic source of life and create a synchronicity and fraternity with other living beings. This is also a process of self-discovery, a journey to the depths of one’s own hearts. It is through the “other” that we discover things about ourselves.

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Basho used the phrase *karo tosen* to describe haiku. *Karo* means a brazier (stove) in the summer, and *tosen* is a fan in the winter. In other words, haiku may serve no practical use in our present reality but are nonetheless of great importance. People do not need haiku to live, nor will haiku fill hungry stomachs. But to lead a richer life, haiku—as well as other forms of culture and art—can be of paramount importance.

Culture and art may not be practical, but modern society has lost so much in its relentless pursuit of the practical lifestyle. This is something that I believe needs to be reexamined.

By embracing the world that remains unexpressed, the haiku attains unity with the fullness of the natural world. Through haiku, one can become one with a flowering violet, for example; you come to respect all forms of life, both human and otherwise. I am convinced that such an appreciation of the preciousness of life—which can perhaps be called the spirit of haiku—can help us find solutions to conflicts between peoples, environmental degradation, and many other problems besetting modern society.

September 17, 2010

Yuzuriha's Crusade to Keep Handicrafts Alive

By Tanaka, Yoko

Many of the handicrafts of northern Japan were born in response to the region's harsh climate and reflect a lifestyle in deep respect for and affinity with the natural environment. They also embody a rich, proud spirit that lies at the heart of Japanese culture, and efforts must be made to preserve them for generations to come.



The pristine forests of Towada are full of life and energy.

“All the good things in life have been made by hand since the prehistoric Jomon period, including food, utensils, homes, bridges, and Buddhist statues. . .” This is a comment I read somewhere that made a very deep impression on me. Our ancestors made everything they needed for their survival on their own, utilizing the plants and animals near at hand. Japan's traditional handicrafts, consequently, embody the ingenuity born of a lifestyle in deep affinity with nature and through close contact with their neighbors. This no doubt gave rise to the country's beautiful yet utilitarian handicrafts that have a universal appeal. Life today has become very convenient, but at the same time we have also lost touch with something very precious; this is something we are reminded of every time we run into a meticulously handcrafted item or are in the midst of family and friends.

Yuzuriha Gallery and Shop on the shore of Lake Towada in Aomori Prefecture have been

Tanaka, Yoko President, Craft Shop Yuzuriha.

showcasing the handworks of northern Japan for 22 years. The items on display have been painstakingly chosen by visiting the artisans in person one by one. Through a process of trial and error, I worked with them to explore how craftworks can help enrich the modern lifestyle and endeavored to convey to customers the story behind each handmade product.



Decorative sashiko embroidery is hand-woven, stitch by stitch.

The long, forbidding winters make many parts of the Tohoku region of northern Japan nearly inaccessible, but they have also engendered a rich assortment of handicrafts. One example is Aomori's *sashiko* (embroidery) made by women, including during the months of heavy snowfall. It was originally a way of repairing torn daily garments and work clothes with patches in the shape of familiar flowers or animals, but this functional stitching technique is used today to produce highly decorative and beautifully refined quilts and embroidery. Tohoku's winters are too cold to grow much cotton, so even tattered, worn-out pieces of cotton fabric were precious. Stitching patches to hand-woven linen cloth provided greater warmth,

enabling people to survive the frigid winters. Fabric was more than a daily necessity; it was as important for survival to the people of northern Japan as the food they ate, and women treated pieces of cloth with as much care and love as they showed for their families.



Mage-wappa boxes that men in mountain villages used to make from thinly sliced pieces of Akita cedar.

One item produced by men in mountain villages is the *mage-wappa* box made from thinly sliced pieces of Akita cedar. The slices of cedar wood are steamed, allowing them to be curved into shape, and spliced together with the bark of the cherry tree. *Mage-wappa* boxes are suited to storing lunch, as cedar keeps away bacteria and absorbs moisture, so food items remain fresh and delicious. The pattern formed by the cherry bark served as a “signature” of the person who made the box, so when they ran into an accident in the mountains, they could release the box into a nearby stream as a way of alerting villagers further downstream. The mountains were also sources of vines, taken from *akebi* and wild grape trees, which were woven into *kago* baskets that served an invaluable role in people’s daily lives. People expressed gratitude to the mountains for “sharing” the vines with them, despite the severe seasonal limitations on when such blessings could be gathered.

People of the past held the powers of nature in deep respect and adapted their lives to the harsh conditions, acquiring in the process a steadfast will to live, pride in their lifestyle, and humility. In this age of material affluence and the emphasis on mass production and cost effectiveness, we must not forget that the objects we require for daily life were originally all made by hand, and that the materials used were obtained from nature. All handicrafts, including those that are no longer produced today, recount a rich and engaging tale of people’s intimate ties with nature and with others. They also embody the spirit of the Japanese people, unchanging despite the changing times, that serves as the wellspring of Japanese culture.

The forests of Towada in Aomori Prefecture are resplendent in their natural beauty. With each winter, the leaves on the trees fall one by one until none are left, and while on the ground they serve as fertilizer until next spring under a blanket of pure white snow. Snow-covered forests are so beautiful, people say, because they clothe so much underneath. The same, perhaps, can be said of people, developing a natural richness and luster as we go through life’s experiences. Preserving such richness for future generations is a

mission toward which I feel we should all contribute what we can.

Photos: Takeshi Hosokawa (from Yoko Tanaka’s Yuzuriha no uta)



A young Japanese serow walks across a frozen lake in the severe Tohoku winter.

August 9, 2010

Craft, Community, and the Cost of Global Capitalism

By Kato, Hideki

At a time when baskets mass-produced in China can be had for a few hundred yen, who would pay a hundred times that for a similar basket—an everyday item, after all—laboriously hand-woven in conformance with traditional Japanese techniques? That consumer selection would weed out such items and doom them to extinction on the marketplace seems inevitable. “It’s too bad,” we say, “but that’s life.”

But before we dismiss handwork as a quaint relic of the past, we need to understand just what it is we are dismissing. The creation of a single hand-made object entails a multitude of processes, beginning with the gathering of materials. Hand-woven textiles, for example, require not just weavers but also people to spin the thread, dye it, and so forth. Those occupations shape the lifestyles of the people engaged in them, and those lifestyles differ from one another as a result. In the past, the need for all these different people to collaborate, interact, and deal with one another led to the development of complex social customs, rules, and mores. In time this interaction evolved into a network of social relationships—a community, in other words—in which people came together for festivals, celebrations, and solemnities. In this way whole cultures evolved.

Urbanization, economic globalization, and the triumph of money as the be-all and end-all of our economy and society have driven the hand-made object from our midst and in the process destroyed the foundation of communities and cultures that evolved over the centuries. Needless to say, this phenomenon is not limited to Japan. Leaving aside certain luxury goods produced for the wealthy—Kashmiri rugs, English furniture, Italian leather—cheap, mass-produced goods have taken the place of hand-made objects

Kato, Hideki *President of the Tokyo Foundation. Joined the Ministry of Finance in 1973. Served in several positions, including in the Securities Bureau, the Tax Bureau, the International Finance Bureau, and the Institute of Fiscal and Monetary Policy; resigned in September 1996. Founded Japan Initiative, a not-for-profit, independent think tank, in April 1997, serving as its president since then. Served as professor of policy management at Keio University, 1997-2008. Assumed the chairmanship of the Tokyo Foundation in April 2006. In October 2009 became secretary general of Japan’s Council on Administrative Reform within the Cabinet Office, and in April 2010 became president of the Tokyo Foundation when it became a public interest incorporated foundation.*

in the daily lives of consumers around the world, and as a result, the communities that grew up around handicraft economies are now either extinct or endangered.

We need look no further than Tokyo to get a sense of where this trend leads. With money, one can do or get almost anything in Tokyo. But without money, one can do almost nothing, because the ties that once bound people to one another have all but dissolved. The harsh truth of this was driven home late in 2008, when thousands of temporary workers who had lost their jobs and homes in the wake of the October financial crisis converged on Hibiya Park seeking food and shelter to tide them over to the new year.

When a mass-produced basket replaces a hand-woven basket, little or nothing is sacrificed in terms of the basket's function. But something else is lost. In a series of articles, using a mundane basket as our starting point, a fast-disappearing way of life will be explored in an effort to better understand what it is we are losing and whether it is something we can really afford to lose.



Hand-woven baskets like these, most often made from bamboo, were ubiquitous in rural villages, where farmers, fishers, peddlers, and others used them to carry goods of all kinds on their backs. (Courtesy of Shikoku-mura)

* * *

About the Series “Craft, Community, and the Cost of Global Capitalism”

In a world awash in mass-produced goods, hand-crafted articles seem destined to vanish from our lives, except perhaps as luxuries, curiosities, or hobbies. As handicraft industries succumb to urbanization and globalization, communities succumb as well. This series examines a vanishing way of life from a variety of angles; explores the implications of its disappearance for society, culture, and the environment; and raises serious questions about the costs of global capitalism.

September 13, 2009

Rediscovering the Treasures of Food: Dried Kaki

By Shimamura, Natsu

The kaki (Diospyros kaki), or Japanese persimmon, is one of the few fruits that are native to Japan. Until sugar production began in Okinawa and western Japan in the early seventeenth century, dried kakis were the only form of sweetening, except for honey, available in Japan.



Popular “Confectionary”

A scenic temple named Zuirin-ji lies near Mino-Kamo railway station in Gifu Prefecture, central Japan. The historical temple enshrining successive shoguns and heads of ancient governments is popularly called the Kaki Temple by local residents. The transoms of the temple’s main hall bear kaki motifs, while baskets that were used to offer kakis to the imperial family are still displayed in a corner of the room. An old map preserved at the temple indicates two kaki-producing sites, one of which is located at the back of the temple. The resident priest says the sites were places where dried kakis were made. The village of Hachiya, where the temple is located, offered dried kakis to the shogun every year as an officially recognized confectionary manufacturer for the Edo shogunate.

Why was the dried kaki treated as confectionary? The reason dates back to the time before Japan began to buy expensive sugar from abroad in exchange for silver and copper.

Shimamura, Natsu Was a Research Fellow of the Tokyo Foundation from 2007 to 2009. Nonfiction writer. Earned a degree in fine arts from Tokyo National University of Fine Arts and Music. Is a member of the Japan Writers Association and oversees the “Ark” Japan project at Slow Food Japan.



The sugar trade continued after Japan cut off most of its ties with other countries in the seventeenth century, but after silver and copper supplies became depleted in Japan, a man succeeded in creating sugar by growing ocarina plants and turning them into sugar, a technique he learned in China after accidentally drifting there on a boat. Sugar making subsequently gradually spread in Okinawa and western Japan, but before this time, dried kakis were the only form of sweetening in the country, except for honey.

The Kaki Temple hosts a tea ceremony featuring dried kakis every January. This annual event is proof that the local community takes great care to maintain its tradition of making dried kakis as a chief product of the town of Hachiya.

The school song of Hachiya Elementary School, located next to the temple, was composed by novelist Shoyo Tsubouchi, a leading literary figure in the early twentieth century. The words of the song are now displayed on a black granite monument that stands in the schoolyard. The song describes the district's kakis as being so renowned that they were presented to the imperial court a thousand years ago. This is corroborated in a document written by an eleventh-century scholar, who describes the delivery of dried kakis to the court from Minokuni, where Hachiya lies.



When the temple was built in the early sixteenth century, its founding priest Jinsai donated dried kakis to the Ashikaga shogunate. Records say that the shogun was so impressed that he conferred to it the name of "Kaki Temple." The sixth resident priest, Meikyu, who sympathized with the high customs the villagers had to pay the central

government, negotiated with the authorities and won a concession from Shogun Toyotomi Hideyoshi exempting the villagers of 5 to (375 kilograms) of rice duties for every 100 Hachiya kakis offered.

Threats to Survival

Dried kakis, which were much loved by rulers in Japan, were also popular among foreigners. Luis Frois, a sixteenth century Christian missionary from Portugal, was served dried

Hachiya fruits by Oda Nobunaga, the national's military leader at the time, according to Frois's book entitled *Historia de Iapan*. In 1900 Hachiya kakis were presented by the Japanese government at the World Exhibition in Paris and won a silver medal. This probably contributed to the popularization of the word kaki in Europe. Novelist and poet Hermann Hesse is said to have been greatly fond of the fruit as well.

There were two occasions, though, when the very survival of the Hachiya kaki came under threat. In the first few decades of the twentieth century, the spread of silkworm culture as a state industry swept away many kaki plantations. In the village of Hachiya, about 30 kaki-growing households turned their lands into mulberry fields to feed the silkworms. Kaki growing was preserved, though, thanks to Toshio Murase, who, as a 20 year old in 1930, decided to devote his life to reviving the Hachiya kaki. Murase as a boy had learned to make dried kakis at secondary school and felt that it was his calling to make the product. Local elementary schools in this area still maintain this tradition of teaching children to make dried kakis.



Young Murase listened to the recollections of elderly members of the community and gradually increased his stock of kaki trees. His passion never waned even when he was sent to the battlefield in World War II. From the front he wrote to his wife about fertilizer to be fed to his trees.

As food ran out during and after the war, grain replaced kakis in the fields, as the fruit was seen as luxury item. Trees surrounding the fields were turned into firewood. The Murakami family, however, devotedly held on to the kaki legacy. Later, in 1978, Toshio called on the local community to establish an organization to promote Hachiya kakis, which helped to further revive dried-kaki making. In 2007 the Hachiya kaki was admitted into the global "Ark of Taste" by Slow Food, a foundation based in Italy, as an esteemed food heritage of humankind.

In recent years, the Hachiya kaki has been going through another critical phase. The kaki is one of the few fruits that are native to Japan and has long been the predominant sweetening agent. Kaki fruits hanging in front of a farmhouse for drying during the winter remind many Japanese people of landscapes they knew as children. However, in the past 10 years or so, this tradition of kaki hanging has virtually been replaced by wheeled platforms, invented to protect precious dried fruits from the elements. Yet, some households still hang their kakis for their own consumption.



In one of his haiku, the seventeenth century poet Basho wrote, “In the old villages, no house is without its kaki tree.” Such a rural scene, however, is now quite rare. About 45% of the growing area is shared with such commercial species as *fuyugaki*, seedless *hiratanenashigaki* and *tonewase*. Many local species, said to have once numbered a thousand nationwide, have been rapidly disappearing.

Factors behind these trends include, on the consumers’ side, the market dominance of imported sugar; the invention of artificial sweeteners, such as saccharin; and a drastic

increase of excessively sweetened foods produced by chain stores and factories of Western-style confectionaries. Even beverages include huge amounts of sugar. As a result, dried kakis have lost not only their status as the main domestic sweetener but also patrons capable of appreciating their delicate sweetness and subtle bitterness.

What is more worrying is the problem of successors. About 80 farmers now produce Hachiya kakis, and 46 are capable of processing them into dried fruit. The average age of these farmers, though, is 74. Few are young and ambitious, save for the grandson of Toshio Murase and his spouse. In 2002, a year blessed by good weather, shipments reached a record 8,400 cases of 1.5-kilogram kakis. This has not been surpassed in recent years, though, and shipments remain unstable. This represents a renewed crisis for the fruit, which is the pride of Hachiya - having been immortalized by Shoyo Tsubouchi - and of Japan as a whole.



Kaki fruits hanging in front of a farmhouse for drying during the winter.

How Dried Kakis Are Made

The *dojo* Hachiya kaki, which was presented to successive shoguns, is probably the most highly priced brand among dried-kaki products. The best fruits with good color and shape, which account for some 30% of the crop, cost ¥1,000 (about \$10) per piece. A case of 400 grams or more can cost 3,000 yen and is suitable as a gift, as the fruits are packed in neat wooden boxes. When seeing the hard work on site to create the finest dried fruits, people will no longer think the prices are too expensive.

To create quality dried kakis, producers must first grow big fruits with fine texture and taste; otherwise, all the ensuing hard work will be in vain. Koichi Horibe, chairman of the *dojo* Hachiya kaki association, has about 100 kaki trees in his field. At most they stand only as tall as the average human. “They are delicate trees, and become prone to diseases when they grow too tall,” explains Horibe. So, when he grafts kaki trees, he uses the mountain kaki species as the base root. Although the fruits are small, his mountain kaki trees are close to the original species and resilient to both diseases and cold.

A field of Hachiya-kaki trees “demands meticulous care throughout the year.” In the winter after the harvest, farmers add fertilizer to the soil so that the trees will bear good fruits next year too. From January to March, growers scrub off the surface of the trees to keep away insects and diseases. In mid-May, they also remove redundant blossoms, and in June they remove surplus new buds to avoid the scrambling of branches. In July, growers remove all but one fruit on each branch. When the harvest approaches, growers add fertilizer to prepare the field for the coming winter. Straws are spread at the foot of each tree to protect the intrusion of bacteria, and fallen leaves are neatly removed so as not to give any room for germs. The care taken to grow kakis in Hachiya is reminiscent of how the finest vineyards are tended.

The following outlines the process for making dried kakis.



The fruits are turned around many times.

Harvesting: In the middle of November, later than for most other kaki species; the fruits are left to mature for three to seven days, until their texture becomes as soft as earlobes.

Peeling: A process done by hand, with the use of peelers, unlike Ichiya kakis; within three hours after the peeling, the fruits are fumed with sulfur for about 20 minutes to ease astringency. A chain of fruits, with two kakis bound together horizontally, is hung in a breezy shade for 10 to 15 days.

Sun-drying: Only from 9 in the morning until 4 in the afternoon on the drying platform, for 10 to 25 days; the fruits are turned around many times so that both sides are exposed to wind. On rainy days they are placed in front of fans. At the same time, the stems of the fruits are trimmed in a neat uniform manner.



Kneading: 20 to 25 days after peeling, they are kneaded during the sunny hours when the fruits “shine.” They will turn black if kneaded in humid air, which makes their surface sticky.

Sweeping the surface with rice spikes: The surface is gently scratched, leaving tiny scars on the skin, which prompts the sugar from inside the fruit to cover the surface. The sugar then frosts over the skin.

Shipment: After several more days of sun drying, the fruits are ready for shipment in the

middle of December. The Murases buy rice straw from their relatives and use them to lay the gift boxes. They beat the straw, removing hardened and discolored areas, in a process that reduces the straw to 40% of the original volume. The straws are cut to the same length and placed in the boxes. “If we could use fresh green stems, that would make our kakis look even more vivid,” says Kotoko, daughter of Toshio Murase. The entire process is done by members of the Murase family. They cut bamboo trees growing in the hills behind their house and use them to hang their fruits. The family does not use modern conveniences, such as plastic. This reflects the esthetic underlying the kaki-growing tradition.

Where Are They Produced?

The town of Hachiya is in Gifu Prefecture, central Japan, and is about an hour’s drive from Nagoya. It is part of the Mino Plain and is blessed with warm sunshine through much of the year, with little snow in winter. This contrasts with the image of harsh winters people have of Gifu’s more mountainous areas. The genial weathers make Hachiya an rich farming area, known for its production of sweet *fuyugaki* and pears.

The Hachiya kaki is a bitter, large-sized kaki that turns sweet only when dried and grows only in this town. When Shogun Tokugawa Iyeyasu passed by the village on a military campaign en route to nearby Ogaki Castle, local farmers presented him with these persimmons. The shogun is said to have been much delighted with the gift, as “large kaki” in Japanese is pronounced *ogaki*, which was the name of the castle he was about to attack. This anecdote reflects Hachiya’s long history as a center for large kaki production. The



The sugar from inside the fruit frosts over the skin.

Hachiya species has since spread to Fukushima, Nagano, and 13 other prefectures.

Besides its size, characteristics of the Hachiya kaki include the fine texture of its fruit and a low degree of moistness, an ideal combination in making dried kakis. A historical area on the opposite side of Mino-Kamo Station does not produce any Hachiya kakis, though; the area dotted with old lodges is apparently too humid due to the influence of the nearby Kiso River.

Despite being surrounded by such

snow-heavy areas as Sekigahara, Ena, and Hida, Hachiya gets little snow. Instead, winters are mostly sunny, ideal for making dried kakis, as the process is to a considerable extent dependent on weather conditions. Differences in daytime and nighttime temperatures, little rainfall, and adequate sunshine all intensify the delicate tastes of the fruit.



Encroaching Urbanization

While many families still grow a Hachiya kaki tree, most of the 80 growers of the fruit are concentrated in a narrow area clustered around Hachiya.

This community with a thousand-year tradition is losing much of its historical landscape, however, due to the construction of modern homes, partly owing to its proximity to Nagoya, one of Japan's largest cities.

The kaki is one of the few fruits that are native to Japan. In 1912 there were almost a thousand local kaki species in Japan, according to Professor Satoshi Taira of Yamagata University, citing a government survey from that period. Now, fewer than a third of them remain. Taira blames this change on the urbanization of rural communities and Westernization of dietary habits. There is a danger, therefore, that Hachiya, which is easily accessible not only from Nagoya but also from Tokyo, could become swept up in such changes.

Photos: Yasuko Fujisawa

June 24, 2009

Rediscovering the Treasures of Food: Rice Grown in Rice Terraces

By Asada, Kuniko

Rice terraces are paddies fields made on sloping land that follow the natural contour lines. Suited to the Japanese geography, they are ideal for sustainable agriculture, having the ability to filter water and nurture organisms, among other benefits. Today rice terraces are also growing into a focus of green tourism.

History and Benefits

Rice terraces are commonly seen in hilly and mountainous areas, which are defined under the Food, Agriculture, and Rural Areas Basic Act as “areas with poor geographical conditions and disadvantages to agricultural production.”



Rice terraces are formed on sloping land.

Throughout history, rice has played a significant part in the lives of the Japanese. *Tanada*, the Japanese word for rice terraces, first appears in historic documents dating from the early Muromachi period (fourteenth to sixteenth centuries). That the ancient Japanese made rice fields on slopes, where tilling was harder than on level land, is a testament to the supreme status of rice. Rice was the most valuable of all cash crops. Under Toyotomi

Asada, Kuniko President, Fudo Club. Engages in a slow and small business in which quality products made with care in small quantities are able to survive.

Hideyoshi, who unified Japan in the sixteenth century, all agricultural products came to be listed in land registers in units of rice. This made way for the *kokudaka* system that developed during the 300-year reign of the Tokugawa shogunate, in which land value was expressed in *roku*, a unit based on rice output.

Given the importance of rice, the Japanese went to great pains to perfect the *tanada* so that they could turn slopes into paddies and grow rice even in adverse environments. Today rice terraces are recognized for the following multiple, far-reaching benefits.

- **Water retention and flood adjustment:** The terraces function as dams by holding rain-water, which slowly seeps underground and gently flows into the rivers without flooding them. At the same time, the terraces serve as filters that purify the water.
- **Landslide prevention:** Many rice terraces are located in landslide-prone areas. This may be due to the fact that slopes resulting from landslides retain water well and thus are relatively easy to till. Regular maintenance of the land surface through its use as rice fields leads to landslide prevention.
- **Ecosystem conservation:** Rice terraces support slow, natural circulation in the ecosystem, cycling the water held by the nearby forests and woods and nurturing organisms that make their home in that water, such as frogs and insects.
- **Scenic value:** The landscape of rice terraces is a work of art created by humans for the purpose of producing food. The terraces blend in with the natural scenery and give viewers a great sense of peace and comfort.

From Shortage to Surplus

Over the last several decades, rice has rapidly grown into an overabundant and unprofitable crop for the first time in history.

Japan was obliged to import rice in the period immediately after World War II, when food was scarce, and the government promoted rice cultivation. It undertook major land improvement projects across Japan, in which small, inefficient rice paddies were consolidated to enable large-scale cultivation. Rice yields surged with the development of improved varieties, upgrading of agricultural techniques, and mechanization. In 1968 the manufacture of mechanical cultivators peaked, and rice output also reached a record high of 14.45 million tons. This was more rice than the nation could consume, and surplus rice

became a serious issue. Thus, in 1970, the government introduced a new policy, this time of reducing rice acreage.

The issue of surplus rice owes itself not only to agricultural circumstances but also in large part to the Westernization of the Japanese diet, which has drastically brought down rice consumption. Annual per capita consumption of rice today is 62 kilograms, compared with 120 kilograms in the 1960s. The annual production volume has nearly halved as well, to about 8.55 million tons in 2006. By contrast, consumption of flour has grown from around 4.80 million tons in the 1960s to around 6.30 million tons by 2004. It is coming to share the position of national staple with rice.

But given the growing prominence of metabolic syndrome resulting from a Westernized diet and overeating, the Japanese diet—at the foundation of which is rice—deserves a new look. Rice has underpinned the Japanese diet not only as the staple food but also as an ingredient for making such seasonings as miso and vinegar. Rice and soybeans, the two most basic foodstuffs of Japan, have together supported the health of the Japanese people, who traditionally ate very little meat. Although neither contains all of the essential amino acids in sufficient amounts, as animal proteins do, the Japanese were able to take in the complete set of essential amino acids by combining the two.

Rice Terraces Abandoned

Rice terraces are also coming to a crossroads. With 67 percent of farmers being 60 years old and above, more and more farmlands are lying uncultivated. According to the 2007 Annual Report on Food, Agriculture, and Rural Areas in Japan of the Ministry of Agriculture, Forestry, and Fisheries, abandoned plots have increased from 6 percent of all farmlands in 1995 to 10 percent in 2005. This amounts to 386,000 hectares, which is 1.8 times the area of Tokyo. In hilly and mountainous areas 208,000 hectares, or half of the total abandoned area, have fallen into disuse. Of particular note is the Chugoku region, which has the highest concentration of rice terraces in Japan. Farmlands here are being abandoned here at an alarming rate, suggesting that maintaining rice terraces is quickly becoming difficult. The mechanization of rice production has put rice terraces at a pronounced disadvantage over flat rice paddies, and rice terraces are evidently first in line to be abandoned.

Meanwhile, there are those who insist on growing rice in rice terraces. One of them is Iio Jozo, a vinegar manufacturer based in Miyazu, Kyoto Prefecture. Since 1964 the rice that the family company uses to make vinegar has been organically grown in rice terraces

mainly located in the mountainous Seya district. This was initiated by Terunosuke Iio, the previous owner and father of the current owner, who questioned the effects of pesticides on human health and on the paddy field ecosystem.

An age of spectacular economic growth had just begun. Pesticides had become indispensable for mass production of rice, mechanization was getting under way, and agricultural land improvement projects were proceeding at a dizzying pace. While many farms switched to large-scale production, Terunosuke resisted the trend. It was his conviction that good vinegar can only be made from good rice, and he went from farm to farm seeking their cooperation in producing organic rice. Terunosuke preferred rice terraces over flat paddies because they are free from the effect of pesticides used in neighboring fields and the risk of sewage contamination.

Rice Production by Iio Jozo

Growing rice in rice terraces has many merits, but it is highly labor intensive. Large machines cannot be used in terraces, necessitating much of the work to be done by hand. It is reasonable to assume that most rice terraces remaining across Japan continue to rely on local old-style techniques today.

Pesticide-free rice production further requires an immense amount of additional work: protecting the rice plants from insects and disease, as well as weeding. Rice cultivation by Iio Jozo has been a history of trial and error. One of the techniques that it has tried is to keep the terraces irrigated even during the winter to check the germination of *konagi*, a troublesome annual weed that commonly grows in rice fields and spreads its seeds all over. Winter irrigation resulted in runny, finer-grained mud that kept the *konagi* from taking root and germinating, but perennial weeds still survived.

Keeping away insects has been equally challenging. Producing a thin film of oil on the surface of the paddy water with used tempura oil collected from restaurants proved largely successful in suffocating the rice water weevil. To prevent disease, meanwhile, the company sprinkles its own agricultural vinegar, called Biotop, diluted 300 to 1,000 times.

In addition to pesticide-free cultivation, Iio Jozo also insists on planting the rice seedlings by hand. Rice planters first came into use in 1954, and seedling production was modified to meet the needs of mechanical planting. The planters called for seedlings of uniform size, which could not be achieved in outdoor nurseries. Nursery cabinets were then developed so that the seeds could be made to germinate simultaneously. Small seedlings

came to planted, moreover, to prevent the root injury that could occur with larger seedlings when the planters rip them off the seedbed. But as the planting density cannot be adjusted at will with mechanical planting, Iio Jozo plants the seedlings by hand.

Another merit of planting by hand is that the seedlings take root faster than with mechanical planting. Fifty years since the introduction of mechanical planters, manual planting is being appreciated in a new light.

Preserving Rice Terraces

Economically based undertakings like Iio Jozo's case, in which the manufacturer aspires to sustainable agriculture and production by valuing its ties with local farmers and specifically using rice grown in rice terraces, are rare.

Meanwhile, an effort to conserve rice terraces and their natural surroundings was launched in 1995 in the form of the National Rice Terrace Liaison Council, which links municipalities having rice terraces, various organizations, and individuals through the common interest of rice terraces. One of the council's activities is organizing the annual Tanada Summit. First held in Kochi Prefecture, the fifteenth summit will be take place in 2009.

June 02, 2009

Rediscovering the Treasures of Food: Wasabi

By Shimamura, Natsu

Wasabi is known across the world as a condiment for sushi. It only grows under highly specific conditions, and, most of all, it needs clean, running water. For four centuries, producers have cultivated the delicate plant in stepped fields that their ancestors constructed with stone. Today, however, fresh wasabi roots have largely been replaced by cheaper pastes and powders.

Wasabi in Japanese History

Excavations of archeological remains have revealed that Japanese ate wasabi (*wasabia japonica* Matsumura) as early as the Jomon period (around 14,000 BC to 400 BC). Having discovered its anthelmintic and sterilizing effects, they ate small-rooted *sawa* wasabi (water-grown wasabi) that grew in mountain streams as medicine. According to the book *Wasabi no subete* (All About Wasabi), a late-seventh-century wood strip suggesting the existence of an herb garden was unearthed in 2001 at the ruins of Japan's ancient capital in Asukamura, Nara Prefecture. On it was a series of kanji characters signifying "wasabi."



Freshly harvested wasabi roots are bright green.

Opinions remain divided as to where wasabi was first cultivated, but Utogi, a mountain village in the upper reaches of Abe River in Shizuoka Prefecture, is considered the likely origin. The story goes that, during the Keicho era (1596-1615), a villager brought home wild wasabi plants from Mt. Wasabi, the source of Utogi River, and replanted them in the village spring. In time the roots grew large, and other villagers who saw this also began growing the plant. Even today the small field where wasabi was allegedly first cultivated is preserved in Utogi.

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In 1607 wasabi plants were presented to Tokugawa Ieyasu, who had moved into Suruga Castle in present-day Shizuoka Prefecture after retiring from his position as shogun. Ieyasu highly prized the wasabi due to its connection with the plant *Asarum caulescens*. The kanji characters for “mountain” and “asarum” are used together to signify wasabi, presumably because wasabi leaves resemble asarum leaves, which are featured in the family crest of the Tokugawa clan.

Wasabi gained prominence with the development of sushi. For centuries *sushi* referred to *nare zushi*, made by fermenting fish and rice for two to three months. But a method of fermenting sushi overnight was invented in the 1780s, and several decades later there appeared an unfermented type of sushi made with fresh fish caught in Edo Bay (Tokyo Bay). Wasabi root came to be preferred as a flavoring that counters the smell of raw fish with its hot vapors that sting the nose, enhances the appetite, and prevents food poisoning. It also grew into an indispensable condiment for buckwheat noodles, a commoners’ food. Wasabi cultivation took off across Shizuoka, and wasabi came to be actively traded in markets.

Rise of Cheap Substitutes



Wasabi fields are found in densely wooded mountains.

Today, farms growing wasabi are gradually decreasing. The greatest reason is that the majority of wasabi pastes and powders, which are commonly used in the home as well as overseas, use imported horseradish or wasabi. The annual production of processed wasabi comes to about 1,000 tons, two or three times the volume of fresh wasabi. Even fresh wasabi has been imported from Taiwan and China since the 1970s. After the collapse of the bubble economy in 1991, moreover, many of the restaurants that had been using costly fresh wasabi roots switched to cheap processed wasabi, so the demand for fresh wasabi is not growing.

Another problem regards farm size. Because spring water is essential for growing wasabi, wasabi farms are concentrated in mountainous areas, where the farms are inevitably “small-scale farms” by national standards. Under the Food, Agriculture, and Rural Areas

Basic Act enacted in 1999, which focuses on farms of 4 hectares or more, wasabi farms across Japan are too small to receive subsidies. Even the largest of them, which owns wasabi fields in both Utogi and Yamanashi Prefecture, has a total acreage of no more than 0.6 hectares. The wasabi fields of the approximately 130 members of the association of wasabi farmers in Abe (the upstream Abe River area, including Utogi), comes to only about 15 hectares. This figure was 20 hectares until several years ago; more and more wasabi fields in the mountains are being abandoned and left to ruin.

Heavy Labor and Sophisticated Skill

A trip to the wasabi fields brings home the sophisticated skill of wasabi farmers. Generations ago their ancestors cleared the dense forest, dug into the stony earth of the mountain, drove wedges into the rocks to break them, carried stones from the banks, and so constructed magnificent stone-lined fields on treacherously steep slopes. Wasabi farmers used to take photographs of newly completed wasabi fields and send them to their relatives and friends. They clearly took pride in the fields into which they had put so much labor.



Stepped wasabi fields have been handed down through the generations.

Even today, maintaining and repairing the masonry is an indispensable skill for producers of water-grown wasabi. The wedges have long since been replaced by drills, but the drilling machines weigh close to 20 kilograms, and making and maintaining a wasabi field remains heavy work.

Wasabi cultivation also requires post-harvest “washing” of the soil. The risk of disease rises when accumulated organic matter, such as clay, dead insects, and decayed leaves, stagnates the flow of the water. To prevent this, the surface soil is turned over and carefully washed with a sprayer.

There are several different types of wasabi fields. In Yamaguchi, Shimane, and Hyogo Prefecture wasabi is commonly grown in *keiryu* style fields, made along mountain streams. An improved version is the *jizawa* style, which was invented in Abe and is still seen in the Okutama area of Tokyo and in Yamanashi Prefecture. But as both of these styles do not yield uniform growth and the harvest volume is not large, the *tatami-ishi* style was created near Mt. Amagi in Izu, Shizuoka Prefecture. As Yoshinori Hoshiya writes in his book *Wasabi*, a *tatami-ishi* style field is deeper in construction than that of the shallow *jizawa* style. Large stones are laid in the bottom, followed by a layer of smaller stones, which is topped with a plow layer about 15 centimeters deep. With good drainage and plenty of water, fields of this style are able to produce high-quality wasabi.

Wasabi Cultivation

Takahiro Ozawa and his son took us to their wasabi field. But as they made sure to note, “Every wasabi farm has its own cultivation method that’s been handed down in the family, so each family grows wasabi using a very different method.”



Wasabi plants bear tiny white blossoms in the spring.

Wasabi plants produce small white flowers between March and April. Long vines hanging down the stone wall are harvested for the seeds, which are cased in pea-like pods. The seeds are stored in a humid environment, being vulnerable to dryness. The seedlings are grown in greenhouses for 2 to 3 months. The Ozawas say that only about 70 percent uniformity in size and shape can be attained at best with plants grown from harvested seeds. The seedlings are then replanted in wasabi fields, where they are grown for another 11 to 18 months. Two-year wasabi roots take time to grow but have superior flavor and aroma.

Once harvested, the discolored stems and leaves are removed while still out in the fields.

Then, with the help of the entire family, the plants are sorted, removed of the fibrous roots and worm-eaten parts, and trimmed. The leaves and fibrous roots are not discarded, however. The leaves are delicious boiled and seasoned or as tempura, and the fibrous roots are shipped out for use in such processed products as wasabi paste.

“The number of wasabi growers is small, partly because the plants only grow in highly selective environments,” say the Ozawas. “Due to this, not much research has gone into wasabi, and there may actually be as many varieties of wasabi as there are wasabi farms.” Moreover, many of the farms grow several different varieties.

Good Water for Good Wasabi

A number of factors affect the flavor of wasabi, including water quality, water temperature, stones, insolation, and the presence of organic matter. But the correlation between these factors and the growth of wasabi is as yet unclear, and further research is to be awaited.

The key to growing good wasabi is controlling the flow of water. A sufficient volume of water must flow evenly. In places where there is not enough water, as well as in years of insufficient water, the roots do not grow large, and the harvest volume goes down. Also, wasabi does not grow well in places where the water splashes, so in the old days this was prevented by inserting cryptomeria branches in the stone wall in stepped fields.

The water must be spring water, with little temperature variation year-round. The ideal temperatures are between 11 and 19 degrees Celsius. Wasabi is fairly resistant to cold, growing naturally as far north as Sakhalin, but it will freeze if the temperature falls to 5 degrees below zero. To keep them from freezing, therefore, the plants are covered with nets in the winter. In the summer they need to be shaded, as they are susceptible to heat and can die out in no time. Alder and other trees are planted for natural shading. In the coming years, wasabi farms in Shizuoka Prefecture and in western Japan will be hard put to find ways to cope with global warming.

“Wasabi is grown with only water and no fertilizers, so the quality of the water is all-important,” explains Takahiro Ozawa. “There’s just no way of beating a farm blessed with excellent water. That’s why I’d say that the first and foremost condition for growing good wasabi is that your predecessor has left behind a prime location.” The wasabi of Gottenba, which is a regular winner in food quality contests, is grown with the plentiful sub-soil water flowing from Mt. Fuji.

As wasabi is cultivated in flowing water and the effects of the water on the environs can be profound, the use of pesticides is mostly prohibited. Several years ago, for instance, trout farms suffered damage from the pesticides used by upstream wasabi farms in Nagano Prefecture. Pesticides for expelling plant lice have recently been exceptionally permitted, but they are rarely used in Abe, where plant lice have not posed a problem. Rather, the pests for local wasabi farmers are stoneflies and other insects that inhabit streams. They can go so far as to wipe out the harvest, and the bad news is that there is nothing to be done about them.

Stone and sand gravel, over which water can flow smoothly, are suited for wasabi growth. But a moderate amount of organic matter is needed as well, and too much sunlight is detrimental. The best location, then, is a place surrounded by deciduous trees and aged cryptomeria trees. Hidden among the trees, wasabi fields are beyond public view for the most part.

Rural Depopulation and Urban Diets

The mountains from which the Abe River flows, with the Akaishi Mountains close at hand, are a major source of water for the residents of Shizuoka Prefecture. It is a region that has seen serious flood damage roughly every 30 years. Each time the wasabi fields have been swept to ruin, and each time villagers have joined hands to reconstruct them. Wasabi represents a dietary tradition that has been nurtured by generations of people who have coexisted with nature in all its manifestations.

About 10,000 people used to live in the Abe district, but today that number has halved. While continuing wasabi production is a certainly concern, locals face the more basic question of whether or not they will be able to continue living here. Depopulation in mountainous areas is linked in no small way to the diets of people across Japan. As it is difficult for new entrants to begin wasabi production, which takes place on steep slopes deep in the mountains and does not pay well, it is important for consumers to support wasabi farmers who are currently in the business by buying their products.

Photos: Kazuo Kikuchi

January 11, 2011

Problems with Mandatory Adoption of International Financial Reporting Standards

By Sato, Takahiro

The Tokyo Foundation has issued a research paper identifying the basic features and problem areas of the International Financial Reporting Standards, which Japan is moving to adopt. What will introducing the IFRS cost? How will the new standards affect taxes? And what accounting strategies should Japan embrace? The paper addresses these and other issues from various angles. The following is a summary of the report.

Japan's accounting standards have come to a turning point. The Financial Services Agency is expected to come to a final decision on the mandatory adoption of the International Financial Reporting Standards sometime around 2012. If the standards are adopted, they will likely be applied from 2015 or 2016. While the FSA is strongly inclined to make such a decision, this will have serious repercussions. There are a number of concerns regarding the IFRS, one pertaining to their theoretical shortcomings as a set of accounting standards, and the other relating to the mandatory nature of their adoption.

The first concern is with the key IFRS concept of "fair value." According to basic economic theory, the fair value of an asset should be its fundamental value, equivalent to the present value of future cash flow calculated using all available information. First, the collapse of Lehman Brothers and the ensuing global financial crisis have clearly shown that market prices have the potential of diverging widely from fundamental values. Second, under the IFRS, assets without market prices will be assigned values based on mathematical projections of future earnings. This will leave the door open for unscrupulous managers to manipulate calculation models and basic statistical data.

The IFRS are known as "principle based" standards that do not prescribe detailed rules, leaving the task of actual accounting processing to the discretion of individual companies

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and auditors. Transactions of similar nature may, therefore, be processed quite differently according to how they are interpreted by each company. This can easily give rise to window dressing. It is also highly conceivable that companies and auditors in Japan, out of lawsuit fears, would choose to be overly conservative in processing their accounts, as was the case in the recent introduction of the Japanese SOX law.

Adoption of the IRFS will ultimately give companies more discretion over how they present their financial standing, leading to a diversification of processing formats. This is hardly likely to be in investors' interests. One often-mentioned justification for the mandatory adoption of the new standards is that international uniformity would facilitate cross-border comparisons. But given the greater leeway companies would have in processing the figures, the validity of such comparisons would be tenuous at best. These concerns have been voiced by both researchers and business people in Japan, but the FSA does not seem to hear them.

The mandatory adoption of the IFRS is also problematic from the viewpoint of the global accounting system. The emphasis has been on achieving uniformity, and no attention has been paid to whether the standards are actually appropriate. Business environments differ widely from one country to the next, and so there is no guarantee that the IFRS are the best for all countries.

Let us suppose that all states opted for mandatory adoption. The IFRS would then enjoy a monopoly in the absence of any competition. People have noted that the standards are ill matched for industries in which fixed assets claim a high share of corporate balance sheets (typically, the manufacturing sector). Should the IFRS emerge as the sole set of standards, though, comparisons with other standards would become impossible. Without competition, the quality of the accounting standards could very well decline.

Until now, companies in Japan have been able to choose whether to apply Japanese accounting standards or adopt US ones, and investors have never complained. They should continue to be given a choice, with the IFRS being fully exposed to competition in the accounting standards market.

December 21, 2010

China's SCO Policy in the Regional Security Architecture

By Masuda, Masayuki

Introduction

As many analysts and scholars have pointed out in recent years, China's new security concept employs a cooperative and comprehensive approach, and has become less antagonistic than before to military alliance with regard to developing and implementing concrete policies.¹ In this context, considerable attention has been given to China's involvement in the Shanghai Cooperation Organization (SCO), its closer relations with the Association of Southeast Asian Nations (ASEAN) through ASEAN +1 (China) and ASEAN +3 (Japan, China, and South Korea), and the ASEAN Regional Forum (ARF).² Such organizations are concrete examples of policy developments based on China's new security concept, which is the ideological basis for Chinese leadership within a foreign policy towards regions. Previous studies have focused on the significance of the regional approach of Chinese diplomacy, however, and little consideration has been given to the possibility of a mutual relationship emerging with other regional security mechanisms, including with the United States and its allies.

In part, this lack of interest is due to the fact that the basic design of China's new security

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¹ David Shambaugh, "China Engages Asia: Reshaping the Regional Order," *International Security*, Vol. 29, No. 3 (2004/2005), p.91.

² See, e.g., Akio Takahara, "Chugoku no shin anzen hosho kan to chiiki seisaku (China's new security concept and its regional policy)" Akio Igarashi and Akio Takahara eds., *Higashi ajia anzen hosho no shin tenkai* (New development of security in East Asia), (Tokyo: Akashishoten, 2005); Kazuko Mori, "Chugoku no ajia chiiki gaiko (China's diplomacy in Asia)" Akio Watanabe ed., *Ajia taiheiyo rentai koso* (25 years after Ohira's initiative for Asia-Pacific Cooperation), (Tokyo: NTT shuppan, 2005); Kazuko Mori, "Chugoku no ajia chiki gaiko: shanghai kyoryoku kiko wo megutte (China's diplomacy in Asia: focus on the Shanghai Cooperation Organization)," Akio Watanabe, ed., *Ajia taiheiyo to aratashii chiiki shugi no tenkai* (Shaping the future: Asia Pacific in the 21st century), (Tokyo: Chikura shobo, 2010); Chien-Peng Chung, "China's Roles in the SCO and the ARF: Implications for the Asia-Pacific Region," Michael H. H. Hsiao and Cheng-yi Lin eds., *The Rise of China: Beijing's Strategies and Implications for the Asia-Pacific*, (London and New York: Routledge, 2009).

concept—providing a rebuttal or counterpoint to the military alliance strategy of the United States—continues to play a prominent role in China’s diplomatic and security policies. The China’s defense white paper *China’s National Defense in 2008*, for example, despite promising to encourage conducting security dialogues and cooperation with other countries based upon the new security concept, also makes it clear that China will continue to “oppose the enlargement of military alliances.”³ Further evidence for the persistence of this underlying attitude came at the SCO leaders’ summit in July 2005, when the leaders made a joint declaration calling for a clear timetable for withdrawal of US-led anti-terrorist forces from Central Asia. These circumstances suggest that there is little room in China’s design of regional security cooperation for the inclusion of US alliances or other security cooperation arrangements lead by the United States. In addition, although many Chinese scholars have cited the emergence of nontraditional security threats as one reason for setting high value on regional security cooperation, they continue at the same time to emphasize that traditional military alliances cannot deal effectively with non-traditional security threats.⁴ For China, in other words, the significance of regional cooperation and multilateral security mechanisms stems largely from the opportunity such arrangements provide to form a countermeasure to alliance relationships and US-led security cooperation.

But even if China remains critical of US alliances and US-led security mechanisms, and continues to push regional security cooperation based on its new security concept, there is little prospect that such regional cooperation will ever replace alliances and US-led security mechanisms. Providing a critical countermeasure to American alliances may form the fundamental basis of China’s foreign and security policy design, in other words—but this is not a position that can be easily implemented as concrete policy. A research project carried out by scholars at the Institute of Strategic Studies at the National Defense University of the People’s Liberation Army (PLA), for example, points out that multilateral and bilateral mechanisms coexist in parallel throughout the region, and anticipates that bilateral arrangements such as American alliances with Japan and South Korea will continue to exist alongside multilateral mechanisms for many years to come.⁵ If such is the case, boosting cooperative relationships and improving amicability with these mechan-

³ Information Office of the State Council of the People’s Republic of China, *China’s National Defense in 2008*, (January 2009).

⁴ See, e.g., Guo Rui, “Guoji tixi zhuanxing yu dongbeiya duobian zhidu anpai gouxiang (Transformation of the international system and a vision of multilateral arrangements in northeast Asia),” *Tongji daxue xuebao: Shehui kexue ban* (Journal of Tongji University: Social science), Vol. 19, No. 6 (December 2008), pp. 86-92.

⁵ Yang Yi ed., *Zhongguo guojia anquan zhanlue gouxiang* (A vision of China’s national security strategy), (Beijing: Shishi chubanshe, 2009), p. 222.

isms is a real policy issue for Chinese diplomacy, and forming a theoretical framework for them is an essential task. The same project concludes that ensuring that such multilateral mechanisms accord with US security interests will be vital to the security and stability of the region in the years to come.

Based on this understanding, this paper attempts to clarify the present state of China's regional security design by considering concrete policy developments. It suggests points of common interest between China's proposals for regional security cooperation and US alliances and security cooperation led by the United States, which many in the past had viewed as mutually opposed. For the most part, my examination focuses on the SCO, a regional organization of which China was a founding member and in which it continues to play a leading role.

1. China's Design for Regional Security Cooperation

(1) Regional Cooperation in "Harmonious World"

An indication of the type of international order that China would like to see came in a speech given by President Hu Jintao in September 2005 at a meeting of heads of government commemorating the 60th anniversary of the founding of the United Nations (UN). One characteristic of the "harmonious world" argument was an emphasis on multilateral diplomacy, including joint efforts to deal with any security threat. The Chinese leadership had recognized the importance of multilateralism and multilateral diplomacy since the second half of the 1990s, but the context for this was geopolitical. At an internal meeting of the PLA in October 2001, Jiang Zemin gave a speech as chairman of the Central Military Commission (CMC) in which he underlined the need to build an advantageous strategic position in the international climate following 9/11 and American military action in Afghanistan, focusing on three diplomatic arenas: (a) relations with the major powers; (b) regional relations; (c) multilateral diplomacy.⁶ Obviously, the geopolitical context continues play a part in Chinese diplomacy. But the "harmonious world" argument was part of a new Chinese diplomatic vision of "taking neighbors as friends and partners (*yulinweishan yilinweiban*)" that was first unveiled at the 16th National Congress of the Communist Party of China (CPC) in November 2002, and represented the development of a multilateral diplomacy in the neighboring region based on this view. An editorial in

⁶ Jiang Zemin, "Yingzao youli zhanlue taishi, zengqiang guojia zhanlue nengli (construct a favorable strategic condition, strengthen national strategic capacity)" (October 31, 2001), Jiang Zemin, *Jiangzemin wenxuan* (selected works of Jiang Zemin), Vol. 3, (Beijing, Renmin chubanshe, 2006), pp. 353-365.

the *People's Daily* (*Renmin ribao*) of 11th December 2006, commented on China's regional diplomacy in the following terms: "China's policy of 'taking neighbors as friends and partners' constitutes a crucial impetus for the building of a harmonious world. China's efforts in this regard must necessarily begin with our relations with neighboring countries. In pursuing its diplomatic policy in the region, China will place the highest importance on the diplomatic ideals of peace, a preventative military strategy, and cooperation in security policy, recognizing the autonomy of each country and respecting regional diversity in order to successfully build a peaceful and stable international security environment marked by friendly regional relations, mutual benefit, equality, and cooperation."⁷

Based on this perspective, President Hu Jintao made a call for a "harmonious periphery" at a SCO leaders' summit held in Shanghai in June 2006, and proposed four measures to bring this about.⁸ His proposals were: signing a treaty on long-term good-neighborliness, friendship and cooperation to solidify amicable relations between SCO member states; stronger working-level partnerships for comprehensive development; human and cultural exchanges to build stronger social foundations; and, finally, a call for "openness and cooperation for the purpose of world peace," with the SCO as a venue for "broad-based international cooperation and proactive international exchange." The proposals suggest that China is not interested in regional cooperation merely from the perspective of geopolitical balancing, but is now seeking stronger cooperation from a regionalist perspective. China apparently arrived at the view that closer functional cooperation was essential in a number of fields in order for the various countries of the region to benefit from regional mechanisms, and has moved to put this insight into practice as policy. In addition to the annual Heads of State and Heads of Government Councils, there are twelve mechanisms in place for regular ministerial-level meetings. Additionally, two permanent bodies were established in 2004: the Secretariat in Beijing, and the Regional Counter-Terrorism Structure in Tashkent. To further encourage functional cooperation within this framework, working groups have been established in a number of specific areas, including e-commerce (chaired by China), customs (Russia), quality and inspection (Kazakhstan), investment promotion (Tajikistan), and development of cross-border poten-

⁷ Guo Jiping, "Haolinju haopengyou haohuoban (good neighbors, good friends, good partners)," *Renmin ribao* (people's daily), December 11, 2006.

⁸ Hu Jintao, "Gongchuang shanghai hezuo zuzhi geng jia meihao de mingtian (create a brighter tomorrow for the SCO together)," (June 15, 2006), *Renmin ribao*, June 16, 2006.

tial (Uzbekistan), with each SCO member state chairing a group and taking responsibility for planning cooperation in the relevant field.⁹

(2) The Architecture over the Shanghai Cooperation Organization

If China and its partners are serious about making real progress on regional cooperation in Central Asia, the SCO will be just one of the policy measures used to bring it about. As Xu Tongkai, director general of the Department of European Affairs in the Chinese Ministry of Commerce, has pointed out: “Five of the SCO member states also belong to the Eurasian Economic Community (EurAsEC), and all six take part in regional economic cooperation mechanisms such as the Central Asia Regional Economic Cooperation Program under the Asian Development Bank (ADB) and the United Nations Development Program (UNDP)’s plans for a new Eurasian land-bridge international cooperation mechanism.”¹⁰ The reality is that there is particularly high demand for regional economic cooperation, especially in investment and technology, which is another reason why the SCO’s principle of openness is being emphasized. Accordingly, Xu proposed strengthening collaboration between the SCO and such international financial bodies as the EurAsEC, the ADB, and the UNDP, using the experience, funding, and technological advantage of these bodies to create beneficial conditions for economic cooperation in the region.

In the field of security, too, there are signs of attempts to position the SCO within an overall structure of the region. SCO Deputy Secretary General Vladimir Zakharov has said, “We will push forward with a wide variety of dialogue, exchanges, and cooperation both with individual countries and with international bodies, aiming to achieve peace, security, and stability in the region based on the principles of equality and mutual consultation.”¹¹ Zakharov pointed out that dialogue was ongoing based on the memorandum of understanding with the Collective Security Treaty Organization (CSTO) in September 2007, and that the SCO maintains regular contacts with both the European Union (EU) and the Organization for Security and Cooperation in Europe (OSCE). Granted, the process of

⁹ Gong Xinshu and Liu Qingyan, “Shanghai hexuo zuzhi kuangxia xia jingji hezuo zhiyue yinsu ji yuanyin fenxi (economic cooperation constraints factors analysis within the framework of the shanghai cooperation organization),” *Chongqing gongshang daxue xuebao: shehui kexue ban* (journal of Chongqing technology and business university: social science), Vol. 26, No. 3 (June 2009), p. 24.

¹⁰ Director General of the Department of European Affairs in the Chinese Ministry of Commerce Xu Tongkai’s Speech at the international symposium on Trade Policy of China and Central Asian countries, and regional economic cooperation, April 27, 2006. Available at http://www.sco-ec.gov.cn/crweb/scoc/info/ArticleZt.jsp?a_no=28752&col_no=203 (accessed December 6, 2010).

¹¹ *Shanghai hezuo zuzhi ziliao huibian* (compilation of materials and document of shanghai cooperation organization), Vol. 4 (Center of SCO Studies, Shanghai Academy of Social Sciences), p.14.

building relationships between the SCO and other international and regional bodies is still in its infancy, remaining at the preliminary stage of contacts and dialogues. Given the security situation surrounding the SCO, however, building external relations will be an important part of improving the organization's problem-solving ability.

Of particular interest from this perspective is an essay by Wang Jian, associate professor at the Shanghai Academy of Social Sciences (SASS), who examines issues confronting the SCO from the viewpoint of regional public goods.¹² According to Wang, the achievements of regional policy represent an important part of such public goods. These include regional peace and security, regional systems to manage and control infectious diseases, and regional financial stability. The inadequate provision of such public goods is a major problem in the Central Asia region, and Wang points out that the SCO instead faces large numbers of what he calls "regional public bads." He suggests that non-exclusive and non-rivalrous "club goods," which spread their benefits easily over a limited region, may be one way of overcoming these "public bads" and providing public goods. Building on this, Wang suggests that the SCO needs to improve the provision of regional public goods in areas such as security cooperation against terrorism, anti-drug networks, energy cooperation, protection of water resources, and stability of ecosystems, by strengthening regional cooperation among member states. One of the interesting aspects of the discourse is its awareness, albeit limited, of the question of how to guarantee the nonexclusivity of the SCO toward countries and actors outside the region. The paper stresses the importance of considering national, regional, and international policy agendas together "in a unified way" when formulating policies for effective provision of regional public goods. As part of this process, Wang suggests the possibility of granting certain countries the status of "observers or cooperation partners," according to the issues involved. Given that the SCO is still in the capacity-building stage in terms of providing public goods, however, Wang believes that allowing actors from outside the region to participate from an early stage would lead to a "dispersion of resources," and therefore argues that external actors should be allowed to participate in the capacity-building process on a selective basis.

Formulating an appropriate format for collaboration with the Russian-led CSTO, which has the ability to act instantly and with which a memorandum was exchanged in September 2007, is therefore an important policy issue. China has been circumspect and noncommittal in terms of the relationship between the CSTO and the SCO. For example,

¹² Wang Jian, "Shanghai hexuo zuzho de weilai fazhan lujing xuanze: cong diqu gonggong chanpin de shijiao (future development path selection of shanghai cooperation organization: from the regional public goods perspective)," *Shehu kexue* (journal of social sciences), No. 8 (2007), pp. 67-72.

associate professor Li Shuyin at the Department of World Military Studies in the PLA Academy of Military Sciences, remains cautious on the subject of relations between the two organizations, despite the exchange of a memorandum between them. “The SCO is not the only option that countries in Central Asia have in terms of security cooperation,” Li says. “This is bound to have a certain influence on the SCO’s security cooperation efforts.” Li points to the existence of multiple military cooperation mechanisms, including the CSTO, as an obstacle on future development of the SCO.¹³ The CSTO, however, has been quite proactive in pushing forward collaboration with the SCO, such as proposing joint military exercises during the negotiation phase.¹⁴ But China has remained wary of military cooperation and drills between the CSTO and the SCO. Senior lieutenant Qi Guowei, director of the foreign affairs office of China’s Central Military Commission, has emphasized that unlike the CSTO, the SCO is not an alliance with military characteristics, and has stressed that no plans exist for military exercises between the two organizations.¹⁵ Reflecting this attitude on the part of the Chinese, the September 2007 memorandum between the SCO and the CSTO states that the two organizations will cooperate “according to the capabilities of each organization.” According to the agreement, the two sides will cooperate in the following fields: (a) Support for regional and international safety and stability; (b) Counter-terrorism; (c) Narcotics smuggling; (d) Illegal weapons trading; (e) Cross-border organized crime; and (f) Any other areas of shared concern.¹⁶ Cooperation is thus limited to non-traditional security issues. This suggests that in its relations with CSTO and other regional organizations, China is looking not for military but political collaboration.

Another point to bear in mind regarding Chinese diplomatic principles is that China’s primary aim is not to strengthen its relations with regional bodies directly, but to develop its relations with regional bodies, using the United Nations as an intermediary. In January 2010, China’s permanent representative to the United Nations Zhang Yesui called a special meeting as UN Security Council Chairman. The subject of the meeting was “cooperation between the UN and regional and sub-regional organizations in maintaining international peace and security.” In addition to confirming the primary role of the United Nations in supporting international peace and security, the purpose of the meeting was to

¹³ Li Shuyin, “Shanghai hezuo zuzhi de anquan hezuo (security cooperation in the SCO),” Xing Guangcheng ed., *Shanghai hezuo zuzhi fazhan baogao 2009* (annual report on the shanghai cooperation organization: 2009), (Beijing: Social Sciences Academic Press, 2009), p. 86.

¹⁴ “CSTO, SCO to Sign Cooperation Protocol,” *ITAR-TASS*, July 31, 2007.

¹⁵ “Shanghe wuyi ji’an tiaoyueguo yanxi (SCO will not have military exercises)” *Mingbao*, August 29, 2007.

¹⁶ *Shanghai hezuo zuzhi ziliao huibian*, Vol. 4, p. 1.

strengthen cooperation and collaboration between the United Nations and regional organizations and to encourage regional organizations to use their advantages more effectively.¹⁷ At the end of the meeting, Zhang spoke in his capacity as a representative of the Chinese government, stressing the importance of the following four points: (a) The principles of the Charter of the United Nations need to be adhered to; (b) The Security Council should encourage and create conditions and an environment that are favorable for the regional organizations' efforts to resolve regional disputes peacefully through preventive diplomacy, conciliation, and consultation; (c) The United Nations and regional organizations need to strengthen coordination and form synergy; and (d) One of the top priorities of the cooperation between the United Nations and regional organizations is to assist regional and sub-regional organizations in capacity building.¹⁸ For China, therefore, strengthening cooperative relations with the United Nations is a fundamental premise of building relations between regional organizations. China demands a primary leadership role for the United Nations—from conflict resolution to capacity building support.

2. The SCO in Search for External Relations

(1) Enlargement of the SCO: Observer Status

As discussed above, the SCO is developing cooperative relationships with several international organizations. This process has developed in accordance with the SCO Charter passed in June 2002, which sets out regulations for establishing relationships of cooperation and dialogue with countries or organizations outside the SCO.¹⁹ Article 1 of the Charter makes it clear that one of the goals and tasks of the SCO is to “maintain and develop relations with other states and international organizations,” while Article 14 says that the organization “may grant the status of a dialogue partner or observer” to a state or international organization in order to carry out dialogue and cooperation. However, the charter did not lay down concrete rules and procedures for granting such status, leaving this to be decided by subsequent special agreements between member states. At a meeting of foreign ministers of SCO states in November 2002, an agreement was reached on a temporary plan for external relations.²⁰ A subsequent agreement allowed for the invitation of nonmember states and international organizations to participate in SCO foreign ministerial summits and other meetings. There were no indications of a comprehensive

¹⁷ “Zhang Yesui jieshao benyue anlihui zhuyao gongzuo (Zhang Yesui introduces a main work of UNSC this month),” *Zhongguo xinwenshe* (China news), January 5, 2010.

¹⁸ S/PV.6257, January 13, 2010, p. 39.

¹⁹ “Charter of the Shanghai Cooperation Organization.” Available at <http://www.sectsco.org/EN/show.asp?id=69> (accessed December 7, 2010).

²⁰ <http://www.sectsco.org/CN/show.asp?id=105> (accessed on December 6, 2010).

plan for the SCO's overall foreign relations, however. One reason was that a consensus had still not been reached among member states regarding the geographical range of the SCO. A joint communiqué issued at the SCO foreign ministers' meeting in September 2003 revealed that an agreement had been reached to "push forward with cooperation among the relevant states and organizations," but that debate was still continuing as far as the geographic range of such arrangements was concerned.²¹ A joint communiqué issued at the Heads of State meeting at the end of the same month expressed the leaders' intentions to "push ahead with dialogue and cooperation of all kinds in the economic area."²² The SCO's deliberation process had thus led to a shared policy structure on foreign affairs both in the areas of security and the economy, but no consensus was possible on the question of which states and international organizations should be admitted as observers or dialogue partners, or the geographical extent of the organization.

In June 2004, the Regulations on Observer Status at the Shanghai Cooperation Organization were introduced, making it possible for observer nations to take part in heads of state and heads of government summits.²³ Article 1 of the regulations stipulates: "A state or an organization, wishing to receive observer status at the SCO, proceeding from respect for the sovereignty, territorial integrity, and equal rights of the member states, recognition of the main objectives, principles, and actions of the organization, forwards a letter, signed by a head of state or a head of organization respectively, through the secretary general to the Council of Heads of SCO Member States." This simply recites the international norms for procedures of this kind, and provides no clear rulings on the necessary qualifications for applying for observer status.

This lack of clear guidelines regarding application requirements for the granting of observer status later gave rise to foreign relations instability between SCO and the rest of the world. The first country to which the SCO granted observer status was Mongolia, in 2004, followed by Pakistan, Iran, and India, all in 2005.²⁴ According to Chinese President Hu Jintao, the participation in the SCO of Mongolia, Pakistan, Iran, and India as observ-

²¹ "Shanghai hezuo zuzhi waijiao buzhang fei lixing huiyi lianhe gongbao (joint communiqué of the SCO foreign ministers' meeting)" September 5, 2003.

²² "Shanghai hezuo zuzhi chengyuanguo zongli huiwu lianhe gongbao (joint communiqué of meeting of the prime ministers of the SCO member states)," Waijiaobu Ouyasi (Department of European-Central Asian Affairs, Ministry of Foreign Affairs) ed., *Shanghai hezuo zuzhi wenxuan xuanbian* (compilation of selected document of shanghai cooperation organization), (Beijing: Shijie zhishi chubanshe, 2006), p. 315.

²³ "The Regulations on Observer Status at the Shanghai Cooperation Organisation." Available at <http://www.sectSCO.org/EN/show.asp?id=65> (accessed on December 7, 2010).

²⁴ "Shanghai Cooperation Organization Approves Iran, Pakistan, India Observer Status," *IRNA*, July 5, 2005.

ers further demonstrated to the international community the principle of openness of the SCO as well as its cooperative stance in participating in international and regional affairs.²⁵ Many experts and analysts in China also tended to regard the granting of observer status to these countries as marking the “expansion of the SCO.” The *Study Times* (*Xuexi shibao*), for example, the organ of the Party School of the Central Committee of the Communist Party, published an article (dated June 20, 2005) titled “Evaluating the Expansion of the SCO,” which claimed that the SCO “already has ten members” and that “with this most recent expansion, the area covered by the organization now stretches to incorporate the Middle East and the Indian subcontinent, making it a huge organization capable of squaring up to NATO from afar.”²⁶

This expansion through the granting of observer status, “without regard for geographical range” increased American concerns about the SCO, especially in the post-9/11 context. The US government had long designated countries such as North Korea and Iran as “sponsors of terrorism,” but following 9/11, President George W. Bush described North Korea and Iran as belonging to an “axis of evil.” Iran was granted SCO observer status, while the United States’ own application for the same status was turned down. Additionally, the SCO leaders’ summit in 2005 issued a joint declaration calling on the countries of anti-terrorist coalition in Afghanistan to set final deadlines for the temporary use of the infrastructure facilities and for the presence of military contingents on the territories of the member countries of the SCO.²⁷ These factors led to the SCO’s international image as a venue for airing grievances against the United States. This made the United States, in particular, suspicious about the form the SCO was taking. At an Asian Security Summit held on the eve of the SCO leaders’ summit in 2006, US Defense Secretary Donald Rumsfeld expressed his surprise at Iran’s participation in the SCO, describing it as “a leading terrorist nation.”²⁸

(2) Concept Building for Future Relations with the United States: Dialogue Partners

Professor Zhao Huasheng, director of the Center for SCO Studies at Fudan University, points out that “the relationship with the United States is the most sensitive and difficult relationship of the SCO.” According to Zhao, there was a lack of a consensus among SCO member states not so much on the form that relations with the United States should take

²⁵ “Full Text of Chinese President Hu Jintao’s Speech at the SCO Astana Summit,” (July 5, 2005), *Xinhua*, July 6, 2006.

²⁶ Zhang Jianjing, “Ping shanghai hezuo zuzhi kuorong (evaluating the expansion of the SCO),” *Xuexi shibao* (study times), June 20, 2005.

²⁷ “Shanghai Forum Calls for Deadlines for US Bases in Central Asia,” *ITAR-TASS*, July 5, 2005.

²⁸ “Iran Is a Leader in Terror, Rumsfeld Tells Defense Group,” *New York Times*, June 4, 2006.

but on the question of whether to build a cooperative relationship with the United States at all.²⁹ But the question of how to deal with the United States is an issue that the SCO cannot avoid. If the current state of affairs is allowed to continue, and the organization's member states and observer states fail to develop a shared vision of the kind of relationship they want with the United States, it is possible that the foundations of SCO cooperation will become subject to external influence and therefore weakened.

So how does China view the relationship between the SCO and the United States? To begin from the conclusion: It appears that China envisages building with the United States a relationship of cooperation on specific issues, based on the SCO dialogue partners regulations ratified in August 2008. The annual report on SCO development in 2009, edited by the Institute for Eastern European, Russian, and Central Asian Studies at the Chinese Academy of Social Sciences, suggested that consideration be given to building a mechanism for dialogue between the SCO and the United States, putting forward concrete proposals for strengthening cooperation with NATO in "certain well-defined areas, such as border region security and narcotics control" and that "consideration might also be given to using contact groups between the SCO and Afghanistan to develop dialogue and cooperation with the United States in the field of counter-terrorism."³⁰

The SCO first revealed concrete policies relating to Afghanistan shortly after 9/11. At an extraordinary foreign ministers meeting held in Beijing in January 2002, a joint statement was issued that revealed the general trend of SCO views and policies on Afghanistan.³¹ The statement "welcomed" the downfall of the Taliban and said that regional and sub-regional organizations had an indispensable role to play in delivering a body blow to international terrorist networks based in Afghanistan. The SCO promised to pass measures to strengthen its counter-terrorist capabilities, and vowed to "carry out constructive dialogue and cooperation with the temporary Afghan government and the future power structure in Afghanistan." But the emphasis of the declaration was a clarification of the SCO's principled stance in terms of the reaction of the international community, including such issues as the sovereignty and territorial integrity of Afghanistan, its unity as a state, and the need for the international community to respect the principle of nonintervention in internal affairs. On security matters, the SCO agreed that the United Nations

²⁹ Zhao Huasheng, "Dui shanghai hezuo zuzhi fazhan qianjing de jidian kanfa (views on the outlook for SCO development)," *Guoji wenti yanjiu* (international studies), No. 3 (2006), p.27.

³⁰ Li Shuyin, "Shanghai hezuo zuzhi de anquan hezuo," p. 88.

³¹ "Shanghai hezuo zuzhi waijiao buzhang fei lixing huiyi lianhe shengming (joint statement of the SCO foreign ministers' meeting)," (January 2002), *Waijiaobu ouyasi ed., Shunying shidai chao-liu, hongyang 'Shanghai jingshen'* (go with the time, aggrandize the 'shanghai spirit'), (Beijing: Shijie zhishi chubanshe, 2002), pp. 188-192.

should take the initiative in leading the activities of the International Security Assistance Force (ISAF) and the rebuilding process in Afghanistan.

In the discussions on Afghanistan at the 60th session of the General Assembly of the United Nations in November 2005, China's deputy permanent representative to the UN Zhang Yishan spoke on behalf of the SCO, calling on the international community to unite in pushing forward the peace-building process in Afghanistan.³² During the discussions, Zhang did not merely confirm the SCO's position in principle in terms of the response of the international community, but also suggested concrete areas for cooperation. He stressed the importance to stability of how the community dealt with the production and spread throughout the region of the narcotics that provided the bulk of the Taliban's funds, and made clear the SCO's intention to work with the international community to strengthen measures dealing with the narcotics issue and to carry out humanitarian aid. Concrete SCO involvement in Afghanistan began that month with the establishment of an SCO-Afghanistan contact group in same month. Although the contact group was an ad hoc organization, SCO aid to Afghanistan was carried out after the group deliberated and reached a consensus.³³ The SCO increased its involvement in Afghanistan in 2008. Additionally, in light of the deteriorating security situation in that country, a joint statement issued at a SCO leaders' summit in August 2008 recognized that the ISAF must cooperate with the Afghanistan government, neighboring countries, and other concerned nations, making it a priority to deal decisively with the problems of narcotics production and smuggling in Afghanistan; and called for a United Nations Security Council debate on the subject. As for the SCO itself, it declared its intention to cooperate closely with the relevant countries and regional organizations to develop a wide-ranging partnership network to respond to the threats of terrorism and narcotics. As a concrete step toward this end, a decision was taken at the leadership summit to strengthen the functions of the contact group and to hold a special conference on Afghanistan to discuss the issue of jointly fighting terrorism, drug trafficking and organized crime.³⁴

The SCO's calls for a wide-ranging partnership network on the Afghan problem were reflected in improvements made to bolster the legal foundations. At the SCO leaders' summit in August 2008, the "Regulations on the Status of Dialogue Partner" were ratified, with the purpose of creating conditions conducive to the development of mutually bene-

³² "Rebuilding War-torn Afghanistan, Achieving Peaceful Settlement of Aalestinian Question Focus of General Assembly Debates," GA/10426, November 28, 2005.

³³ S/PV.6257, January 13, 2010, p. 21

³⁴ "Shanghai hexuo zuzhi chengyuanguo yuanshou dushangbie yuanyan (Dushanbe declaration among the heads of state of the SCO)," *Renmin ribao*, August 28, 2008.

ficial relations with concerned states or organizations around the world.³⁵ These regulations stipulate that “a state or an organization who wishes to obtain the status of partner forwards a letter addressed to the SCO secretary general which contains a request to be granted such status and is signed by the minister of foreign affairs or the head of the executive body of an organization” and that “a decision to grant the status of partner is taken by the council of heads of member states on the recommendation of the council of foreign ministers.” The scope of such cooperation is outlined in a memorandum. For example, when Belarus was accepted as the organization’s first dialogue partner in April 2010, the specified areas of cooperation were the economy, transport, distribution, finance, and the fight against terrorism and narcotics.³⁶ In order to carry forward cooperation within these areas, the dialogue partner receives the right to take part in ministerial level meetings established under the Heads of Government Council. Additionally, the option exists to establish working groups and high-level committees in the relevant areas of cooperation. In this context, professor Yu Jianhua, director of the Institute of Eurasian Studies at the SASS, has proposed establishing an international cooperation mechanism to respond to the Afghanistan problem, with Afghanistan, the United States, and NATO participating as dialogue partners of the SCO.³⁷

In late March 2009, the SCO held a special conference on Afghanistan in Moscow. In addition to SCO member states and observers, some 20 countries and international organizations were invited, among them Afghanistan, the United States, the United Nations, and the CSTO. Noting the participation of US Deputy Assistant Secretary for South and Central Asian Affairs Patrick Moon, Yu claimed that “dialogue between the United States and the SCO has begun,” stressing the significance of the conference from the perspective of building a cooperative relationship between the SCO and the United States.³⁸ The United States did not send an especially high level representative to the conference. Nevertheless, if there are plans to grant the United States dialogue partner status on the issue of Afghanistan in the future, it is possible not only that the United States will participate in the dialogue framework of the SCO as it exists today, but that, with the consent of the

³⁵ “Regulations on the Status of Dialogue Partners of Shanghai Cooperation Organisation,” August 28, 2008. Available at <http://www.sectSCO.org/EN/show.asp?id=64> (accessed December 6, 2010).

³⁶ “Sergei Martynov: Belarus Becomes SCO’s First Country-Partner,” *BelTA* (Belarusian Telegraph Agency), April 28, 2010.

³⁷ Yu Jianhua, “Afghan wenti yu Shanghai hezuo zuzhi (Afghanistan issue and the SCO),” Chen Peiyao and Xia Liping eds., *Guoji zhanlue zongheng* (international strategic review), No. 5, (Beijing: Shishi chuanshe, 2009), p. 260.

³⁸ Yu Jianhua and Dai Yichen, “Feichuantong anquan quyue zhili yu Shanghai hezuo zuzhi (on regional governance of non-traditional security and the SCO),” *Shehui kexue*, No. 7 (2009), p. 26.

United States and the SCO member states, ministerial-level discussions within a new, expanded framework (SCO+USA) might one day be possible.

Conclusion

In previous studies and Chinese diplomatic pronouncements, Chinese priorities for regional security have frequently been described as existing in opposition to the development of US-led alliance strategies. Even in regional efforts such as ASEAN+3 and SCO, where China stressed in its diplomatic announcements the nonantagonistic and open nature of regional cooperation, not enough attention has been given to the underlying logic and trends in policy that have made this possible.

By examining the example of the SCO, this paper has shown how China—in the process of establishing a system of dialogue partners within the SCO—has pushed forward a logical strategy and institutional design that makes it possible to construct a system that allows for a certain level of external relations between the regional security organization in which China plays a leading role and the alliances (NATO, for example) and the US-led coalition. Within China, there is an awareness of the need to build stable international relations not just with the United States but with other major states and international organizations such as Japan, NATO, and the EU.³⁹ Crucial to the viability of such future relationships will be the dialogue partner and the possibility that China can continue to push ahead with developing the SCO's external relations so that it is capable of responding both bilaterally and multilaterally to issues. In the security field, the likeliest scenario is an attempt, initially, to establish policy dialogue with the United States and NATO in Afghanistan, concentrating especially on non-traditional security issues such as responding to terrorism and drugs smuggling.

From the Chinese perspective, one important premise of building international relations within regional organizations such as the SCO is to secure a leading role for the United Nations. In this sense, the extent to which China can see a leading role for the United Nations within the development of US alliance strategy will be a decisive factor in determining the viability and extent of any policy dialogue between the SCO and other major states and international organizations. But this is not something that will be decided by China alone. With Mongolia, Pakistan, Iran, and India now enjoying the status of observers of the SCO, the process by which the SCO decides its relationships with the Unit-

³⁹ Pan Guang, "Shanghe jiang jian duihua huoban jizhi (SCO creates mechanism of dialogue partners)," *Jiefang ribao* (liberation daily), August 27, 2008.

ed States and the rest of the world will inevitably become more multi-polar. When it comes to these relationships, China will have to get used to balancing competing interests within the SCO.

This article is Chapter 6 of a report titled “Asia-Pacific Security Architecture: Tiered Structure of Regional Security.”

November 26, 2010

The DPJ's True Mandate

By Murai, Tetsuya

A year and several setbacks after the election that swept the Democratic Party of Japan to power in 2009, DPJ party leaders disagree over the basic meaning of that historic change of government. Were the voters drawn to the DPJ's commitment to clean, open government or its promise to ease people's economic hardships? According to Tetsuya Murai, both sides have it wrong.

As Prime Minister Naoto Kan and his challenger Ichiro Ozawa squared off prior to the election to choose the next leader of the ruling Democratic Party of Japan, my attention was drawn above all to the candidates' dispute over the "starting point"—the original reason—for the DPJ's historic rise to power a year earlier.

Ozawa argued that the key was the DPJ's commitment to a budget that "puts people's lives first," in keeping with the policies outlined in its 2009 election manifesto, and insisted that any modification of those policies would be a breach of the party's commitment to its voters. Kan countered that modification of the manifesto was inevitable given the government's fiscal constraints and argued that the DPJ's real starting point was clean, participative government.

In fact, both assertions strike me as beside the point. The historic change of government ushered in by the August 2009 general election was driven not by voters' faith in the DPJ but by their loss of faith in the Liberal Democratic Party's brand of government. And since the LDP's brand of government is really the only brand Japan has known in the decades since World War II, the DPJ's victory was surely powered by something deeper than the details of its manifesto. But what?

To answer that question we need to take a sweeping, bird's-eye view of the LDP government that persisted for a half-century and ask why it forfeited the confidence of the people. Once we establish that, the basic reason for the DPJ's rise to power should be

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clear.

The Bulwark of Sectionalism

In his diary, Ichiro Hatoyama, a dyed-in-the-wool party man, wrote ironically of the bureaucracy's "transfer of power" (*seiken hokan*) from the political parties to the military before World War II—an allusion to the way the architects of the Meiji Restoration had deposed the Tokugawa shogunate by nominally returning sovereignty to the emperor. When the military was dismantled after the war, the bureaucrats threw in their lot with the US Occupation authorities and looked askance at Hatoyama, whom the Occupation had purged from public life. Call it the worldly wisdom of those who know how to preserve their own power by joining forces with whoever happens to be in the ascendant.

The Japanese bureaucracy also knew the technique of enhancing its power by dividing it up among various agencies in a kind of reverse divide-and-conquer strategy. So effective was that strategy that the Occupation's General Headquarters, which relied heavily on the cooperation of Japanese administrators, ended up with a sectionalist structure that mirrored the administrative organization of the Japanese government.

Prime Minister Shigeru Yoshida, on the other hand, managed to avoid dependence on the bureaucracy throughout his long tenure. Never has a Japanese prime minister been so successful in streamlining government and limiting government spending in the face of the bureaucracy's relentless drive to expand its own organization and budget. This was a time of "tough choices," when everything was subordinated to Japan's postwar recovery. Through his relationship with powerful former bureaucrats like Hayato Ikeda and Eisaku Sato (both of whom later became prime minister), Yoshida was able to keep the civil servants in line and assert forceful political leadership, often skipping such steps as cabinet meetings.

Nonetheless, Yoshida encouraged bureaucratic sectionalism. His aim in doing so was to foil the efforts of party politicians like Hatoyama to exert strong, unifying leadership. And in fact, after Hatoyama ousted Yoshida and took over as prime minister in 1954 (having been allowed to return to public life in 1951), he found himself stymied by the sectionalism that Yoshida had built as a bulwark to protect the bureaucracy.

To be sure, the Hatoyama cabinet devised a variety of reforms intended to break down that bulwark. At the forefront of this effort was strongman Ichiro Kono, who served in a number of cabinet posts during his career, including that of minister of construction.

Aiming for a wholesale reallocation of budget funds to benefit the rural prefectures, he tried to impose his agenda at meetings of the administrative vice-ministers. He set up conferences among the heads of related ministries and pushed for a budget office directly under the prime minister. He also tried to increase the number of political appointments in the government. It is interesting to note the similarities between his efforts and some of the measures the DPJ has implemented.

But the reforms by which Kono hoped to strengthen political leadership were ultimately modified and diluted. The reason is that rapid economic growth generated ever-increasing tax revenues, which eliminated the need for painful spending cuts or administrative downsizing. The “tough choices” of the era of reconstruction gave way to the “mutual harmony and benefit” of the rapid-growth era, and the LDP settled into the role of perennial ruling party.

The Rise and Fall of Porkbarrel Politics

The prime minister who best represents the LDP during this second phase is Kakuei Tanaka. Tanaka created a vast system for distributing government benefits to every corner of the nation by means of *zoku giin*, Diet members with close ties to specific sectors and the agencies charged with overseeing them.

But continued economic growth was needed to finance such a system. As the economy stagnated during the 1990s following the collapse of the bubble economy, the mechanism of “mutual harmony and benefit” could no longer function. Devoid of unifying leadership, the LDP quickly fell victim to the “reverse divide-and-conquer” effect of bureaucratic sectionalism. Meanwhile, since the LDP was also the source of the bureaucrats’ power, the party’s decline led to a weakening of the bureaucracy as well.

Two Leaders, Both Out of Step

With the nation’s political and administrative leadership failing, Naoto Kan and Ichiro Ozawa each began pushing for political reform. Kan, who began his career as a grassroots activist, focused from the beginning on clean, open, participative government. As he rose to prominence in national politics, this impulse was sublimated into a call for political leadership.

Ozawa, the LDP renegade, criticized the culture of “mutual harmony and benefit” on the grounds that it was impossible to decide anything without unanimous agreement. For

him, political leadership meant a unifying authority strong enough to break free from such constraints.

But neither Kan nor Ozawa could keep pace with the changes sweeping Japanese society. From around 2000 on, the budget deficit began to balloon, threatening the nation's entire social security system. An increase in the consumption tax was essential, but the public would only tolerate such an increase if the government demonstrated the political leadership needed to streamline government and cut spending. Tough choices could no longer be avoided.

The political leadership of Kan and Ozawa, however, was rooted the conditions of the 1990s, when the government still had some residual fiscal strength. Kan's grassroots emphasis on social security went counter to the need for fiscal discipline. Ozawa sought deregulation to undercut the power of the bureaucracy, but he showed little interest in limiting spending. Paradoxically, it was the LDP's own Prime Minister Jun'ichiro Koizumi who finally took a knife to the budget with his "structural reforms."

The True Meaning of Leadership

Desperate to wrest control from the LDP, Kan and Ozawa decided to merge the opposition parties they headed, the DPJ and the Liberal Party. The expanded DPJ spotlighted the side-effects of Koizumi's structural reforms, namely, widening income disparities and the battered economies of Japan's rural areas. This focus took shape in the DPJ's 2009 election manifesto, which pledged to "put people's lives first" and allocate fiscal resources to ease the hardships of ordinary citizens.

The LDP, meanwhile, lapsed back into dysfunction as soon as Koizumi stepped down, reverting to its old "mutual harmony and benefit" mode of policy making. Fettered by all manner of political constraints, it showed itself utterly incapable of leading. In their frustration with the LDP, the people turned to the DPJ, which was free of such constraints. This is what brought about the historic change of government that put the DPJ in power for the first time.

The fundamental problem is that political leadership in the DPJ, as embodied by Kan and Ozawa, remains mired in the assumptions of the 1990s. Kan's commitment to clean, participative government is admirable, but doubts remain as to his ability to exert a strong, unifying kind of leadership. Faced with the vast bulwark of sectionalism erected during the LDP's long monopoly on power, Kan already displays signs of succumbing to depen-

dence on the bureaucracy. He can talk about social security all he likes, but unless he begins to demonstrate a willingness to make the tough choices, he will never win a mandate for a consumption tax rate increase.

Ozawa seems to be capable of the strong, unifying leadership needed to break free from the bureaucracy's "reverse divide-and-conquer" constraints, but his involvement in money politics and influence peddling remains a sticking point. The public has no confidence in his "manifesto budget" because their concerns over the means of financing it remain unanswered.

By now, the basic reason for the DPJ's historic rise to power should be evident. The party's mandate was to show the voters in clear and concrete terms how it intended to navigate the transition from an age of "mutual harmony and benefit" to a new era of tough choices. The DPJ should take this opportunity to return to that starting point and begin anew.

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August 4, 2010

The Upper House Vote and the Process of “Creative Destruction”

By Curtis, Gerald L.

The Democratic Party of Japan’s setback in the July 11 House of Councillors election has produced “a political gridlock worse than anything Japan has experienced in half a century,” notes Gerald Curtis, a Tokyo Foundation senior fellow and the Burgess professor of political science at Columbia University. This is part of a process of “creative destruction,” though, that Japan must pass through to create an effective and responsive government.

QUESTION: How do you analyze the results of the July 11 House of Councillors election?

GERALD CURTIS: The election results have produced a gridlock worse than anything Japan has experienced in half a century. It’s much worse than the situation the Liberal Democratic Party faced before it lost power to the DPJ, when it had a two-thirds majority in the House of Representatives. The Democratic Party of Japan doesn’t have that now, so it will be unable to override a House of Councillors rejection to pass key pieces of legislation.

The DPJ will have to find other parties that will agree with it on specific pieces of legislation. The possibility of this happening, though, is very small. Much likelier is that the LDP, Minna no To (Your Party), and Komeito will resist making policy agreements with the DPJ because they will feel that if they vote with Prime Minister Naoto Kan, they’ll be helping him out. So they’ll take an uncompromising position, demanding that he swallow their position whole. Rather than make policy agreements, they are likely to put a lot of pressure on Kan to dissolve the Diet. This Diet is not likely to last for three more years. This political standoff will prevent the country from dealing with many important issues, regarding both domestic and foreign policy.

Curtis, Gerald L. Senior Fellow of the Tokyo Foundation. Burgess Professor of Political Science, Columbia University. After earning a social science degree from the University of New Mexico in 1962, attended Columbia University, where he got his MA (1964) and PhD (1969) in political science. Went on to serve as assistant professor and associate professor at Columbia, where he was also director of the Weatherhead East Asian Institute from 1974 to 1990. Became a full professor in 1976. From 2000 to 2006 was a visiting professor at the National Graduate Institute for Policy Studies. In 2004 was awarded the Order of the Rising Sun, Gold and Silver Star.

What we're observing now in the Japanese government is part of a process of "creative destruction." Eventually a new political party system and new decision making mechanisms will emerge to replace the system that existed under nearly a half century of LDP rule, but to create something new means destroying things that currently exist. Right now it is easier to see the destruction than the creation but clearly Japanese politics is in a phase of major change and evolution. This may be good news for Japan in the long run, but the short term consequences are mostly negative. There's a very good chance that the next lower house election will result in an even more confused political situation. It is conceivable that there will be a major party realignment. This is likely to produce weak and ineffective governments for some time to come.

It would have been much better if the DPJ had won a majority in the upper house election. Then its responsibility for the government's performance would be clear and the voters would be able to hold it accountable in the next lower house election. Under this gridlock situation, each party will be blaming the other for the government's failure to deal with the nation's problems and the public will find it hard to choose among them.

Public unhappiness with the choices given them was evident in this election. The LDP won more seats, but the DPJ won more votes nationwide. Public opinion polls show declining support for the DPJ but no increase in support for the LDP. They're disappointed with the DPJ, but they're not attracted by the LDP either. The voters want to be led, they want a party that can persuade them about what needs to be done, but they're not getting it in any of the choices presented to them. The public is looking for politicians who have a compelling vision about where the country should be heading and how to get there.

QUESTION: What are the prospects of running into such a leader?

CURTIS: You never know who that leader is until he shows up. No one expected Junichiro Koizumi to be so popular. He wound up staying in office almost longer than anyone else in the postwar period. He was enormously popular but he was not a populist. He didn't tell the public what he thought they wanted to hear; he told them that the country needed to take risks, to do things differently in order to prosper. And the public believed in him and therefore supported his policies. Some people thought Kan might show a Koizumi-like determination and rally public support, but the way he raised and then waffled on the issue of increasing the consumption tax badly damaged his image.

QUESTION: Perhaps the lack of visionary political leader is a problem with the electoral

system, with the campaign period being so short, so candidates aren't really tested before they enter office.

CURTIS: There no doubt are structural factors that contribute to the paucity of political leadership in Japan. The rapid turnover of prime ministers cannot be simply a coincidence. The mostly single-member district system is inappropriate for Japan. This is a society without deep social cleavages along the lines of religion, ethnicity, race, class, and so on, so that with a two-party system, the two major parties invariably wind up being very similar. That's why there have been these wide swings in voter support since the single-member districts were created.

In Britain or the United States, where you still have strong cleavages based on region, religion, and race, there's a core base of support for each party, and there's fundamental stability. But here, neither party has an anchor in society. Japan would be much better off going back to a modified system of multiple-seat districts or adopting a fully proportional representation system.

The election law's excessive restrictions on campaign practices keeps politicians campaigning as they did decades ago even though the society has changed enormously; Politicians are still going around with loudspeakers on their trucks blaring out their names and saying please vote for me. This is because most campaign practices that are usual in other countries are prohibited here: no door-to-door calls, limits on the written materials you can distribute, no freedom to use the Internet during the campaign period, and so on.

In recent years the LDP and the DPJ have adopted a policy where if the party president resigns the person chosen to replace him has to serve out the term of his predecessor and then stand for election again. So instead of Kan being elected to a regular two year term as DPJ president when Prime Minister Hatoyama resigned, he is serving out Hatoyama's term and has to face an election in September.

QUESTION: What can Kan do to stabilize the political situation?

CURTIS: There're only two things he can do. One is to appeal to other parties to support particular policy initiatives and compromise with other parties on key issues. There has to be a willingness on the part of Kan and the DPJ to make the Diet the central site for actual policy formulation and to find new ways to cooperate across party lines.

In Japan, the practice has been for the bureaucracy to draft policy and for the cabinet to submit it to the Diet, and the Diet either passes it or doesn't pass it. But the idea of actually writing legislation in Diet committees—or even revising them—doesn't happen here, or very rarely, so this is an opportunity to make the Diet an important site for actual policy formulation.

The second thing he has to do is find ways to appeal to the public for support. The key to effective political leadership in a democracy is the power to persuade. For American politicians this is common sense. President Barack Obama was tireless in trying to convince the public to support his health care reform and to use public support to pressure Congress to go along. But few Japanese politicians operate from this assumption. Koizumi did, but he was the exception. The question is whether Prime Minister Kan will be able to communicate to the public, build support for his policies, pressure the opposition parties to compromise and forge policy agreements across party lines. I am not very optimistic, and if he does not succeed, the political system will be immobilized.

QUESTION: Advances were made by women legislators in the most recent election, with Renho being one of top vote garnerers. Do you think this indicates a trend?

CURTIS: There are a couple of trends going on. One is that there are more professional women in Japan who are interested in careers in politics, such as Yukari Sato and Satsuki Katayama, both of whom were defeated in the last lower house election and came back and won in the upper house election. These are serious women who have had serious careers before entering politics. But the sample is still small because women have had few opportunities for advancement. The disadvantages of being a woman in Japan are still greater than in other countries.

The other trend is for parties to run women simply because they're pretty or because they have name recognition. This is demeaning to women. There are a lot of women in politics who are there because the LDP and the DPJ thought they could win for reasons that have nothing to do with politics. So, ironically, I think the larger number of the women reflects a kind of chauvinistic mentality.

Renho was a TV announcer, but she's also a serious politician. The motivation for running so many women, though, reflects values in this society that partly explain why women are disadvantaged in professional life.

QUESTION: What are the foreign policy implications of the DPJ administration? How will the alliance with the United States be affected?

CURTIS: The United States wants to have a good relationship with Japan and that means having a close and positive relationship with the Japanese prime minister. But ever since Koizumi left office, there hasn't been a prime minister who has survived more than a year in office. So while the desire to have a strong relationship is there, there is a natural reluctance to invest a lot of time and energy in developing personal relations with a government leadership unless you can be fairly confident that they're still going to around for awhile. The combination of political instability in Japan and the controversy that emerged over the issue of relocating the Marine Air Station at Futenma has made it difficult for the United States and Japan to engage with each other as fully as they should on larger issues, like the environment, energy, nontraditional security threats, and how to cooperate in ensuring stability in East Asia.

QUESTION: Talk of hiking the consumption tax probably cost the DPJ the election, but the fiscal situation is something that must be addressed. How should the public debt be dealt with?

CURTIS: Unlike the situation when Ryutaro Hashimoto or Noboru Takeshita was prime minister, the majority of Japanese seem to feel that an increase in the consumption tax is unavoidable. Unfortunately, because of the way Kan raised this issue, he actually set back the timing of introducing an increase.

Increasing the consumption tax without having some kind of strategy to increase growth, though, will only depress the economy. So this has to be part of a broader tax and spending reform package. One thing Japan could do to increase government revenue without a tax increase is to introduce a taxpayer identification system. If every taxpayer had the equivalent of the social security number used in the United States there would be far less tax evasion.

Coming back to the election results and the long-term positive effects of "creative destruction," last year's lower house election produced the biggest turnover of the members of parliament since the purge under the Allied Occupation. The LDP will no doubt increase its seats in the next lower house election and that too will bring in new people into the Diet, so over a period of five years or so, there's going to be hundreds of new Diet members. There are seventy to eighty DPJ politicians serving as cabinet ministers, senior vice ministers, parliamentary secretaries and the like. They are gaining experience

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in how to run a government and over time some of them will emerge as impressive political leaders. New blood in the Diet will result in changes in the relationship between politicians and bureaucrats, and the Diet will play a more central role in policymaking. In the long term, these are positive, creative developments, as the system will become more transparent and politicians will come to understand that you really have to persuade the public.

June 23, 2010

Postal Reform and the Fiscal Investment and Loan Program: Toward Democratic Control of Government Finances

By Tanaka, Hideaki

Japan's postal system does much more than deliver the mail. Its savings program collects vast sums that help finance government programs. For this reason proposed changes to the postal privatization plan adopted in 2005 are problematical not only for the finance industry but also for fiscal democracy and accountability. In this article, the first of a three-part series, the author explains how the postal system gave birth to "the second budget."

On April 30 this year, the cabinet of Prime Minister Yukio Hatoyama voted to submit to the Diet postal reform legislation intended as a "course correction" for the postal privatization plan adopted in 2005. The bill hit several snags during the drafting process, as divisions surfaced even within the cabinet over such proposed changes as raising the per-customer deposit ceiling for postal savings and providing special corporate tax exemptions for the postal system's financial services. Because the basic idea behind the reform bill is for the government to play a bigger role than that envisioned in the original privatization plan, most of the criticism thus far has centered on concerns that the rest of the finance industry will be put at an unfair disadvantage.

Although the fundamental ideological issue may be private versus national control of the finance industry, the proposed "correction" also raises important questions pertaining to the management of the postal-savings and postal-life-insurance funds. The problem relates not just to risk but also to reform of the Fiscal Investment and Loan Program—often called "the second budget"—and the principle of democratic control of government finances. To better understand the current situation and how it developed, we need to go back about 125 years.

The Postal System and Public Finance

In 1875, the Meiji statesman Hisoka Maejima, known as the father of the Japanese postal

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system, introduced a postal savings program to stand alongside the new system's mail delivery and money remittance services. Maejima hoped the system would expand rapidly and promote thrift among the general populace, but postal savings accounts were slow to catch on. In time, however, deposits grew—thanks in part to the incorporation of “savings education” in the grade school curriculum—and in 1885, they were placed in the account of the Deposit Bureau, newly established within the Ministry of Finance. At the beginning, the Deposit Bureau invested the bulk of those funds in government bonds under the ministry's Deposit Rules. Beginning in 1907, however, the Deposit Bureau's investment of postal savings funds began to include direct loans to the national treasury's general account and special account and the purchase of special bank bonds (used by prewar government financial institutions, such as the Industrial Bank of Japan and the Bank of Chosen, to raise capital). This was the origin of the Fiscal Investment and Loan Program legislated after World War II.

During the Taisho era (1912–26), the Deposit Bureau stepped up its purchase of special bank bonds and its loans to special banks to help fund domestic programs and foreign investment. Thus postal savings, channeled through such institutions as the Industrial Bank of Japan and the Bank of Chosen, were used to finance such projects as the Seoul-Busan Railway on the Korean Peninsula, and the Kirin-Changchun Railway and Taiji Mine in northeastern China. Since there was nothing in the Deposit Rules circumscribing the Deposit Bureau's investments, the bureau operated at the discretion of the government, and as a consequence problems emerged almost from the start. A typical example was the trouble surrounding the so-called Nishihara loans, ostensibly private loans extended to a Chinese warlord during 1917 and 1918 with the help of Deposit Bureau funds. The borrower defaulted, and the Japanese government was obliged to assume the debt, paying both interest and principle. In short, the postal savings fund was being used for private overseas investments, and the state was covering the losses.

Accountability for the Special Accounts

Such problems led to calls for tighter controls. In 1925 the government enacted legislation establishing the rules governing the management of the postal savings fund.¹ That was when the special account budgets began to be submitted to the Diet every year.

¹ *Yokinbu yokin ho* (Postal Savings Deposits Law) and *Okurasho Yokinbu tokubetsu kaikei ho* (MOF Deposit Bureau Special Account Law).

The third basic service of the postal system, life insurance, was introduced in 1917 with the establishment of the postal life insurance program, known as Kampo. The Kampo fund was managed independently until 1943, when it, too—with the exception of money loaned to prefectural governments—was placed under the management of the MOF Deposit Bureau.

After World War II, new legislation passed in 1951² put the MOF Trust Fund Bureau in charge of fund management and laid the groundwork for integrated management of government funds under the Fiscal Investment and Loan Program, or FILP. Beginning in 1953, MOF was required to submit to the Diet an annual Fiscal Investment and Loan Plan covering all government-operated funds—including the Kampo fund, which at that time was again being managed independently—as information to support budget deliberations. Over time, FILP grew so large as to earn the appellation “the second budget.” Through this system, public funds collected via the postal savings and Kampo programs (as well as the public pension system) were pooled into FILP and used to finance quasi-governmental bodies, the special account, local governments, and so forth.

When FILP first came into being, the Diet had no role in deciding how the funds were invested, that is, which entities received loans. However, legislation enacted in 1973³ made the Fiscal Investment and Loan Plan subject to Diet approval every year. More accurately, it mandated that all loans or investments with terms of five years or more be included in the special account budgets. The rationale was that, even though FILP used financial instruments in raising and spending funds, much like a private bank, it was still allocating resources as a tool of government policy. For that reason, it should be treated in the same way as the general budget, which is financed by taxes, and subject to Diet approval via the budget process. Underlying this decision was the principle of democratic (parliamentary) control of government finances, one of the key concepts enshrined in the Constitution of Japan.

Although FILP has come under frequent criticism in recent years, it played a key role after World War II in the development of social infrastructure essential to Japan’s economic development by financing the construction of national expressways and airports, promoting housing construction, subsidizing social welfare facilities, and supporting local

² *Shikin Un'yobu shikin ho* (Trust Fund Bureau Fund Law) and *Shikin Un'yobu tokubetsu kaikei ho* (Trust Fund Bureau Special Account Law).

³ *Shikin Un'yobu shikin oyobi Kan'i Seimei Hoken no tsumitatekin no choki un'yo ni taisuru tokubetsu sochi ni kansuru ho* (Special Measures Law for Long-term Appropriation of the Trust Fund Bureau Fund and Postal Life Insurance Reserves, or Long-term Appropriation Law).

public works projects. With the end of the rapid growth era, however, FILP's function and character began to change. During the post-bubble recession of the 1990s, the government relied on FILP spending to stimulate the economy. By 1996, annual lending under the Fiscal Loan and Investment Plan had reached a peak of 40.5 trillion yen, and by the end of fiscal year 2000 the program's assets totaled 417.8 trillion yen. At a time when General Account spending was under harsh constraints, FILP assumed much of the burden.

FILP under Fire

Since the basic source of FILP funds was postal savings and other interest-paying deposits, FILP was required as a rule to invest in programs or projects that promised a certain minimum return. But in some cases the government used a combination of direct spending and FILP loans to fund quasi-governmental corporations set up to administer programs that, while not profitable, meshed with policy objectives. An example is the interest subsidies paid to the old Housing Loan Corporation, which provided low-interest home loans to the public.

As FILP grew in scale and boosted its lending to such public corporations, those "FILP agencies" came under increasing attack for inefficiency and wasteful spending. Strictly speaking, the agencies' management problems were separate policy issues, not a FILP issue per se. But the climate in which FILP functioned had changed dramatically over the years. The system may have functioned fairly efficiently at a time when demand exceeded supply and funds had to be lent selectively. But once supply began to exceed demand, it was all too easy to lend the funds indiscriminately and inefficiently, without regard to priorities.

The problems surrounding the agencies through which FILP funding was channeled became a major impetus for reform of the FILP system. The Administrative Reform Council, chaired by the late Prime Minister Ryutaro Hashimoto, recommended "fundamental reform of the Fiscal Investment and Loan Program" in its final report (December 13 1997). Reforms were also deliberated within the Ministry of Finance, which administered the program. The report released by MOF's advisory council (November 27, 1997) enumerated FILP's problems, noting that its ballooning scale and ever-expanding fund encouraged wasteful loans, that its escalating investment in short-term assets and Japanese government bonds was creating distortions in the financial market, that its long-term fixed lending rates were incompatible with market principles, and that evaluation of the programs it financed was lax.

Reform was finally accomplished with the enactment of the relevant legislation in May 2000. The law put an end to the compulsory deposit of postal savings and pension reserves in the MOF Trust Fund Bureau and required that FILP raise funds, on an as-needed basis, by floating “FILP bonds” (essentially Japanese government bonds) on the market. The new system was designed to ensure that demand drove the supply of funds (raised via the capital markets) instead of letting the supply of funds (from sources like postal savings) determine lending. The postal savings, Kampo, and pension funds were to be managed independently via the financial market by investing them in FILP bonds and FILP agency bonds (issued by public corporations, etc.) on the basis of portfolio considerations. This severed the direct flow of funds between the postal savings programs and government agencies via FILP. As a consequence of these reforms, lending under the FILP Plan dropped by 63% between fiscal 1996 and 2006, from 40.5 trillion yen to 15.0 trillion yen.

The Diet’s Role and Postal Privatization

Under the new system, an exception was made for loans to local governments, which are often hard-pressed to raise adequate funds through local taxes. This allowed the independently managed postal savings and Kampo funds to provide direct financing to local governments within the frameworks of the Local Government Bond Plan and the FILP Plan. However, the amounts were to be determined not through separate negotiations with local governments but on the basis of allocations approved by the Diet through the budget process, and the loans were to have uniform terms set by the government in keeping with market principles. In this way, FILP funding as a fiscal tool remained subject to Diet approval via the budget process. Because lending to local governments functions as a tool of policy through allocation of resources, the annual FILP Plan was required to disclose all such lending, including loans from the postal savings and Kampo funds, in a consistent tabular format. The fiscal 2006 FILP Plan, for example, includes 170 billion yen from the postal savings fund and 310 billion yen from the Kampo fund among its disbursements to local governments.

With these changes, FILP reform was basically complete. But reform of the postal savings and life insurance systems continued. Japan Post was established as a special public corporation in April 2003, and the cabinet of Prime Minister Junichiro Koizumi forged ahead with his plans for postal privatization. The project hit a temporary setback when the House of Councillors rejected the government’s privatization bills in June 2005, but Koi-

zumi called an election of the House of Representatives over the issue, and in October 2005 the privatization bills were finally passed in a special session of the Diet.

Under the privatization plan, Japan Post was reborn as a joint-stock company, Japan Post Group, in October 2007, and the rules requiring Diet approval for loans from the postal savings and Kampo funds to local governments were scrapped. From fiscal 2007 on, resources from the postal savings and Kampo funds were no longer itemized in the FILP Plan; instead, loans from those funds to local governments were treated the same as financing from private banks.

Risk and Accountability

After the Democratic Party of Japan unseated the Liberal Democratic Party in August 2009, the new administration decided to correct perceived problems in the 2005 postal privatization plan. The specifics of this “course correction” are contained in the postal reform bill that the Cabinet submitted to the Diet at the end of April. A detailed examination of the legislation is beyond the scope of this paper. My focus here is on how the latest reform would impact investment of the postal savings and investment funds.

The current reform plan would raise the upper limit on postal savings deposits per depositor, as well as the upper limit on individual insurance policies, a change that has drawn considerable criticism. But one aspect of this policy that needs more attention is how the government intends for these much augmented funds to be invested.

On April 20, at an internal meeting organized by the Ministry of Internal Affairs and Communications with DPJ politicians, Internal Affairs and Communications Minister Kazuhiro Haraguchi submitted a written proposal calling for more effective use of postal savings deposits and life insurance reserves. The proposal stresses the need to change the current portfolio, which invests money mainly in JGBs, in order to “boost returns, while giving due consideration to security issues and keeping investment sound through risk management.” More specifically, the document suggests the following:

1. Investment and financing targeted to growth areas

(1) Investment and financing via cooperation, etc., with overseas funds:

Investment of assets in creditworthy projects carried out under intergovernmental agreements, etc. (investments in and loans for infrastructure projects or venture businesses relating to high-speed rail, toll roads, water supply, etc.)

(2) Investment in and financing of projects implemented under public-private partnerships:

Development of social capital (bridges, hospitals, schools, and similar facilities) through PFIs [private finance initiatives] and PPPs [public-private partnerships]

(3) Investment and financing in future growth industries:

Medicine/nursing, environment, information and telecommunications

2. Foreign bonds

3. Loans to individuals

Home loans, personal loans

At the same time, the proposal insists that “investment decisions would be left to the independent judgment of Japan Post Bank and Japan Post Insurance.”

On April 27, moreover, the daily *Asahi Shimbun* reported that Haraguchi, in anticipation of the new postal reform legislation, had ordered his agency to study the possibility of investing something on the order of 10 trillion yen in postal savings and postal insurance funds in growth areas in Japan and abroad. Haraguchi was quoted as saying that the investments would be aimed at strategically supporting Japanese firms working in infrastructure development and other overseas programs. “Japan Post Holdings, Japan Post Bank, and Japan Post Insurance will make their own decisions; we will just assist strategically,” Haraguchi explained. “It will all be according to the business judgment of private management, so it isn’t like a sovereign wealth fund,” he maintained, adding that they were thinking in terms of “about ten trillion yen to start.”

In an editorial, the *Asahi* expressed concern that “the funds’ investment activities could be hidden from the public eye and could incur losses for which the taxpayers might end up bearing the cost.” A number of critics have lashed out against the plan, warning that it could end up reviving the old, pre-reform FILP system and the wasteful spending associated with it. They are troubled by similarities between some of the investment categories in the aforementioned proposal and those financed with postal savings and Kampo funds prior to the 2000 FILP reforms.

Public or Private?

Article 13 of the postal reform bill before the Diet stipulates that “postal operations shall be carried out with a view to contributing to the healthy development of regional economies and to the economic vitality of the private sector, as by nurturing small and medium-sized businesses,” and it identifies “services that contribute to local communities” as one of the responsibilities of the new Japan Post companies. In addition to the basic postal and financial services mandated by law, they would be free to make use of the nation’s post-office network to develop new areas of business oriented to improving the lives of local residents, merely by notifying the government of their intentions. As long as they could explain how their new enterprise meshed with the objectives of the new postal reform law, they would be at liberty to branch out into all kinds of businesses.

The bill enumerates the companies’ new operating principles, including security, soundness, and profitability, but it does not answer the big question of how those principles square with one another and which are to take priority. In asset management, there is generally a tradeoff between risk and returns. Haraguchi’s stated intention to break away from reliance on JGBs suggests that the new policy will tolerate greater risk for the sake of higher returns. Yet the emphasis on services that “contribute to local communities” suggests a more public orientation, which generally demands lower risks and lower returns. Is the management policy Haraguchi envisions that of a for-profit business or that of a public service? If both, how does he intend to strike a workable balance given their conflicting priorities?

At this point, the structure and approach that will govern the new companies operations remain a question mark, but where investment of the postal savings and insurance funds is concerned, the government must make a fundamental choice: public or private? Is the plan for each company to make its own investment decisions from the perspective of a private financial institution, even though it has certain public responsibilities, such as universal service? Or are these decisions to be shaped by government policy? A case can be made for or against either option. This is a policy decision, but if the government goes with the latter option, then there is a need for rules and regulations to preserve democratic control of government finances.

The role of government is to fund programs and projects that are too unprofitable or risky for the private sector. Government programs are by nature unprofitable or risky. To be clear, I do not rule out the idea of allowing a higher level of risk in the investment of postal savings and postal insurance funds, but if policy considerations are driving these risky investments, then they must be subject to democratic control, and this is done

through the Diet's deliberation and approval of the budget. This is our system for allocating resources in ways that the market cannot accomplish. The Japan Finance Corporation, established in October 2008 through the merger of the National Life Finance Corporation, the Agriculture, Forestry, and Fisheries Finance Corporation, and similar bodies, is a joint-stock company, but because it provides the financing that our political leaders deem necessary to carry out their policies, its outlays are subject to Diet approval just like those of its predecessors.

FILP was criticized for adding to the public burden by supporting wasteful projects and spendthrift public corporations, but at least it extended loans with the approval of the Diet, not at the sole discretion of the administration. When questions were raised about the management or finances of a public corporation, such bodies as the House of Representatives Committee on Audit and Oversight of Administration, the Board of Audit, and the Ministry of Internal Affairs and Communications were empowered to investigate. If the current postal reform eliminates the role of the Diet on the grounds that Japan Post Bank and Japan Post Insurance are joint-stock companies, yet allows the government to interfere in the allocation of their resources on policy grounds, it will be turning the clock back 100 years. Without suggesting that the situation today is analogous to that existing a century ago, we should nevertheless ask ourselves if we can afford to repeat the mistakes that gave rise to the Nishihara loans.

Learning from the Past

Under the current reform legislation, the Japan Post Group would remain wholly government funded for the time being. Future plans call for the government to retain more than a one-third stake in the parent company, Japan Post Holdings, and for Japan Post Holdings to control more than one-third of Japan Post Bank and Japan Post Insurance shares. While Haraguchi claims that investment of the postal savings and investment funds would be left to the business judgment of these joint-stock companies, there is no denying that the government (or its representative in the person of the minister of internal affairs and communications) will retain tremendous influence over their management. How can the companies be expected to make independent business decisions in defiance of the minister of internal affairs, knowing that the minister has the power to appoint and dismiss their directors?

Such an arrangement also raises the specter of preferential financing for specific agencies or organizations out of political considerations. Yet if a company lost money on such a

loan or investment, the politician behind it all could evade responsibility on the grounds that any investment by a joint-stock company was strictly a business decision.

Let me repeat: The issue here is not whether postal services should be privatized or what form of management is most appropriate for these services. My point is that, if postal savings and insurance funds are to be employed for the purposes of public policy, we must maintain a mechanism for democratic control, whether by Diet approval or some other means. The FILP system came under criticism for loans that were never recovered even though its activities were subject to oversight by MOF officials, the Diet's budget and audit committees, and the Board of Audit. How can we expect a more judicious allocation of resources to emerge from the "business judgment" of a joint-stock company—or, more accurately, a quasi-governmental body with a public function—that is free from such oversight? Up to this point, democratic control over the government's investment and loan activities has been gradually strengthened through the Fiscal Investment and Loan System. Now, postal system reforms threaten to reverse this progress.

The government's postal reform bill stops short of delineating the new companies' business operations and activities on the grounds that much of this should be left to the discretion of management. Theoretically, such vague provisions would leave the companies free to do virtually anything they chose, providing it did not run counter to the goals and principles of the reform bill. Taking risks that most would consider excessive could be justified by the principle of profitability.

If the purpose of the latest postal reform is to correct the 2005 privatization plan by strengthening the government's hand and utilize the postal savings and insurance funds for policy purposes, then a mechanism for democratic control is necessary. At the very least, the government needs to propose specific rules and guidelines for fund investment and gain a public consensus for them. Those who would overhaul a major public institution have a responsibility to base those efforts not only on factual analyses of the present situation but also on a full understanding of the historical processes that brought us to this point—lest they condemn us to repeat the mistakes of the past.

May 21, 2010

The Urgent Task of Lowering Japan's Corporate Tax Rate

By Morinobu, Shigeki

Japan must consider lowering its corporate tax rate, which is among the highest in the world, to protect jobs and address the needs of a graying population. EU member states have actually seen tax revenues rise by lowering corporate taxes and expanding the tax base, and this offers valuable hints on how Japan can proceed with its own tax reform.

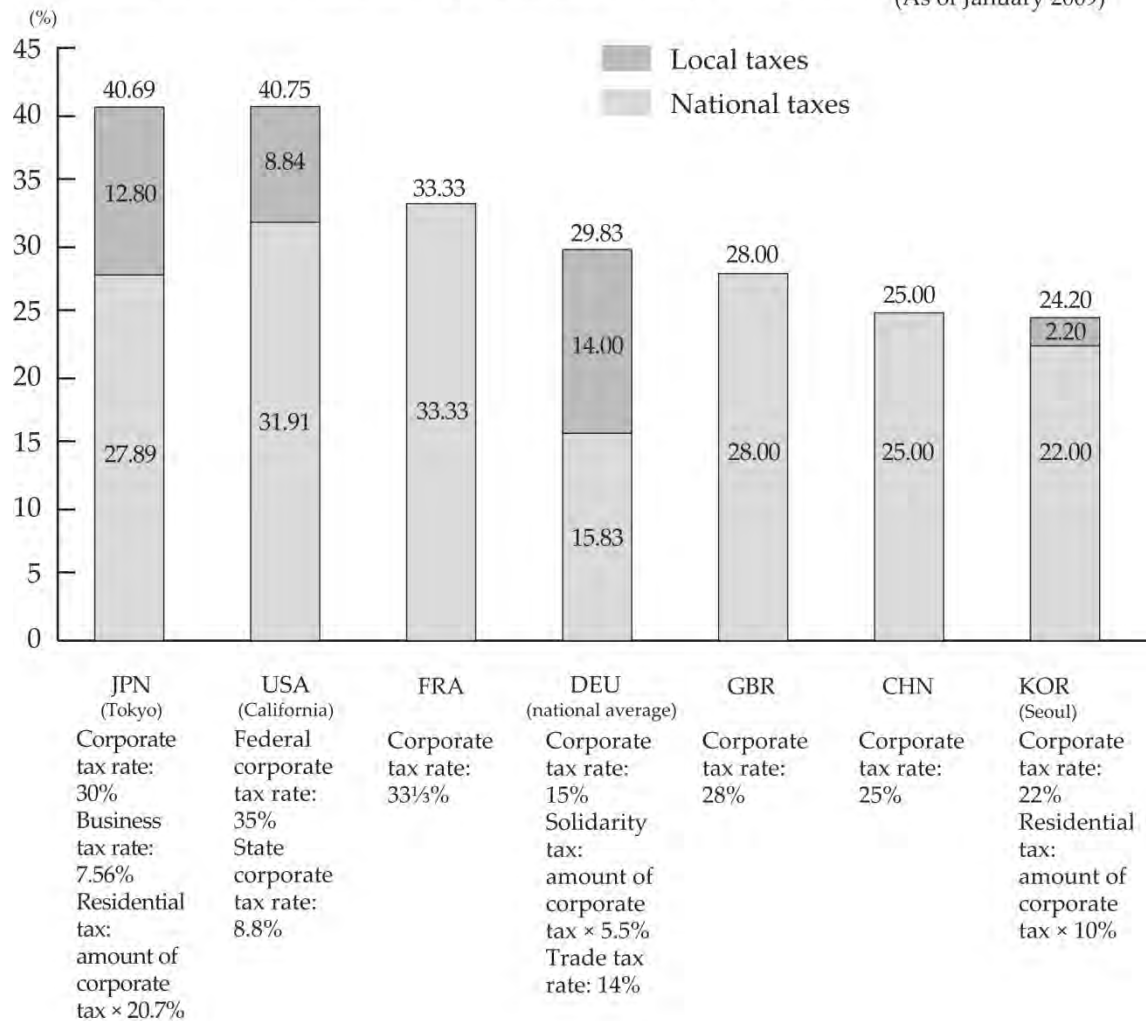
The Need for Reform

Remarking in the Diet on March 12 that corporate tax rates “should rightly be guided lower,” Prime Minister Yukio Hatoyama hinted that he would launch discussions on reducing the rates. His Democratic Party of Japan had been criticized for lacking a growth strategy, so many welcomed the remark as the first bright news in a long time.

An international comparison of nominal and effective corporate tax rates reveals that the statutory rate in Japan and the United States are around 40%, some 10 percentage points higher than other industrial countries (Figure 1). This, as will be described below, is the result of repeated efforts by countries other than Japan and the United States to lower their rates and attract foreign businesses.

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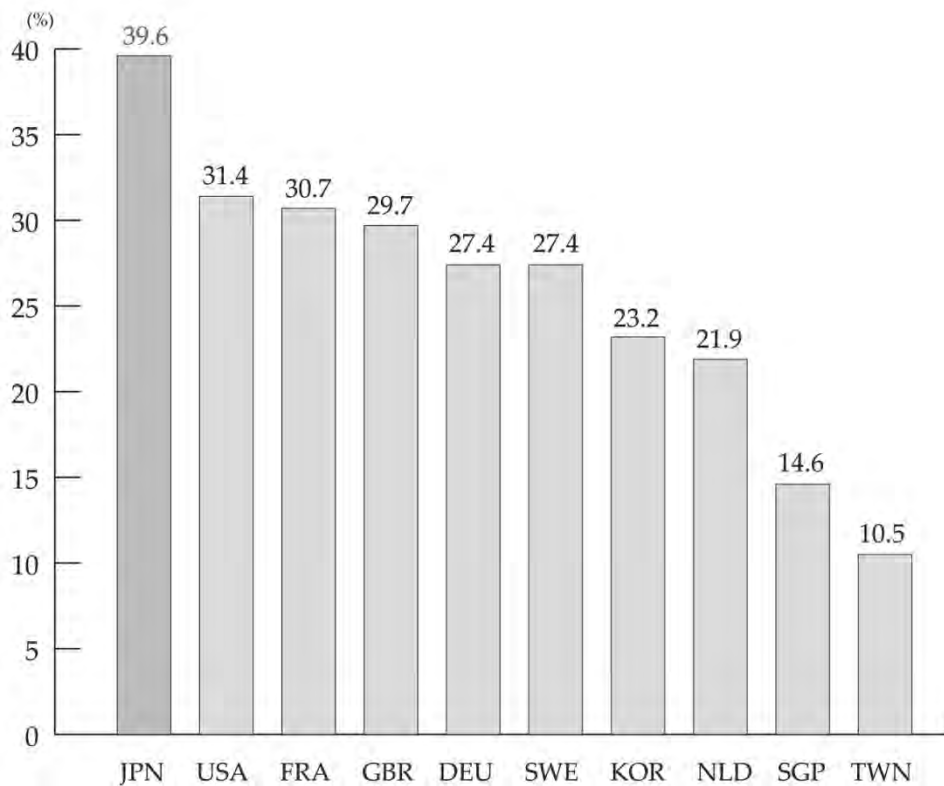
Figure 1. International Comparison of Statutory Corporate Income Tax Rates
(As of January 2009)



The general feeling in Japan is that there is no need for lower rates since they are on a par with the United States. But this is quite misleading, for a look at the effective tax rate (corporate taxes as a share of pretax income) in Japan and the United States reveals that it is nearly 10 points lower in the United States.

Why is this so when the statutory rates in the two countries are essentially the same? Part of the reason is that in the United States, taxable profits are calculated according to a different set of rules from those used in the calculation of profits in financial statements, but a much bigger factor is the aggressive tax planning efforts made by US businesses.

Figure 2. International Comparison of the Tax Burden(Effective Tax Rates),
Fiscal 2004–06



Notes: (1) Average for fiscal 2004-06, consolidated basis. (2) Tax burden = corporate tax (after application of accounting for income taxes) ÷ pretax earnings. (3) Companies covered here are those included in the Nikkei 225, S&P 500, Europe 350, and S&P Asia Pacific 100 indices and whose financial data were available.

Source: Calculated using S&P's Compustat corporate financial database.

An increasingly popular method of transferring income is to establish an intangible property company (IPCO) in a low-tax country to collect and manage royalties from the licensed use of intellectual property rights, which are a major source of income for many businesses. Multinational pharmaceutical and beverage companies receive huge sums for the use of registered patents and trademarks, and many of them now retain such profits in low-tax countries.

Even among Japanese companies, there is a growing trend to view taxes as costs, particularly with the rise in the share of foreign shareholders and such deregulatory moves as amendments to Japan's Companies Act. Some are transferring or retaining their income in low-tax countries, leading to the drain of the country's added value and the loss of employment and tax revenues. Under the tax system revisions of fiscal 2009, income

that had been retained by an overseas subsidiary can now be transferred back to Japan tax-free, but this has the possibility of actually encouraging more companies to retain their earnings at their foreign subsidiaries.

This is not difficult to foresee when one looks at the partner countries of Japan's foreign direct investment and inward direct investment (Figure 3). The country with the largest balance of direct investment in Japan was the United States, as of the end of 2006. In second place was the Netherlands, with the Cayman Islands coming in fourth and Singapore seventh. As for Japan's direct investment in other countries, the list was topped by the United States, followed, similarly, by the Netherlands in second place, the Cayman Islands in fifth place, and Singapore in seventh place. Both the Netherlands and Singapore offer preferential tax rates as a way of attracting foreign capital, and many companies in the industrial world are evidently conducting their investments via these countries. The Cayman Islands are famous as a tax haven. This shows that direct investment to and from Japan is already being conducted via low-tax countries and also that the tax system is a major factor in investment decisions today.

Figure 3. Direct Investment to and from Japan

From Japan					To Japan				
(¥ hundred million)					(¥ hundred million)				
	Country, territory	Balance of foreign direct investment (end of 2006)	Direct investment (flow)			Country, territory	Balance of foreign direct investment (end of 2006)	Direct investment (flow)	
			2005	2006				2005	2006
1	United States	186,004	13,599	10,834	1	United States	49,933	85	140
2	Netherlands	54,012	3,620	9,940	2	Netherlands	14,478	2,663	-8,612
3	Britain	37,595	3,221	8,424	3	France	13,734	-88	322
4	China	36,052	7,262	7,172	4	Cayman Islands	9,989	1,218	-51
5	Cayman Islands	25,469	4,260	3,347	5	Britain	5,929	155	2,093
6	Thailand	17,647	2,355	2,307	6	Germany	5,449	259	-622
7	Singapore	16,969	634	444	7	Singapore	5,001	679	1,265
8	France	15,536	607	978	8	Switzerland	3,139	-908	369
9	Australia	14,486	693	547	9	Canada	2,716	-1,098	-3,209
10	South Korea	12,688	1,966	1,768	10	Hong Kong	2,293	1,129	-2,467
11	Belgium	11,452	-224	163	11	Belgium	2,260	-1,407	1,024
12	Brazil	9,310	1,069	1,654	12	Luxembourg	1,945	396	-18
13	Hong Kong	9,247	1,963	1,755	13	Taiwan	1,754	-34	128
14	Malaysia	9,232	590	3,455	14	Sweden	882	-72	778
15	Indonesia	8,868	1,341	864	15	Italy	588	7	56
16	Germany	8,818	304	1,312	16	Australia	577	-125	41
17	Canada	8,108	1,189	1,028	17	South Korea	503	32	126
18	Taiwan	7,525	914	571	18	Spain	232	48	47
19	Philippines	5,058	470	427	19	China	119	13	14
20	India	2,753	298	597	20	Russia	54	-	-

Note: Negative figures for the flow of investment indicate that the amount collected exceeded the amount invested in that year.

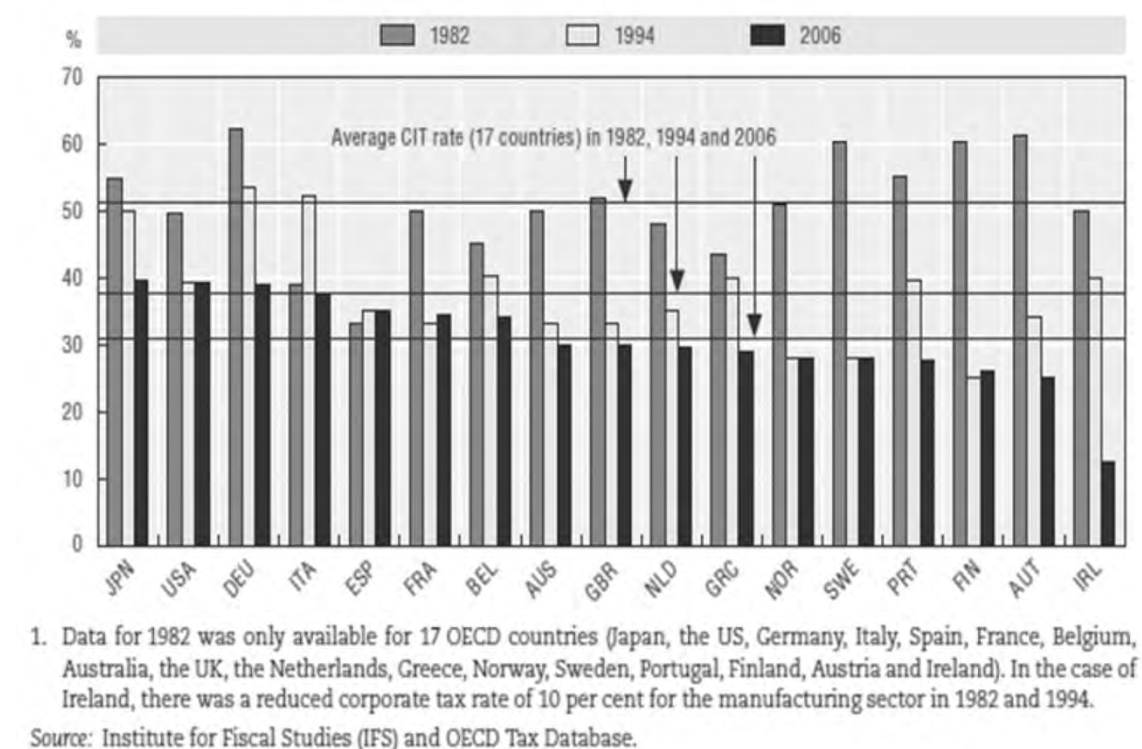
Source: Balance of payments statistics aggregated by the Bank of Japan.

To protect jobs in the face of international competition and to finance the necessary costs of an aging population despite a falling birthrate, Japan must not only prevent domestic companies from moving abroad but also attract greater foreign direct investment from other countries. This state of affairs is the chief reason and offers ample justification for lowering the corporate tax rate. Most arguments for a lower tax burden to date have focused on the impact it would have in encouraging capital investment and economic activity. The international competitiveness argument is more compelling; Germany, for instance, has been implementing corporate tax reform to enhance the competitiveness of operating in the country and to reclaim the tax revenue that had been flowing to the Netherlands and Ireland.

Essence of the Tax Reduction Race

The Organization for Economic Cooperation and Development has published the results of an interesting study on the correlation between tax competitiveness and tax revenues.

Figure 4. Statutory Corporate Income Tax Rate, 1982–2006



The closer integration of the European Union has engendered an extremely fierce race for lower corporate taxes among the member states over the past decade, with the tax rate declining by several points, as mentioned above. East European states lowered their

rates in an attempt to attract German and French businesses and expand employment. This incited a “race to the bottom,” as the West European states reacted with lower rates of their own to keep domestic companies at home and to attract foreign ones. Figure 4 shows how the rates have declined over this period.

The OECD study shows, though, that while the EU member states have been cutting their corporate tax rates, corporate tax revenue as a percentage of gross domestic product has actually been rising. This seemingly paradoxical relationship between corporate tax rates and tax revenues has elicited great surprise and interest among the member states.

Figure 5. Taxes on Corporate Income as a Percentage of GDP

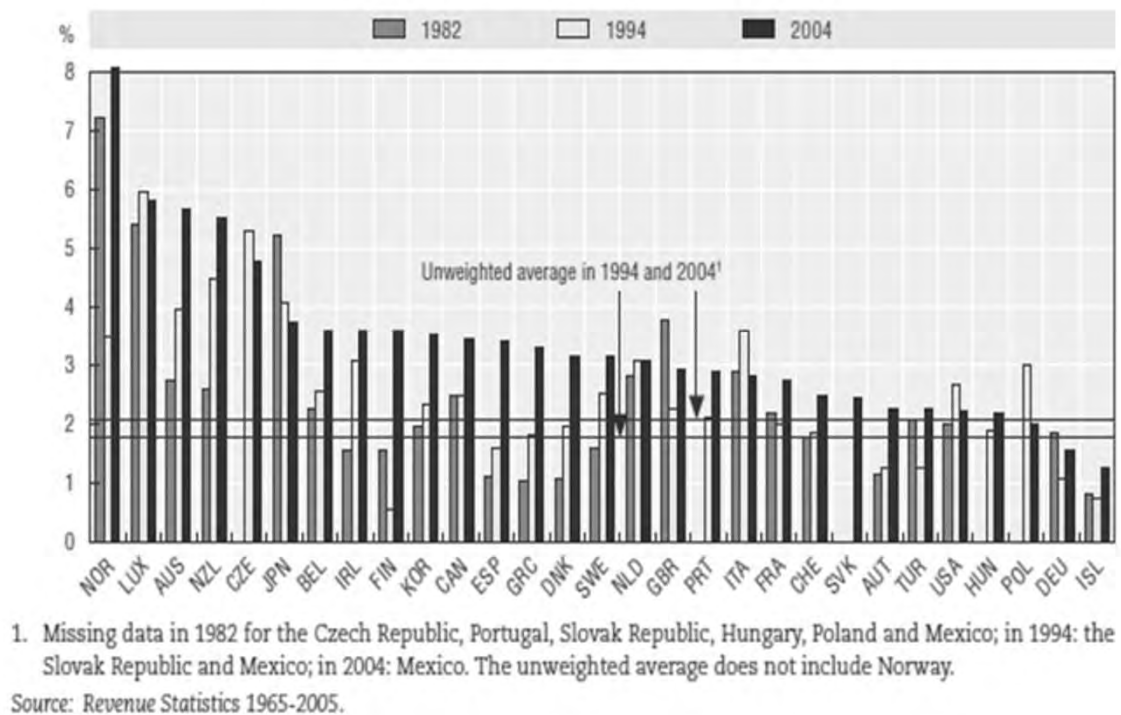
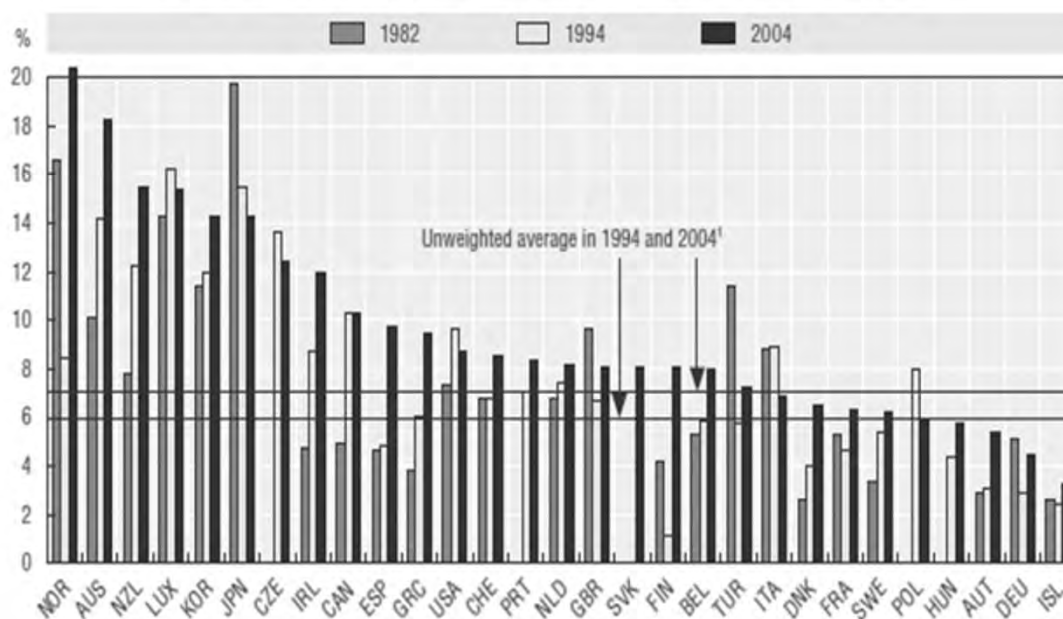


Figure 5 shows taxes on corporate income as a percentage of GDP. indicating that the percentage rose from 1994 to 2004. Corporate tax revenue as a share of total tax revenues (Figure 6) has also risen between 1994 and 2004.

Figure 6. Taxes on Corporate Income as a Percentage of Total Tax Revenue



1. Missing data in 1982 for the Czech Republic, Portugal, Slovak Republic, Hungary, Poland and Mexico; in 1994: the Slovak Republic and Mexico; in 2004: Mexico. The unweighted average does not include Norway. For Portugal: 2003 instead of 2004 information.

Source: Revenue Statistics 1965-2005.

Why have lower tax rates resulted in higher revenues? The OECD report and researchers in the EU point to the following factors. They have analyzed trends in all member states by identifying three components of the tax-revenue-to-GDP ratio.

The first component is what is called the effective tax rate, which has remained relatively steady in most countries. It is this component that has been most affected by the lowering of corporate tax rates and the accompanying expansion of the tax base.

The second component is the corporate share of all added value in the economy. This percentage has been rising gradually in many countries, which is believed to have been caused by a shift from the personal sector to the corporate sector owing to the lower tax rates of the latter.

$$\begin{array}{ccccccc}
 \text{Corporate} & & \text{Corporate} & & \text{Corporate} & & \text{Operating} \\
 \text{tax} & & \text{tax} & & \text{operating} & & \text{profit} \\
 \text{revenue} & & \text{revenue} & & \text{profit} & & \text{of entire} \\
 & & & & & & \text{economy} \\
 \hline
 \text{GDP} & = & \text{Corporate} & \times & \text{Operating} & \times & \text{GDP} \\
 & & \text{operating} & & \text{profit} & & \text{(third} \\
 & & \text{profit} & & \text{of entire} & & \text{component)} \\
 & & \text{(first} & & \text{economy} & & \\
 & & \text{component)} & & \text{(second} & & \\
 & & & & \text{component)} & &
 \end{array}$$

The third component is corporate profits as a share of GDP, which rose in many countries during the first decade of the millennium. This has been explained as a reflection of the many new companies that individuals established stirred by the spirit of entrepreneurship.

This analysis has produced two major conclusions. The first is that in many countries, corporate taxes were lowered together with an expansion of the tax base, such as through a reexamination of special tax measures and depreciation methods. This approach is typified by the taxation reforms carried out in Germany and Britain.

The second conclusion is that the tax-cutting race seen during the past decade resulted in an increase in business start-ups. The lower tax rates gave people incentive to start their own business, offering empirical proof of vitalized economic activity.

Steps to Follow

Debate on reforming the tax system is likely to begin in Japan as well. The links between corporate tax rates and business behavior is quite complex, though, with the statutory rate believed to affect the overseas transfer of profits and the effective rate influencing investment decisions. The Hatoyama administration has announced it is freezing the consumption tax rate for at least four years, so the prospects of a lower effective tax rate within the framework of reforms for the tax system as a whole remains rather opaque.

Given such murky prospects, it may be a good idea to first reform the corporate tax system and lower the tax rate, combined with an expansion of the tax base. Because such reforms would be tax neutral and result in lower rates, there should be little resistance from the general public. They may have the added benefit of encouraging entrepreneurship—invigorating economic activity and leading to higher tax revenues, as was seen in the EU—and of dampening corporate plans to shift operations to low-tax countries.

Ways of expanding the tax base include reexamining the special tax treatment now available in some cases; shifting the method of tax depreciation from one based on fixed rates to that on fixed sums; placing limits on deductions for interest payments, and abolishing preferential rates for stock transactions.

The next step would be to lower the effective corporate tax rate as part of comprehensive reforms that would also include the consumption tax. There would be a need to

cover any revenue shortfalls resulting from a lower effective corporate tax burden, so any adjustments would have to be considered in conjunction with discussions of a consumption tax hike.

The reluctance to reforming corporate taxes comes from the perceived individual-corporate dichotomy. It should be remembered, though, that businesses and individuals are on the same boat and in a state of mutual dependence. In their capacity as employees, creditors, and shareholders, individuals are provided with the added value generated by businesses in the form of wages, interest, dividends, and capital gains. Thus, corporate tax reform in Japan would not be aimed at helping Japanese business firms but at enhancing the competitiveness of basing corporate operations in Japan and of generating the necessary revenue to address the graying of the population. An early start to the tax reform debate would be most welcome.

May 20, 2010

The Long Road to Fiscal Stabilization

By Kobayashi, Keiichiro

Japan's fiscal 2010 budget is the largest ever, and there are growing concerns that long-term government bond prices could crash, sending long-term interest rates soaring. Are such fears about Japan's public finance warranted?

The chances of a fiscal collapse or a crash in the bond market are probably quite low over the next few years—and no doubt over the next decade as well unless there is a fundamental breakdown in Japan's industrial structure. But there will surely come a time four or five decades hence when instability in the bond market will impact quite negatively on the Japanese economy.

There are bond-related concerns over the short, medium, and long term. I will deal with each of them in turn.

As for the short term, the likelihood of a crash in the bond market is closely linked with trends in the foreign exchange rate. Should investors lose confidence in Japanese bonds, faith in the yen will also falter. As the yen grows progressively weaker, investors may opt out of yen-backed bonds in favor of more profitable foreign assets. Should such a situation continue, the bond market could very well nosedive.

Cyclical Mechanism

The yen, though, is unlikely to remain weak for long. A slight depreciation will make Japanese exports cheaper, leading to a bigger trade surplus. This will cause the yen to appreciate and subsequently make yen-denominated assets more attractive again. In-

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vestors will be more inclined to purchase Japanese government bonds (JGBs), pushing up their prices. It is thanks to such a cyclical mechanism that the JGB market should remain stable for at least the next several years.

This assumes that Japan's export industry will remain competitive. Should it begin to totter in the future, prompting both domestic and foreign investors to project perennial trade deficits for the country, the market will come to assume that the yen will depreciate and stay weak. This will make foreign assets more attractive than yen-denominated ones, and investors will begin dumping JGBs. This will cause bond prices to tumble and significantly diminish the value of the yen.

This assumes, of course, a structural weakening of Japan's export industry, as indicated, for instance, by several consecutive years of negative economic growth. Such a turn of events could trigger a collapse of the bond market.

It is inconceivable that the economy would become that feeble, though. Even if growth slows down, there would surely be at least some growth, so a financial collapse and a bond market crash are probably not very likely.

This is not to say, however, that there is no need for concern. Even if the economy continues to grow, the bond market would remain precarious. The government is so heavily in debt today that raising taxes would do little to reduce such debts right away, as interest payments would continue to snowball. Achieving fiscal stability will take around two to three generations.

A condition where expenditures equal revenues is called primary balance. An estimate made a few years ago by Keio University Professor Takero Doi at the Research Institute of Economy, Trade, and Industry shows that even if fiscal discipline was implemented so that revenues exceeded spending by a significant margin for over 40 years, it would still take about 100 years for government bonds to stabilize.

This is because the primary balance does not include expenditures for the amortization of bonds. Even after the achievement of primary balance, therefore, huge interest payments would still have to be made, so revenue shortfalls would continue, and government debt would keep accumulating for several more decades. Even if the government cuts back its programs and starts living within its means, it already has so much accumulated debt that it will keep running up deficits.

In this scenario, the government's net liabilities—calculated by subtracting total assets from outstanding debt—will continue to grow through the first half of this century, ballooning to three times the country's gross domestic product around 2060 before beginning to contract. It will be about 2100 when total government debt will finally diminish to an equivalent of the country's GDP.

Burdening Future Generations

The total financial assets held by Japanese people in bank deposits and other instruments are only around three times GDP. This means that should the government's net liabilities exceed this level, then it will become impossible for the Japanese people alone to finance the debt; foreign investors will inevitably come to make up a substantial share of JGB holders.

One reason that Japan's stock market is so sensitive to trends in US stock exchanges today is because foreign investors account for a big share of the transactions on Japanese bourses. Should foreign ownership of Japanese government bonds rise, trends in the bond market will likewise come to rely heavily on the decisions of foreign investors.

What this suggests is that a minor rumor could have a major impact on market psychology, and the dumping of government bonds would become commonplace. Bond values would fluctuate wildly, resulting in the destabilization of both long-term interest rates and inflation and impacting negatively on both the corporate and household sectors. It may even lead to a vicious circle that could enfeeble the Japanese economy. Such economic and fiscal precariousness would expose the next generation of Japanese—and the one after that—to the kind of economic crises that afflicted Argentina and is now threatening Greece.

It is important to take heed of our responsibilities toward future generations and chart a long-term course toward fiscal rehabilitation.

February 5, 2010

The Challenges Facing the New DPJ Government

By Kato, Hideki

The Tokyo Foundation hosted a public seminar entitled “The Challenges Facing the New DPJ Government” in Washington, DC, in mid-January in conjunction with the 16th Annual Japan-US Security Seminar, held to commemorate the fiftieth anniversary of the Japan-US alliance. The event attracted great interest, being attended by over 170 government officials, other experts, and media personnel. The annual security seminar was sponsored by the Embassy of Japan, the Japan Institute of International Affairs (JIIA) and Pacific Forum CSIS. The following is the text of the keynote speech delivered by Tokyo Foundation Chairman (now President) Hideki Kato.

Good morning, and thank you for attending the Tokyo Foundation Seminar. It is a great honor for me to be given the opportunity to speak to you today about the current political situation in Japan.

My address is motivated by the fact that the Japanese system of governance is not well understood by those outside Japan.

Today, I would like to focus on two things. The first is governance and the political system in Japan. And the second is the Hatoyama administration: what it’s trying to do, what is happening at the moment, and future prospects.

Governance and the Political System in Japan

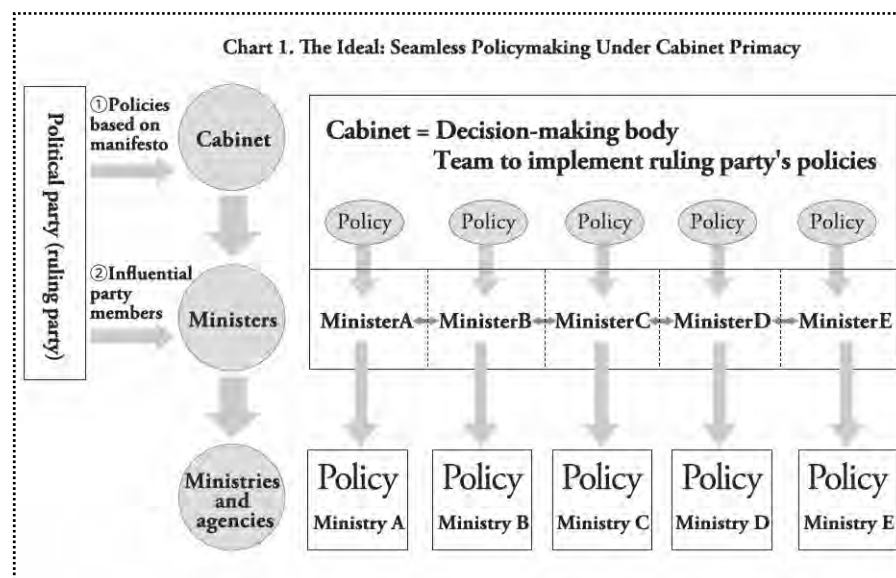
A parliamentary cabinet system is generally understood to consist of a process whereby political parties publish manifestos—or policy platforms—the party or coalition of par-

Kato, Hideki President of the Tokyo Foundation. Joined the Ministry of Finance in 1973. Served in several positions, including in the Securities Bureau, the Tax Bureau, the International Finance Bureau, and the Institute of Fiscal and Monetary Policy; resigned in September 1996. Founded Japan Initiative, a not-for-profit, independent think tank, in April 1997, serving as its president since then. Served as professor of policy management at Keio University, 1997-2008. Assumed the chairmanship of the Tokyo Foundation in April 2006. In October 2009 became secretary general of Japan’s Council on Administrative Reform within the Cabinet Office, and in April 2010 became president of the Tokyo Foundation when it became a public interest incorporated foundation.

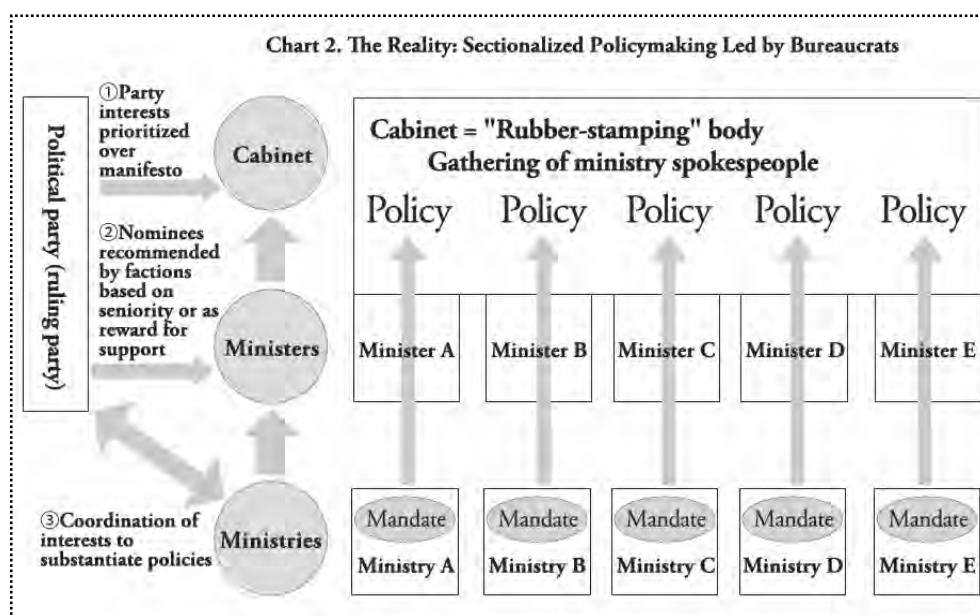
ties that wins an election and has a majority in the parliament assembles a cabinet, and ministers appointed to take charge of the policies advocated in the ruling party's manifesto implement those policies, using bureaucrats as staff. This is the true meaning of "political leadership." But in Japan, both parties and voters have tended to pay little heed to manifestos, even though they are essential to the first step of the process, and little effort has been put into producing them. The subsequent steps in the process of "political leadership" have not been established.

The factors behind this situation include the multimember constituency system that Japan employed until the 1990s and the fact that for many years the public did not need to make major political choices. At the root, however, are problems arising from the manner in which the parliamentary cabinet system has been employed in Japan.

As shown in Chart 1, in an ideal parliamentary cabinet system, the ruling party formulates policies based on its manifesto, and a cabinet comprising influential members of the ruling party is formed to implement those policies. Based on cabinet discussions of basic principles for managing state affairs, cabinet ministers implement the policies utilizing the bureaucrats in their respective ministries. As the cabinet considers policies from the perspective of the overall management of state affairs, this mechanism holds the interests of individual ministries in check and enables bureaucratic sectionalism and regulatory redundancy to be eliminated.



The reality of the system as it has been practiced so far in Japan, however, greatly differs from the ideal, as shown in Chart 2. In this setup, the ministries come first, and bureaucrats take charge of everything from policy formulation to implementation in areas that are within the mandates of their respective ministries. Ministers are effectively figure-heads who simply “sit” on top of that structure, as shown by the fact that, at their inaugural press conferences, the vast majority of ministers read out texts prepared by bureaucrats. Most ministers, moreover, have taken to promoting the existing policies of their ministries and speaking for the ministries’ interests and positions as soon as they are appointed, no matter what views they may have espoused earlier. As a result, the ministerial coordination and cabinet leadership expected in a true parliamentary cabinet system take a backseat. The priority given to precedent and bureaucratic sectionalism makes it difficult for the government to effect drastic policy shifts or to respond swiftly to changing social conditions.



Under the new administration led by the Democratic Party of Japan, the so-called council of three political-level appointees comprising the minister, senior vice-minister, and parliamentary secretary has been established within each ministry. This is intended to enable politicians to take the lead in determining government policy, rather than bureaucrats. Newly appointed cabinet ministers of previous Liberal Democratic Party administrations were first given a briefing by the bureaucrats. Soon after the senior vice-ministers and parliamentary secretaries were appointed by Prime Minister Yukio Hatoyama, by contrast, meetings of the political-level council were held—on the very

day of the appointment at the Ministry of Education, Culture, Sports, Science, and Technology; the following day at the Ministry of Health, Labor, and Welfare; and within several days at the Ministry of Finance and the Ministry of Land, Infrastructure, Transport, and Tourism. As a rule, the new administration also banned press conferences by

administrative vice-ministers—the highest-ranking bureaucrats—so as to revamp the decision-making mechanism that had hitherto been led by the bureaucracy.

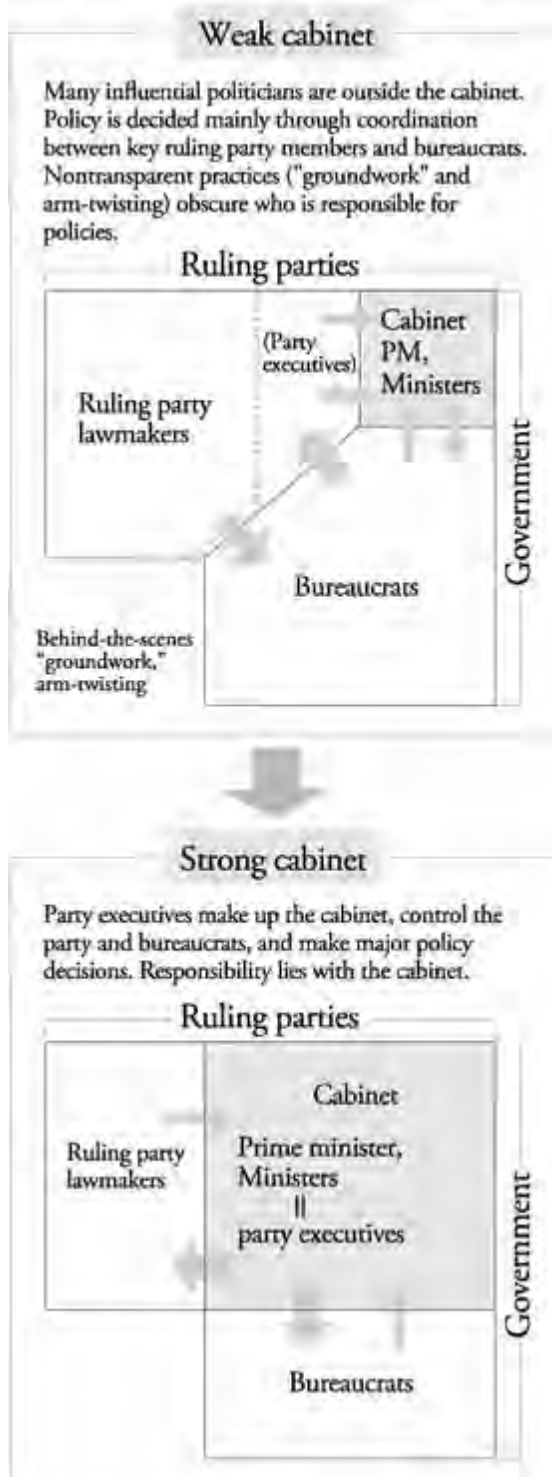
Dual Power Structure

Another factor that weakens the power of the cabinet and prevents the parliamentary cabinet system from functioning properly in Japan is the dual power structure consisting of the ruling party and cabinet.

In an ideal parliamentary cabinet system, the cabinet is a team that executes the policies of the ruling party, like the “strong cabinet” in Chart 3. Power within the ruling party is concentrated in the cabinet because those who become ministers are the party’s prime movers, and ruling party lawmakers who are not in the cabinet ordinarily do not defy the cabinet’s policy decisions, much less revoke them.

Under the LDP administrations of the past few decades, however, it became the norm for ruling party members outside the cabinet to wield more power than the cabinet, as shown by the “weak cabinet” in the Chart. As a result, many policy decisions were effectively made through repeated contact, behind-the-scenes “groundwork,” negotiations, and arm-twisting between

Chart 3. Power Structure Between Ruling Party and Cabinet



top ruling party politicians—including “tribal” lawmakers with close ties to specific lobbies—and bureaucrats, in total disregard of the cabinet. This deviates greatly from the principles of the parliamentary cabinet system and obscures who is responsible for making government policy.

The decision-making process within the dual power structure, which has become almost institutionalized over the decades, can be summarized as follows. In the case of the LDP, the party has its own policy coordination section called the Policy Research Council, which checks the bills and other policy proposals put forward by the cabinet. Government bills cleared by the Policy Research Council are then approved by the party’s General Council before being submitted to the Diet. This is called “prior screening” by the ruling party, a practice that is virtually unheard of in other major countries. It is not unusual for government bills to be drastically modified or even rejected in this process. The rejection by politicians outside the cabinet of policy proposals that representatives of the same party drafted in order to implement the party’s manifesto, in effect, amounts to a rejection of the parliamentary cabinet system itself. At the same time, in the sense that it reinforced the impression that any proposal approved by the ruling party would be approved by the Diet, it was also one of the factors that reduced the Diet to a rubberstamping role.

While all political parties have a broadly similar structure, in the LDP’s case the chairman of the General Council, the chairman of the Policy Research Council, and the secretary-general constitute a troika of top party officials who wield tremendous power over party affairs. Under LDP administrations, this troika had more power and a louder voice in many respects than the cabinet ministers, who were the policy chiefs of the government. The three executives controlled policy decisions despite having no legal rights or responsibilities regarding government policymaking. As a result, when a government policy proposal conflicted with the ruling party’s position, instead of the minister rallying the party around the proposal by the government or a government committee, the party’s wishes were often given precedence.

In this regard, the DPJ has brought about many changes. However, the party’s secretary general, Ichiro Ozawa, is still in a position to control political funding and the selection of candidates. Although Ozawa is outside the cabinet, he is still at the center of power. Having control over funding and candidates essentially means being able to control policies.

This results in a weak cabinet, enabling politicians to become a minister even if incom-

petent. They are not able to grow and develop even after become minister, leading to an increasing number of hereditary politicians. A certain member of Parliament of the UK came to Japan and he said, jokingly, that the House of Representatives in Japan is more like the House of Lords.

The weak cabinet, bureaucracy-led politics, sectionalism, and non-transparent decision making are all deviations from the ideal parliamentary cabinet system.

These are not fundamental, institutional issues, so improvements can be made without overhauling existing political institutions. There is, rather, a need to deal with conflicting interests within political parties. The LDP did not have the capacity to do that. Whether or not the DPJ can do so is something that will be tested going forward.

In a nutshell, this is an issue of party governance. The DPJ is aware of this and has done several things. One, Ozawa has said that he will focus his energies on the management of party affairs as secretary general, not involving himself in policy matters. Another change has been the creation of the “political-level council” comprising the minister, senior vice-minister, and parliamentary secretary to make policy decisions.

Challenges for Hatoyama

Now I would like to refer to what is actually happening now and the future prospects for the Hatoyama cabinet.

Firstly, with regard to reforming the system of political governance, this is something that the DPJ called for in its manifesto and is very important. The issue here is the expectations of the general public and the challenges that are involved.

Reference was made earlier to the mood of the Japanese public. The DPJ’s landslide victory in last year’s general election and the high support rate that Hatoyama continues to enjoy is not necessarily due to the DPJ’s policies but due to the expectations for change.

The Japanese people do not feel an imminent threat right now—security or otherwise. Rather, the public is frustrated by rigidity in society. I believe people are looking for change.

There are many factors behind this mood. Since the administration of Junichiro Koizumi, there has been a widening of income disparities and increases in the burden of an aging society.

I think that one major factor is the media factor.

The Japanese are not very active when it comes to participating in public debate and have low awareness of the need to participate. At the same time, there is pent up dissatisfaction in society. This is the result of media reports critical of the way government and politics are run. While not actively participating themselves, dissatisfaction has built up among the Japanese people over their political leaders.

Each morning, at eight, nine, and ten o'clock, Japanese television viewers tune into what are called "wide shows," which are essentially gossip shows dealing with celebrity scandals, sports, and to some extent, political news. These shows have stirred up considerable discontent.

Review of Governmental Programs

So, in that sense, the Japanese are looking for change. And the DPJ's answer to this public mood has been the creation of the Governmental Revitalization Unit within the Cabinet Office.

The Government Revitalization Unit was established in order to reform the overall national administration, including the budget and system of national administration, from the people's standpoint, and also to review the division of roles among the national government, local public authorities, and private companies.

Their first task was to reassess the budget requests for fiscal 2010. It held budget-screening hearings called *jigyo shiwake* to assess the need for around 450 publicly funded programs, out of the total of some 3,000 for which the ministries and agencies of the central bureaucracy had filed funding requests for fiscal 2010.

Jigyo shiwake is something that we proposed at Japan Initiative, a private think tank I founded in 1997 and still serve as president. We conceived of this idea seven years ago and have been working to have it implemented. We began a campaign of public budget-screening hearings at the municipal level and then moved forward to the national level. We conducted the first hearings for the national budget with the then ruling LDP in August 2008 and also with the DPJ in June 2009 when the party was still in the opposition.

The original intent of this review was not to achieve spending cuts per se but to ring

about changes in public administration, whether at the prefectural, municipal, or national level, and also to achieve structural changes to the system itself.

The DPJ promised many new programs in its manifesto, including a child allowance, and it needed to find revenue sources to finance them. Hatoyama became prime minister in September, and the fiscal 2010 budget needed to be put together very quickly. There was not much time. That is why the administration decided to prioritize budget cuts before embarking on the task of making institutional reforms.

The spending review process in full public view was held over nine working days from November 11 to 27, with three working groups handling the assessments.

One feature of the process was that people outside of government would be tapped as reviewers. Things would be seen from the eyes of an outsider. In this regard, the budget assessors (*shiwakenin*) included private-sector analysts, in addition to DPJ Diet members and the senior vice-ministers and parliamentary secretaries of each ministry.

The review took place in a school gymnasium, where the senior bureaucrats from each ministry were seated on one side, and the assessors seated on the other. The assessors asked questions, and the officials responded to those questions.

Another feature was that the process was completely open to the public. All the proceedings were broadcast live via the Internet. This process generated great public interest. Nearly 20,000 people came to watch these proceedings in person, and an additional 340,000 people viewed them online each day in real time.

Before this process began, I warned Prime Minister Hatoyama that once it starts, it will be like a sporting event where the results would be reported daily on television and the newspapers, much like a baseball game or sumo match. And this is exactly what happened.

It is a bit populist in its approach, but I believe that the discussions that took place were at a very high level. Nevertheless, we have only just exposed the issues that need to be tackled going forward.

Around 90 percent of the conclusions of the review process were reflected in the budget for fiscal 2010. Future tasks include reviewing those government programs that were not

evaluated this time and deepening the scope of debate to the systems underlying each program.

According to a joint opinion poll conducted by the *Sankei Shimbun*, a conservative daily, and the Fuji News Network, a nationwide TV station, the Hatoyama cabinet's approval rating was 68.7 percent right after the inauguration, then dropped to 60.9 percent in October. Unlike his three LDP predecessors, whose approval rating continued to drop, however, Hatoyama's approval rebounded slightly to 62.5 percent in November. During the review of government programs, it came close to 90 percent at one point. It no doubt helped to boost Hatoyama's popularity.

There have been some media polls indicating that the approval rating for the Hatoyama cabinet has dipped below 50 percent. The lowest so far as been 48 percent in the survey conducted by the *Asahi Shimbun*. The aforementioned *Sankei Shimbun*, incidentally, reported a support rate of 51.0 percent.

One factor behind the decline has no doubt been the money scandals that have surfaced involving both Hatoyama and DPJ Secretary General Ichiro Ozawa. The administration is only three months old, however, and it still remains to be seen whether it can leverage the momentum gained during the budgetary review process to advance the political reforms that the public is seeking. The administration's ability to make good on its promises is being put to the test.

I would like to conclude my talk at this point with the observation that the success of the Hatoyama administration will probably hinge not just on the personal competence of Mr. Hatoyama but on the effectiveness with which each member of his cabinet and the Prime Minister's Office fulfill their functions.

January 8, 2010

Program Review: The First Step to Budgetary Reform

By Tanaka, Hideaki

As part of the fiscal 2010 budget process, the Government Revitalization Unit, which was established under the Cabinet Office by the new Japanese government, implemented a program review to eliminate wasteful spending in ministries and agencies. The GRU asked private experts and ruling party politicians, rather than budget examiners in the Ministry of Finance, to examine about 450 public programs.

(See the end note for more information on the program review.)

They assessed the efficiency and effectiveness of various programs through intensive discussion with officials from relevant ministries. This was open to the public and broadcasted live via the Internet. The process of program review drew great public interest. Based on this experience, we must explore ways to further improve budgetary procedures.

For the first time, a program review was carried out at the national level as part of the compilation of the government's budget for fiscal 2010. This was a process to examine public spending done not by budget examiners but by private experts and politicians. What is most interesting is that the public could see the discussion between experts and officials from ministries and the final decisions by experts. Citizens were surprised to find that large amounts of tax revenue are being spent for programs whose performance is not clear. On the other hand, government ministries and agencies reportedly felt they were not afforded sufficient time to adequately explain their programs, and some even expressed anger at having programs unilaterally rejected. Some people have claimed the discussions were one-sided and disorderly. This was a first-time experiment implemented within a limited timeframe, and the review itself can undoubtedly be improved in some ways.

As one example of the findings of the program review, a certain foundation authorized

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by a relevant ministry has an approximately ¥1 billion budget, mostly from government funds. Until now, the public was not aware that the half of the total budget goes toward personnel expenses and other overhead costs. That foundation hired ex-officials who had previously worked in the relevant ministry; thus, it can be said that most of the public money put into the foundation was spent to maintain their daily living. This was brought to light as a result of the change of government.

The program review has generated a great deal of commentary and criticism. People are wondering about the authority of private experts and politicians who do not have a position in the government to examine public programs. Why can they cut or propose to cut public spending without delegation? Most of these objections, however, are based on misunderstandings. What matters most is not just cutting spending but realizing the problems of the budgeting system in Japan.

Information Asymmetry in Budget Negotiation

The first thing that struck me about the program review was the question of why there are so many wasteful programs—despite that fact that the Ministry of Finance assesses the annual budget, the Ministry of Internal Affairs and Communications evaluates programs, the Board of Audit and the National Diet's Committee on Audit conduct ex-post evaluations, and many other bodies review budgets—and why so much tax revenue is spent so inefficiently. The private experts, who are mostly businesspeople or academics, do not have experience in reviewing spending and programs, but they can do it. How did the Finance Ministry and all the other government bodies involved in budgeting overlook so much questionable use of budgetary resources? It is indeed of great value to implement the assessment of programs in an open manner. In previous years political intervention in the budget process was common practice, and the annual budget process was not transparent. That is why so-called pork-barrel politics are prevailing in Japan. It is of course difficult to assess the outcomes of government-backed programs correctly, and thus it is political values that in the end decide the choice of programs. Nevertheless, the government should explain the efficiency and effectiveness of programs to the public.

Why are there so many wasteful programs? Generally speaking, guardians, who are budget examiners in the Finance Ministry, fail to cut spending in the process of budget negotiations with spenders. This is because spenders monopolize the information on programs needed to assess the funding, so the availability of information is asymmetrical. Normally, spenders do not tell the truth about the effectiveness of programs, simply

because to be honest means the loss of budgets and resources. Spenders need not consider raising tax revenues; thus, their behavior is just to maximize their budget. The relationship between guardians and spenders is ambiguous and give-and-take. Therefore, traditional budget examinations and negotiations cannot eliminate wasteful programs.

The second issue is the information necessary for evaluation and assessment and the lack of incentives. At the program review session, government ministries and agencies sought to convince reviewers by explaining the necessity of their programs and budgets, based on program sheets explaining the purpose, background, and budget for each program. Their explanations, however, primarily consisted of reasons why the country must carry out the program—simply put, they were trying to create a pretext. Most of the ministry officials argued that their programs are necessary because they are necessary for the country or public. When there is a fiscal surplus, large numbers of programs can be carried out, provided they serve the people's needs. The issue is whether the nation should support such programs in the midst of severe fiscal conditions, as well as whether they are efficient and cost-effective. Reviewers told officials from ministries and agencies that they had studied programs in advance, and they did not simply arrive at their decisions of whether programs are to be maintained or not in one-hour meetings. The bureaucrats, however, generally failed to provide information on efficiency and cost-effectiveness.

Another criticism was that it is inappropriate to cut spending for education, research and development, and other such programs due to budget deficits—that the nation should invest public money for future generations. I do not disagree with that in general, but in a fiscal situation in which government debt is rising to 200% of gross domestic product, we have to consider carefully whether the cost of such programs should be passed on to future generations. Even if these programs are to be carried out, we must make every effort to achieve more efficiency. At all times, budgetary constraints determine the necessity of any given program, rather than the objective of programs. If the overall constraints are too tight, then the government should ask the public about the possibility of tax increases. It is often argued that public spending for education and health care service in terms of GDP is low in Japan compared to other developed countries. That is to be expected, since our taxes and contributions are among the lowest of any developed country.

In the private sector, cost effectiveness is critical for management. Why don't public services care about it? That is because those who obtain more resources are praised as

good officials, and their concern is the input of resources. Therefore little attention is paid to how those budgets are spent and what they achieve and produce. To put it extremely, virtually no information on cost effectiveness or the like exists. Ministries have had to evaluate their relevant policies or programs since the Public Policy Evaluations Act was enacted in Japan in 2001, but in reality this results only in printing documents as thick as telephone books. The Act does not work as expected. There also exists the problem of incentive compatibility. If programs' performance was assessed as "not good," it might result in cutting budgets, so there is little incentive for government officials to provide accurate information for assessment. The management idea of getting feedback on results and using it to make improvements does not exist among government employees. It is no use to simply put more resources into a program, unless they are spent efficiently and effectively.

Political Leadership Must Be Here

What is needed most is political leadership. Legislators from the ruling party including parliamentary secretaries took part in the program review, but where were the relevant ministers themselves? They were instructed by the prime minister to act as "internal finance ministers" before their budget requests for the next year, but in actuality there was little evidence that they assessed their budget requests seriously, and it can be said that they just authorized budget figures that bureaucrats made to maximize their available resources. By the middle of November a guideline for compiling the next budget had finally been worked out, but it seems too late to ask third-party experts to review programs and spending within such a short period of time. The cabinet members should share the sense of fiscal severity and prioritize programs in accordance with budgetary constraints. Before finding fault with the program review, should ministers and vice ministers take the initiative to assess their own budget requests?

Needless to say, the results of program review will not be automatically put into the next year's budget. It is the cabinet that makes a budget, and thus the question of political leadership will be urgent. Well before the approaching end of the year, ministries, bureaus, and interest groups involved in programs that were assessed to be abolished by the program review had already begun lobbying against any such abolition. Political negotiation and decisions are needed for reducing spending as well as increasing spending. If there were no budgetary constraints, anything would be possible. However, to implement various programs to which the DPJ committed itself in the election mani-

festos without spoiling fiscal discipline, it is critical to reallocate resources in a “pay-as-you-go” way.

The program review has provided many lessons to us. It was done under severe time constraints in its year, but by evaluating the process itself, we can make the most of the experience for the next year’s effort. A program review is primarily done by ministries and agencies themselves as their own business. Ministers, with the help of outside experts, must exert their leadership in deciding priorities and reallocating resources in order to ensure that policies can be achieved. A ministerial committee will make a decision on politically important issues. The role of budget authorities is to clearly define the budgetary limitations and set rules of the game in order to enable resources to be redirected to the areas of highest priority. Unless efforts are made to stop the game of maximizing budget resources, streamline the budget process itself, and assess results and performances, wasteful budgets will not be eliminated. It is urgent to ensure efficient and effective implementation of budgets, including public procurement. For that purpose, it will be necessary to foster government employees with expertise in contracts and competitive tendering.

In conclusion, we have to proceed in reforming the budget system based on the first year’s program review. Without this reform, the vicious cycle will continue and wasteful programs will go on being reproduced. Since the 1980s, other developed nations have reformed their respective budget systems in a variety of ways in an effort to ensure fiscal discipline, but Japan has been left behind. International comparative research verifies the relationship between budget deficits and budget institutions or the budget process. Japan’s fiscal deficit, said to be the worst among all developed countries, is rooted in her budget institutions, such as lower transparency. Canada, which had struggled with deficits since the 1980s, underwent a change of government in 1993. The new administration reformed the national budget system, primarily through the introduction of a program review, and succeeded in fiscal consolidation. Government expenditures were drastically reduced, with some ministries and agencies cutting spending by as much as 20% or 30%.

Finally, I would like to present some proposals for more effective utilization of the program review. The process should be carried out before summer, which means “start before the preparation of the budget begins” so that we analyze and discuss various programs for structural reform, rather than just cutting spending. Subsequently, strict expenditure ceilings over several years should be placed on government ministries and agencies, and these bodies should tailor their budget requests based on government

policies, using various reviews and assessments including a program review by external experts, an evaluation by the Board of Audit, and information from their own evaluations. The results of program reviews represent one type of value assessment, and others may be possible, but it should be noted that the reviews should be done by those who are knowledgeable about how programs are going on the “front lines.” If ministries and agencies do not follow the limitation guidelines, they must provide sufficiently persuasive rationales to convince experts, and offset spending with other cuts in order to maintain expenditure ceilings. When new programs are proposed, resources must be reallocated within the relevant ministry or agency budget. Provided they abide by expenditure ceilings (or baselines), ministries and agencies should be given some discretion to reallocate resources. Expenditure ceilings over several years will also mean a guarantee that ministries and agencies will be provided with resources as long as certain conditions are met. This is because conflicts between spenders and guardians on budget formulation will be eased and ministries will be able to pay attention to increasing program efficiency rather than maximizing their budget. Most importantly, ministers will perform the function of deciding budget priorities.

It will also be necessary to streamline various programs that are already included in budgets. When the same program is carried over from the year before with the same level of funding, little effort is made to improve its efficiency, and this is all the more true in light of the current deflationary economy. Efforts must be made to get ministries and agencies to produce consistent—or even better—results with less funding. But Japan’s problems will not be resolved by cutting spending alone. Despite the severe fiscal conditions, economic growth must be achieved and measures must be taken for the next generations.

Background Information

How the program review (jigyo shiwake) was carried out

The public hearings to review various programs on the budgeting process were carried out by the Government Revitalization Unit, a new body formed under the Yukio Hatoyama cabinet that took power in September 2009. The GRU was established in order to reform the overall national administration, including the budget and system of national administration, from the people’s standpoint, and also to review the division of roles among the national government, local public authorities, and private companies. The GRU’s first task was to examine budget requests from the perspective of their ne-

cessity and efficiency. It held budget-screening hearings to assess the need for around 450 publicly funded projects, out of the total of some 3,000 for which the ministries and agencies of the central bureaucracy had filed funding requests for fiscal 2010.

The program review process took part over nine working days from November 11 to 27, 2009, with three working groups handling the assessments and hearings. All the proceedings were open to the public and broadcasted live via the Internet. This process captivated the public interest: nearly 20,000 people came to watch these proceedings in person over the nine days they took place, and an additional 340,000 people viewed them online each day in real time.

The budget assessors (*shiwakenin*) included the DPJ's Diet members, private-sector analysts and thinkers, and senior vice ministers and parliamentary secretaries for each ministry. They examined various programs by such criteria as necessity, urgency, and efficiency and announced their judgments based on working-group discussions.

The process of the program review of one item goes as follows:

- Officials from relevant ministries and agencies describe their program in 5–7 minutes
- Ministry of Finance Budget Bureau officials suggest issues and problems that appeared in the previous budget process in 3–5 minutes
- The DPJ's Diet member heading the session defines an agenda and summarizes major issues to be discussed in around 2 minutes
- Debate takes place, with Q&A between assessors and ministry or agency officials, for around 40 minutes
- The DPJ's Diet member heading the session concludes discussions and presents the final assessment in 2 minutes

Japan Initiative, a private think tank founded in 1997 by Hideki Kato (currently chairman of the Tokyo Foundation), has been recommending a program review in order to reform Japan's administrative and fiscal systems. Hideki Kato, who still serves as Japan Initiative's president, was tapped as a member of the GRU; he is now secretary-general of this new government body.

January 21, 2009

From Cash Handouts to Refundable Tax Credits

By Morinobu, Shigeki

Prime Minister Taro Aso has announced the distribution of around ¥2 trillion in cash benefits to all Japanese citizens. The purpose of these handouts remains unclear, though, and the argument is tangled over whether to set income limits for eligibility for them. Many decry the move as mere political largesse. How can this measure be made more effective in meeting the real needs of the people?

Refundable Tax Credits: The Better Choice

A number of developed Western nations have had great success with the introduction of a system of refundable tax credits aimed at providing economic support to lower- and middle-income taxpayers. Let me explain this system simply in terms of the proposed ¥2 trillion outlay for Japan's cash handouts. Divided equally among the roughly 10 million dependents aged 15 or younger in households with less than ¥6 million in annual income, this would come out to ¥200,000 per head, to be distributed to the households where those dependents live. A family with two eligible children would receive a credit of ¥400,000. If that family's tax bill for the year was higher than this amount, it would be deducted from the taxes due; if the tax bill was lower, or if the family's income was below the taxation threshold, the family would receive the difference, which makes the credits "refundable." This is an effective, efficient approach that combines the taxation and social security systems to achieve the same income-redistribution goals that they do, and it is in broad use in the other developed nations of the world.

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The refundable tax credit systems in place in Western nations can be placed in four categories according to their policy aims.

The first of these is earned income tax credit (EITC) systems. These credits are granted in defined amounts to lower- to middle-income households where the taxpayers have worked at least a minimum number of hours. This system aims to prevent the moral hazard of the situation where it makes more economic sense to rely entirely on welfare benefits and to keep people from falling into the poverty trap. It is meant to encourage people's efforts to improve their job skills and live more self-reliant lives, and as such it is often implemented in concert with jobs training and education programs.

The second category is child tax credit (CTC) systems. These provide credits to households with children, with the amount increasing along with the number of minors. This approach helps to prevent poverty among single-parent households and to provide child-rearing support; in these ways it serves as a measure to counter dwindling birth-rates as well.

Systems in the above two categories saw expanded use in Britain under Prime Minister Tony Blair and in the United States under President Bill Clinton. Based on the concept of "workfare," which helps people attain self-sufficiency through work, they are today fundamental parts of the UK and US taxation systems.

The third category is tax credits to offset social insurance costs. Here the aim is to reduce the burden on those in lower income brackets of taxation and social contributions. The Netherlands and South Korea have introduced systems along these lines, although the Dutch system merely offsets the contributions required of lower-income taxpayers and involves no rebates to them.

In the fourth category are tax credits to offset consumption tax liabilities. Such systems are in place in Canada and Singapore to reduce the regressive impact of consumption tax hikes on people in lower income brackets. They involve deductions and refunds of liabilities for consumption tax on basic necessities from the income tax amount. This approach is far more effective than straightforward tax rate reductions in countering the regressive nature of taxation.

Approaches in these categories have recently come to be viewed as potentially beneficial for Japan as well. The government's Tax Commission clearly stated in its recommendation report on tax reform for fiscal 2008 that exploring these options would be a mea-

ningful task for Japan, as many nations were making use of these systems to provide “assistance to low-income people, particularly among the younger generations, childrearing assistance, employment assistance, and an approach to offset the regressivity of consumption tax. Some countries take the tax and social security regimes as a whole and use refundable tax credits to lessen the social insurance premium burden.”

Two Issues to Tackle

There are a number of challenges to overcome if a refundable tax credit system is to be introduced in Japan. Below I examine two of the major challenges in detail.

The first of these is the need to create a framework for managing the system. In all the nations that offer refundable tax credits, a single taxation authority handles both the tax reductions and the provision of benefits. People who fall below the minimum income threshold apply directly to the tax authority for inclusion in the system and receive their benefits from that same authority after an examination of their situation. For salaried workers, it would be quite possible to follow the example of Britain when it first introduced its system and have their employers handle the necessary calculations in the year-end adjustment of payment records for taxation purposes.

The problem with this approach is that to include the self-employed in the system, the state must get an accurate picture of their income levels. The Japanese expression *ku-royon*, or “nine-six-four” taxation, expresses the difficulty faced here: the authorities are said to be able to monitor some nine-tenths of salaried workers’ income, but just six-tenths of that of the self-employed and four-tenths of what farmers make. This leads to varying accuracy in assessing the incomes of those who make salaries and others, giving rise to unfairness in the system. Another problem is that calculating income on a household basis will require considerable extra work to square the current individual tax filing system. Overcoming these issues may require the introduction of a system of taxpayer identification numbers.

A November 2008 report issued by the National Commission on Social Security called for consideration of the introduction of a system of social security numbers. Giving each citizen a number for life would allow the centralized management of personal information connected with social security schemes, thus clarifying the balance between pension, medical care, and nursing care benefits and obligations. Ever since the governmental Council on Economic and Fiscal Policy recommended such a system in its 2006 Basic Policies for Economic and Fiscal Management and Structural Reform, deli-

berations have moved forward with the goal of implementing social security numbers in fiscal 2011 (April 2011-March 2012). Japan could use these numbers for taxpayer identification as well, framing them not merely as a tool to facilitate tax collection but also as a means of identifying taxpayers so that they can receive benefits under the refundable tax credit system.

The second issue that must be faced is the need to fundamentally rearrange and unify the disparate systems now in place for social security and taxation in Japan, creating a new framework to bring these tasks all together. We will need to reexamine from the ground up a whole raft of the country's present systems-including child benefits and childcare allowances, welfare and other benefit systems, basic income reductions, for spouses and the like, and minimum-wage regulations-as we design this framework.

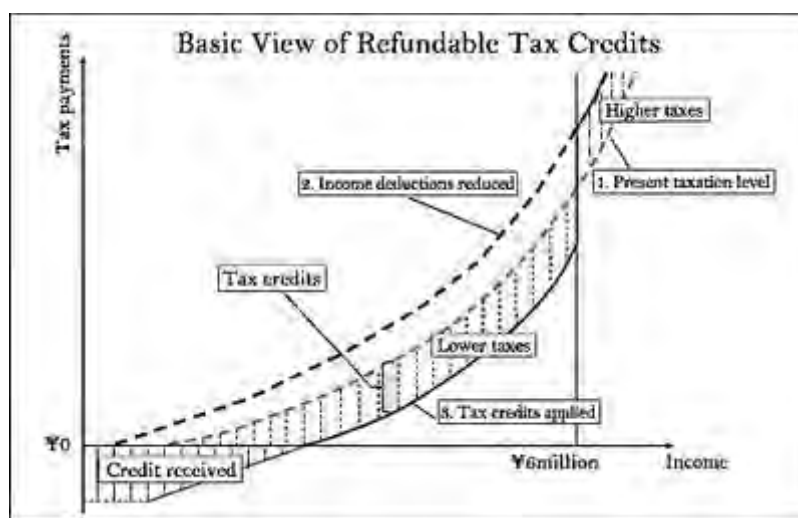
At its November 12, 2008, meeting, the pensions subcommittee of the Social Security Council listed eight areas of focus for reform of Japan's pension systems. Topping the list was a recommendation for the creation of a system to lower insurance fees as a way to offer relief to people with low incomes or receiving scant pension benefits. The approach of using public funds to help people in low-paying jobs meet the required level of pension payments is one that matches the Dutch and Korean systems of refundable tax credits to offset social insurance costs outlined above. In the Dutch version, the high insurance (payroll tax) payments made by low-income individuals are deducted from their income taxes, thereby reducing their overall burden. The system is designed so that the amount deducted climbs along with their income, however: the more they work the more they can reduce this burden, thus providing them with an incentive to work harder. This approach is considerably less likely to produce a moral hazard than the straightforward insurance fee reduction system being considered by the Japanese government council, and is naturally a better choice from the perspective of making effective use of public funds.

Needed in Kasumigaseki: Creativity and Decisiveness

Strong political leadership will be a must in implementing policy on this scale. In the administrative system in place today in Japan, tasks are divided among multiple entities, with the Ministry of Finance in charge of taxation and the Ministry of Health, Labor, and Welfare in charge of social security matters. As things now stand it is nearly impossible to execute policy that goes beyond these narrow fiefdoms. The introduction of refundable tax credits, involving as it does the distribution of those credits by tax officials and the formation of a new consciousness viewing both taxes and social security contribu-

tions as the same sort of public obligation, may end up bringing about a reorganization in the nation's central bureaucracy in Tokyo's Kasumigaseki district, including such steps as the unification of the collecting authorities. There will be serious resistance to the introduction of such a system for this very reason. In short, bringing refundable tax credits to Japan is deeply tied to doing away with sectionalism in Kasumigaseki. Korea's Ministry of Strategy and Finance, which launched that nation's new system in January 2008, successfully overcame resistance from the offices in charge of social security, and the Office of the President showed leadership in designing and implementing the new program.

On December 24, 2008, the cabinet of Prime Minister Taro Aso approved a medium-term reform program for Japan's tax and fiscal system. This program will involve a reappraisal of various tax deductions and the tax rate structure with a view to restoring the individual income taxation system's original function of smoothing out disparities and redistributing income. It involves moves to increase the burden borne by high-income taxpayers, such as by adjusting the maximum tax rate and the upper limit to allowable deductions. At the same time, it will take a comprehensive approach to taxation and spending, including refundable tax credits and other aspects of the expenditures side, looking at ways to reduce the burden on middle- and lower-income households with attention paid to areas like child-rearing. The first step should be to secure needed revenues by paring back income deductions while converting them into tax credits, thereby increasing the system's income redistribution capacity. In the meantime we will also need to begin putting together concrete plans for a system tying together tax credits and refunds whose benefits will extend even to those whose income is below the minimum taxable level.



The attached chart in the above illustrates the idea nicely. In designing this system, the basic idea is to ensure that the overall system remains revenue-neutral. The present taxation scheme is represented by line 1; when income exemptions are reduced the effective taxation climbs to the level in line 2. This additional revenue is then used to provide refundable tax credits, amounts of which are determined by the number of children, for example, to households with total income below ¥6 million. This lowers the effective taxation on their income to the level in line 3. The result is that households below the ¥6 million income threshold pay lower taxes, while those with higher income pay more, thereby enhancing the income redistribution effect of the system.

If Prime Minister Aso were to position his proposed ¥2 trillion in cash handouts as the first step toward the creation of a system like this, they would be seen as more than mere political largesse. The decision of which form the system should take of the four categories described above—one aiming to reverse the falling birthrate, one to aid the working poor, one to make up for missed pension contributions from low-income individuals, or one to counter the regressive nature of consumption tax hikes—should be made on the basis of discussion among the people of Japan from now on.

Whatever the end result, what Japan needs today is strong political leadership that can overcome the divisions between the bureaucratic organs in Kasumigaseki. In this sense, the achievement of a new structure for Japan's income taxation will represent a touchstone for Japan as a state whose political leaders are firmly in charge.

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The following is a list of some articles to be found on the Tokyo Foundation website.

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