Voices
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Rethinking corporate governance in Japan

Shigeo Abe, editor in chief of the magazine, Sentaku, talks with SPF Chairman Setsuya Tabuchi

A tale of two banks

[illegible] I always read the interviews you do for your own magazine, *Sentaku*, but today it's your turn to be the interviewee; I'm looking forward to asking you about various topics.

I'm on very good terms with [former U.S. Federal Reserve Board Chairman] Paul Volcker. We get together for a meal every time he comes to Japan. When I had breakfast with him just the other day, he asked me, "Who's superior, Shinsei Bank President Masamoto Yashiro or Nissan Motor President Carlos Ghosn?" I replied, "Mr. Yashiro had the backup of Ripplewood Holdings, but Mr. Ghosn did it by himself, so I think he's the more capable of the two." What would you say?

Shigeo Abe: I agree with you completely. Recently I saw Gillian Tett, who was formerly the Tokyo bureau chief for the *Financial Times*, when she was in Japan for a visit. Over the past year and a half or so she has written a book tracing the process from the failure of the old Long-Term Credit Bank of Japan to its rebirth as Shinsei Bank. I helped out to a fair extent, but she also talked to Paul Volcker, who is serving as an advisor to Shinsei Bank. She has gathered very detailed information about the process from the nationalization of the LTCB through its sale to Ripplewood and about the involvement in Japan by Ripplewood and the elements of American society that are behind Ripplewood.

Americans know hardly anything about the LTCB's failure, because there's been practically nothing written about it in English. Virtually nobody in the United States understands the scope of the financial-sector failures in Japan or how serious the problem was. I'm hoping that Ms. Tett's book will help correct this ignorance. It's going to be published in September by HarperCollins, a major U.S. publishing house. And the *Nikkei* (*Nihon Keizai Shimbun*, Japan's top economic daily) is slated to publish a Japanese translation.

What's of special note about this book is that Ms. Tett also touches on the case of Nippon Credit Bank, which suffered a fate similar to that of the LTCB, and she reports on an interview she conducted with the widow of Tadayo Honma [the former Bank of Japan executive director who became president of NCB when it was effectively nationalized] after he committed suicide.

Tabuchi: Wasn't that shortly after he became president?

Abe: Actually, he killed himself after he had been appointed to stay on as president of Aozora Bank, which was set up as the successor of NCB. The president of the LTCB while it was under government control was another former BOJ executive director, Takashi Anzai (currently president of IY Bank), but he stepped down when the LTCB became Shinsei Bank. After having headed the bank during the transition culminating in its sale to Ripplewood, reportedly he was asked to stay on but declined. Unlike Mr. Anzai, Mr. Honma was unable to decline.

On top of that, since the LTCB had been sold to Ripplewood, there was pressure not to sell NCB to foreign investors.

And while Shinsei Bank, which was the successor to the LTCB, became wholly owned by an investment consortium led by Ripplewood, the ownership of Aozora Bank is much more complex, involving Softbank, Orix, Tokio Marine & Fire, and the foreign investment group Cerberus. I'm sure this made the job of reconciling differences very difficult. Ms. Tett explains these circumstances with particular reference to the foreign investors' perspective.

The book is going to be titled *Saving the Sun: A Wall Street Gamble to Rescue Japan from Its Trillion-Dollar Meltdown.* I understand that an editor at HarperCollins came up with this title, but it looks peculiar here in Japan; I'd say it reflects the perception gap between the Americans and the Japanese. The Americans always consider themselves the good guys and see all the complications within Japan as defects. But the Japanese don't necessarily agree that the U.S. brand of capitalism is the best solution to everything. I think this perception gap has continued to be a factor in the background of the cases of Shinsei Bank and Aozora Bank.

Yashiro and Ghosn: Contrasting roles

Abe: During the decades after World War II, a set of long-term credit banks, namely, the LTCB, NCB, and the Industrial Bank of Japan, functioned as a distinct sector within the financial system, providing industry with funds for recovery and growth. But this system of segregation had already lost its raison d'être by the late 1970s. In the latter part of the 1980s, as a result of the delaying tactics of the IBJ, the process of financial system reform was plagued by dissension, and in the end the cross-entry of institutions into each other's sectors was permitted only in the form of sector-specific subsidiaries. With this halfway measure the process of closing down the long-term credit banking system was delayed until 1997–98, when it was swept away by market pressure.

When the LTCB was sold to Ripplewood and was reborn as Shinsei Bank, people hoped that the new management would bring in a completely new business model for this anachronistic sector. And to back this up, the government sweetened the sale conditions with a three-year special collateral agreement [an agreement to buy back any of the loans that Shinsei Bank assumed from the LTCB if they declined by 20% or more in value through the end of March 2003].

Ripplewood figured that when this collateral agreement ran out, it could recoup its investment by making an initial public offering of the banks' shares. But it ran into a storm of complaints about "vulture capitalism," more specifically that Shinsei Bank was pulling back from its loans and didn't even care if its former borrowers went bankrupt. Mr. Yashiro was summoned to the Diet, where he was subjected to a severe grilling.

The image of the new bank was seriously damaged. And it did reduce the total volume of its lending. At this rate, it appeared that, far from introducing a new business model, the new management was just achieving balance through downsizing. The story that the bank's financial statements tell is one of reduced lending and of profits derived in large measure from drawdowns of reserves, which were made possible partly by taking advantage of the special government warranty.

And so they were unable to make the planned initial public offering.

From September through December last year Ripplewood's CEO, Timothy Collins, was exploring the possibility of getting the bank's shares listed, but given the overall weakness of stock prices, the company's advisor judged that an IPO wouldn't work. That has left Ripplewood with the question of how to recoup its original investment. There's probably considerable pressure from Ripplewood's investors back in the United States to earn better profits from Japan, so I think Mr. Yashiro is in a difficult spot. Though it's malicious to call organizations like Ripplewood "vulture funds," it's true that they don't seek to rescue others just out of the goodness of their hearts. When they bail out an institution, as in the case of Shinsei Bank, they're hoping to make a profit on the deal. But no IPO means no profit. The situation is especially tough for Mr. Yashiro and his associates because Ripplewood is looking for a quick return on its investment.

The story at Nissan Motor is quite different: Renault has acquired a controlling stake in the Japanese automaker as a long-term investment, so Mr. Ghosn, who was sent in from Renault to run Nissan, isn't expected to make a short-term profit. Furthermore, Nissan had greater technological strength than Renault. Also, the auto market isn't in such a depressed state as the market for banking services.

So Nissan faces a better set of conditions than Shinsei Bank does. Mr. Yashiro is heading the bank as the representative of Ripplewood, and the measure of his success is not his personal ability as a manager but the question of whether the bank's shares can be sold in an IPO. This depends on an external factor, namely, the question of whether the glut in Japanese banking can be corrected. So I think we need to make some allowances.

Tabuchi: I understand there's talk of Mr. Ghosn becoming CEO of Renault itself.

Abe: If he had failed in his attempt to revive Nissan, I expect we would have heard a lot of talk about "overrated" foreign CEOs. But for starters he sold off the bank shares that Nissan had been holding under cross-shareholding arrangements. That was quite an accomplishment. I was impressed by his boldness in making this move at a time when nobody yet realized what a millstone bank shares were going to become. A very big reason for Nissan's salvation was that it was unaffected by the subsequent plunge in bank share prices.*

Are outside directors performing?

Tabuchi: If I may change the subject, recently there's been an increase in outside members of corporate boards of directors here in Japan. Is this just a case of copying the American model? Or is it in line with the proper model of the joint stock company in a capitalist economy? Also, what sorts of responsibilities do outside directors have?

Abe: I don't know the details of every case, but the issue in the United States has been whether outside directors are really able to offer opinions from a neutral standpoint. In the case of Enron, which collapsed in the wake of revelations that it had been cooking its books, the board included an impressive lineup of outsiders, but not one of them knew about the virtually fraudulent management practices that were going on or offered any words of caution. There have also been complaints that these directors were effectively unable to speak out against Enron's management because the company was providing assistance of various sorts to the foundations and funds that the directors were involved in. A class action suit has been filed against them on the grounds that they need to assume some of the blame for the company's failure.

This isn't a problem limited to Enron. I believe there are concerns that the presence of outside directors at other companies has become a mere formality and that they've effectively become "yes men" for management. At American International Group, for example, it's said that Chairman and CEO Maurice (Hank) Greenberg exercises such powerful leadership that the outside members of the board are completely unable to raise objections. The board includes stellar members, names like Carla Hills, a former U.S. trade representative, and Barber Conable, former president of the World Bank, but some people have reported that these outsiders are almost completely unable to speak up about AIG's management. I believe there are lots of companies like this.

WorldCom also had outside directors, but none of them were able to rein in Bernard Ebbers's cowboy-style management. So it seems doubtful whether the system of outside board members is functioning as it should even in the United States. If the outsiders are going to be expected to see through improper accounting practices and speak out against management, they need to have a staff of their own. If all they do is go to the company for a board meeting once a month and listen to what management tells them, I don't see how they can play the role that's expected of them.

Tabuchi: I assume that outside directors read the company's financial statements, but I imagine that few of them dig deeper than that.

Abe: Getting behind what's written in the financial statements is no easy matter. I used to work in the Capital Market and Corporate News Department at the *Nikkei*, and I can say that in order to uncover shenanigans in corporate financial statements you have to look at about 10 years' worth of records, analyze the changes, and figure out what the irregularities mean. It's an interesting process, but it's extremely time consuming. People who serve as outside directors often have seats on several companies' boards, but I don't think it's a job that you can really do simultaneously at multiple companies.

Tabuchi: Japanese companies have also started to appoint lots of outside directors and otherwise change their top management setup. At Nomura Securities, where I used to work, there's now a lineup of operating officers, and the form of organization has changed into a holding company. I hope this arrangement will work.

Abe: Within the Japanese business world, both general meetings of shareholders and meetings of boards of directors have become ritualized, and little substantive discussion takes place at them. And when companies set up executive boards or boards of senior officers to hold management meetings, these quickly become formalities too. In practice, I think, it's generally just the president and a tiny group of people around him who decide on management policies and strategies. There's a tendency to waver between a bottom-up approach aimed at democratic decision making and a top-down approach focusing on strategic leadership, and it seems to be hard to come up with a system that functions well. One problem is that the Japanese tend to focus excessively on form over content.

At Sony, for example, when Nobuyuki Idei [now chairman] was appointed president, he introduced an American-style system of operating officers. It seems to me that this was a stratagem aimed at shifting authority away from former CEO Norio Ohga's team. Since then the operating-officer system has become something of a fad in Japan, but as I see it, the real reason it has become so popular is that it offers a way to reduce the number of senior officers, so as to get away from the situation where a lot of people assemble, listen to explanations they don't understand, and fail to decide on anything. But the details concerning strategic decision making and the assignment of responsibility have yet to be worked out. Decreasing the number of directors and adopting an operating-officer system aren't bad things, but companies haven't yet reached the point of having their directors take responsibility and make strategic decisions properly.

Shigeo Abe

Shigeo Abe was born in Tokyo in 1948. He graduated from the University of Tokyo with a degree in sociology in 1973 and joined the Nihon Keizai Shimbun, Inc. the same year. He was a finance reporter and then a senior staff writer in the Editorial Headquarters for Europe, the Middle East, and Africa for the *Nihon Keizai Shimbun* newspaper, editor in chief of the magazine *Nikkei Venture*, and a visiting researcher at the University of Cambridge, and since 1999 has been editor in chief of the magazine *Sentaku*.

Learn from the American model of leadership

Tabuchi: You wrote about Dwight Eisenhower's meteoric rise during World War II from army chief of operations to five-star general in charge of the European theater. In Japan that sort of dramatic rise would be impossible, whether in reaching the top level of the old military command or in becoming editor in chief of a magazine. This is probably a feature of our country that won't change, wouldn't you agree?

Abe: America is certainly a dynamic country, and that's something that extends to the way it handles human resources. In the past it tended to be treated as a rank newcomer in international society; it was thought of as an assemblage of drifters and a place where things were carried to extremes. The pendulum would swing from one extreme to another, as in the case of the fight between the North and South over slavery, or in the case of Prohibition, when the outlawing of alcohol led to the growth of underworld gangs. But by the end of the twentieth century it had become the world's only superpower. Even so, the swings of the pendulum are great. Looking at what it has done in Iraq, we see that it's a wild country that will kill thousands of people on a flimsy pretext. But at the same time, it has certainly accumulated considerable know-how when it comes to building leadership. For example, a black person like Colin Powell has become secretary of state, and another black, Condoleezza Rice, is the president's national security advisor. And it continues to motivate the general public with the fantasy of the "American dream." This is a clever approach. I'd have to say America has a certain something that has allowed it to become a great power.

Another point of difference with Japan is the substantial progress that the United States has achieved in its handling of information disclosure. You can get information from various public institutions even over the Internet, but when you go looking for documents in the legislative archives, for example, you run into a wall of confidentiality beyond which you aren't allowed to look. Both current information and past records are carefully controlled. Leadership means managing all the information that an organization possesses. Even though the leader doesn't know all the details, there's a system that sifts through the information and determines which parts of it need to be passed on and what points require strategic decision making. This is the linchpin of the American leadership setup.

Take President George W. Bush. He's a person who makes wild gaffes when he speaks without a prepared text, but even so he's able to function perfectly well as the chief executive. This is because the U.S. system of government is designed to support whoever occupies the White House.

Also, there's a system of ranking that controls the level of access different people have to confidential information. Anybody who takes public office is subjected to a thorough investigation of their private lives, including checks into whether they have had extramarital affairs or whether they are homosexual. Admission into the inner circle is based on a strict selection process. So while America seems to lead in terms of information disclosure, it's only the information with a low level of sensitivity that gets freely disclosed, while the most sensitive information is rigorously guarded. They have a fully developed management system in this area.

Tabuchi: That's quite impressive.

Abe: And it's not just the government. Business corporations are the same. Strategic decision making is the domain of an inner circle of selected individuals. Japan should probably completely rethink its organizational arrangements with reference to the American model.

The importance of overcoming Japan's fear of China

Tabuchi: People now talk about the Japanese economy's "lost decade," but before that, during the cold war, Japan prospered like a dog making off with the bone that two bigger dogs had been fighting over. Thinking it was on to a good thing, our country took this approach to the limit during the 1980s, leading to the formation of the bubble economy. But then the cold war ended, and the third dog could no longer make off with the bone. As I see it, the deflation that we've been experiencing is no more than a return to normal from a state of overinflation. The rise in prices during the bubble years was centered on land, but now I think land prices may have fallen about as far as they are going to.

Abe: I believe there are two main causes of the current deflation. One is that domestic costs in Japan, including land prices and wages, were too high and are now being corrected. The other is that goods are flooding in from China and other low-wage countries, and this is making it impossible to maintain the high-cost structure of the Japanese economy.

A few years ago there was a great deal of talk about the "threat" from China. And it's certainly true that labor in China is cheap. But if the Chinese market develops, it will offer tremendous business opportunities for Japan. Steel is a good example. The Japanese steel industry was able to develop thanks to its advanced technology, but then China and South Korea gradually caught up. Nissan and other domestic users demanded price cuts from steelmakers, and people thought the industry was doomed to decline. But from last year on into this year steelmakers have enjoyed a recovery. This is thanks to the rise in the demand for steel in China, which the steelmakers in Shanghai and South Korea can't keep up with.

To be sure, China has its problems and uncertainties. There's the question of how long the Communist Party will keep its hold on power, and there's also the problem of the huge losses run up by state-owned enterprises, but even so, we can't talk about Japan's prospects for the twenty-first century without looking at our giant neighbor. Though it's true that we're no longer in a position to run away with the bone, so to speak, that doesn't mean that Japan is going to fall to the level of poor countries like the Philippines or Bangladesh. The emergence of the Chinese market is clearly a plus for Japan. In that sense I think we're over the initial shock of the "lost decade" and have entered a new phase.

What's needed in this connection is for the Japanese to overcome the lingering fear of China as a threat. Unless we can do that, it's not going to be possible for Japan to grasp its new opportunities. We have to get away from the pattern of unthinking imitation, where firms rush to get into the Chinese market because "everybody else is doing it" and then, when they get burned, decide that China is no good and pull out. Businesses that are thinking of setting up shop in China need to coolly assess the conditions, including the prospects for making a profit. Another point is that Chinese who have studied in the United States are gradually rising through the ranks; this is causing the political risks of doing business in China to recede and making it more feasible to get along with key people there.

Tabuchi: I totally agree that China is changing too. SPF

**Following this interview, Carlos Ghosn was named as number 10 in* Fortune *magazine's ranking of the world's 25 most powerful business leaders outside the United States. He also took top spot in this year's survey ranking of the "ideal business leader" by the Japan Management Association.*

Exchange between small businesses in Japan and Central Europe

By Naotaka Oh
Associate Program Officer
The Sasakawa Central Europe Fund

In fiscal 2002 the Sasakawa Central Europe Fund inaugurated the two-year project Promotion of Small Enterprises: Sharing Experiences between Japan and Central Europe. In Central Europe small businesses, providing people with employment and a livelihood as they do, have underpinned the transition to a market economy and are essential to the region's socioeconomic survival and development. Despite this, the paucity of forums for communication among small business proprietors and the almost total lack of cooperation across industries or promotion of local industries make it difficult for business proprietors to raise their social standing.

To acquaint Central Europeans with small business initiatives in Japan, the project invited eight people from the Czech Republic, Hungary, Poland, and Slovakia—one researcher and one small business proprietor from each country—to visit Japan June 14–24.

Places the group visited included Kawagoe City, Saitama Prefecture (cityscape preservation and shopping districts); Takayama City, Gifu Prefecture (tourism and promotion of local industries); Nagahama City, Shiga Prefecture (local development and small business); Higashi Osaka City, Osaka Prefecture (cross-industry technology applications and exchange); and Tsubame City, Niigata Prefecture (world economic trends and changing local industries). In each locale the visitors observed typical cases and engaged in unexpectedly lively exchanges of views. In addition to sharing knowledge and insights, the participants on both sides had a chance to discover the differences in various industrial sectors between continental countries and an island nation. Short though it was, the visit was highly significant.

At the Niigata Prefecture Regional Industry Promotion Center (Kenoh Messepia), visitors from Central Europe look at a display.

The Fund will endeavor to transfer the knowledge and insights gained to Central European countries through activities there.

Vietnamese delegation invited to Japan

By Masato Seko
Associate Program Officer
The Sasakawa Pan Asia Fund

The Sasakawa Pan Asia Fund's exchange projects have two main aims: to deepen knowledge of cooperative relations with other Asian countries through contact between leading figures from those countries and various sectors in Japan and to strengthen bilateral relations by building personal networks. In one such project, a five-member delegation from Vietnam led by Nguyen Thi Binh, former vice-president of Vietnam and now president of the Vietnam Peace and Development Foundation, visited Japan July 31–August 9 to commemorate the thirtieth anniversary of the establishment of diplomatic relations between Japan and Vietnam.

Nguyen Thi Binh was a member of the Central Committee of the South Vietnam National Liberation Front during the Vietnam War. In 1972, as foreign minister of the Provisional Revolutionary Government of South Vietnam, she headed its delegation to the Paris peace talks. Dressed in traditional Vietnamese costume, she was known admiringly as "the warrior in *aodai*" and is still held in high regard by the people of Vietnam. In her present position she is devoting special effort to relief for victims of the defoliant Agent Orange, used by the U.S. forces during the war.

Nguyen Thi Binh, left, gives a lecture August while visiting Japan.

During its stay in Japan the delegation visited the Ministry of Education, Culture, Sports, Science, and Technology, the Defense Agency, the Research Institute for Peace and Security, and the Osaka International Peace Research Institute. It also met with Prime Minister Jun'ichiro Koizumi and exchanged views on the significance of Japan-Vietnam relations and policies for regional security. On August 6, the anniversary of the 1945 atomic bombing of Hiroshima, the delegation attended the commemorative ceremony in Hiroshima's Peace Memorial Park, and Nguyen Thi Binh stressed the importance of peace in a speech at the World Congress against A- and H-Bombs.

To Japan, Vietnam is a key member of the Association for Southeast Asian Nations. This project has contributed to the strengthening of bilateral relations through personal exchange.

From Istanbul to Vladivostok

Redefining oneself through Asian eyes

By Chan Woo Lee
Program Officer
The Sasakawa Peace Foundation

Asia's shift from "object" to "subject"

Asia is a vast region, stretching from Turkey through the Middle East, South Asia, Central Asia, and Southeast Asia to Northeast Asia and the Russian Far East. More than 2.5 billion people of diverse races, political and economic systems, religions, and cultures live here. Historically, the region has had the experience of being an "object" under the rule of Western nations, the Soviet Union, and Japan—itself an Asian nation. In the twentieth century, the region made the shift to being the "subject," or active agent, of its own development.

The end of the cold war, around 1990, was followed by great political changes. In Southeast Asia, the three socialist countries of Indochina (Cambodia, Laos, and Vietnam) joined the Association of Southeast Asian Nations; and the dissolution of the Soviet Union led to the independence of Central Asia and South Caucasus region, which became part of Asia politically as well as geographically. This seismic shift galvanized the search for a vision of a "new Asia." Until the mid-1990s the economies of Southeast and Northeast Asia grew so dramatically as to win the sobriquet "East Asian miracle." The 1997 Asian financial crisis, however, put an end to rosy visions of Asia's future, and so-called globalization, cast in the mold of the American-style economic system, became universal.

Since the terrorist attacks in the United States on September 11, 2001, America's "war on terror" and confrontation with the so-called axis of evil (Iraq, Iran, and North Korea) have become the dominant themes of the opening years of the twenty-first century. The three countries designated by the United States as the axis of evil are all located in Asia. Due to this confrontation the U.S. presence in Asia is strengthening. As a result, the issues of security and confidence building to prevent regional conflict are being accorded more importance than ever within Asia.

Meanwhile, moves to promote military, economic, political, cultural, environmental, educational, and other forms of exchange with Islamic countries and India have emerged. To add to Asia's diverse values and systems, the problems confronting the region are becoming more complex.

A scene from the seminar Civilization Dialogue: Hinduism and the World, held November 22, 2002, in Japan.

In search of an identity sharing pluralistic value systems

In view of the rapidly changing international situation, in June 2002 SPF renamed the Sasakawa Southeast Asia Cooperation Fund the Sasakawa Pan Asia Fund. The Fund's aim is to respond flexibly to the diverse issues arising in Asia, while helping Asian countries devise an "Asian-style" model of development for Asian countries and use it to engage in dialogue with the West and Russia. The concept of "Asian style" means the pursuit of an identity that can share Asia's pluralistic value systems. In short, the Fund's vision is to identify an Asian-style model for coexistence and coprosperity and share it with the world. Below we will look at SPF's Pan Asia programs by region.

Central Asia

In 1994 SPF initiated the project Implementing Market Economies in Central Asia: Implications from East Asian Experiences to assist Central Asian countries in the shift to market economies after the dissolution of the Soviet Union. In 2000 the target region was broadened and the project renamed Capacity Building for Development in Central Asia and Caucasus. This name change indicated a priority shift from assistance for economic transition to the search for means to resolve various problems emerging in the course of this transition, such as diversification of domestic politics, confidence building in the context of security, strengthening of external economic relations, and achievement of a balance between development and the environment.

In June 2003 the Fund cohosted an international workshop in Moscow with the Institute of World Economy and International Relations (IMEMO) of the Russian Academy of Sciences, bringing together experts on political and economic affairs and international cooperation in Central Asia. The meeting served to strengthen the network of Central Asian, Russian, and East Asian experts.

On June 20 and 21 the Fund cohosted an international workshop in Tbilisi, Georgia, with the Georgian Foundation for Strategic and International Studies (GFSIS) to discuss the Caucasus region's interregional cooperation and confidence building. In July, with the cooperation with the U.S.-based EastWest Institute, the Fund carried out a training program in Istanbul to develop young leaders in Central Asia and the Caucasus. The focus was on development of the human resources needed to bring about a shift to democratic systems and sustained and stable economic and social development in the region. About 50 young leaders (equal numbers of men and women) received training in the international situation, security, international organizations, multilateral interregional cooperation, and other subjects.

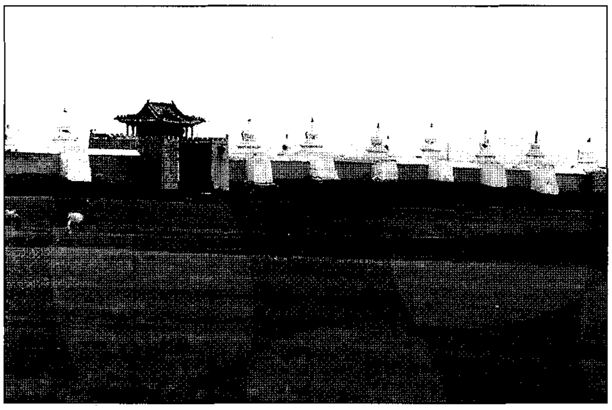
The Fund's cooperation with Russian and U.S. research institutions reflects its emphasis on the search for an Asian identity that is not closed but open and diverse.

Southeast Asia

After its establishment in 1992, the Sasakawa Southeast Asia Cooperation Fund implemented projects supporting the three Indochinese countries' transition to market economies, development of human resources, and personal exchange. In 1995 projects targeting Myanmar were added, along with projects in the new fields of media education and the training of journalists. At present the Fund is undertaking projects aimed at developing human resources in marketing, agricultural economics, economic development paradigms, journalism, and other fields to deepen Asian-style cooperation and solidarity. (Please refer to www.spf.org/e/project/2003/ for further details.)

Northeast Asia

In Northeast Asia, the Fund has implemented projects proposing schemes to enable North Korea's peaceful coexistence with the international community through engagement rather than isolation. Unfortunately, as a result of such problems as North Korea's abduction of Japanese nationals and the activities of North Korean spy ships in Japanese waters, Japan's relations with North Korea have deteriorated, and cannot be improved by Japanese engagement alone. At present Japan's security and its relations with North Korea need serious review. SPF is exploring projects to ensure a framework for the security and peaceful coexistence of the people of Northeast Asia. Since 2002, for example, it has been supporting an initiative of the Mongolian Development Research Center (MDRC) to promote Mongolia's development and create a mechanism for Northeast Asian cooperation.



Mongolia's ancient capital Karakorum, historically associated with Genghis Khan.

South Asia

South Asia is one of the Fund's major focuses. Of particular interest is India, with its distinctive civilization. In 2002 the Fund inaugurated a project in intercivilizational dialogue concentrating on Hinduism. Understanding between India and Japan, while recognizing pluralistic value systems, confirms the depth of the relationship and contributes to enhancing Asian-style intellectual exchange. At present the Fund is exploring the development of new projects targeting South Asia.

Relations with Russia in an Asian context

Politically and culturally, Russia cannot be said to be part of Asia. People in the Russian Far East identify with Europe rather than Asia. Nevertheless, the countries of Central Asia and the Caucasus used to be part of the Soviet Union, and Russia is involved in the regional issues of Northeast Asia. The Russian Far East is an essential factor in Northeast Asian security and economic cooperation.

Relations between Russia and Asia are complex in being both interregional and intraregional in nature. To build dialogue with Russia within the broad context of Asia, since 2002 the Fund has been supporting the project Russia and Japan in Asia, implemented by the Japan Center for International Exchange (JCIE). The Fund will maintain its commitment in this area in order to rebuild relations between Russia and Asia through more robust dialogue.

The above was an overview of the Fund's projects in Asia, from Istanbul to Vladivostok. The Fund's views Asia as "subject," not "object," and its aim is to expand intercivilizational and interregional dialogue and exchange. SPF

SPECIAL REPORTS | Asia as *Subject* Opinions

From Silk Road to Cotton Road: Central Asia in transition

By Kap-Young Jeong
Professor of economics and director, Institute of East and West Studies at Yonsei University

It has been eight years since I began participating in SPF's Central Asian projects. From the beginning, it was a great adventure and thrill for me to travel to the Silk Road, meet professionals with different backgrounds, and evaluate Central Asian economies. In fact, for an economist from Korea, particularly from South Korea, the region has several interesting points.

First of all, the Central Asian economies may be a mirror image of North Korea's, implementing a planned economic system. Thousands of ethnic Koreans have been farming in the region as a result of the tragic legacy of forced immigration under the former Soviet regime. This implies that implementation of a market economy in Central Asia may provide valuable lessons for the transition of the North Korean economy. Also, the Korean development experience may have significant implications for a successful transition in Central Asia. These factors combined drew my attention to SPF's Central Asian projects.

My expectations of the Central Asian projects have been quite ambitious; and so far, my findings from several years of these projects have been quite interesting. We can easily confirm that the command economy has ruined all but a few top hierarchies. The market works anywhere, anytime. Rich resources do not necessarily guarantee a blessed economy. Political leadership is a crucial factor to an economy. Finally, opening the market is a must for developing the economy.

Having said this, I think the East Asian initiative for implementation of a market economy in Central Asia has great potential. I think it is the duty of East Asian countries to help the transition to a market economy in Central Asia, not only for humanitarian reasons but also for the prosperity of both East and Central Asia. This is because in the current global economy development of any country eventually leads to mutual benefits. Also, expanding trade and exchange between the two regions can easily improve the social welfare of the partners.

There are many barriers to increasing trade and exchange between East and Central Asia, however. Although the two regions have many common traits as parts of Asia, there are many constraints to expanding exchange. Besides geographical distances, the language barrier is too big to easily overcome.

There are also immense historical and cultural differences, and the gap in economic development between the two regions is wide. Until recently, economic institutions and market traditions have been totally different, too. Accordingly, development of trade has been quite limited due to these barriers and constraints.

Our next question is how we can lead Central Asia to open, expand, and help the transition to a market economy by implementing the East Asian experience. It seems a difficult task in every respect. It is like exploring another Silk Road. On my first trip to Almaty, I concluded that there really was a long, long way to go. I also found that the old Silk Road had been replaced by cotton farming, and it could very well be called the "cotton road."

Time, however, really flies and can resolve many problems. After several years of endeavor, Central Asia is now taking at least the first few steps on the road to a market economy. The speed of market penetration in Central Asia has been really fast, and market incentives work equally well in Central Asia. People's mentality and motivations are real forces leading the transition to a market economy in Central Asia.

The question now is, have we really contributed to the transition in Central Asia? I would say yes. I realized that just telling the success story of development from almost nothing to a middle-income country was an exciting stimulus to the professionals in Central Asia.

Whenever I told them that Korea's per capita income was just $90 or so in the early 1960s, Central Asians were always anxious to hear which factors were behind the success story. I think the study tours bringing people from Central to East Asia have been the most successful part of the projects, because field experience is a necessary step to satisfying their curiosity.

I would say without reservation that SPF's Central Asian projects have contributed substantially to the transition in Central Asia. It has been a way not only to open East Asian professionals' eyes to the market economy but also to lead them to pay attention to a new transitional economy. These projects have been a pioneering initiative to explore the adventure of implementing market experience in another part of Asia. Furthermore, the projects demonstrate what NGOs and NPOs should do to expand exchange in an underdeveloped part of the world.

I would suggest expanding the projects to recruit more professionals from the two regions involved. In particular, the projects should place the highest priority on extending field study by Central Asian professionals in East Asia, simply because field experience is the best way to fully understand a real market economy. The more people experience a real market, the sooner will the "cotton road" transform itself into an efficient market economy.

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Problems of the ambiguous "Basic Framework"

On the recent amendment of the Civil Code provisions on public-interest corporations

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The "approval" system and its supervisory setup, the root of all evil

On June 27, 2003, the Japanese government approved the "Basic Framework concerning Fundamental Reform of Public-Interest Corporation System." This was two years after the Intermediate Corporation Law had been enacted by the National Diet together with a supplementary resolution that referred to the necessity of amendment of the Civil Code for the first time in over a century, and a year after the Cabinet Taskforce for Administrative Reform had issued its "Review of Basic Points at Issue" in response to the supplementary resolution and the Cabinet had mandated "Efforts towards Fundamental Reform of the Public Service Corporation System." Meanwhile, independently of this discussion of systemic reform, the Tax Commission set up a working group on taxation of nonprofit corporations in 2002 and has been engaged in discussion from the viewpoint of the tax system.

The system itself and tax measures are two separate things. Nonetheless, it cannot be denied that there is the appearance that the two have been conflated. In part this is because the public-interest corporation system has always been addressed as if tax measures were part and parcel of it, and in part because of such factors as the historical background and attachment to the social meaning and function of the system. In short, various views that should have been discussed on different planes have been juxtaposed on the same plane. This article aims to disentangle the issues.

I will not go into all the details of the two-year process outlined above, but the atmosphere surrounding the discussion and its meaning were more or less as follows.

First, as so graphically demonstrated by the 2000 scandal involving accounting irregularities by KSD, a public-interest corporation set up to assist small businesses, public-interest corporations have had an image of scandal, rampant corruption, and dubiousness. Whether or not the image has actually worsened since then, it is safe to say that it has stuck. On the other hand, the NPOs set up under the 1998 Law to Promote Specified Nonprofit Activities (the NPO Law), while not perhaps as pure as the driven snow, differ from public-interest corporations, and the attitude of not wanting to be seen in the same light as public-interest corporations has gradually strengthened. Moreover, it has been hard to shake off the image of public-interest corporations being in collusion with the bureaucracy and serving its interests and being nothing but sinecures for retired bureaucrats.

At present, public-interest corporations can be established only upon approval by the relevant government agencies following rigorous screening. And because they are obliged to submit to ongoing oversight by those agencies, public-interest corporations end up almost completely devoid of independence or governance. That scandals still occur means the supervisory setup that goes with approval is totally dysfunctional. I would go further and say that this approval system, along with the attendant supervisory setup, is the root of all evil.

Problems of supervision and the ambiguous "Basic Framework"

Rather than discussion of the impotence and harmfulness of the approval system and supervisory setup, however, the prevailing view has been that since public-interest corporations are so rigorously overseen by the regulatory agencies it is all right to accord them preferential tax treatment. What is more, it is argued that the national authority needs to determine the conditions of preferential treatment. It is obvious that the infallibility of the decisions of the executive branch of government takes the place of constitutional legitimacy.1)

This way of thinking is most convenient to the stakeholders, especially the tax authorities. Unlike taxation of individual profit-making activities, in the case of public-interest corporations there is almost no need to pass judgment on the actual state of their activities. Moreover, once public-interest corporations are established they are automatically accorded tax privileges—a far cry from the procedures required for corporations designated "corporations promoting specific public interests" and thus eligible for special treatment regarding donations. That is why there is a fair amount of support from various quarters, strange bedfellows though they may be, for the idea of lumping together groups that have some feature in common.

Reviewing the discussion, we can identify four major issues: first, the approval system and the supervisory setup integral to it; second, what types of corporations to be designed to take the place of public-interest corporations as they have been defined so far; third, what preferential tax measures to be provided to corporations engaged in what kinds of activities, and on what grounds; and fourth, how to identify and weed out existing public-interest corporations that are considered dubious. There is also the related issue of whether it is possible to prevent other dubious corporations from springing up. I will now look at each of these issues, and will also consider how the ambiguous "Basic Framework" mentioned at the outset addresses or does not address it.

What is the point of a registration system if the supervisory setup is to be revived?

It seems generally agreed that the approval system and its supervisory setup have together been the root of all evil. There is a reason I use the equivocal phrase "it seems." The

"Basic Framework" acknowledges the evils of the approval system and the desirability of creating a registration system for establishment of nonprofit corporations. Knowledgeable people have pointed this out for a long time, and its articulation in the "Basic Framework" is a big step forward. But the framework states only that the criteria for nonprofit corporations established under the registration system whose activities are in the public interest,[2] as well as the agent applying the criteria, will be "studied."

Since the "Basic Framework" calls for the criteria to be "objective and clear," we will not see a de facto resurrection of the approval system. But we could well see a revival of the supervisory setup in connection with judgment of actual activities. If this were to happen, what would have been the point of switching to a registration system?

Some may think I am being overly suspicious, but there are grounds for my distrust. Since corporations can be established under a registration system simply by registration, that is, compliance with certain formal conditions, it is quite possible that the stated purpose of an organization and its content will differ. Even if a corporation declares that it has been established "to serve the public interest," there is no guarantee that its actual activities will. Therefore someone, somewhere, must still pass judgment on corporations (that is, their activities) that deserve some kind of special treatment, including tax breaks. If this is coupled with the mentality of preventing misbehavior before the fact rather than dealing with any breach of the conditions after the fact, resurrection of the supervisory setup will be a very real concern.

This is also linked to the second issue, what classification of corporations to create under a registration system. The "Basic Framework" calls for a system of nonprofit corporations regardless of whether they serve the public interest. Naturally, then, the new system could include not only intermediate corporations and NPO corporations but also the school corporations, social welfare corporations, religious corporations, and so on established under more than 100 statutes.

I say "could include" rather than "will include" because there is a belief that the present reform targets only public-interest corporations, that is, the foundations and associations specified in Article 34 of the Civil Code, and that no other corporations are addressed. This is one of the reasons I call the "Basic Framework" ambiguous. While maintaining that the present system is flawed because it equates the acquisition of corporate status with the judgment of being in the public interest and preferential tax measures, and therefore advocating a new system of nonprofit corporations regardless of whether they serve the public interest, the "Basic Framework" says only that its relationship to the present intermediate corporations and NPO corporations will be "reviewed."

Should the definition of public-interest corporation be widened or narrowed?

There are three ways of thinking regarding what to do next. One is to interpret the meaning of nonprofit corporation broadly, so as to bring as many different kinds of corporations as possible under this umbrella. The argument is that just as there are various formats available for for-profit incorporated associations, such as joint stock company and limited liability company, so too should there be for nonprofit corporations. The second way of thinking is to leave the present classification of corporations as is for the time being and focus on creating a legal framework only for the public-interest corporations specified in Article 34 of the Civil Code, or for those plus intermediate corporations and NPO corporations. The third way of thinking is that since it is somewhat illogical to expand the parameters to include only intermediate corporations and NPO corporations out of the many nonprofit corporations that have come into being as spinoffs of Article 34, consideration should be limited to the public-interest corporations mentioned in Article 34. In regard to the first way of thinking, people may think it is too soon to rush to bring a myriad other corporations under the umbrella. But if discussion is limited to public-interest corporations to begin with, it makes little difference to me what approach is chosen.

The reason the discussion has been fixated on this point has a great deal to do with preferential tax measures. As I have already noted, the corporation system and tax treatment are essentially two different things. Moreover, there are many issues in relation to the corporation system, from the constitutional guarantee of freedom of association to considerations of continuity and sustainability of operations; the recognized merits of incorporation go far beyond tax breaks.[3]

So far, public-interest corporations have enjoyed these merits upon gaining corporate status. According to the "Basic Framework," corporations will "generally be obligated to pay tax." If tax breaks are to be limited to "specific cases," those who collect taxes will attempt to limit "specific cases" as far as possible, while those who champion civil society will want the net cast wider, if possible taking in all or most of the present categories.

The question of whether being nonprofit should be enough to qualify for tax breaks or whether the concept of public interest or social contribution should be added complicates the discussion. Moreover, relevant tax measures cover two tax systems—income tax and tax on donations—and the grounds for preferential treatment, or the types of organizations that should qualify, are not necessarily the same. When the discussion fails to distinguish between the two, confusion reigns.

Income is taxed because it is used for oneself, in other words, there is a distribution of profits. If so, there are no grounds for taxing NPOs that do not distribute profits. Does this mean, then, that a steel mill or a taxi company should not be subject to income tax if it is an NPO? Or should exemption be limited to certain organizations in fields that are deemed to "serve society and people"—for example, international exchange, environmental protection, and animal welfare? Or, in addition to limitation by field, should NPOs be divided according to whether they aim to serve the public interest? In addition, should these criteria be "all or nothing," or are gradations possible in accordance with the extent of the public-interest component? As we can see, a variety of issues are involved.

Here I am not going to discuss which of the above ways of thinking should be adopted. Instead I will look at some of the problems that it is claimed will arise when preferential tax measures are applied. What, for example, should be done in the case of organizations that do not use their income to serve society and people and do not pay significant salaries,[4] but simply let income accumulate (the issue of internal reserves)? Is this to be considered acceptable or unhealthy? And what about corporations that, having accumulated savings, dissolve themselves and distribute the savings among the members? It may have to be prohibited when a corporation has accepted donations from outsiders who agree with its aims, but, some may ask, what is wrong with distributing savings accumulated from the unused portion of members' annual fees when an organization is dissolved? I exclude donations because it would obviously be inappropriate to divide up funds received from well-intentioned donors among an organization's members. I shall have more to say on this below.

The problem of definition leads to questions over the criteria for tax breaks

There is another issue pertaining to income. It seems to me we need to distinguish between a corporation's core activities and other activities. In other words, should we not distinguish between a bakery set up to create employment for people with physical disabilities and one set up to collect funds to be used to campaign against global warming? The former would be eligible for tax breaks, but the latter would be taxed like an ordinary company. By "core" I mean the "certain cases" eligible for preferential tax treatment referred to earlier.

In this connection, income from fees in membership-type organizations is core income, but since corporations will "generally have an obligation to pay tax" on membership fees, this will mean taxing fees unless they are totally spent. Since this is probably unworkable, we could simply focus on whether income-producing activities fall into the category of core activities. Some, however, hold that even without going into the complexities of what are and are not core activities, it should be possible to pass special tax laws decreeing that activities aimed at social welfare, such as employment of the disabled, are tax exempt, as under the present legal system.

In regard to donations to nonprofit corporations, it is well known that the present tax system and its operation take an extremely restrictive view of the kinds of corporations eligible for donations. Many people urge a more liberal approach, myself included, but I will not discuss that here. Instead, taking tax breaks for donations as a given, I will address two questions having to do with corporations that receive donations. I should add that I am referring to nonprofit corporations.

The first, already mentioned, is the question of whether corporations should be allowed to distribute their assets upon dissolution. It is natural to frown on this, I think. By the same token, only corporations that do not distribute their assets upon dissolution should be eligible for tax breaks on donations.

The second question is whether all corporations that do not distribute their assets upon dissolution should be eligible for tax breaks. Should they also be required to demonstrate that they serve the public interest in some way? I think a good case can be made for shaking off the spell of attempting to define the content of "public interest," which perforce changes with time and place, and regarding all NPOs except those that are concerned solely with improving the welfare of their own members as serving the public interest.

Finally, there is the question of how to identify and weed out existing public-interest corporations that do not really function for society and people. There are several types of organizations that fall into this category. Typical are (1) organizations that used to serve the public interest but are now for-profit businesses or other types of organizations that do not deserve tax breaks, (2) organizations whose activities have little or no relevance today and either continue to exist out of inertia or have become nothing but sinecures for retired bureaucrats, and (3) organizations whose activities are clearly and consistently contrary to the aims for which they were established.

Public-interest corporations are thoroughly screened to determine that they meet the specifications, and the supervising agency or agencies have all the facts. It would be most pragmatic to begin by having the supervising agencies select the corporations deemed to fall into the above-mentioned category and list them publicly. Simultaneously, public-interest corporations must undertake self-purification by drawing up their own standards. I would like to reemphasize that checking on and evaluating corporations' activities should be carried out after the fact. There are attempts to exclude organizations before the fact on various pretexts, but I cannot agree with this.

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[1] Article 30 states: "The people shall be liable to taxation as provided by law." Article 84 states: "No new taxes shall be imposed or existing ones modified except by law or under such conditions as law may prescribe."

[2] This refers to the so-called second tier—in other words, those corporations freely established under a registration system (the first tier) that deserve some kind of special treatment.

[3] The classic example is the for-profit corporations established under the Commercial Code.

[4] This conflicts with the principle that nonprofit organizations shall not distribute profits.

2003 PROGRAM AGENDA (Projects approved September 2003)

Regular Projects

Project Name	Implementing Agency	Type	Year	Budget (¥)
Establishing an Online Resource Center for NPOs/NGOs	Voluntary Health Association of India (VHAI/India)	G	1/3	2,900,000
Building Civil Society Capacity in Negotiating Debt Conversion	The Synergos Institute (USA)	G	1/2	6,900,000

The Sasakawa Pan Asia Fund

Project Name	Implementing Agency	Type	Year	Budget (¥)
ASEAN Young Politicians Retreat Workshop	Centre for Strategic and International Studies (CSIS/Indonesia)	G	2/3	4,600,000
Strengthening Parliamentarian Dialogue in Cambodia	Cambodian Institute for Cooperation and Peace (Cambodia)	G	1/3	5,000,000
Business Case Development: Enhancement of Business School Education in Uzbekistan	SPF	SO/C	1/3	12,000,000
Supporting for Journalism in Asia	SPF, Yayasan 21 Juni 1994 (Indonesia), The Mass Communication Organization of Thailand (Thailand)	SO/C	1/3	18,000,000
Capacity Building in Strategic Decision-Making: Lessons from the Development Experience in the Asia-Pacific Region	Georgian Foundation for Strategic and International Studies (Georgia)	G	1/2	7,200,000
Interaction for Progress: ASEAN and Myanmar / Phase II	Information & Resource Center (Singapore)	G	2/3	19,900,000
Enhancement of Corporate Governance in Azerbaijan: Experience of Malaysia	SPF, Economic and Business Research and Education Centre, Khazar University (Azerbaijan), Malaysian Institute of Economic Research (Malaysia)	SO/C/G	1/2	5,700,000
Corporate Governance in Azerbaijan	Economic and Business Research and Education Centre, Khazar University (Azerbaijan)	G	1/2	(4,290,000)
Towards an Asian Economic Community: The Way Forward	Research and Information System for the Non-aligned and Other Developing Countries (India)	G	1/3	9,100,000

Note: G=Grant Project; SO=Self-Operated Project; C=Commissioned Project

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