

JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

Initiatives to be Taken by Japanese Industry to Prevent Global Warming (CO² Reduction)

by Yasuo Hosoya, Keidanren Task Force Climate Change Issue,
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1) The non-participation by the United States in the Kyoto Protocol is a fatal blow to anti-global warming initiatives

The 1994 United Nations Framework Convention on Climate Change (UNFCCC) encourages countries to take ambitious steps to curb global warming by playing “common but differentiated” roles, even while scientific data and knowledge are being accumulated.

The United States took a leading role in the crafting of that convention. But in March 2001, the Bush Administration created a worldwide uproar by withdrawing from the Kyoto Protocol – the basis for rule-making under the Convention.

The volume of greenhouse gases (GHG) emitted by the US consti-

tutes approximately 25 percent of the world total and approximately 39 percent of those emitted by all industrial nations. That is roughly five times the volume of Japan’s emissions and almost equal to the combined emissions produced by the EU, Russia, and Japan. International unity on solving the critical problem of global warming is absolutely critical.

Non-participation by the US in the Kyoto Protocol is tantamount to making everyone’s efforts come to nothing. It is highly regrettable that the US – which was expected to make a great contribution as the world’s leader, in terms of its scientific knowledge, long-term technological development, and progressive and independent initiatives – has chosen to abandon the Kyoto Protocol.

That said, the Administration has reaffirmed its willingness to contribute to the framework convention and is expected to clarify its position. The best option, of course, would be for the US to return to full participation in the Kyoto Protocol. The alternative is ugly – the US would unavoidably come to be considered merely a

willful, powerful country that threatens the global environment.

2) Problem areas in the Kyoto Protocol can be dealt with through negotiations concerning “promise timetables” following Phase II

Although the Kyoto Protocol has great historical significance, it is only the first step in dealing with global warming – a problem which will plague many generations to come. Needless to say, it is essential for countries to work together to achieve the first step in curbing emissions.

Admittedly, the Kyoto Protocol contains flaws in its Phase I’s “promise timetables:”

- The use of 1990 as a base year puts unequal burdens on countries. The targeted reductions greatly advantage the EU at the expense of Japan and the US. Japan, for example, vastly improved its energy efficiency since the oil shocks of the 1970s, but now has virtually no room to make additional improvements.
- Stringent reduction targets and tight deadlines—particularly

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for Japan and the US—allow too little latitude.

- The too-restrictive use of flexible measures and carbon sinks. *Flexible measures*=such measures as CO² reduction projects jointly implemented by developed countries (II), hosted by developing countries (COM) and emission trading (ET). *Carbon sinks*= CO² absorption by trees, croplands, etc.
- Compliance regulations might become even more stringent.
- How developing countries will participate in the future is not made clear.

“Compared to the EU, Japan and the US are clearly disadvantaged by emissions caps.”

Hopefully the US will participate to resolve these issues during the next COP (Conference of Parties convention) in Marrakech, October 29 to November 9, 2001. In addition to softening the impact of Phase I on some countries, it is also important that the conditions following Phase II be discussed as soon as possible. Hopefully, the US will exercise leadership during the next step and will take the initiative in submitting new proposals.

3) Are the 7 percent reductions required of the US more stringent than the 8 percent expected of European countries and the 6 percent expected of Japan?

According to the Japan Economic Research Institute, by setting 1990 as the base year, the actual reduction target for the EU will be reduced to about 3 percent. Activities already underway, such as the rehabilitation of antiquated facilities in the former East Germany or the conversion of fuel from coal to natural gas in the United Kingdom, will result in a decline in GHG production, thereby establishing credits against targeted reductions.

By contrast, there is no such wiggle room for Japan and the US. Using business as usual activities (BAU) as a base, the GHG emission volumes in 2010 for the U.S. and Japan are likely to increase by more than 20 percent against the standard year. The actual rate of reduction required would be approximately 26–27+ percent. Compared to the EU, Japan (which already ranks number one in the world in terms of energy efficiency) and the

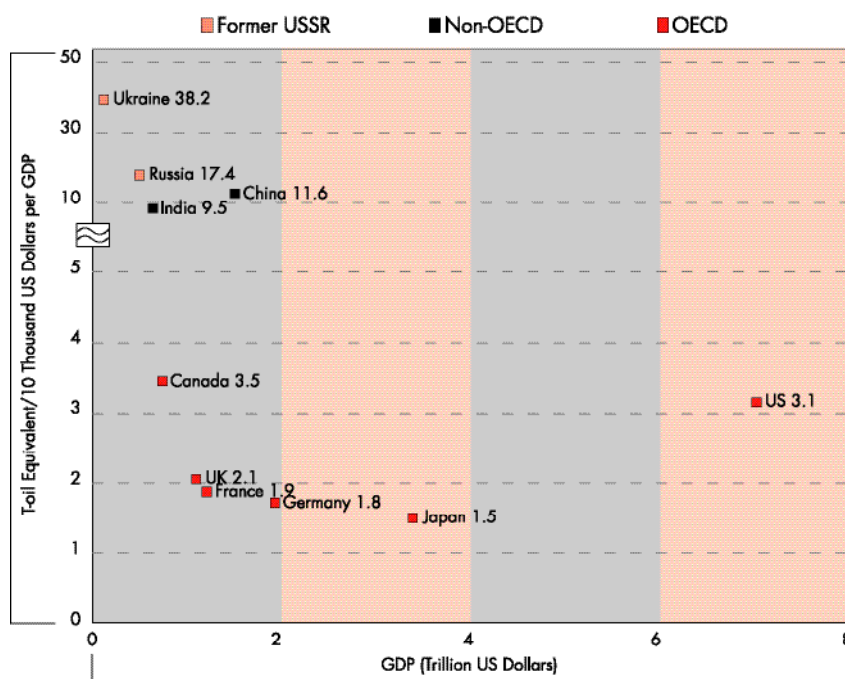
US are clearly disadvantaged by emissions caps.

While energy efficiency is not everything, it certainly significantly influences GHG emissions. From the start, Japan's margin for GHG reduction through improving energy efficiency is extremely limited. Some worry that a reduction of 20+ percent will bring about too great an economic burden for Japan to bear.

But what about the US? There are wide-ranging views, but according to the Organization for Economic Cooperation and Development (OECD) International Energy Agency, using GDP as a benchmark, the U.S. consumes energy at a rate about twice that of Japan (Reference the attached graph). By contrast, the consumption volume by the major EU countries is approximately 1.5 times more than that of Japan, Canada is more than double, China and India approximately 6 to 8 times, while that of Russia is more than 10 times Japan's rate.

On a per capita basis, GHG emissions in the U.S. are approximately twice those of Japan. And the CO² volume compared to GDP is approximately three times Japan's. Admittedly, the US and Japan do not have the same national land areas or meteorological conditions, but it still seems apparent that when

WORLD GDP AND PRIMARY ENERGY CONSUMPTION PER GDP IN 1998



SOURCE: IEA ENERGY BALANCES OF OECD COUNTRIES (1997–1998)
IEA ENERGY BALANCES OF NON-OECD COUNTRIES (1997–1998)

compared to Japan, there remains considerable room for CO₂ reduction in the U.S.

If, as a result of some future framework convention, economic activities must unavoidably be conducted “under carbon restraints,” the US still has sufficient room in which investment to achieve efficiency and low carbon levels makes sense. In view of the fact that there are many countries, both advanced and developing, to which technological development can be transferred and applied, the US will be able to provide technical expertise. There are plenty of opportunities

for the export of technology and fierce competition among advanced countries, including Japan, can be expected in the future.

4) Impact on Japan

The bottom-line is that Japan will have to endure a great economic impact as a result of the “Kyoto curse” because it is burdened with extremely stringent targets that competitors from other countries – notably the U.S. and some developing countries – are not.

If the US, which seems to have significant room to increase energy efficiency, withdraws from the Kyoto

Protocol because it fears economic damage, then it will give up its power to persuade other countries to cut emissions. Not surprisingly, there are many in Japan who quietly favor a Japanese withdrawal.

Japanese industry, burdened by very stringent targets, recognizes that positive and long-term initiatives to deal with earth environment issues are the basis for sustained economic development and good business management. Thus, in 1991, there was the announcement of the Keidanren Global Environmental Charter, followed in 1997 by the announcement of the Keidanren Voluntary Action Plan on the Environment, including measures to prevent global warming. The latter, a publicly announced “social pledge” by Keidanren, integrated the CO₂ reduction plans that had been voluntarily made by 36 different industries.

According to this plan, yearly performance levels will be monitored by Keidanren. After all necessary strengthening and improvement measures have been implemented, the results will be submitted to a governmental advisory council. The performance of each company had been publicly announced, with the goal of ensuring transparency and systematic progress.

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The overall objective of this plan is to maintain CO² emission levels by participating enterprises at a level lower than that of 1990 – even in the year 2010 when CO² emission levels based on the BAU are expected to increase by approximately 12 percent. In order to accomplish this ambitious goal, participating industries must establish their own targets and make an all-out effort,

despite extremely difficult circumstances. Results will soon be published on how much emis-

sions companies cut in 2000. Some 43 Japanese industrial sectors now regularly report their emissions – representing 80 percent of all Japanese industries and around 43 percent of all emission sources.

The results to date indicate a tendency toward emission levels varying depending upon fluctuations in economic activity. However, due to additional efforts made concerning the effectiveness and efficiency of nuclear generation, any increment appears to be under control, though barely so.

Since CO² is emitted as a result of all human activity and energy usage, it is not practical to adopt conventional restrictive/obligatory

reduction measures especially for industry. The most efficient/effective/practical measures are considered to be those carried out on a voluntary/long-term/flexible basis by operators who are thoroughly familiar with their own industries and technologies.

Japanese industry favors a mechanism under which technical results and knowledge obtained through

tions by all major nations, including the US. ■

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such initiatives can be utilized internationally through technology transfer and enhanced staff training, etc. In implementing practical mechanisms for various programs and JI/CDM based on the Kyoto Protocol, it is important to make them as simple and as cost-effective as possible.

The COP-7 meeting in Marrakech is essential because it will provide an important opportunity to rectify any warped and unequal aspects included in the current negotiations. Marrakech will also set forth a vision about how to proceed with these initiatives following Phase II. High expectations are placed upon participation and positive contribu-

9-11 and After

by Daniel Bob, Senior Advisor, Reed Smith, LLP

The attack of September 11 and the ensuing events have had global repercussions, including important effects on Japan. Those effects have led Tokyo to take significant actions in the security sphere and to reassess the country's response to its unrelenting economic problems.

In terms of security, Prime Minister Koizumi moved quickly to demonstrate Japan's support for the United States in the new war against terrorism. The Prime Minister pledged to provide humanitarian assistance and pressed for passage of legislation that will permit Tokyo, for the first time since World War II, to provide supplies to allies in war zones far from Japan.

In moving forward on this legislation, Prime Minister Koizumi edged Tokyo ever closer to addressing the fundamental constitutional question that lies at the heart of Japan's participation in any international security problem. That question concerns the accepted interpretation of the country's constitution which posits that Japan forever renounce the use of force as a means of solving international problems.

It is important to recognize, however, that Japan's current interpretation of its constitution was

shaped as much—if not more—by the country's economic self-interest as by any idealistic desire to serve as a model peaceful state. Indeed, the historical record shows that the

At the same time, Yoshida foresaw the need for Japan to take on added responsibilities once the country prospered. He believed that other nations would never tol-

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American drafters of Japan's constitution explicitly held that it did not prevent Japan's participation in regional security contingencies. Moreover, amendments proffered by Japan to the draft constitution provided the government of Japan the flexibility to participate in collective security arrangements, if it so chose.

However, in order to focus the country's limited resources on economic recovery, then-Prime Minister Shigeru Yoshida—the key Japanese official involved in advancing the currently accepted constitutional interpretation—and his successors, sought to avoid being drawn into any overseas commitments. They repeatedly asserted that Japan was constitutionally prevented from security activity overseas and constructed an elaborate set of policies to buttress that assertion.

erate Japan receiving special international status once it caught up economically with the West.

Yoshida's strategy of avoiding collective security arrangements through constitutional interpretation brilliantly laid the groundwork for Japan's remarkable postwar economic success. But his views on how Japan's international role would have to change after that success was achieved were just as prescient. There is no better example of his foresight on this matter than the criticism Japan received as a result of the country's awkward response to the Gulf War.

Indeed, it was partly the shadow cast by the Gulf War that led Prime Minister Koizumi to craft his activist response to the war against terrorism. With the failed policies of a decade ago in mind, Koizumi

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took advantage of a general lifting within Japan of the near-taboo regarding discussions of security. Moreover, he made concerted efforts to assuage the concerns of Asian neighbors over Japan taking a more prominent role in security matters. Given all these considerations, there was little opposition to the Prime Minister's legislation.

Clearly, there is support in the new U.S. Administration for Japan taking the steps necessary to engage in collective self-defense. Many key members of the Administration, for example, signed on to last year's so-called Armitage

Report which labeled "Japan's prohibition on collective self-defense... a constraint on alliance cooperation. Lifting this prohibition would allow for

closer and more efficient security cooperation" with the United States. At the same time, these officials recognize that the U.S. cannot exert overt pressure on Japan on an issue of such sensitivity. As the Armitage Report goes on to state, "This is a decision that only the Japanese people can make."

Moreover, given the enormous economic problems that Japan faces—larger than ever in the after-

math of the terrorist acts—the considerable political effort that would be required for a constitutional debate now might diminish Japan's ability to institute urgently needed economic reforms. In that sense, a new form of the Yoshida doctrine lives on as the focus remains on fixing Japan's economy rather than on finally addressing the issue of Japan's ability to participate in collective self-defense arrangements.

Certainly, Japan's struggle to boost its sagging economy cannot be put delayed. More to the point politically, Prime Minister Koizumi

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has staked his tenure on delivering a reform program that will yield long-term economic health.

Yet, the terrorist attacks have significantly weakened the global economy and thus Japan's ability to cure its ills. Demand for Japanese products is down substantially, with Japan's exports declining in August—before the attacks—by almost 10% from last year's levels. Corporate Japan closed its books

for the first half of the fiscal year at the end of September when the benchmark Nikkei 225 index was at its lowest level in 18 years. Simultaneously, new accounting reforms went into effect that require banks and other firms to report their earnings based on the market value of equities rather than original book values. Meanwhile, Standard and Poors is considering lowering the credit ratings of Japan's debt and many of Japan's largest banks. And Japan's industrial production fell by more than 10 percent in August for only the second time in 20 years.

In short, as Japan's Finance Minister Masajuro Shiokawa said at the start of October, Japan's economic situation is "very bad."

The question now is what Prime

Minister Koizumi can and will do in response. In Koizumi's favor, his popularity remains at unprecedented levels—though it has dropped a bit. His rhetorical commitment to reform has remained relatively unchanged. And the public continues to support reform.

Yet Koizumi's political enemies are waiting to exploit his every mistake. The scale of the Japan's problems is immense, the core issue

being the country's terminal banking sector. The sheer scale of loans to "problem borrowers" is staggering, far larger than that of any other country that has faced a banking crisis. The government estimates that Y120 trillion of loans are bad or "under caution." But a recent Goldman Sachs report gauges the amount at closer to Y240 trillion—about \$2 trillion.

The Prime Minister has said he is determined to "normalize the bad loan problem over three years at the latest." Getting rid of bad loans will necessarily mean putting weak companies out of business, yielding unprecedented postwar levels of unemployment. And with Japan's ratio of public sector debt to gross domestic product easily exceeding that of the other major industrialized nations, and overnight interest rates near zero, the fiscal and monetary flexibility available to ease short-term pain is severely limited.

Optimists take the view that fundamental reform in Japan can only be carried out in crisis. And certainly the terrorist attacks have created a wholly new atmosphere. Pessimists, however, cite the depth of reform required of Japan, to the point that there will necessarily be social and even cultural consequences. Japan will be a very different place indeed if the full range of structural and

banking reforms needed to right Japan's economy is implemented.

Failure to carry out such reforms will have obvious negative economic consequences for Japan over the long run. But failure may also permit new political figures to take residence in the Kantei—perhaps including those whose views on Japan's role in the world will trouble even the country's closest allies. ■

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Keizai Koho Center (KKC) is an independent, non-profit organization designed to promote the understanding of Japan's economy and society at home and abroad. Its financial resources are derived entirely from the private sector.

KKC fosters a deeper understanding of Japan's basic social structure. Furthermore, it conducts public affairs activities to improve the Japanese people's recognition of Japan's global role.

The views expressed in this newsletter are of the contributors and do not necessarily represent those of the Keizai Koho Center.

Dedicated Japanese Funds

Japanese Companies Step Forward with \$37 Million in Donations

The Japanese business community was profoundly shocked by the terrorist attacks on September 11. Almost immediately Japanese companies rallied to assist the U.S. by contributing to various relief funds established to aid survivors and their families.

The Keizai Koho Center and Keidanren (the Japan Federation of Economic Organizations) have prepared a survey of the gifts made thus far. Japanese companies – large and small – have made donations in the form of providing direct funds, material, and volunteer services. Many firms, especially those with operations in the United States, have also urged their employees to also volunteer on an individual basis.

Summary As of October 22, 2001

To date, 223 Japanese firms and business groups have made monetary contributions of \$34,579,779 (¥4,218,733,000) 1\$=¥(Yen) 122.

This is not a complete tally – more contributions have been and will continue to be sent from various Japanese firms and individuals.

In addition, a dedicated fund established by Keidanren and other business organizations for the families of New York's fallen fire fighters and police officers. To date, the Japan Relief Fund has collected \$3 million. (¥380,310,000: As of October 25, 2001)

For a full description of contributions by the Japanese business community thus far, please see our website: www.kkc.or.jp/english