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Editorial Note.....Ichikawa Hiroo i

Research Papers

Policy-Making Process and Relationships
between Politicians and Bureaucrats in Japan:

Comparison and Verification of Three Models.....Tanaka Hideaki 1

Disability and Employment:

The Social Cooperative as a Sustainable
Social Business Model.....Laratta Rosario 31

Institutional Dimensions in Russia's
Natural Gas Policy in Northeast Asia:

Some analytical observations.....Shadrina Elena 43

Risk Management Policies for Mega-Cities:

Lessons from Tokyo on March 11, 2011.....Kubo Takayuki 69

A Study of Management Style of
“Japan's Small-Medium Sized Enterprises”:

From the View of ‘Fixed Accounting System’.....Ishii Hiromune 85

* All manuscripts in this journal have been peer reviewed
and approved of by the editorial board for publication.

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List of Contributors..... 105

Editorial Note

Meiji University started a number of professional graduate schools in 2004. They included the schools of Governance Studies, Global Business and Accountancy, in addition to the Law School. These became addendum to but separate from the existing academic and thesis oriented courses in the Graduate School of Meiji University. The new schools offer Master of Public Policy, Master of Business Administration, and Master of Professional Accountancy for the qualified students. Of these new professional schools, the Governance Studies is catered primarily for local elective officials and regional government staff members. The School provides professional and pragmatic trainings in public administration and management for these seasoned students. Originally the size of the Governance Studies was set at the total of 50 Japanese students per annum. However, over the years, the School has begun to accept many trainees from various transitional countries. A large number of officials from Malaysia have already been exposed to Japanese methods of government management at Meiji University. Currently, foreign trainees in the School include the students from Bangladesh, Congo Republic, Indonesia, Kyrgyz, Laos, Malaysia, Myanmar, Philippines, Vietnam, and Laos. From 2014, a plan has been made to establish the Graduate School of Global Governance which is a Doctoral Program in the Governance Studies area.

The Governance Studies has a Japanese quarterly journal. Faculty members and a selected number of students have contributed manuscripts on various issues related to government and governance to the quarterly. In addition to the Japanese version, the Governance Studies has decided to launch an English edition of the journal. It is labeled as '*Meiji Journal of Governance Studies*.' The present volume becomes an inaugural edition, while this will subsequently be followed by a regular annual volume. In this inaugural publication, the Governance Studies is highly honored to have a contribution from Professor Jon Pierre of Gothenburg University, Sweden. Professor Pierre is one of the most renowned academics in the globe in the area of public administration and government management. His contribution to this initial volume has certainly helped enhance the quality as well as reputation of the journal. The School is highly grateful for his work and perseverance, since the schedule of the publication was delayed due to many on-campus impediments.

In addition to Professor Jon Pierre, the current edition includes the works of a number of the faculty members from overseas. One of them is from the United Kingdom, while others are from Italy and Russia. They have been teaching community affairs, environmental issues, 'local branding,' etc. in English. Their lectures often provide international perspectives and stimulate foreign trainees. The interactions between these foreign professors and foreign trainees seem to epitomize the degree of globalization at Meiji University in general and the Governance Studies in

particular. As the editor in chief of this journal, I would like to express my sincere appreciation to Professor Emeritus Akira Nakamura for his editorial help and the Professional Graduate School Office for their logistic support. The Governance Studies hopes that not only would this new edition help enlarge interests among academics and practitioners in Japanese public management, but the inaugural volume would prepare new dimensions to analyze the public sector management in various countries.

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Policy-Making Process and Relationships between Politicians and Bureaucrats in Japan Comparison and Verification of Three Models

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1 Introduction

The Democratic Party of Japan (DPJ) took up the reins of government in euphoria in September 2009, but it ended in December 2012. It lasted for just three years and three months. During that period, the prime minister changed every year. This symbolizes the failure of the DPJ's "politician-led government" to function as expected. Moreover, the transition from the Kan Administration to the Noda Administration has witnessed the virtual revival of such traditional institutions as the administrative top officials' meeting consisting of secretary-general of all ministries and the practice of prior review by the ruling party. In a sense, politics has returned to the old model that dominated during the long years of Liberal-Democratic Party (LDP) rule. As the DPJ's concept of a politician-led government has been extensively discussed (Ito [2011], Sasaki and Shimizu [2011], Takayasu [2011], *Nihon Keizai Shimbun* [2010] and others), this paper will focus on the policy-making process with special attention to the role of politicians and bureaucrats. While the change in government exposed a bitter reality, the experiment with politician-led government did serve the purpose of clarifying the various problems that exist in Japan's policy-making process. The Kasumigaseki District where government ministries congregate has long been criticized as a bastion of bureaucrat-led government. Leaving the details of the definition aside, the recent government change did prove how easy it was to break free from the grasp of bureaucrat-led government (Nakano, 2010). On the other hand, the experiment also proved that a government cannot function properly in the absence of bureaucrats or under the leadership of the "ministerial troika" (comprised of minister, vice minister and parliamentary secretary of government ministries).

Policy-making ranks among the most important tasks of government, and the study of the policy-making process is directly linked to the issue of politics. In order to establish the characteristics and determinants of the policy-making process, such studies analyze the inter-relations between systems and institutions, the external environment and the actors. Discussions of which is superior — bureaucrats or

politicians — may be useful in analyzing the behavior and influence of the actors in policy-making, but the real answer lies in the results. Carrying the logic to the extreme, it can be said that as long as the results are good and democratic procedures have been followed, the means and process can be justified. Conventional, policy research has focused primarily on the behavior of the actors, and not much attention has been paid to the outcome of the policy-making process and the content of policies.¹ This is because such evaluations invariably require certain value judgments. On the other hand, it is possible to evaluate policies from the perspective of the characteristics and procedures followed in the process of deliberating on policies, and the stability and effectiveness of policies.

A policy is the translation of the government's political priorities and principles into programs and courses of action to deliver desired changes (NAO 2001, 1). In this context, the policy-making process consists of the process of discussing, approving and implementing public policy (Stein and Tommasi 2008, 6), or the process by which governments translate their political vision into programmes and actions to deliver 'outcomes' — desired changes in the real world (UK Prime Minister and the Minister of the Cabinet Office 1999: 15). Our principal interest in this paper is to investigate the factors that determine the capacity to design, approve and implement effective measures. The World Bank (2010, 3) makes the following point: "The scope and quality of the policy process are highly dependent on each country's idiosyncratic bridge between politics and administration or the particular national balance between political calculus and technical assessment." Thus, the question is: What kind of balance is conducive to formulating better policy?

The purpose of this paper is to identify problems in Japan's policy process from the perspective of the characteristics of the process and the effectiveness of the resulting policies. This is undertaken through a comparison of the following three models: the conventional LDP model ("Ruling Party and Bureaucracy Model"), the "Council on Economic and Fiscal Policy Model" (CEFP Model) as it functioned under the Koizumi Administration, and the DPJ's "Ministerial Troika Model." Jumping immediately to the conclusion, it can be said that the greatest problem in Japan's policy process is that the policy process lacks "contestability." It has been argued that one of the problems in Japan's policy process is that the ruling party functions as a player invested with veto power, but the actual problem is that sufficient analysis and deliberation is not undertaken to enable coordination and consensus building. The LDP government came back at the end of 2012 following the dissatisfaction toward DPJ, and Japan is returning to its conventional model, although the policy-making process of the Abe Administration may differ from it. The policy-making process in Japan has been back and forth, but the real question that must be asked is: What incentives and what tasks should be given to bureaucrats to better results?

The rest of this paper is structured as follows. Section 2 gives a literature review and outlines the analytical framework. Section 3 focuses on social security policies and examines the respective policy processes of the three abovementioned models. Section 4 presents a cross-sectional comparison of the policy processes of the three

models and analyzes their problems. Finally, Section 5 presents the conclusions of this study.

2 Literature Review and Analytical Framework

While policy can be defined in various ways, all definitions have a certain point in common. This is found in the government's perspective and its attempts to influence society and the economy and to achieve certain goals.² "Policy process" refers to the process of making and implementing such policies. This process includes such actors as politicians, bureaucrats, interest groups and scholars.³ During the 1950s, Lasswell formulated a "process model" for analyzing the policy process by dividing it into a number of stages (Lasswell 1956). While Lasswell adopted seven stages of intelligence, promotion, prescription, invocation, application, termination and appraisal, others have developed process models with differing numbers of stages.⁴

In each process, actors take action and make policies. Generally, the policy process is a process of transaction and negotiation between political actors. The behavior of political actors in the policy-making process — as shaped by their roles, incentives, and constraints — will depend, in turn, on the workings of political institutions and on more basic institutional rules that determine the roles of each of the players, as well as the rules of engagement amongst themselves (Stein and Tommasi 2008, 13). Furthermore, the structural, social, political and economic environments influence political and policy making activities (Birkland 2005, 202). Recent years have seen the development of the "core executive theory" (Rhodes and Dunleavy 1995, Ito 2008), which explains the central government's policy coordination process in terms of mutual relations among such actors as the prime minister, the cabinet, ministers and bureaucrats and the exchange of resources among these actors.

Even assuming that relations among actors are important in the policy process, it would be premature to generalize the influence of a specific actor for all stages of the policy process since the policy process has multiple stages. Aberback et al. (1981) interviewed government administrators in major advanced countries and developed a four-part model for the relationship between politicians and bureaucrats. These cover the four stages of policy implementation, formation, coordination and concept. Image IV in Aberback et al. (1981) shows that, with the exception of the implementation stage, politicians and bureaucrats share common roles, and that government administrators engage in the political process. In analyzing Image IV in Aberback et al. (1981), Campbell (1988) concludes that the type of political engagement by senior officials differs between central agencies, such as the Cabinet Office and Ministry of Finance, and other government ministries. Furthermore, relations among actors also differ according to differences in the policy process and the type and content of policies.⁵ In other words, the relation between politicians and bureaucrats and the role of bureaucrats cannot be explained in terms of a simple policy-administration dichotomy.

In Japan, discussions of political and policy processes have been almost exclu-

sively focused on the actors. But the important issue is to identify processes capable of generating good policies. An attempt to define what constitutes “good policy” calls for a discussion of the types of systems and processes capable of generating good policies. IDB (2006) lists the following attributes of policies that give rise to good results: stability, adaptability, coherence and coordination, the quality of implementation and enforcement, public-regard and efficiency. The World Bank (2010) identifies the following attributes of good policies: consensus-built among key stakeholders, economically sound, implementable politically, implementable technically, sustainable, and stable. Finally, the Cabinet Office (1999) lists the following characteristics of modernised policy: strategic, outcome focused, joined up, inclusive, flexible and innovative, and robust.

The analytical framework of this paper is based on the aforementioned literature. We define three decision-making models based on the relationship between politicians and bureaucrats. The first model is “Ruling Party and Bureaucracy Model”, which is the conventional LDP model. In this model, politicians outside the government and bureaucrats co-operate each other in the policy-making process and the former often exercises veto power. This model is found in almost LDP governments until around 2000, although the characteristics of the model differ more or less between them. The second one is “Council on Economic and Fiscal Policy Model” (CEFP Model), which is found under the Koizumi Administration from 2002 to 2006. In this model, prime minister plays an important role in the decision-making process together with outside experts and academics. CEFP Model differs from Ruling Party and Bureaucracy Model in terms of the role of prime minister, although the partnership between politicians and bureaucrats in the former model is almost the same as that of the latter model. The third one is “Ministerial Troika Model” under the DPJ administrations from 2009 to 2012. In this model, ruling party is not involved in the decision-making process as the major player, although the characteristics of this model change in the second half of DPJ era.

Policy-process and decision-making models differ according to the policies and the stage of the policy process that the models focus on. With this in mind, it should be noted that this paper focuses on social welfare policies. Specifically, the following policies are examined in the context of each of the three models to be compared. First, under the “Ruling Party and Bureaucracy Model,” the 1999 pension reform under the LDP Administration is examined. For the CEFP Model, the 2004 pension reform under the Koizumi Administration is examined. Lastly, for the “Ministerial Troika Model,” the introduction of the new child allowance system under the DPJ Administration is examined.⁶

The policy process is examined in three stages: defining policy objectives, policy formulation and deliberation, and coordination and decision-making. This form of research has previously been undertaken by Nakamichi (2005). Specifically, Nakamichi focused on attempts to categorize policies and to create policy-process models, which he then used in the analysis of the policy process to determine the dynamics of the relations between politicians and bureaucrats in Japan. Nakamichi states that, “The importance of the media in the process of formulating policy issues

is growing; government administrators are playing a greater leadership role in formulating policies; and the importance of political parties and Members of Parliament in policy-making is growing.” (p. 181) However, the present paper is not primarily concerned with the relative strengths of bureaucrats and political parties. Rather, this paper concentrates on factors affecting the outcome and the characteristics of policies. Thus, the role of bureaucrats is observed from the perspective of making “good policies,” and differences in the three policy processes (institutions and the behavior of actors) are analyzed to identify the problems that exist in Japan’s policy process.⁷ While generalizations based on the analysis of specific policies should be avoided, social security policies represent an area in which the coordination of interests is difficult, and they are therefore considered to be particularly useful in identifying the problems in Japan’s policy process.

In light of the prior literature, this paper adopts the following criteria for policy evaluation: (1) economic soundness and efficiency, (2) political and technical feasibility, and (3) effectiveness, stability and sustainability. Similarly, the following criteria are used for evaluating the policy process: (1) identification and definition of needs and problems, (2) involvement of stakeholders and collection of a wide range of views, (3) presentation and analysis of multiple alternatives, (4) cross-ministerial deliberation, (5) consensus building and coordination.

3 Case Studies in Policy Process

(1) *Ruling Party and Bureaucracy Model: Pension Reform of 1999*

Following the process of revising fiscal projections, deliberations leading to the 1999 pension reform began in earnest in May 1997 in the Pension Council which consisted mainly of external experts. In December 1997, the Pension Council released its “Points at Issue,” which was followed by the publication of two documents on pension reform by the Ministry of Health and Welfare. These were entitled “Pension Reform: Five Alternatives” and “Methods for Balancing Benefits and Contributions, and their Impact on Insurance Premiums,” both of which presented the fiscal projections of the Ministry of Health and Welfare. Next, the “White Paper on Pensions” was published in February 1998, and a “Survey of Experts” was conducted in March based on a paper explaining the “Five alternatives.” In October 1998, the Pension Council released a position paper stating that increases in insurance premiums for the Employees Pension System should be kept under control. The position paper also argued that it would be difficult to increase the ratio of subsidy to the Basic Pension and to review the exemption given to full-time housewives on the payment of Basic Pension insurance premiums. Responding to this, the Ministry of Health and Welfare in the same month announced its proposed plans for pension reform. This comprised three separate proposals, all of which called for higher insurance premiums and lower pension benefits while maintaining the current institutional framework. The proposals also contained such features as a freeze on wage indexing, reduction in pension benefit for those aged above 65 and having also earnings, and introduction of a gross remuneration system in place of monthly wage.

After the proposals of the Ministry of Health and Welfare were released, differences of opinion quickly emerged between the government and the ruling party on the question of whether or not to raise insurance premiums. Addressing the question of higher insurance premiums on October 18, Acting Chairman Yuya Niwa of the LDP Policy Research Council stated, "For the time being, a freeze must be put in place." It was reported that Cabinet Secretary Hiromu Nonaka and Deputy Chief Cabinet Secretary Tejiro Furukawa had given their consent to this policy direction and had conveyed it to the prime minister.⁸ Speaking at the Economic Policies Ministerial Conference of October 19, Health and Welfare Minister Sohei Miyashita resisted this direction by stating, "How can there be any discussion if the starting point of the debate is a freeze on insurance premiums?"⁹

In February 1999, the Ministry of Health and Welfare finalized the Outline for Pension Reform to reflect the above policy direction. Thereupon, the scene of the debate moved to the coordination process that took place within the coalition of ruling parties. The LDP approved a partially revised version of the Outline for Pension Reform (raising the subsidy rate for the Basic Pension System to 50 percent and simultaneously lifting the freeze on raising insurance premiums) in a joint conference of its Pension System Research Commission and Social Policies Division. However, consultations with its coalition partner, the Liberal Party, became bogged down when the Liberal Party rejected some of the elements of the proposal put forward by the Ministry of Health and Welfare and the LDP. Specifically, during consultations of the Meeting of Policy Officers, the Liberal Party demanded that the 5-percent cut in benefit levels be deleted and that the Basic Pension be changed to a 100-percent tax-based system. In the negotiations and coordination that followed, both parties finally agreed to raise the subsidy rate of the Basic Pension to 50 percent. Thereupon, provisions concerning necessary fiscal resources were added to the Supplementary Provisions of the Pension Reform Bill, and the resulting revised bill was submitted to the Diet in July 1999.

(2) *CEFP Model: Pension Reform of 2004*

The 1999 pension reform failed to address several issues that required resolution, the most important of which were the early lifting of the freeze on insurance premiums and meeting the funding requirements for raising the subsidy rate to the Basic Pension to 50 percent (Ministry of Health, Labour and Welfare, 2004). Procedures for the 2004 pension reform were launched when the Pensions Subcommittee of the Advisory Council on Social Security started its deliberations in January 2002. In December 2002, the Pension Bureau published a document entitled "Directions and Issues Concerning the Framework for Pension Reform." The 2004 pension reform process differed from the conventional style of deliberation due to the creation of the Council on Economic and Fiscal Policy (CEFP) that followed administrative reforms of the central government.¹⁰ CEFP started its deliberations on April 1, 2003, based on "Points at Issue Concerning Pension System Reform," which had been drafted by a non-government member of CEFP. In the meeting held on April 16, Statements of Opinion were submitted not only by the Minister of Health, Labour and Welfare but

also by the Minister of the Economy, Trade and Industry, the Minister of Finance and by non-government members of CEFP. Thereafter, the basic principles for pension reform were included in “2003 Basic Policies for Economic and Fiscal Management and Structural Reform” (approved by the Cabinet in June 2003). In September, Health, Labour and Welfare Minister Chikara Sakaguchi presented the Ministry’s simulations and projections for benefits and contributions. During the same month, the Pensions Subcommittee finalized its “Views on the 2004 Pension Reform.” Following the lower house election held in November, the Ministry of Health, Labour and Welfare presented its final proposal for pension reform during the same month. The fundamental point of conflict in the 2004 pension reform derived from differences between the Ministry of Health, Labour and Welfare and the non-government members of CEFP. While the Ministry emphasized maintaining current benefit levels, non-government CEFP members wanted to keep pension contribution levels from rising.¹¹

The proposal was then submitted for discussion by such organs as the LDP Pension System Research Commission, the Joint Committee of Ruling Parties on Pension System Reform, and the Joint Meeting of the Government and Ruling Parties. A decision was reached in the December 16 2003 meeting of the ruling parties to raise the subsidy ratio to the Basic Pension to 50 percent by fiscal 2009. On February 4, 2004, a final resolution was reached in the Joint Meeting of Ruling Parties on Pension System Reform (the bill was submitted to the Diet in the same month). However, the Ministry proposal had been almost totally overturned in the internal discussions of the LDP and New Komeito. Specifically, the proposed higher insurance premium rates for the National Pension System were drastically reduced. In the Employees’ Pension System, the collection of insurance premiums from actively employed persons of age 70 and above was postponed, as was eligibility for part-time workers.¹² It was reported that throughout this period, Prime Minister Koizumi hardly commented on these developments and confined himself to merely observing the negotiations that were taking place among the ruling parties on the grounds that pension reform was not a concern of the Prime Minister’s Office.¹³ As in the previous case, this second pension reform avoided and postponed difficult decisions. Masajuro Shiokawa, whose term in office as Finance Minister extended through September 2003, explained that the Minister of Health, Labour and Welfare had requested that temporary measures be accepted pending passage of the budget for the following fiscal year, and that for this reason the pension reform bill was finalized without making major changes in the pension system.¹⁴

(3) *Ministerial Troika Model: Child Allowances*

The DPJ Manifesto formulated for the 2009 lower house election contained a commitment to provide new child allowances of 26,000 yen per month (13,000 yen per month during fiscal 2010) regardless family income regardless to all children until the end of junior high school. The objective of this commitment was to “Review income tax deductions for dependents and spouse, and provide the support of society as a whole for the upbringing of every one of the children who will support

the society of the future.” To honor this commitment, the Hatoyama Administration, which had come into office in September 2009, launched into necessary deliberations and negotiations in the fiscal year 2010 budget compilation process, its first budget process. Unlike in the conventional approach, however, no deliberations were undertaken in ministerial councils or by CEFP. Instead, all deliberations took place behind the scenes. Consequently, it was not until the final stages of the budget compilation process that the outstanding issues in the debate became known.¹⁵

There were two key issues in the debate concerning the introduction of child allowances: income threshold on eligibility, and the level of contributions by local governments. The government’s straitened fiscal conditions added urgency to these two issues. As a result, debates raged everywhere in the DPJ on how to handle the child allowance issue as the budget compilation process approached the end of 2009. A proposal for income threshold was contained in the List of Demands submitted by DPJ Secretary General Ichiro Ozawa to Prime Minister Yukio Hatoyama on December 16.¹⁶ It was reported that the prime minister responded to the demands of his party as follows. “Rather than calling this the will of the party, I would call it the will of the people. I express my appreciation for this.”¹⁷ Nevertheless, at the meeting with Secretary General Ozawa at the prime minister’s official residence in the evening of December 21, Prime Minister Hatoyama informed Ozawa of the decision not to adopt income threshold.¹⁸ On the issue of local government contributions to new child allowances, an agreement was reached on December 23 in discussions involving Vice Premier Naoto Kan, Finance Minister Hirohisa Fujii, Home Affairs Minister Kazuhiro Haraguchi, and Health, Labour and Welfare Minister Akira Nagatsuma. Under the terms of the agreement, it was decided that the framework of the Child Benefits System would be retained, and the new Child Allowance System would be superimposed on top of the existing structure.¹⁹ However, no decisions were made on the structure and management of the system for fiscal year 2011 and thereafter. From the outset, this failure loomed as a major threat to the sustainability of the system.

The introduction of the new Child Allowance System was finalized in just over four months from the start of the new DPJ Administration. However, throughout this period, the government did not present any information on how the system was to be financed, the net effect of the Child Allowance System by income level and family structure when combined with the concurrent abolition of the tax deductions for dependents, and the percentage of households that would actually experience a net increase in benefits. Moreover, it remained unclear what had been discussed and decided by whom and where.

This problem came to a head when the Diet began deliberating on the Child Allowance Bill. For example, in the February 24, 2010 session of the House of Representatives Health, Labour and Welfare Committee, Health, Labour and Welfare Minister Nagatsuma sidestepped the question on how the government had arrived at the monthly amount of the Child Allowance by stating, “We examined cases from other countries and took various factors into account. The decision was finalized before the election.”²⁰ The LDP brought up the question of why foreigners residing in Japan

with children living abroad were eligible for benefits. While the government was aware of the existence of this problem under the Child Benefits System which was previous system, it did not have enough time to redesign the system in order to fulfill its campaign promise. Hence, for fiscal year 2010, it had no other option but to utilize the existing framework of the Child Benefits System.²¹

Child Allowance payments started in June 2010. However, because no decisions had been made on the management of the system for fiscal year 2011 and beyond, there was considerable confusion in the government's internal discussions and in discussions between the government and the ruling party when the fiscal year 2011 budget compilation process got under way. The situation was further complicated by the results of the 2010 upper house election. Under the "divided Diet" that emerged from the election, repeated changes had to be made in the design of the system. In the 2011 Ordinary Session of the Diet, the Kan Cabinet was forced to abandon the goal of making full-amount payments in fiscal year 2011 due to the shortage of government revenues. Thereupon, a bill for revision was submitted calling for payments of 20,000 yen per month only for children younger than three. However, negotiations between the ruling and opposition parties broke down, and an alternative bill was passed that uniformly set all payments at 13,000 yen through September 2011. Later, the Child Allowance System was submitted for joint review by the ruling and opposition parties. Ultimately, the decision was made to continue with the Child Allowance System through March 2012, and to return thereafter to the previous Child Benefits System.

4 Analysis and Observations

(1) *Identifying Policy Issues*

What socio-economic problems are to be addressed, and what policies are to be adopted? While these questions mark the starting point of any policy process, the choices that are actually made depend heavily on the judgment of those involved in the policy process. In many instances, the process of selection and elimination at this point can be highly arbitrary.²² Under the traditional "Ruling Party and Bureaucracy Model," although there have been exceptions (such as the administrative reform of the central ministries carried out by the late Prime Minister Ryutaro Hashimoto), the task of identifying policy issues is primarily carried out by bureaucrats (Table 1).²³ The Ruling Party and Bureaucracy Model was created during the period of Japan's accelerated economic growth, and the leadership role in policy-making was given to the bureaucracy because under the prevailing conditions, "policy choices did not have to be made under conditions of serious conflict over distributional issues, and therefore the process did not come face-to-face with politics in the true sense." (Takahashi 2002, 111) However, the situation changed with the end of the period of accelerated growth. The CEFP Model emerged at a time when Japan was confronted by a growing need for structural reform. While CEFP has been thoroughly studied (Ota 2006, Shimizu 2007, Shiroyama 2006, Takenaka 2006), the critical point of importance is that, whereas policy-making had always

Table 1 Comparison of Three Models of Policy-Making

Stage	Actors	LDP Administrations Ruling Party and Bureaucrats Model	LDP Administrations CEFP Model	DPJ Administrations Ministerial Troika Model
Identify policy issues	Politicians (prime minister, ministers, ruling party)	△Ruling party politicians convey requests to bureaucrats	◎Prime minister uses CEFP to identify policy issues (revision of Cabinet Law clarifies prime minister's right to submit initiatives)	◎Proposals made by top three ministry officers based on election manifesto
	Bureaucrats	◎Identify need for reform in present systems	○Convey requests to CEFP	△Await instructions from top three ministry officers
	Advisory councils, etc.	△Convey requests to ministries and ruling party (frequently a mouthpiece for ministries)	◎CEFP clarifies the issues on hand with support from its Secretariat	×Councils viewed as stand-ins for bureaucrats and not utilized
Policy formulation and deliberation	Politicians (prime minister, ministers, ruling party)	○Deliberation in ruling party committees	○Deliberation in ruling party committees	△Ruling party Diet members submit requests to policy committees of ministries and agencies ◎After revival of Policy Research Committee, deliberation in ruling party committees
	Bureaucrats	◎Submit proposals prepared by ministries and agencies to Councils, and prepare details of legislative bills	◎Prepare details of legislative bills	◎Prepare details of legislative bills
	Advisory councils, etc.	○Deliberation based on proposals received from ministries and agencies (necessary data is provided by ministries and agencies) ○Independent analysis and examination of proposals is insufficient	◎CEFP deliberates on basic directions (transparency has improved, but deliberations are not necessarily independent) ○Parallel deliberations carried out in the deliberative committees of ministries and agencies	×Councils viewed as proxy for bureaucrats and not utilized (insufficient data and information, and no independent deliberation)
Coordination and decision making	Politicians (prime minister, ministers, ruling party)	◎Prior investigation by ruling party committees (committees hold veto power)	◎Prime minister's approval signifies final decision ○Prior investigation by ruling party committees (diminished veto power of committees)	○Ad hoc coordination by ministers and powerful ruling party members because ministerial committees did not function
	Bureaucrats	◎Laying groundwork within government, ruling party, related industries, etc.	○Laying groundwork within government, ruling party, related industries, etc.	△Involvement in prior coordination before sending the proposal to the ministerial level has also declined
	Advisory councils, etc.	×No role after submission of recommendations	△Follow-up by CEFP	×Councils viewed as proxy for bureaucrats and not utilized

Notes:

1. Assessed by the author based on analysis presented in this paper. Symbols indicate levels of involvement (◎indicating the strongest level of involvement, ×indicating the weakest level and △indicating somewhere between them).
2. Under DPJ administrations, advisory councils were generally not utilized. However, in certain instances such as the Social Security Investigative Meeting, meetings and conferences were created with ministers, ruling party politicians and private-sector experts as members.

been monopolized by the bureaucrats of the respective ministries with jurisdiction, CEFPP succeeded in making its way into the policies arena as an agenda-setting actor.

The DPJ Administration born in September 2009 immediately began to make changes in the policy process in an effort to realize the party's stated goal of "politician-led government." The DPJ Manifesto issued at the time of the 2009 lower house election contained the following three policy process-related proposals: (1) establishment of a "National Strategy Unit" under the direct jurisdiction of the prime minister and charged with the tasks of agenda-setting and formulating a national vision, (2) policy formulation, coordination and decision-making centered around the top three politicians of individual government ministries, and (3) policy coordination in ministerial committees (abolition of the administrative top officials meeting). The core principle in the DPJ policy process is the unification and integration of the government and the ruling party, a principle that was clearly spelled out in the Cabinet Meeting Memorandum entitled "On the Relation between Politics and the Bureaucracy," which was issued immediately after the launch of the DPJ Administration (September 16, 2009). The principle was again delineated in the Memorandum entitled "Policy-Making in a Unified Framework for the Government and the Ruling Party," which was issued by DPJ Secretary General Ichiro Ozawa and distributed to all DPJ Diet members (September 18).²⁴ In the new policy process envisioned by the DPJ, the policy committees of individual government ministries and agencies (chaired by their respective vice-ministers) would receive the proposals and views of ruling party members. In the next step, teams of ministers would formulate policy proposals to be submitted to the Cabinet for approval. However, in the process of compiling the fiscal year 2010 budget, Secretary General Ozawa himself came forward to directly submit requests pertaining to the budget and the tax system to the government. As evidenced by this case, the attempt to create a unified and integrated framework began to waver shortly after the launch of the DPJ Administration.

A key problem in the Ministerial Troika Model was that the prime minister and individual ministers soon began to make personal statements on policy directions that had not been properly thought through. Prime Minister Kan's advocacy of the "abandonment of nuclear power generation" was a typical example of this tendency. It is hard to imagine why even the prime minister would be allowed to initiate a major shift in policy without prior consultation with or among cabinet ministers. Subsequently, the Noda Administration had to revise the course of "abandonment of nuclear power generation," resulting in even greater confusion in Japan's nuclear power policies. Another critical failure originated in the DPJ Manifesto that was serving as the template for agenda setting. The problem was that the Manifesto itself lacked internal consistency and had not been systematically compiled. Needless to say, policy-making is predicated on access to a wide range of information and data. But an opposition party simply does not have access to such information before taking office. Therefore, it would have been very natural for the DPJ to review the contents of the Manifesto and its order of priorities shortly after taking office. However, the DPJ lacked the requisite flexibility.²⁵ Coming into office in the

fall of 2011, the Noda Administration created the Council on National Strategy and Policy to function as a “command post overseeing important policies and as a driving force in policy promotion.” As it turned out, however, this newly created Council²⁶ resembled the earlier CEFP in appearance only.

(2) *Policy Formulation and Examination*

In the “Ruling Party and Bureaucracy Model,” bureaucrats played the leading role in formulating and examining policies. A stage for the exercise of these functions was often provided by the government’s various advisory councils. In more recent years, council reports and recommendations have in certain cases been written by council members. However, members generally do not have the time to draft reports and primarily concern themselves with expressing their views orally. As a result, the writing of reports and recommendations is left to the council’s secretariat, which goes about this task based on the logic and dynamics of the bureaucracy. The reform of pensions and other social security systems can easily lead to confrontation based on the differing interests of the discussants. Therefore, in both the 1999 and 2004 pension reform, the Ministry of Health, Labour and Welfare made a conscious effort to defuse the tension and generate discussion by publishing various alternative scenarios and trial computations, by undertaking a number of questionnaire surveys, and by organizing public hearings for participation by the general public. However, prior to this, issues related to the fundamental structure and fiscal resources needed for the Basic Pension Program had never been fully examined, a failure that can be traced to the vested interest that the bureaucracy had in preserving the social insurance approach.²⁷

In the CEFP Model, a transition was made from a system in which ministries with jurisdiction monopolized the policy formulation and examination processes to a system of competition among policies proposed by ministries with jurisdiction.²⁸ Ota (2006, 148) comments on CEFP as follows: “For the first time, the sustainability of the system and the balance between benefits and contributions were earnestly discussed because a forum for discussion had been created. This represents a major advance that differentiates this process from other earlier pension reform initiatives.” While it is true that CEFP discussed a broad range of issues, there were some clear limits to its functionality from the perspective of policy-making. For instance, in the 2004 pension reform, legislative bills were drafted for raising the subsidy rate to the Basic Pension to 50 percent. But no clear rationale was given for why the rate should be raised to 50 percent.²⁹ Nevertheless, CEFP was ultimately unable to derail the carefully crafted pension reform proposal of the Ministry of Health, Labour and Welfare that was aimed at rejecting tax-based universal pensions and maintaining the currently operating pension insurance (Shinkawa 2004, 324). Thus, while the policy process was a success from the perspective of achieving the political objectives of the prime minister, it was less than perfect from the standpoint of independent analysis and deliberation and the submission of independently derived recommendations to the government. It should be noted that in Britain and other countries, advisory councils provide a forum for independent analysis and

deliberation by outside experts, and are not structured for participation by cabinet ministers and other politicians.³⁰

In the Ministerial Troika Model, the initial idea was to eliminate bureaucrats from the policy process and to assign the task of policy formulation to the top three politicians (minister, vice minister and parliamentary secretary).³¹ However, by cutting off their dependence on bureaucrats, vice-ministers and parliamentary secretaries quickly became drowned in the work that hitherto had been performed by secretary-generals and director-generals. Furthermore, by prohibiting bureaucrats from engaging in negotiations among themselves, the finely tuned coordinating network that covered the Kasumigaseki District was shredded. Meanwhile, the central bureaucracy underwent a complete change in character and acquiesced to its new role of waiting for instructions from politicians (Shimizu 2011, 13). Viewing advisory councils as symbols of bureaucrat-led government, the DPJ administrations abolished these councils or rendered them dormant.³² As was seen in the analysis of the process leading to the introduction of the Child Allowance System, this style of “politician-led government” resulted in policy formulation that suffered seriously from insufficient analysis and examination.³³ The objectives of the Child Allowance System were vague, its expected policy outcome was never clearly defined, and the entire deliberative process lacked proper transparency.³⁴ These problems were common to various other policy issues, such as the abolition of highway tolls. It has been pointed out that in the traditional Ruling Party and Bureaucracy Model, data and reference materials submitted to advisory councils were used by bureaucrats to manipulate the discussions. Even if this were true, at least a broad range of data, analysis and policy alternatives were being presented to the advisory councils, and a certain level of transparency was being ensured. The level of transparency in the Ministerial Troika Model clearly fell short of this mark.

(3) *Coordination and Decision Making*

Under the Ruling Party and Bureaucracy Model, the coordination function was predicated on a dual structure that separated the government from the ruling party. This dual structure remained in place throughout the years of LDP rule. In this context, coordination constituted a policy process that was carried out through a collaborative effort of special-interest politicians belonging to Policy Affairs Research Council and bureaucrats from related ministries. This arrangement has been variously criticized as “a scrum formation of politicians and bureaucrats,” (Muramatsu 2010) “a partnership of multiple policy networks comprising ruling party politicians (particularly, special-interest politicians), government ministries and agencies, and interest groups,” (Ito 2006) and “collusion for the joint distribution of rent.” (Ito 2011) In this framework, bureaucrats from various government ministries and agencies came into contact with powerful members of the ruling party and pulled the strings from behind the scenes to direct the coordination process.³⁵

CEFP changed the Kasumigaseki District’s internal method of coordination. Previously, a policy proposal had been formally submitted to a meeting only after thorough closed-door consultation and coordination among related ministries and

agencies. “However, the Council on Economic and Fiscal Policy did away with this Kasumigaseki practice of what may be termed the ‘system of unanimity.’ In the new model of coordination that it introduced, topics were openly debated in formal meetings, and coordination was carried out while laying bare differences in opinion.” (Ota 2006, 7) While CEFP changed the government’s internal method of coordination, it did not make any essential changes to the process of coordination between the government and the ruling party. This is because the CEFP did not have any standing in the debate once the discussions had moved to the internal meetings of the ruling party (Ota 2006, 148).

What lies behind the partnership between politicians and bureaucrats is the existence of ruling party politicians without government posts who act as players with veto power.³⁶ While there is no guarantee that a cabinet minister is always right, the superior position ceded to ruling party members with no formal responsibilities would seem to contradict the parliamentary cabinet system. This is not to say that factions within the ruling party have always had veto power. In reality, a level of discipline has always been maintained. As Kawato (1996) has explained, the coordinating function was maintained through appointment to government posts based on the relative strengths of factions and seniority. While it can be said that the prime minister and the Prime Minister’s Office exercised greater power in policy coordination and decision-making under the Koizumi Administration, the duality between the government and the ruling party was effectively preserved.³⁷

Under the DPJ’s Ministerial Troika Model, the initial assumption was that the coordination and decision-making processes would be undertaken as follows: Ministerial policy meetings would be responsible for coordinating between the government and the ruling party, while committees of ministers would take charge of coordinating within the government. However, this did not work out in practice. In both the fiscal year 2010 budget compilation process and the tax revision process, confrontation and disagreement persisted between ministers committed to the party’s Manifesto and the Minister of Finance and others, revealing the lack of coordination within the administration.³⁸ The rule for unified policy-making was nullified, and what resulted was a situation in which it was unclear how policies and guidelines were being discussed and finalized, by whom, and where.³⁹ In the critical stages of tax reform and the budget compilation process, the demands of the party conveyed by Secretary General Ozawa exerted a great deal of influence. Consequently, the National Strategy Unit and ministerial committees were unable to perform the expected coordination function.⁴⁰ DPJ’s Ministerial Troika Model stumbled and struggled since its inception. A simple explanation to that is they were layman. In addition to that, we have to remind ourselves that they faced unfortunate external events such as Great East Japan Earthquake. It must be an excuse. However, I do think the fundamental problem of their failure is that DJP could not revise the relationship between politicians and bureaucrats in terms of achieving their goal of politician-led government in policy-making process. In short, they paid little attention to the role of bureaucrats who cooperate with politicians.

The DPJ experiment in “politician-led government” made it painfully clear that

coordination requires certain structures and mechanisms, the first of which is administrative coordination provided by bureaucrats, and the second of which is cabinet-level coordination. Coordination through ministerial committees is desirable from the perspective of achieving politician-led problem resolution. However, effective coordination on the ministerial level requires the prior examination of problems and alternatives, functions that should be performed by bureaucrats. Ensuring the presence of high-level civil service expertise, as well as a smooth interface between the two groups (politicians and civil servants), is central to a policy process which is able to align government priorities and implementation (World Bank 2010, 17). However, the DPJ Ministerial Troika Model effectively destroyed such relations.⁴¹ In Westminster countries where strict political neutrality is required for civil servants, civil servants in general and senior officials in particular provide a certain coordinating mechanism in the policy process.⁴² The DPJ established ministerial committees intending for them to perform government-wide coordinating functions. However, merely creating a framework does not ensure that it will function. First, ministers and bureaucrats should have been informed that all important matters would henceforth be referred to ministerial committees for coordination. Second, a steady process of building up experience and positive results was necessary.

Under the Hatoyama Administration, the relationship between the government and the ruling party “took on a completely different form of separation as compared to the age of LDP rule.” (Nonaka 2011, 309) But in the Noda Administration that followed the Kan Administration, the system began to return to a traditional LDP model where the ruling party holds veto power. Shortly after taking office, Prime Minister Yoshihiko Noda stated that, in principle, “policy decisions would be subject to the approval of the chairman of the party’s Policy Research Committee.” Responding to this guideline, the document entitled “On Making Policy-Related Party Decisions” (September 12, 2011) was approved by the DPJ Executive Board containing provisions for making policy decisions in meetings between the government and the party’s top three officers, and for the establishment of a Policy Research Executive Meeting and Sectional Meetings (jointly chaired by one co-chair each from the government and the party).⁴³ Moreover, the administrative top officials meeting has been effectively reinstated.⁴⁴ Thus, decision-making under the Noda Administration is based on a “unified model for government and the ruling party.” During the long years of LDP rule, a dualistic structure prevailed between the ruling party and the cabinet. Under the Noda Administration, however, the ruling party and the cabinet have been effectively unified through such mechanisms as the “Government and Top-Three Party Executives Meeting” and the “Government and Ruling Party Meeting on Budget Compilation.” As a result, it has become difficult to clearly determine who, under what authority and what responsibility, is performing the functions of coordination and decision-making.⁴⁵

(4) *Summary*

Based on the foregoing analysis, the three models are evaluated and fundamental problems related to Japan’s policy process are identified. Table 2 summarizes the

Table 2 Evaluation of Policy Process in Social Security Policies

Process Evaluated		1999	2004	2009
Criteria		Pension Reform	Pension Reform	Child Allowance
Policy	(1) Economic soundness/ Efficiency	2	3	1
	(2) Feasibility	3	3	2
	(3) Effectiveness/ Stability	2	2	1
Process	(1) Identification of needs	2	3	1
	(2) Collecting wide range of views	3	5	1
	(3) Multiple alternatives and analysis	3	4	1
	(4) Cross-ministerial deliberation	2	3	1
	(5) Consensus building/ coordination	3	4	1

Note: Five-stage evaluation with “5” the highest and “1” the lowest.

results of the evaluation of the three models based on the criteria outlined in Section 2. The DPJ initially attempted to eliminate bureaucrats from the policy process. While some efforts were made under the Kan and Noda Administrations to rectify excesses, from an overall perspective, Japan’s policy process deteriorated under the aegis of “politician-led government.” Politicians simply cannot take charge of all the details leading to decision-making, and the prowess and capabilities of the bureaucracy are indispensable to policy management. These include the bureaucracy’s information-gathering function, its expert knowledge, and the administrative skills required for forming and implementing policies (Takayasu 2011, 137). Throughout the transition from the CFP Model to the Ministerial Troika Model, Japan’s bureaucrats have suffered deterioration in expertise and specialized knowledge, a problem that has been pointed out from previous years. However, in addition to this, recent developments have diminished the autonomy of bureaucrats.

The DPJ Administration is considering reforming the civil service system in an initiative that has been outlined as follows: “The Prime Minister’s Office would draw up a list of all executive-level civil servants for all ministries and agencies to ensure control of personnel affairs by the Prime Minister’s Office. Demotions would also be made.” (Nihon Keizai Shimbun, January 30, 2010) Certain executive-level appointments of civil servants made after the DPJ came to power have already been criticized for being based on the arbitrary choices of ministers.⁴⁶ Speaking after the ministers’ conference of January 30, 2010, Prime Minister Hatoyama commented on the personnel management of executive-level civil servants saying, “The Prime

Minister's Office will place this in its own grasp."⁴⁷ Speaking to the press at the time of his appointment on January 7, Finance Minister Kan stated, "The authority to appoint and to fire civil servants lies with the people. Therefore, it is natural [for the prime minister as the representative of the people] to exercise the right to manage personnel affairs."⁴⁸ In other words, control of personnel affairs is understood to be an element of politician-led government. There are strong concerns that appointment of executive-level civil servants in government ministries and agencies based effectively on political choices made by the prime minister or cabinet ministers would have various undesirable results, such as arbitrary personnel management and office-seeking behavior, developments that would even further politicize civil servants (diminish their autonomy).⁴⁹ The politicization of civil servants would turn attention away from fact-based accurate analysis and examination. In the Comprehensive Reform of Social Security and Taxes undertaken by the DPJ administrations, problems related to pensions and health care were not revealed because ministers and ruling party members wishing to avoid difficult reforms exercised the prerogatives of "politician-led government."

The CEFM Model was successful because a relation of "contestability" existed in the policy formulation process between CEFM and related government ministries and agencies. While the importance of contestability in the policy process has been widely emphasized in recent years (ANAO 2008, Briggs 2007, Cabinet Office 1999, IDB 2006, Stoeckel and Fisher 2008), in the case of Japan, sufficient reforms have not been implemented to render the civil servants working at government ministries and agencies contestable. Stein and Tommasi (2008, 64–65) identify the following two characteristics which explain different bureaucratic types: (1) autonomy (the extent to which effective guarantees of professionalism in the civil service are in place and degree to which civil service are protected from arbitrariness and politicization), and (2) technical capacities of bureaucrats (the degree to which the bureaucracy has salary compensation and evaluation systems). Stein and Tommasi argue that these are important factors in achieving policy outcomes. It is true that in the Japanese system, a high level of autonomy exists within individual groups of bureaucrats working in government ministries and agencies (Iio 2011, 379). But this autonomy is a reflection of the "politicization" of bureaucrats for the purpose of protecting their own interests. By contrast, in the Japanese system, less importance has been given to the expertise of bureaucrats in policy formulation and assessment (Tanaka 2009).⁵⁰ The autonomy of civil servants is certainly important. Left unattended, however, this autonomy creates a bureaucracy that pursues its own interests. What is needed is competition that cuts through all aspects of the merit system.⁵¹

The autonomy of civil services has been further undermined after LDP-Komei coalition government led by prime minister Shinzo Abe came back in December 2012. Abe administration is a little bit different from traditional LDP politics, because prime minister or PM office plays a leading role in decision-making process, and ruling party sets back. There are several reasons for it. Firstly, LDP learned the failure of DPJ government that they could not manage conflicts between ruling party and government. Secondly, the popularity of Abe is high and he won both

lower and upper house elections. Thirdly, senior LDP politicians who are veto players in decision-making process are already retired. We can observe that the dual structure in decision-making process which has undermined the strength of prime minister and cabinet is disappearing in Abe administration. However strong prime minister causes the lack of check-and-balance system. Civil services now look like too obedient to politicians, and they cannot provide accurate analysis and alternatives to politicians. That is a new phenomenon in Japanese politics and administration.

5 Conclusion

Japan's political and administrative systems were long criticized as being bureaucrat-led, but the 2009 change in government has served to reveal the problems with politician-led government. While the change provided evidence that democratic rules are functioning in Japan, the politician-led government under DPJ rule has further diminished the autonomy and expertise of bureaucrats and has thereby forced the policy process to deteriorate. In reality, this has only served to clearly reveal problems that have always existed in the system. International comparisons point to the low policy capabilities of the Japanese government.⁵² The biggest problem is that contestability is lacking at various levels in the policy process. First, competitive mechanisms do not function fully in the appointment of executive-level civil servants, partly because open recruitment and cross-ministerial posting generally does not take place. Second, advisory councils and other organs do not function as forums for independent analysis and assessment by third parties, and therefore do not act to verify the policy proposals of government ministries and agencies. Third, within the government, the Cabinet Secretariat and other central organs are not given sufficient policy-related functions to confront the ministries and agencies with jurisdiction.⁵³

Under the Noda Administration, some efforts have been made to correct the excesses of politician-led government. Given the rapidly falling birth rate and aging society, the commitment to comprehensive reform of social security and taxes is certainly laudable. But the fact of the matter is that little progress has been made in the processes of policy examination and coordination. Australia's experience with comprehensive reform presents an interesting counterpoint to Japan's comprehensive reform of social security and taxes. In December 2007, Australia's Labor Party returned to power for the first time in eleven years. In May 2008, the Treasurer announced that a comprehensive reform of taxes and social security would be undertaken and appointed a deliberative panel for this purpose.⁵⁴ In August, the government published a discussion paper on current conditions and problems related to taxation and income transfer. Responding to this, the panel spent the next 18 months holding hearings and deliberations. Hearings were held throughout the country to gather the views of the people and to exchange opinions with experts, followed by analysis and examination of data. The process culminated in the presentation of recommendations to the government on the direction of reforms. The

difference with the process followed in Japan for the introduction of the Child Allowance System is starkly obvious.

Japan finds itself in a situation today where difficult structural reforms must be implemented. While fairness should certainly be a consideration, coolheaded analysis, deliberation and coordination based on solid data are indispensable. As such, Japan faces an urgent need to review and revamp its policy process because these conditions cannot be easily met if Japan continues to employ the same processes as in the past. There are a number of prerequisites for good policy formulation, which the World Bank (2010, 5) has enumerated as follows: (1) political authority and technical expertise at the center-of-government, (2) an organizational system that coordinates policymaking, (3) senior public servants who provide expert policy advice and coordinate between policy making and implementation, (4) strong capacity of the line ministries, (5) strong capacity of the legislature, (6) active alternative channels of policy advice. Sadly, in most of these areas, the Japanese system cannot be said to be sufficiently developed.

Notes

- 1 Otake (1990, 269) states, "The analysis of policy-making, more than anything else, consists of expert analysis of the process, and findings are not directly useful for evaluating or criticizing the content of policies."
- 2 Adolino and Blake (2001, 10) refer to "intentional courses of action designed by government bodies and officials to accomplish a specific goal or objective," while OECD (2007, 10) defines a deliberate action of government that in some way alters or influences the society or economy outside the government. Others focus on decision-making, such as Dye (2007, 2), "anything a government chooses to do or not to do," and Howlett and Ramesh (2003, 8), "a complex phenomenon consisting of numerous decisions made by numerous individuals and organizations in government."
- 3 Ito, Tanaka and Mabuchi (2000, 34) offer the following definition. "The political process consists of negotiations and transactions that are based on activities undertaken by such actors as politicians, political parties, bureaucrats, interest groups and citizens in pursuit of realizing their own interests. In this context, policy process specifically refers to the process through which policies are made and implemented."
- 4 For instance, Jones (1984) has eleven stages, Birkland (2005) and Brewer and deLeon (1983) have six stages, and Adolino and Blake have five stages. Lundqvist (1980) posits three stages in policy selection.
- 5 Nakamura (1996) argues that policy-process patterns and the type and behavioral patterns of actors involved in policy process are determined by the nature, characteristics and type of policy. Nakamichi (2005) states that the existence and behavioral patterns of influential actors and the relations between politicians and bureaucrats also differ according to the type of policy.
- 6 Developments and details of the revisions examined in this paper are primarily taken from *Annual Report on Health (Labour) and Welfare*, and from newspaper articles. For details of policy processes related to pension reform, see Shinkawa (2004).
- 7 Referring to "comparative policy-process analysis," Otake (1990) states that this approach is "unlike conventional comparative studies of political organizations and institutions, such as political parties and the parliament, and is instead a form of macro

comparative analysis that, while focusing on a specific policy area, attempts to examine decision-making structures and furthermore to identify the general characteristics of the political system.” (p. 162) The analytical framework of this paper resembles this. In their policy process model, Spiller and Tommasi (2003) consider the causal mechanisms in fundamental institutions and history, the rules of the game in policy formation, the balance in interaction among actors, the policy-making process, and the characteristics of individual policies. The present paper takes the same approach.

8 Asahi Shimbun (Asahi News Paper), October 19, 1998

9 Asahi Shimbun, October 20, 1998

10 According to “Agenda for the Economic and Fiscal Policy Council during 2003” (dated January 20, 2003, and drafted by a non-government member of CEFP), pension reform was included in the agenda for 2003, and the subject was discussed in meetings held on February 20, April 1 and 16, May 28, June 9, October 3, and November 18 and 28. For details of the involvement of CEFP in the 2004 pension reform, see Ota (2006).

11 The Ministry of Health, Labour and Welfare had initially proposed raising insurance premiums from the current 13.58% to 20%. However, this met with strong opposition from the business community, which argued that 20% was too high. Within the government and ruling coalition, there was a clash of opinion between the Prime Minister’s Office, which favored an 18% ceiling, and the Ministry and the New Komeito, which were unwilling to go below 18.5% in order to preserve the 50% benefit level. Following heated negotiations, a compromise was reached to set the ceiling at 18.35% (Shinkawa 2004, 323).

12 Nihon Keizai Shimbun (Nihon Keizai News Paper), January 31, 2004

13 Asahi Shimbun, February 5, 2004

14 Nihon Keizai Shimbun, February 21, 2004

15 An exception to this was the Government’s Tax System Research Council whose membership had undergone some changes. Regarding the review of income tax exemptions for dependents, some data were submitted to the Council on the expected increase in tax revenues resulting from the abolition of income tax deductions for dependents. However, the only reference to child allowances was contained in a document entitled “Personal Income Taxation (Outstanding Issues),” which was distributed at the Council’s 8th meeting for fiscal year 2009 (November 17). The document merely noted that, “In light of ongoing discussions on the introduction of child allowances, thought is being given to abolishing deductions for dependents in the fiscal year 2010 revision. How should this be approached?”

16 The DPJ proposal initially drafted by Chief Deputy Secretary General Tamimitsu Takashima (Secretary General of DPJ Caucus of the House of Councilors) made no mention of income caps for child allowance eligibility. However, Ichiro Ozawa instructed his aides to gather the necessary information and independently calculated how much the system would cost if income caps were introduced. Based on the results, Ozawa decided to advocate the introduction of an income cap (Yomiuri Shimbun (Yomiuri News Paper), December 20, 2009).

17 Asahi Shimbun, December 17, 2009

18 Nihon Keizai Shimbun, December 22, 2009

19 This was a “desperate measure taken for maintaining the level of contributions by local governments.” (Mainichi Shimbun (Mainichi News Paper), December 27, 2009) Negotiations involving the three highest-ranking officers of the Ministry of Finance, Ministry of Health, Labour and Welfare, and the Ministry of Home Affairs had failed to reach a conclusion. It was reported that bureaucrats from the three ministries then hammered

- together a compromise and convinced the politicians to go along with their proposed solution, which kept the existing Child Benefits System as part of the new Child Allowance System and required local governments and employees to bear part of the burden of the system.
- 20 Developments preceding the introduction of the Child Allowance System by the DPJ are as follows. In 1999, a legislative bill was submitted by Diet members for the introduction of a child allowance system (with a 12 million-yen income cap) combined with the abolition of tax deductions for dependent children. In 2006, a bill was submitted by Diet members for a system featuring no income cap, and fully tax-based monthly payments of 16,000 yen per child until the end of junior high school. This proposal required no additional fiscal outlays as the monthly payments of 16,000 yen were to be financed through the abolition of tax deductions for spouses, etc. However, in the January 2007 Diet question and answer session by party representatives, DPJ Representative Ichiro Ozawa stated that a 6-trillion-yen child allowance program was to be created. Dividing this amount by the number of children nationwide yielded the monthly amount of 26,000 yen. That is to say, the figure of 26,000 yen per month was not based on discussions and consensus arrived at within the DPJ, but was instead “an unprincipled 10,000 yen add-on resulting from a top-down directive.” (Mainichi Shimbun, February 28, 2010)
- 21 Yomiuri Shimbun, March 27, 2010
- 22 The National Institute for Research Advancement (1998, 34) states that, “Policy issues are created through the process of definition... and are artificial constructs. It is for this reason that policy issues are easily used for political purposes.”
- 23 For example, the National Personnel Authority (1999) states the following: “Civil servants of the responsible administrative department draft a policy proposal, while taking into account such factors as necessity, level of priority and implementability. The draft is then submitted for basic approval within the relevant ministry, including approval by the minister. In the next step, the draft undergoes adjustment in consultations held with related government ministries and agencies and interested parties. At the same time, approval for the draft is obtained within the government and the ruling party before it is finalized as a policy proposal. In the final stage, formal procedures are completed within the executive branch, including approval by the relevant minister and by the Cabinet. Because this represents the most commonly seen policy-making process in Japan, it leads to the argument that policy-making in Japan is led by the bureaucracy.”
- 24 A document entitled “Basic Guidelines” was also issued when the Hatoyama Cabinet was first formed (September 16, 2009), and contained the following points. “The traditional practice of prior review by the ruling party shall be abolished, and the dual decision-making structure separating the government from the ruling party shall be replaced by an integrated decision-making framework. This shall be done to prevent the creation of Diet members beholden to special interests.” “The Administrative Vice-Ministers Meeting and other institutions that have existed until now shall be abolished. Hereafter, government decisions shall not be delegated to prior coordination by administrative vice-ministers and other bureaucrats.”
- 25 In Britain, to avoid being bound by pledges, manifestos are not necessarily detailed or specific (Blair 2010). Under the Blair Cabinet, Public Services Agreements specifying policy priorities and goals for the forthcoming three years were formulated. This type of approach should have been considered in Japan. For contents of Public Services Agreement, see Tanaka (2005). The document entitled “Reforming the Budget Compilation Process” (approved by the Cabinet on October 23, 2009), which summarizes the outcome of discussions led by the National Strategy Bureau, states that a “system for

disclosure of the achievement of policy objectives” would be adopted. However, such a system is yet to be introduced.

- 26 The Council on National Strategy and Policy is chaired by the prime minister. The chief cabinet secretary and state minister in charge of national strategy serve as its vice-chairmen. Other members consist of four ministers (Ministries of Home Affairs, Foreign Affairs, Finance, and Economy, Trade and Industry), governor of the Bank of Japan, and five non-government members from the private sector. The Council was created based on a cabinet decision. CEFP contained various arrangements and mechanisms to help it function as the command post for promoting reform. These were the leadership of the prime minister, the setting of the agenda for discussions based on papers prepared by non-government members, and the result-oriented management of meetings. The Council on National Strategy and Policy lacks all of these functions and cannot be said to be a “command post” in its present form.
- 27 The Ministry of Health, Labour and Welfare has explained that the Basic Pension System is a “universal national pension program.” However, a universal pension program cannot be implemented by a social insurance approach based on the principle of “contributions.” In Canada and other countries that have adopted universal pension programs, costs are necessarily borne by the general taxes. For details, see Tanaka (2011).
- 28 Ito (2007, 33-34) states the following: “Information and knowledge constitute powerful resources for the bureaucracy. Capitalizing on the asymmetrical access to information that exists between the bureaucracy and the Prime Minister’s Office, the bureaucrats expand the scope of their discretionary powers. Responding to this, the Prime Minister’s Office uses the information and knowledge available to its staff organizations and deliberative councils to reduce this asymmetry in information.”
- 29 Chikara Sakaguchi, the then Minister of Health, Labour and Welfare, is quoted as follows: “Subscribers to the National Pension System were bearing a heavy burden but receiving relatively little. So, the decision was made that the government would contribute half. This had to be done because otherwise the situation would have been unfair compared to people belonging to the Employees’ Pension System and Mutual Aid Association Pension Schemes. Discussions of pension reform were predicated on raising the Treasury’s contribution rate to 50%.” (Nihon Keizai Shimbun, December 15, 2011) “Subsidy” is not borne by the government but is paid for by the people. The burden on the people does not change, whether the money comes from social insurance premiums or from taxes. Thus, it can be said that raising the subsidy rate to 50% actually benefits relatively wealthier individuals covered by the Employees’ Pension System.
- 30 Some OECD countries appoint independent commissions on fiscal matters charged with conducting independent analysis and assessment of such factors as fiscal sustainability and inter-generational fairness, and submitting recommendations to the government. Such functions could have been assigned to CEFP.
- 31 Cases of “elimination of bureaucrats” are too numerous to enumerate. Meetings of the top three ministry officers are held behind closed doors, and bureaucrats are not allowed to be present, with the exception of the Ministry of the Economy, Trade and Industry (Nihon Keizai Shimbun, November 3, 2009). In the Ministry of Health, Labour and Welfare, bureaucrats requesting meetings with Minister Akira Nagatsuma to be briefed on policies are frequently forced to wait one to two weeks (Nihon Keizai Shimbun 2010, 306). When the Hatoyama Administration organized a “policy grand prix,” an online call for policy recommendations, responses were received from even bureau directors and assistant vice-ministers. “The fact that bureau directors, who presumably are meeting

- the minister on a regular basis, chose to mail their proposals instead of conveying them directly to the minister is symbolic of the present relations between politicians and bureaucrats.” (Yomiuri Shimbun, April 19, 2010) Parliamentary Secretary Keisuke Tsumura (Cabinet Office) stated publicly that, “I will take over all the work of the administrative vice-minister.” As Parliamentary Secretary Tsumura fired off his instructions, Administrative Vice-Minister Junji Hamano, who stood to his right, found no opportunity to speak (Asahi Shimbun, January 15, 2010).
- 32 In the upper house question and answer session by party representatives held on October 30, 2009, Prime Minister Hatoyama gave the following answer to a question. “I believe that in most cases, members of deliberative councils were in fact being selected by the secretariat of the ministry in charge. Thus, bureaucrats were selecting individuals whom they found to be convenient, and the bureaucracy was playing a leading role in making policy decisions. Deliberative councils supported and promoted this system... From here onward... the three principal ministerial officers shall be held accountable, and politicians will play a leading role in the selection of council members. We intend to review not only the issue of the choice of members but also other aspects that relate directly to the operation of councils.”
- 33 It can be said that DPJ politicians underestimated the importance of analysis and examination in the policy process. For example, Naoto Kan was quoted as follows before the DPJ came to power. “Highway tolls should be abolished right away. That is very easy to understand. It takes ten years to build a highway, but you need only three months of preparation to abolish highway tolls.” (Asahi Shimbun, April 8, 2009)
- 34 The Institute for Research on Household Economics investigated how child allowances were being used and concluded that, as observed over a short-term period of one year, child allowances had not resulted in increased (additional) expenditure on children. The National Strategy Bureau stated that it had not kept records and other administrative documents from hearings it had conducted with the Ministry of Health, Labour and Welfare during the year-end budget compilation process (Mainichi Shimbun, March 22, 2010).
- 35 Concerning these practices, the LDP itself has engaged in the following self-criticism. “In the management of LDP administrations, the top three ministerial officers frequently delegated their responsibility for policy coordination between the ruling party and the government to the bureaucracy. As a result, bureaucrats were permitted to effectively intervene in policy-making by using their close ties to so-called “special-interest Diet members,” giving rise to a situation that could not be avoid being criticized as being “bureaucrat-led government.” (Liberal-Democratic Party Policy Research Council 2010, 2)
- 36 An example is the collision between Agriculture, Forestry and Fisheries Minister Shigeru Ishiba and LDP Diet members with special interests in agriculture under the Aso Administration. When Minister Ishiba proposed the introduction of an “optional system” permitting individual farming households to choose whether they would participate in the adjustment scheme for rice production, LDP special interest Diet members for whom production adjustment constituted a fundamental commitment objected vociferously. Consequently, the Ishiba proposal failed to become policy. In a meeting of the executive council of LDP Diet members with special interests in agriculture held on March 12, 2009, Chairman Koya Nishikawa of the Committee on Basic Agricultural Policies stated that the “Diet is the highest organ of state power,” indicating that he intended to ignore the government’s position. Other members are reported to have signaled their approval (Sankei Shimbun, March 13, 2009).

- 37 Functioning under the direct jurisdiction of the Prime Minister's Office under Prime Minister Junichiro Koizumi, the National Vision Committee of the LDP National Strategy Headquarters put together a proposal for reforming the policy-making system in March 2002. At the core of the proposal were the "three Koizumi principles," which contained such provisions as eliminating prior party approval as a precondition, and policy coordination in Ministerial Meetings. The proposal was not approved by the LDP and most of its proposals were not adopted. Kaoru Yosano made the following comment in a newspaper interview given after his appointment as state minister in charge of economic and fiscal policy in November 2005, indicating that no change had been made in the conventional coordination model. "My personal position is that policy contents and timing of decision-making should be undertaken jointly and simultaneously with the ruling party. If one precedes the other, the coordination process takes more time, and ultimately the total cost is higher. It is natural for there to be differences in position between the government and ruling party. What is important is to make the effort to unify (coordinate) these positions." (Nihon Keizai Shimbun, December 2, 2005)
- 38 Examples include the confrontation between Land, Infrastructure and Transport Minister Seiji Maehara and State Minister Yoshito Sengoku for National Strategy over the ceiling on tolls for the Honshu-Shikoku Highway; the confrontation between Education Minister Tatsuo Kawabata and State Minister Yukio Edano for Government Revitalization over the reform of independent administrative corporations; and, the confrontation between Health, Labour and Welfare Minister Akira Nagatsuma and Home Affairs Minister Kazuhiro Haraguchi over full-amount payment of child allowances.
- 39 Ultimately, this is a problem of party discipline. "If party discipline is weak, interest groups will have a much better chance of influencing the voters of members of the legislature." (Adolino and Blake 2001, 48)
- 40 According to Asahi Shimbun (February 25, 2010), a total of 30 meetings were held during 2009 for eight ministerial committees (including 11 on basic policies and seven on budget compilation). During 2010, only three meetings were held, all in January. Machidori (2008, 54) states, "It is true the new institutional framework had great political and policy potential, as proven by the Koizumi Administration. But realizing this potential requires a certain context as well as strategies and tactics on the part of actors." In practice, the DPJ Administration lacked the strategies and tactics to make the system work.
- 41 Former Deputy Chief Cabinet Secretary Teijiro Furukawa identifies the functions of Administrative Vice-Ministers Meetings to be the following: (1) confirming that an issue has been sufficiently coordinated before submission to the cabinet, (2) conveying the prime minister's instructions to the top administrative officers in government ministries and agencies, and (3) sharing and conveying of information (Nihon Keizai Shimbun Shuppansha 2010, 494). Under the DPJ administrations, because the agenda was controlled by the top three politicians of government ministries and agencies, the administrative vice-ministers were not informed of the details and therefore could not act in liaison and coordinating capacities.
- 42 For instance, analyzing the behavior of Canada's deputy ministers who are administrative top officials, Schacter (1999) points out that deputy ministers have the requisite skills to work across the government, gather information to support the minister's goal, and engage in coordination on the deputy-minister level to ensure that the minister's initiative reaches other ministers.
- 43 The meeting of the government and top three DPJ officers comprises the following six members: Prime Minister, Chief Cabinet Secretary, DPJ Secretary General, Chairman of the Policy Research Committee, Chairman of the Diet Affairs Committee, and Acting

Secretary General. According to this material, the purpose of this decision-making method is to bring the cabinet and the ruling party together in promoting policies. The material also states that this does not contradict the principle of unifying the policy-making process under the government, and that this method is different from the method of prior examination and consultation practiced under LDP administrations.

- 44 The status of the Administrative Vice-Ministers Meeting changed under the Kan Administration. In the Ministerial Meeting held on December 28, 2010, Chief Cabinet Secretary Yoshito Sengoku made the following request concerning meetings of the top three politicians of government ministries. "We want the government and bureaucracy to work within a unified framework. Therefore, wherever possible, we request that you allow administrative vice-ministers, the director of the minister's secretariat and other members of the bureaucracy to be present in your meetings." (Mainichi Shimbun, December 29, 2010) On January 21, 2011, Prime Minister Naoto Kan invited all administrative vice-ministers to the Prime Minister's Official Residence and admitted that, with respect to policy coordination, politician-led government had in certain areas gone too far after the DPJ had come to power. Prime Minister Kan then explained that the function of policy coordination would no longer be restricted to the top three politicians, and that the participation of administrative vice-ministers and bureau chiefs would henceforth be allowed (Yomiuri Shimbun, January 22, 2011).
- 45 Deliberative councils under DPJ administrations have faced the same problem. For instance, membership of the Council on Intensive Deliberation on Social Security Reform comprises the following. First, the Council has seven executive members consisting of the prime minister and related cabinet ministers. From the DPJ, Chairman Yoshito Sengoku of the DPJ Research Council on Fundamental Reform of Social Security and Taxation is a member. From the People's New Party, Chairman Akiko Kamei of People's New Party Policy Research Council is a member. Expert members include two persons from the business community, one person from labor unions, three scholars, and four other experts. It is difficult to determine what powers and responsibilities are vested in a council consisting of cabinet ministers, ruling party members and private individuals.
- 46 Examples include appointments of the Commissioner of the Japan Tourism Agency, Vice-Minister for Internal Affairs and Communications and Section Chiefs, and executive officers of independent administrative corporations. On December 25, 2009, Land, Infrastructure and Transport Minister Seiji Maehara announced the dismissal of the Japan Tourism Agency Commissioner Yoshiaki Honpo and the appointment of Hiroshi Mizohata (aged 49), a former bureaucrat of the Ministry of Internal Affairs and Communications (Nihon Keizai Shimbun, January 8, 2010). It is said that Minister Maehara based this appointment on personal friendship. In the appointment of the President of the Welfare and Medical Service Agency, an independent administrative corporation, the Selection Committee examined 56 applications received for the post and nominated Chikafusa Aoyagi, a former career bureaucrat of the Ministry of Health, Labour and Welfare. However, the nomination was rejected by Health, Labour and Welfare Minister Akira Nagatsuma, and a new recruitment cycle was started. The Selection Committee once again nominated Chikafusa Aoyagi as its sole candidate. Minister Nagatsuma again rejected the nomination on the grounds that "Mr. Aoyagi has a history of clashing with the Minister of Health, Labour and Welfare on the issue of pensions." (Yomiuri Shimbun, April 16, 2010)
- 47 Nihon Keizai Shimbun, January 30, 2010
- 48 Asahi Shimbun, January 8, 2010

- 49 In Britain and other Westminster countries, the prime minister and cabinet ministers basically do not have authority over personnel management of civil servants. The present author does not oppose all forms of political appointment of civil servants. For instance, advisors and staffs to ministers should be made as political appointments to directly reflect the wishes of the minister.
- 50 Muramatsu (2010) conducted interview surveys of bureaucrats and others between the mid-1970s and 2003. Posing the question, “What are the conditions for good policy-making?” Muramatsu offered respondents the following four choices: (1) clear instructions from legislative branch, (2) discretionary authority of administrative officers within the bounds of certain guidelines, (3) gathering the views of various organizations, (4) expert analysis. In the second and third surveys, very few respondents chose responses (3) and (4), while more than 80% chose either (1) or (2) (Muramatsu 2010, 75). Partly in self-admonition, Nobuharu Okamitsu, former administrative vice-minister of the Ministry of Health and Welfare, has written as follows: “In the existing career system, more importance tends to be assigned to frontline skills (including lobbying to prepare the groundwork and the “politics of give-and-take”). This has had a determining effect particularly on the behavior of bureaucrats who participate in policy formulation. As a result, there has been a tendency to pay less attention to ensuring and developing the high levels of expertise needed in problem solving.” (Okamitsu 2002, 254)
- 51 Tanaka (2007) has suggested the introduction of senior executive service to encourage competition among executive-level civil servants.
- 52 To conduct international comparisons of the strategic capabilities of the executive branch of government, Bertelsmann Stiftung (2009) developed the Sustainable Governance Indicators (SGI) based on a Status Index (SI), which evaluates the status of democracy and economic and policy-specific performance of a country, and the Management Index (MI), which evaluates executive capacity and executive accountability. Criteria for MI consists of (1) steering capability (cabinet composition, strategic capacity, inter-ministerial coordination, regulatory impact analysis, societal cooperation, policy communication of government policies), (2) resource efficiency (legislative efficiency, anticipation of veto players, effective implementation), (3) international cooperation (domestic adaptability, external adaptability), (4) institutional learning (organizational reform capacity). Japan scores 5.50 on MI, which places it in 21st place among the 30 OECD member countries. Norway scores the highest (8.48), while Greece scores the lowest (3.33). In terms of SI, Japan is ranked 22nd.
- 53 Among foreign countries, Britain’s Strategy Unit functions to support the prime minister and the cabinet. For a comparative analysis of such organizations, see World Bank (2010).
- 54 The panel was chaired by Dr. Ken Henry (Secretary to the Department of the Treasury). Other panelists were Dr. Jeff Harmer (Secretary to the Department of Families, Housing, Community Services and Indigenous Affairs); Professor John Piggott (the University of New South Wales); Ms. Heather Ridout (the Australian Industry Group); and Professor Greg Smith (the Australian Catholic University). It should be noted that the Australian system differs from the Japanese. In Australia, strict political neutrality is demanded of all civil servants rising all the way up to department secretaries. Civil servants are also expected to function as experts.

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Disability and Employment The Social Cooperative as a Sustainable Social Business Model

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Abstract

For more than twenty years, social cooperatives have represented a sustainable social business model of working with disadvantaged workers, including the mentally disabled. In these organizations, which encourage workers to become members and co-owners, a stress-free work environment is fostered in which everyone can develop creative solutions to problems, make decisions affecting the wellbeing of others, and deal with emotions. Since inception, they have created thousands of jobs and career paths for disadvantaged workers and given them the chance to feel fully a part of the community. The contention that is argued in this paper is that there are three major factors which account for the sustainability and growth of this model: good regulation; a supportive system of infrastructures; and democratic operational governance. These make the social cooperative an inspiring example of the outcomes that are possible when disadvantaged workers are properly trained in a supportive environment; it is a model which could well prove similarly successful if copied in other parts of the world.

The scope of this study was to explore organizational goals and repertoires as well as support structures and networks of social cooperatives in order to identify the major factors which make this business model so successful. The author draws on his recent work on social cooperatives and presents secondary data on B-type social cooperatives, including a case study.

Keywords: social cooperatives, disadvantaged workers, organizational goals & repertoires, support structure & network, Italy

1. Introduction

According to the WHO (2008), the group of serious mental illnesses classed as schizophrenic disorders represent the third most prevalent disease for people aged from 15 to 44. Even so, the field of psychiatry has yet to discover a cure for this kind of illness, and treatments that currently exist are extremely limited (Davidson et al., 2010). Consequently, the traditional idea of 'community integration', based on the assumption that people who benefit from care and recover will re-enter community life, does not apply to those with serious mental illness. This consideration is leading

to a new vision of 'recovery' within the social psychiatry and mental health community, a shift away from community integration to the more promising idea of 'community inclusion', which is now accepted globally. This new paradigm argues that people with long-term psychiatric disability should be accepted and welcomed by their communities with whatever condition they may have, without having to be cured, fixed, or otherwise made to conform to selected societal norms first. This paradigm also generates a new understanding of the concept of 'recovery' as 'being in recovery', which means leading a dignified and fulfilled life in the face of an ongoing mental illness (as opposed to the more traditional/medical idea of 'recovery from disorder').

However, this poses the question of how to foster community inclusion for people in recovery. One possible answer has been explored within the last half century, however, largely within Western European countries and beginning, at least by some accounts, with the work of the husband and wife team of Franco and Franca Basaglia, innovators in the treatment of mental health disorders, and the Democratic Psychiatry movement (DP) they helped to found in Italy in the 1960s (*ibid*).

The inhuman treatment of psychiatric patients in many parts of Italy had provoked much public disquiet, a situation that no doubt helped the most radical reform within psychiatry that Western Europe had ever experienced. Indeed, the squalid, inhuman conditions in asylums like Gorizia became valuable tools for Franco Basaglia when he was developing DP and gave credence to his strident assertion that psychiatrists had to become politicians within the system. The psychiatric patients' real problem was not their mental illness but rather the way they were treated and how they were viewed; in particular their being treated as miscreants rather than patients, leading to their incarceration and exclusion from the rest of community. Once isolated, the patient would almost inevitably become subjected to the most dehumanizing and humiliating regime where, as Basaglia disturbingly described it, 'medical ideology [became] an alibi for the legislation of violence' (Basaglia, 1964).

DP was a mainly left wing political organization of mental health workers who, by 1978, were already involved in dismantling asylums, such as those in Parma and Trieste. Its fundamental principles were: firstly, to continue the fight against social exclusion throughout psychiatry, both in the work place and in the way insanity is represented and perceived culturally; secondly, to condemn the asylum itself as the most obvious and violent paradigm of exclusion; thirdly, to prevent the reproduction of institutional mechanisms in the community; and finally, to establish a clear link between health care and mental health care, especially through the reform of the Italian mental health care system (S-Hughes & Lovell, 1986).

In 1977, DP assisted the Radical Party, a movement primarily concerned with the defense of human rights, to collect together three-quarters of a million signatures on a petition to reform the mental health legislation and thereby to ban admission to mental hospitals. Under Italian law, such a petition could have forced a national referendum on the issue possibly precipitating a collapse of government. To avoid such a disaster, the government introduced Law 180 in May 1978 and thereby

initiated the dismantling of the asylum.

Recently vacated parts of asylums were put to other uses and this became a key strategy for community inclusion as well as a step toward respecting the rights of the residents. The Basaglias terminated the 'work therapy' program through which residents had performed menial domestic tasks in exchange for tokens and, instead of promoting an artificial 'token economy', instituted a program to encourage residents who were able and interested to take on jobs in return for a level of pay they would have received for similar work in the community. This transformation of passive or indentured residents into competitive workers yielded an enormous opportunity for employment in a range of industries beyond the domestic and food services, with approximately half of the resident population expressing an interest in working. From this modest beginning, and consistent with the principle that citizens have the right to a decent wage for their meaningful labor, the model of social cooperatives was born.

Today, social cooperatives employ a mixed workforce, some with disabilities and others not. These enterprises are able to remunerate their employees at a level comparable to the rest of the business sector drawing either on government subsidies used to compensate for reduced productivity or, when possible, on their own self-sustaining productivity. Beginning with their inception in the Trieste asylum, social cooperatives have since become highly visible across the local business sector, at one point accounting for 45 different areas of operation. It is, in fact, difficult to spend any amount of time in Trieste and not come into contact with some kind of social cooperative. This model has since been replicated in various forms in numerous European countries and elsewhere.

This study will explore organizational goals and repertoires as well as support structure and networks of these cooperatives in order to identify the major factors which make this sustainable business model so successful.

2. The Development of Social Cooperatives in Italy

With the enactment of Law 180 in 1978, now called the Basaglia Law, it was decreed that all asylums and psychiatric hospitals had to be closed and their psychiatric patients transferred to alternative mental health services available, or to be made available, in the community. The Law also required general hospitals serving a population of 200,000 people to establish 15-bed units, later known as Diagnosis and Cure units, for psychiatric patients. If a seriously ill person refused treatment, compulsory admission for no longer than seven days was permitted only with the approval of at least two doctors and the city mayor, with the latter acting as chief local health officer rather than in any legal capacity, and their approval had to be reviewed by a judge after two days. Finally, in addition to protecting existing staff from redundancy, Law 180 stated that no new asylums/mental hospitals were to be built, nor existing ones used as annexes, by the general hospitals.

The period which immediately followed the enactment of the new Law was not an easy one for less well-equipped hospitals. Some psychiatric patients relapsed

because of the sudden transition into communities or families that were not ready to welcome them. One of the first objectives, therefore, was to introduce a psychosocial process directed at re-integration through work, which was seen as one of the most suitable tools to assist psychiatric patients to re-establish relationships with themselves and the world.

A first step in this strategy was to create 'integrated cooperatives' at community level. These were nonprofit businesses in which psychiatric patients and other disadvantaged people (such as the unemployed, homeless, and immigrants) would work and take on co-ownership under professional guidance. This guidance could come from ex-asylum staff who, although re-employed in general hospitals as required by law, were looking to boost their salaries, or from doctors who had previously known the workers as patients.

The workers became registered union members and received a salary in accordance with standard union contracts for each category of work. Although the professional mentors propagated a kind of hierarchical system within the cooperatives, they provided many marginalized people with work opportunities that would otherwise have been difficult to find through conventional means. Indeed, some workers made a permanent transition from a welfare environment to a productive one through their participation in a cooperative. In the 1980s, integrated cooperatives played a decisive role in driving the growth of the Italian Third Sector even though their development was for a long time only partially supported within a legal framework.

It was not until 1991, with the introduction of Law no. 381, that this type of co-operative was recognized and given the name of 'social cooperative'. The Law created a distinction between: a) cooperatives delivering social, health and educational services, which were designated A-type and consisted mainly of social or health workers and professionals; and b) cooperatives producing goods and supplying agricultural, industrial, commercial or other services for private customers or for public agencies, with the objective of achieving the integration into work of disadvantaged people. The Law 381 defines 'disadvantaged people' as barely employable workers comprising people with severe disabilities, people with mental illness, drug addicts or people in state prisons, and specifies that they make up a mandatory minimum of 30% of the workers/members of any B-type social cooperative (Laratta et al., 2010a).

It must be noted that while the concept of the social cooperative was probably the most innovative strategy ever adopted at community level in Italian mental health care, this is not to say that other innovations stemming from the government reforms of 1994 and 1998 were not important. However, they are not within the scope of this paper and so will have to be explored separately. The distinction between A-type and B-type social cooperatives was clearly necessary because Law 381 provided for a 33% exemption from social security contributions for each disadvantaged B-type worker employed.

Another significant feature of Law 381 was that it clearly defined the social co-operative as a *worker-owned* organization of which participants (including

managers and disadvantaged workers), clients (people who benefit from services provided by the cooperative), volunteers (who by law cannot comprise more than 50% of the total workforce), public institutions and financial bodies, can become members and may share in the distribution of up to 80% of the total profits. A national survey on a sample of 320 social cooperatives (ICSI 2007)¹ showed that, whilst they tend naturally to include their members in decision-making processes, the clients, even though less involved, are also often brought into the process informally. Of the social cooperatives surveyed, 98% included workers/volunteers in their membership, and 91% had them on their board of directors; only 9.4% could count clients as members of their organization. Nevertheless, on one hand, having volunteers in the membership and on the board of directors can be considered as a safeguard of clients' needs, since social services sector volunteers are frequently considered as 'substitute' clients. On the other hand, half of all social cooperatives say they involve their clients in strategic decision making, while nearly all of them advise and involve them through informal communications. Characteristically, Italian social cooperatives have a high level of multi-stakeholder membership. Just under half (49.6%) of the cooperatives studied include diverse stakeholder typologies both in their membership and in their board of directors, and approximately a third (32.2%) have a multi-membership, with a single-stakeholder board of directors.

In recent years, social cooperatives have been the main engine for the supply of social services. They have answered the limited capacity of public organizations and companies to meet the needs of specific groups of people. Following the re-orientation of the public welfare system in the 90s, with reforms in the provision of social services and the devolution of control to local authorities, both central and local public authorities, as well as their agencies, progressively outsourced the delivery of services to social cooperatives. In 2005, almost half of the social spending of medium and large-sized Italian towns was managed by social cooperatives and they were awarded approximately 80% of all local authority contracts, of which around 70% resulted from negotiated agreements between the two sectors. Only the remaining 30% came from open competitive tenders (Laratta et al., 2010b). This at least partially explains the proliferation of social cooperatives, which increased in number from a little over 1,000 before regulation to nearly 3,900 in 1996 and reached nearly 12,000 in 2009 (ibid).

3. B-type Social Cooperatives: Organizational Goals & Repertoires and Support Structure & Networks

B-type social cooperatives spread rapidly over a period of years throughout Italy and abroad. They also underwent a marked evolution in terms of both organizational goals and repertoires as well as in their support structure and networks.

As mentioned above, social cooperatives evolved from what were known as 'integrated cooperatives' whose purpose was the stable integration of psychiatric patients and other disadvantaged groups within the community. This goal has gradually shifted toward that of inclusion of the disadvantaged (which still

comprises mentally ill people in the main) in the community. In fact, B-type social cooperatives are now aiming at increasing employment opportunities for disadvantaged workers outside of the organization through innovative and creative activities and on-the-job training to help them lead a full and dignified life. This change of goal had also altered the type of market contracts which B-type social cooperatives embrace. When the goal was that of integration of the disadvantaged worker within the cooperative, open-ended contracts were the norm but, with their current goal, they are making much more use of temporary contracts. However, the cooperatives can only enter into contracts that conform to a specific framework, namely the 'national contract for social cooperatives' (NCSC), which regulates working relations and constitutes a common base for debates with the public administration, a crucial feature for such enterprises. In fact, at times, public administrations can draw on powers which go beyond the regulations imposed by Law 381. For example, one quite important article of the Law establishes that public administrations can assign contracts to B-type social cooperatives, even though this is normally not permitted under contract law. Furthermore, they are allowed to introduce into the conditions of contract a so-called "social clause", which imposes a contractual obligation to employ a specified number of disadvantaged people (Laratta et al., 2011). This partly explains why Law 381, as mentioned in the previous paragraph, provided for public institutions to become members of social cooperatives. The idea is that, if public institutions hold both member and stakeholder status, they will take part in the construction of the budget and assume greater responsibility for attaining the results set out by the organization. This has the effect of creating a fully transparent and democratically governed organization.

B-type social cooperatives have also evolved in terms of organizational repertoire, which Clemens (1999: 62) describes as models which "comprise both templates for arranging relationships within an organization and scripts for action culturally associated with that type of organization; they carry cultural expectations about who can organize and for what purposes". When integrated cooperatives were first created, many of them were dominated by a professional-psychiatric approach. Disadvantaged workers were seen in terms of their needs and condition, and these usually provided the basis for professional schemas and employment plans; the disadvantaged were essentially dependent and had little opportunity to contribute to the cooperative; they were simply viewed as a different type of worker compared to other employees and volunteers. The relationship between the professional and the disadvantaged was effectively contractual, with the former being expected to follow ethical standards of professional practice, even though these were often constrained by funding limitations or other accountability issues. However, after the enactment of Law 381 in 1991, their newly acquired legal status encouraged B-type social cooperatives to initiate a quite different approach. For example, it became expected that relationships would be egalitarian and founded in personal dignity, rather than hierarchical; empowering, rather than diminishing and focusing on workers' strengths, rather than on their pathology or diagnosis. Anyone could be a member, co-owning the cooperative, participating in the management of it and

partaking in all its decision-making processes. Recent research conducted among members of one B-type social cooperative found that even though their monthly salaries were lower than those paid to employees of other enterprises, their level of job satisfaction was much higher (Galera and Borzaga, 2009). What is clear from this study is that one of the reasons for such a sense of fulfillment was the collaborative nature of the organization in that the members with an entrepreneurial interest and those concerned with day-to-day activities are substantially the same group. This creates a stress-free work environment in which everyone can develop creative solutions to problems, make decisions affecting the wellbeing of others, and deal with emotions. Finally, B-type social cooperatives have been able to evolve by creating around them a strong supportive environment through consortia and funding schemes which focus on their specific requirements. Many of the first integrated cooperatives were unable to survive the strong competition for funding along with the pressure of accountability from public administrations and foundations. B-type social cooperatives have overcome this obstacle by networking among themselves, being informally involved in projects, and finally establishing their own consortia which act as umbrella organizations for them. These, for example, provide services such as the preparation of joint tenders, fundraising for bigger projects, and payroll administration. From time to time, municipal contracts are given directly to consortia which then sub-contract them to their social cooperative affiliates and monitor the activities of their members through audit processes. This also facilitates a better distribution of funds and fewer funding pressures. Cooperatives can also borrow from banks at lower rates of interest when arrangements are negotiated and loans guaranteed by the consortia. These are usually established at regional level but coordinated by a few national consortia working close to central government. This system of consortia is then associated with several grant schemes which have been put in place specifically to support B-type social cooperatives. One example of this is the Marconi Fund, which consists in social cooperatives investing 3% of their annual income for the purpose of financing new social cooperatives. Funding for social cooperatives or their consortia also comes from 'cooperative banks', which differ from the norm in that the main target of their investments is social cooperatives (For a detailed description of cooperative banks in Italy, please see Goglio and Alexopoulos, 2012). In addition to consortia and funding schemes, social cooperatives also enjoy a good relationship with local industry as a result of the enactment of Law 68 in 1999. This Law regulates the employment rights of the disabled and requires local firms to hire disadvantaged people or to sub-contract certain services to B-type social cooperatives instead thereby fostering numerous long-term partnerships.

4. A Case study: *Il Tetto*

Il Tetto (pseudonym) is a B-type social cooperative located in the northern Italian city of Turin and is part of a regional consortium. It originated in 1989 through the efforts of parents and friends of mentally disabled people as an inte-

grated cooperative with the object of creating job opportunities for local disabled people and ran a number of day-time employment centers plus a residential area. In 1992, *Il Tetto* registered as a B-type social cooperative because it realized that Law 381 offered an opportunity to develop and, in the same year, entered a contract with the local health and care unit to expand its scope to assist other types of disadvantaged people. Now it employs 96 people, compared with 9 when it started, and has a turnover of €2.4 million. All the workers are also members, including 48 mentally disabled people and 20 former drug addicts and people on day release from prison.

Il Tetto currently provides on-the-job training for disadvantaged workers and employs them in key sectors: landscape gardening, cleaning, waste disposal and recycling. Before joining *Il Tetto* people need to be properly assessed to determine what tasks they can safely undertake. This process starts with an evaluation of how compatible the applicant's abilities are with the work of the cooperative and then develops into a personally-tailored employment training program. As a part of this training, members' individual goals are identified through one-to-one interviews with other workers. These goals are then broken down into easily manageable steps and the trainee's progress reviewed on a regular basis. The final goal is to create career paths for disadvantaged workers to move beyond the entry level jobs. This allows the worker to gain a level of self-respect and equality with others in the workplace and so experience a sense of inclusion in the community. Every day members work side-by-side without assistance from either professional or non-professional workers. Everyone helps and encourages each other and this has proved to be more effective than receiving support from "professionals". The central task of former members is to engage new members in real and meaningful work and to facilitate peer support between them, which is the glue of the social cooperative. It is almost impossible when visiting this cooperative or seeing members working outside to distinguish the disadvantaged workers from the others. Indeed, as they all undertake very useful and necessary activities for the city, even local residents in Turin are unlikely to realize that the person who cleans the city square every morning, for example, is a mentally disabled person or a former drug addict.

As a B-type social cooperative, *Il Tetto* recognizes the importance of collaboration with the local public authority. Turin's local authority has had a close working relationship with *Il Tetto*, contracting out to the cooperative more than 60% of its manual work tasks. This partnership is also kept alive by the fact that one of the articles of Law 381 states that social cooperatives can only charge 4% VAT, compared to the 20% standard rate charged by for-profit enterprises. The cooperative could also not survive without the support of a regional consortium. *Il Tetto*, in fact, has been using the local consortium as a forum to further its interests and in the promotion of its own brand identity. The consortium imposes a limit on the number of employees and contracts that its affiliate social cooperatives, like *Il Tetto*, may have. The main reason for this is to ensure that all affiliates develop along equal lines, thereby avoiding the possibility that one might expand to the detriment of another. Till 1999, *Il Tetto* had only one for-profit partner but, following the enactment of the new law on employment rights for disabled workers, Law 68/1999, the

number rose to 22 which, in turn, contributed to the cooperative's dramatic increase in turnover, and provided consistently positive balances. As a result, *Il Tetto* is also able to make an untaxed annual contribution to the Marconi Fund which helps to finance the establishment of new B-type social cooperatives in other parts of the country.

One activity in particular shows how *Il Tetto*, the local authority and a number of private firms in Turin are forming a kind of co-production partnership which is equally beneficial to all partners, and this is the recycling of paper. The local authority asks *Il Tetto* to collect its waste paper for recycling because the cooperative can offer this service at a reduced cost due to the lower VAT charge; a local firm working exclusively in paper recycling asks *Il Tetto* to deliver the paper they have been collecting every day because it is cheaper than collecting it themselves. The social cooperative benefits in this situation from two contracts — one public and one private — and the three sectors have been working in successful partnership for many years. What is more, the recycling firm only need to turn to *Il Tetto* if they are looking for staff and they have a selection of ready-trained people to choose from. This works well for both; the recyclers save the cost of training a new employee, and the social cooperative can move a worker beyond entry level and take on someone else. At the beginning of 2010, the project for a new, bigger and more functional location for the cooperative was started. The project was self-funded at a total of €200,000 with a small part of the cost being paid by the local authority. Other activities continue to arise and the cooperative is currently planning to start an internal training and external communication program through a bi-monthly publication with a circulation of around 3,000 and to set up an international collaboration project with an Argentinian partner.

5. Conclusion

For more than twenty years, B-type social cooperatives have represented a sustainable social business model of working with disadvantaged workers, including the mentally disabled, and reuniting them with the community. The cooperatives have created thousands of jobs and career paths for people for whom moving beyond entry-level jobs would have been simply unthinkable in previous decades. Through careful consideration of suitable and innovative economic activities designed to fit the workers' abilities, the cooperatives have been able to address the stigma associated with many disadvantaged groups.

However, beyond this success, a model of public service co-production has emerged. By building on each other's assets, experiences and expertise, social cooperatives, public administration and for-profit enterprises have shown that local services can be delivered more efficiently, with the by-product that disadvantaged workers are being employed, regaining self-respect and feeling part of the community again. This co-production model is supported by three factors: a) *effective regulation* by laws which sustain co-produced services and disadvantaged workers of social cooperatives; b) *a support system of infrastructures* such as consortia, coopera-

tive banks and fund schemes which: promote the activities of social cooperatives; monitor their activities by placing accountability demands on them; and prevent overexpansion; c) *a totally democratic operational governance* where transparency among stakeholders and peer-support between members give cohesion to its effective performance.

Italian Law 381/1991 on social cooperatives was the first piece of legislature in Europe to recognize the importance of social businesses. In the last 10 years there has been widespread recognition of this model elsewhere in Europe which has prompted the introduction of similar regulations, an example being those of the UK office of *Regulator of Community Interest Companies*, brought in under the Companies Act of 2004. Underlying this recognition is a deep awareness by administrations that this social business model not only helps to provide local services in a more cost-effective way — some Nobel Prizewinners for Economics have predicted that the richest Italian municipalities would enter a period of default if social cooperatives ceased delivering their services — but also provides the solution to the question of how to include disadvantaged groups of people, such as the mentally disabled, into the community so that they become productive members. The current policy in many countries is to provide expensive therapy for people with mental health challenges, while the social cooperative model embeds rehabilitation into the philosophy of sufferers actually supporting one another on the path to recovery through work integration. Certainly, this is not the only model working toward such an outcome, but it is surely the one with the longest history and social and economic impact. Social cooperatives have become an important and thriving sector of one national economy and would be worth introducing into other parts of the world.

Note

- 1 ICSI 2007 (Indagine sulle Cooperative Sociali Italiane) investigated both A- and B-type cooperatives, and used a complex process of sampling designed to represent the total by typology, region (North-East, North-West, Central, and South Italy), and size (fewer than 15, 15-50, and more than 50 employees). Some of the results of the investigation were presented in Borzaga and Depedri (2007) and Laratta et al., (2010a).

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Institutional Dimensions in Russia's Natural Gas Policy in Northeast Asia: Some analytical observations

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Abstract

The article examines some of the institutional aspects of Russia's contemporary gas policy towards Northeast Asia (NEA). Back in the 1990s, development of natural gas deposits in the Russian Far East was made possible under the scheme of production sharing agreements. Completion of LNG plant in Sakhalin in 2009 helped Russia enter the NEAs' gas markets. In 2013, Russia has effectively established a two-pattern policy for gas export, whereby the EU-oriented pipeline gas export remains monopolised by Gazprom, while the Pacific Rim-oriented LNG export (currently operated by a consortium of international companies under Gazprom's control) is partially liberalised. Russian gas policy towards NEA is explored through the prism of domestic (both in national and regional scopes) and external factors. Specific attention is paid to show how the region-specific pattern of energy policy is utilised in the Russian government communication of the rationale and the goals for its Asia-oriented gas policy.

Keywords: gas policy, Russia, Eastern Siberia and Far East (ESFE¹), Northeast Asia (NEA²)

1. Introduction

Russia is the world-wide known producer and exporter of oil and gas. The country's oil and gas sectors employ less than 3 percent of its working population,³ but they contribute over 50 percent of Russia's budgetary revenue, make up over 30 percent of GDP, account for more than 40 percent of investment and 75 percent of merchandise exports.⁴ Yet, Russia is notorious for its continued failure to put in place adequate natural resource governance. The Revenue Watch Institute grants Russia a score of 56 (out of 100) and ranks it 22nd (out of 58 countries) in the evaluation of Resource Governance Index (RGI).⁵ According to the 2013 RGI, Russia's highest evaluation for *Safeguards and Quality Controls* was still the 24th rank (out of 58) with score 62 (out of 100) with particularly problematic areas being checks on licensing process and management of natural resource funds. The lowest rank (26th/58) and score (39/100) was on *Enabling Environment* over Russia's poor

performance on measurements of corruption control, democratic accountability and the rule of law. Russia received a score of 60 (and the 20th rank) for *Reporting Practices*, which reflects a lack of contract transparency and incomplete government reporting on most aspects of the extractive sector. The Ministry of Finance, the Ministry of Natural Resources and Ecology, the Federal Subsoil Resources Management Agency, the Central Bank and the Federal Statistical Agency are named for their unacceptably poorly organized and incomplete annual reports providing insufficient information about the extractive activities, export prices, taxation, etc. Russia's *Institutional and Legal Setting* was found ineffective resulting in a rank of 38 and score of 57. Legal frameworks are evaluated as being often ambiguous, outdated, and marred by multiple amendments, which leaves room for arbitrary decision-making in the licensing process in favour of state-owned companies (SOCs). Environmental impact assessments are said to be easily politicized and often withheld from the public. Russia's legislative provisions for *state secrets* are found to be over-applied to information related to the oil and gas industries.

For a fairly long time, Russian energy was heavily (and rather unjustly) politicized. Russia's external energy ties were studied for no other reason but to find a source of irreconcilable conflict and an illustration of how power politics decides the outcome of Russia's energy relations (Balmaceda 2008; Goldman 2008; Klare 2008; Rangsimaporn 2009; Wenger, Orttung, and Perovic 2009; Pascual and Elkind 2010; Baev 2010; Chow et al. 2010). A fresh stream of literatures which can be generally classified with the area of political economy (for its major feature to emphasise cooperative nature of energy and involved with it interplay of economics and politics) has been growing recently contributed by studies by Finon and Locatelli (2007), Bayulgen (2010), Bhattacharya (2011), etc. One of the most vividly thriving areas of contemporary energy studies develops upon the backdrop of concepts of governance studies: Florini and Sovacool 2009; Goldthau and Witte 2009; Goldthau 2011; Boussena and Locatelli 2013, etc. Adjacent to the family of governance studies, but yet deserving a special place in their own right, is energy research employing the concepts of institutionalism, where the ideas and norms play central role in the process of energy policy paradigm change (Helm 2005; Andrews-Speed 2010; Kuzemko 2011, 2014). Ample research on limited access order, vested interests, etc. also approach energy policy issues through the prism of institutionalism (Opdahl 2013, Zudin 2013). Lately, New Institutional Economics (NIE⁶) is gaining prominence as a credible analytical framework. Makhholm (2012), for instance, applies the lenses of NIE to pipeline studies seeking to explain the markets, market behavior, regulation and competitive entry. Luong and Weinthal (2010) conduct comparative study on the post-Soviet practices of ownership structures and institutions in mineral resource management.

What was typically overlooked in the literatures on Russian energy is the understanding that Russia's energy policy is not monolith. Shadrina (2010ab) has been attempting to bridge this gap. Arguing that Russia's energy policy differentiates across space, the author analysed European, Central Eurasian and Northeast Asian patterns in Russia's energy policy. Having set focus on Russia's activated energy

ties with Asia, Shadrina (2013ab) has been applying analytical framework of state capitalism to study Russia's region-specific (as regards the Russian Far East) policy. The notion of "region" is indeed an important unit in the analysis of Russian energy policy. From political science perspective, Dusseault (2010) presented perhaps one of the most comprehensive studies into the "center-periphery" problem in Russia's energy policy.

This article incorporates the NIE's concepts. It however omits theoretical discourses for the reason of space. Essential explanations are substituted by references and notes to the relevant sources. The key elements employed in this work can be briefed as follows. Institutions,⁷ as defined by North (1990), have three dimensions: formal rules, informal rules and the effectiveness of their enforcement.⁸ If one of the three has problems, the entire system fails to perform efficiently. Although, as North notes, the main role of institutions "...is to reduce uncertainty by establishing a stable (but not necessarily efficient) structure to human interaction" (1990: 5), institutions define efficiency of the economy "... by their effect on the costs of exchange and production. Together with the technology employed, they determine the transaction and transformation (production) costs" (1990: 6). Inefficient institutions are reasonably attempted to be improved or altogether changed. Regardless of the scale of such a transformation, the process of institutional change is incremental (North, 1990: 6). Distinguishing between formal (public rules) and informal (private rules⁹) institutions helps explain differentials in depth, scope and dynamics of institutional transformations. Indeed, even if formal institutions undergo dramatic alteration overnight (say, juridical system changes), informal institutions, which are more static in their nature, tend to modify gradually thereby affecting the progress of institutional transformation. A very complex process of economic change stirred by the transformation of institutions North (2005) schematically depicts as a cycle where *perceived reality* (informs) → *beliefs* (which shape) → *institutions* (which compose) → *policies* (which bring about some changes and result in) → *altered perceived reality* (which is reflected in) → *altered beliefs* and on and on.

The article scrutinizes Russia's contemporary (throughout the 2000s) gas policy towards NEA. As the Russian government increasingly frequently reiterates the task for the Russian eastern territories development, it at the same time links the success in doing so with a specific role that the Far East should play in Russia's Asia-oriented energy policy. The study discerns the rationale for Russia's energy policy change and Russia's gas export policy goals and objectives in NEA upon a comprehensive approach, which embraces national, regional and external perspectives. The work seeks to answer the following principal questions: 1) What is/are the **rationale**(s) for the Asian Vector in Russian energy policy? (Did it/ they change over time? If so, why?); 2) What are the **goals/ objectives** of Russian energy policy in Asia? (Did they evolve over time? Again, if so, why?); and 3) What Russia can potentially gain from this eastward shift in its energy policy?

While the subsequent sections present more detailed analysis, it can be briefed here that rationale for the eastward shift in Russia's energy policy originates in the Russian government's attempts to moderate *negative externalities*¹⁰ of the country's

too profound dependency on the European gas markets. The latter bears such hazards as vulnerability of public budget over the volatility of export revenues from the dominant external market. Of no less importance, owing to the key role that the energy plays in Russian economy, the sector's concentration in Russia's west be- leaves the country's scarcely populated and underdeveloped eastern territories of economic dynamism. It is against these concerns that Russia proclaimed energy export expansion to Asia in 2003. In addition to market failures, *policy* or *government failures*,¹¹ such as issues with ensuring property rights, unintended side effects in- volved with such energy policy measures as tenders, licensing, subsidies and taxa- tion, etc., spectrum of principal-agent problems, issues associated with regulatory risk (interest groups, tent-seeking, lobbying, corruption, etc.) and regulatory capture (such as liberalisation, privatisation and regulation), etc. can be equally named as factors explaining Russia's (under) performance in energy governance.

The article concerns some of the institutional aspects in the realm of Russia's gas policy vis-à-vis NEA. In so doing, the study demonstrates that Russia has suc- ceeded in entering the NEA countries gas markets, but Russia's prospects in NEA are challenged by a range of domestic and external factors. Developing these argu- ments, the article shows that Russia's shift eastward is a pragmatic two-goal pursu- ing choice. The latter exemplifies a reactive policy course, because: first, through diversification away from the EU markets with increasingly incompatible with Russia's own energy governance institutions, Russia attempts to secure gas export revenues; and second, gas exports to the NEA markets are perceived as one of the most expedient means to revive the vast and resource rich but shrinking economi- cally Far East. It is argued that if concerned about the long-term prospects in the NEA gas markets, Russia needs to employ more comprehensive domestic and for- eign gas policy.

2. Materials and Methods

A great variety of accounts has been employed to develop this work. Materials on gas policy and relevant statistics have been retrieved from the official web-sites of respective government institutions in charge of energy policy making and collect- ing and disseminating statistics in Russia and three other countries under study (China, Japan and Korea). Principal programme documents in the area of Russia's energy policy¹² were examined upon the method of content analysis.

The IEA, EIA and BP data helped evaluating the dynamics and trends in gas supply-demand and trade in NEA. In order to keep measures related to quantities and values of gas uniform, this paper adheres to the conventions employed by BP Statistical Review of World Energy (BP Annual).¹³ Also, primary data about the four countries' major national oil companies (NOCs) and state-owned companies (SOCs) were collected from their respective web pages, such as Gazprom, Rosneft and Transneft in Russia, JOGMEC in Japan, Kogas in Korea, CNPC, Sinopec and CNOOC in China.

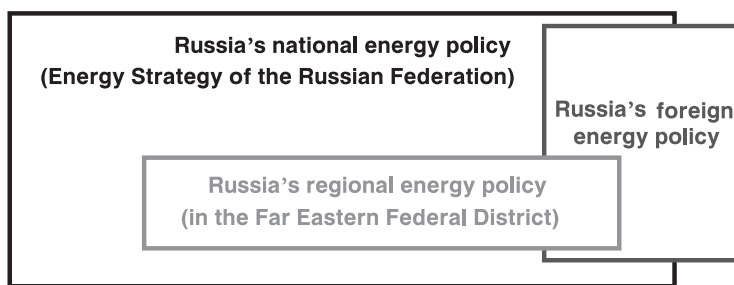
Secondary data have been obtained from the published research by the think

tanks conducting energy studies (such as the Institute of Energy Strategy and Skolkovo Energy Centre in Russia, Institute of Energy Economics in Japan (IEEJ), Energy Research Institute in China (ERI), Korea Energy Economics Institute (KEEI) in Korea, etc.), but also through daily reading of diverse sources of industry news available in three languages (Russian, English and Japanese).

Since the article discerns region as a unit for Russia's energy policy analysis, relevant materials and data were collected from the web-sites of the Ministry for the Development of the Russian Far East and those of East Siberian and Far Eastern local governments. Publications of the Institute of Oil and Gas Geological Exploration of Siberian Branch of Russian Academy of Sciences (RAS) in Novosibirsk and the Economic Research Institute Far Eastern Branch of RAS in Khabarovsk were of help in grasping the up-to-date situation on the studied questions.

Russia's energy policy towards NEA is analysed as being shaped by the domestic factors of national and regional scope, as well as external determinants (Figure 1).

Figure 1 Regional Energy Policy in Russia's Energy Policy



Source: composed by author.

Finally, a broad network of professional contacts within both academia and oil and gas industries realms in Russia, Asia and Europe, as well as personal communications with the industry practitioners, businesses and experts at a great number of conferences and events, of which the 2013 Oil and Gas Conference in Sakhalin was certainly one of the most remarkable experience of the author, these all, in one way or another, contributed to this work.

3. The Eastward Shift

3.1. *Why Shift?*

According to E. On estimates for the year 2013, Russian gas occupies 29.5 percent in the EU imports and 23 percent in the EU gas consumption. History of Russia-EU energy relations knows examples both of cooperation and conflicts. The latter have become especially frequent in the past several years, involving a broad gamut of actors and resulting in state-state, state-business and business-business conflicts. The Russian actors are frequently accused of not obeying the EU rules and at times even penalized for violating them. The most telling example of this kind is the

European Commission (EC) antitrust investigation against Gazprom¹⁴ which may result in a penalty of some \$15 b. While Gazprom has been demonstrating its will to settle some of the issues, the company could not agree to the EC requirements to revise Gazprom's pricing policy by linking gas prices to the spot market.¹⁵

While dealing with the EU member states, Russia is exposed to the EU supranational regulatory provisions. Russia-EU gas discourse can be understood through the developments in two main dimensions: 1) widening discrepancy between the EU and Russia's energy governance institutions; and 2) major structural shifts in the globalising gas market. Kuzemko (2014) provides an excellent analysis of the ideational discrepancies (liberal market in the EU vs hands-on approach in Russia) presenting the essence of Russia — EU conflict in the realm of energy relations. Concepts of institutionalism can also be employed to explain the divergences occurring because of structural transformations. Sketched in the opening part of this article logical framework (perceived realities-beliefs-institutions-policies, etc.) allows to see the core of Russia-EU differences.

While the partners pursue a seemingly identical ultimate goal/objective of *energy security*, they have different interpretation of such simply because one side is a producer and an exporter, while another is a consumer and an importer. It is only natural that a large consumer of imported energy resources is concerned about security of supply, while a large producer, whose socio-economic and political stability is endangered by its profound dependency on energy export revenues, is worried over security of demand. In largely abstract but yet quite adequate form, energy security of a supplier as well as a consumer can be perceived through the categories of price, volume and market structure. Table 1 presents the case of gas security as perceived

Table 1 Perception of Gas Security: Russia vs. EU

Russia: Security of Demand*	EU: Security of Supply
policy prime objective	
gas exports revenue maximization → state control over national gas sector & outward expansion (access to EU's mid- & downstream)	efficiency of gas market → liberalisation of intra-EU gas market & access to Russia's gas value chain
perceived threats	
falling/fluctuating price	unfair/fluctuating price
external competition (downward pressure on export price; shift towards less attractive pricing; etc.); shrinking volume demanded the EU's economic situation; climate policy; increasing G2G competition; etc.; deteriorating access to the market the EU's terms of ownership unbundling, the "third country clause", etc.;	price discrimination; rigid pricing (TOP provision in Gazprom's contracts); etc.; unguaranteed volume Russia's insufficient investment in gas development; untoward foreign investment regulation; gas export diversification; etc.; supplier's market power traditional perspectives (transit, 'gas OPEC', etc.) and new dimensions (Russia's eastward expansion, G2G competition); etc.

Source: composed by author.

Note: *incorporates ideas of the Draft of Russia's Doctrine of Energy Security (Conceptual Theses); can be accessed at <www.labenin.z4.ru/Docs/en_bezop_project.doc>.

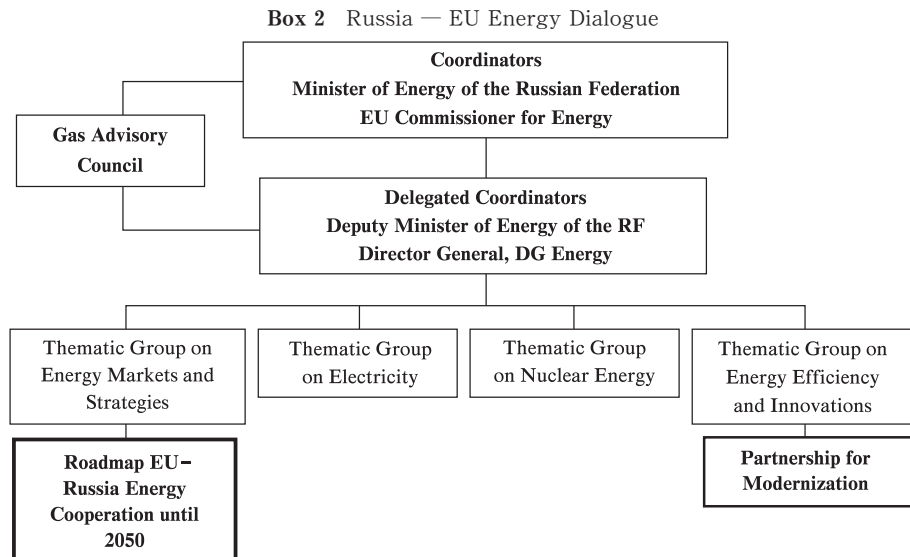
by Russia and the EU. National institutions for energy governance in Russia and the EU are established in order to address their respective concerns in the realm of energy security.

Russia and the EU are locked into a deep symmetrical dependency, but their gas relations are not smooth. One of the principal reasons here is the multidirectional/asymmetrical character of the institutional changes that are unfolding in Russia and the EU. While Russia has been departing away from initially designed plan for the deregulation of the domestic gas sector towards the norms of state capitalism, the EU has been methodically proceeding the harmonization of the member states energy policies progressing towards further liberalization of the EU common energy market (Box 1). Consequently, the partners find themselves increasingly uncomfortable within once appropriate setting. No doubt, the efforts to establish the appropriate institutions for fostering the bilateral cooperation are continued. Seeking to embrace new dimensions, Russia and the EU have established a number of new frameworks, such as the Partnership for Modernization, the Roadmap EU-Russia Energy Cooperation 2050, etc.) (Box 2). At the same time, Russia and the EU are simultaneously opting for the diversification of their gas ties as one of the key policy choices ensuring the attainment of their respective goals in the realm of gas security.

Box 1 Principal Developments towards European Single Gas Market

Year	Document	Significance
1991	Gas Transit Directive (1991/296/EEC)	Member states agreed on third-party access (TPA) to transmission pipelines
1998	First EU Gas Directive (1998/30/EC)	Member states choose between regulated and negotiated TPA to transmission
2003	Second EU Gas Directive (2003/55/EC)	Elimination of notion of transit and introduction of an identical treatment to all gas flows inside the EU, irrespective of whether they were cross-border; mandated regulated TPA to all transmission on the basis of tariffs (or methodologies) approved by national regulatory authorities (NRAs)
2004	Council Directive (2004/67/EC)	Concerns measures to safeguard security of gas supply
2005	Regulation (1775/2005)	Conditions for access to the natural gas transmission networks
2009	Third Energy Package (2009/73/EC)	Unbundling of transmission assets in the form of either ownership unbundling (OU), or independent system operator (ISO), or independent transmission operator (ITO); certification of transmission system operators (TSO) meeting the unbundling requirements; entry-exit (EE) organisation of access to transmission system networks; development of pan-European Network Codes (NCs) on cross-border issues

Source: composed based on <http://faolex.fao.org> and Yafimava, K., 2013. The Third EU Package for Gas and the Gas Target Model: major contentious issues inside and outside the EU. The Oxford Institute for Energy Studies. NG 75, April.



Source: composed by author.

3.2. *Rationale: Why Northeast Asia?*

“... Russia’s reorientation toward the Pacific Ocean and the dynamic development in all our eastern territories will not only open up new economic opportunities and new horizons, but also provide additional instruments for an active foreign policy.”¹⁶

Geopolitically, NEA is one of the most complex regions. Boggled down in territorial disputes, divided by numerous unresolved historical issues and preoccupied with the traditional security concerns that linger over the region, the NEA states are showing few signs of joint action on the energy front. In the absence of a common set of rules, having almost no energy resources of their own and being therefore critically dependent on energy imports, the NEA states have instead resorted to implementing a variety of policies. These consist of measures of external policy, such as resource diplomacy, and domestic strategies, such as renewable energy, energy conservation and the like, with the imperative goal being yet again to ensure national energy security.

Not to disregard the specifics of the national approaches in place, energy policies of NEAs can be broadly described by so-called ‘3E’ concept (term originally coined by Japan), which underpins common for large energy consumers and importers concerns about the affordability of energy (price, *economics* of energy), the maximization of *efficiency* of energy resource utilization and the minimization of the *environmental* footprint.

In a sense, Russia’s role towards the NEAs and the NEAs’ role towards Russia are reminiscent of those in the Russia-EU context; it is the same “supplier-consumer” mode, but there is no discernible tension in Russia’s energy ties with the NEAs. It is worth asking: Is there a kind of institutional consistency observed in Russia-

NEA-3 energy relations? Overall, it appears to be accurate enough to liken the energy policies of the states concerned for their pursuit of a pragmatic course (Table 2). It, however, becomes clear at a very first glance that this is the case of different types of pragmatism.

Table 2 NEA's Energy Policies: Compatibility in Pragmatism

<p>Russia — pragmatism of a large producer & export-dependent economy; production of increasing volumes and export worldwide at best possible price; depletion in traditional producing provinces, worse geology & economics of greenfields, intensifying external competition from unconventional, etc. narrow down policy choices</p>	<p>China — pragmatism of a large consumer & net importer and a developmental state (secure supply ⇒ sustainable economic development); enhanced development of indigenous gas (unconventionals: CBM, shale & SNG); transition to a low carbon economy, by 2020 non-fuels in primary energy consumption 15%; renewables & nuclear (18 NPPs operating, 1.7% of electricity; ~30 reactors of capacity 34 GW under construction; >50 reactors in the planning stage; total capacity by 2015~40 GW)</p>
<p>Korea — pragmatism of a 100% oil&gas-import-dependent economy competing for supply with two neighbours; geopolitically problematic location; paradigm 2030—renewables (4.3% by 2015; 11% by 2030) & nuclear (currently 12 NPPs, 23 reactors (6 offline), about 30% of electricity → BUT Fukushima & domestic issues pressure for revision of the initial plan for +10 reactors and, 41% of electricity by 2030 to 29% of electricity by 2035¹⁷)</p>	<p>Japan — pragmatism of a mature & stagnating ~100% oil & gas-import-dependent economy forced to overhaul energy policy after the 2011 nuclear disaster; now all remaining 50 (4 destroyed by the 2011 disaster) reactors are offline, decision on the restarts is awaited; by 2030: nuclear-energy free (?), renewables 20%; macroeconomics accentuates cost-efficient solutions; climate change policy toughens the choices</p>

Source: composed by author.

Note: NPP stands for nuclear power plant.

Economic and environmental considerations are among the most principal factors defining contemporary energy policy of a state. In NEA context, two shifts deserve special attention. For Japan, energy price has become by far more decisive aspect of policy making, while environmental dimension is turning into a serious denominator of China's energy policy.

To Russia, NEA's growing gas demand and expanding in NEAs gas deficit emerges as a blessing. Since 2009 the region became the primary importer of Russia's LNG (Table 3).

Table 3 NEA-3 Shares in Russia's LNG Exports, %

Country	2009	2010	2011	2012
China	3.78	3.81	2.29	3.54
Japan	55.82	61.42	67.82	76.45
Korea	20.42	29.10	26.96	19.88
NEAs' total	80.02	94.33	97.07	99.87

Source: calculated by author based on BP data.

What makes the region particularly attractive to Russia is that the NEA represents one of the most lucrative markets for its traditionally higher than in any other market price and significant import volumes. Indeed, the world's largest (Japan and Korea) and the fastest growing (China) gas markets are in NEA (Table 4). In addition, NEA is not consolidated by any intraregional institutions.

Table 4 NEAs' LNG Imports Growth Rates, %, y/o/y

Country	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
China	—	—	—	(*)	287	14.73	72.07	67.54	29.84	21.90
Japan	6.92	1.05	-0.82	7.26	8.50	3.73	-6.76	8.82	14.41	12.67
Korea	9.02	13.95	1.87	12.12	0.73	6.29	-6.07	29.45	10.94	2.68

Source: calculated by author based on BP data.

3.3. *Russia's Eastern Gas Policy*

From the very outset, the development of gas reserves in Russia's east has been attempted in a specific form. The inception of the Sakhalin projects has taken place in the early 1990s amidst a profound devastation of the Russian economy. Seeking the ways to increase so much needed for the public budget export revenues and keep afloat Russia's vast eastern lands, the government realised that development of energy sector may be that (nearly only one available) expedient way to address both challenges. However, the government also realised that the development of the Far Eastern greenfields would be impossible without foreign capital and the expertise. Under such circumstances, the Russian government endorsed two production sharing agreements (PSA): the Sakhalin II in 1994 and the Sakhalin I in 1996¹⁸, which later on were severely criticised as not protecting well enough Russia's own (most of all commercial) interests. Up-to-date, the LNG plant in Prigorodnoe, which commenced LNG exports in 2009 under the Sakhalin II project, remains Russia's only gas link with the NEA markets. Not only did the LNG exports to NEA prove to be commercially attractive to Russia, they also revealed the benefits of gas-to-gas (LNG vs. pipeline) and region-to-region (NEA vs. the EU) diversification. In brief, the Asian Vector proved to be chosen correctly.

Throughout the post-Soviet period, Russian gas sector has undergone certain transformations, but their scale was somewhat smaller than in the oil industry. Gazprom is as a direct successor to the former Ministry of Gas Industry of the Soviet Union. Although Gazprom was partially privatized and reorganized into a Joint Stock Company (JSC) in 1993, state control over Gazprom was re-established in the 2000s and state currently owns 50.002 percent of the company's shares (Shadrina and Bradshaw 2013). The major reason for a very cautious approach towards the deregulation of the gas industry is that gas plays an important role in the domestic energy mix, therefore gas policy unavoidably influences other key policies affecting the social and economic situation in Russia.

Perhaps, the time when the PSAs were concluded was the period of the most

liberal policy in Russia's Soviet and post-Soviet history of gas. Following the 2006 Gazprom's entry to Sakhalin II¹⁹ and gas exports transferred under Gazprom's rein²⁰, Russian gas sector was shut up tightly for the IOCs, unless they were ready to accept some insignificant role in a project led by the Russian SOCs. Thus, Russia's gas policy transformed from being relatively liberal (at least welcoming foreign investment) into what is commonly evaluated as rigid heavily controlled by the government system of "manual" (hands-on) resource management.

Russia's contemporary gas policy towards NEA is enforced by two sets of policies. One could be named region-specific (as regards the ESFE) pattern of Russia's gas policy enacted through a number of incentives to activate the development of onshore and offshore gas projects in the eastern part of Russia. Another could be referred to as sector-specific two-pattern (as regards LNG and pipeline gas) policy. The latter has eventually materialised December 1, 2013²¹ as a result of heated debates at the institutions in charge of policy making and intensified rivalry among Gazprom and other domestic gas producers (Novatek, Rosneft, etc.) striving to seize a chance for a big business.

3.3.1. Goals and Objectives of Russia's Eastern Gas Policy

“... [G]overnment and private sector resources should go toward development and achieving strategic objectives. For example, let us look at such objectives as developing Siberia and the Far East. This is our national priority for the entire 21st century. The challenges we will need to tackle are unprecedented in their scale, which means we must take unconventional approaches.”²²

The thesis about the importance of the Far East for Russia's political/geopolitical/economic well-being has always been one of the most exploited “politically correct” statements which the Russian government used to send a formal signal of concern to Russia's vast eastern territories about their fate.²³ The signal was hardly reaching out to 4 percent of Russian population scattered across the lands occupying 3/5 of Russia's territory. From the very outset of his third presidential term, Putin made the ESFE to look like its development is indeed the government's utmost urgent and primary task (Box 3).

In fact, the emphasis on the region of ESFE in Russia's energy policy is not a novelty. Russia's energy strategies traditionally contain regional component (Table 5).

Comparing three documents — two Strategies till 2020 and till 2030 and the Draft till 2035 — for their overall goals and objectives for energy policy in ESFE (regional policy) and toward Asia (external policy), it is easy to notice that the prominence of the ESFE and Asia agendas have been growing constantly and the wording of relevant tasks has been gaining increasingly urgent tone.

For the first time, numerical targets for the Asian markets in Russia's energy policy were set in 2003.²⁴ In the Energy Strategy (ES) till 2020, the Russian government envisioned that as much as 30 percent of Russia's oil and 15 percent of gas would be exported to China, Korea and Japan. The task of diversification of

Box 3 Institutions for the Development of the Far East: Attempted and Succeeded

December 2006: Kamil Iskhakov, presidential plenipotentiary (PP) to the Far Eastern Federal District (FEFD), proposed creation of a ministry for the development of the Russian Far East. The idea was not supported.

November 2011: the then President Dmitri Medvedev and the government proposed to establish a RUR 500 m (\$ 16 m) JSC Fund for Development of the Far East and the Baikal region (the Fund) affiliated with Vneshekonombank (Bank of Foreign Economic Activity). In 2012, the Fund's capital was increased to RUR 15 b (\$ 0.5 b).

January 21, 2012: Sergei Shoigu, Minister of Emergency Situations, proposed the creation of a state corporation for the development of Eastern Siberia and the Far East (the Corporation). It was seen as to be subordinate to the President and receive broad authorities, including the authorities in licensing natural resources. Project was rejected by the government; Ministry of Finance was particularly against.

May 21, 2012: the Federal Ministry for the Development of the Far East (MDFE) was created by the presidential decree. Viktor Ishayev, PP in the FEFD, requested the unprecedented powers, including those over the federal property in the region, which were not granted.

March 2013: Ministry of Economy proposed the establishment of an autonomous non-profit organization to finance projects in the FEFD. The idea was supported by Viktor Ishayev, but after his resignation in August 2013, the project was shelved.

August 31, 2013: Yuri Trutnev succeeded Viktor Ishayev as the presidential envoy to the FEFD, but also retained his post of Deputy Prime Minister. In October 2013, Trutnev managed to expand the MDFE's authorities over the subsidies, management of special economic zones, selection and implementation of investment projects, etc.

October, 2013: Alexander Galushka, Minister for Development of the Far East proposed to create a network of *territories for advanced export-oriented development* and for their coordination — four development institutions to be supervised by the MDFE. The initiative was not supported by the government.

February 5, 2014: Deputy Prime Minister Yuri Trutnev presented the idea of creation of the *territories for advanced development* (TAD) with preferential taxation (payroll, property, etc.) in the FEFD. The establishment of a new JSC Development of the Far East with capital of RUR 69 b (\$ 2 b), additional funding of RUR 100 b (\$ 3 b) for the Fund and its autonomy from Vneshekonombank, two specialised autonomous organisations for the development of the Far East, registration of SOCs operating in the FEFD in the region, etc. are named among the considered measures. Additional RUR 170 b (\$ 5.2 b) for the JSC financing are requested from the government. These propositions are reminiscent of those made by Sergei Shoigu (the Corporation) in 2012 and Alexander Galushka in 2013, which at the time were rejected by the Ministry of Finance and the Ministry of Economy. The new proposals are to be detailed by March 2014.

Source: compiled based on publications by Kommersant <<http://kommersant.ru>>.

Russia's energy ties was re-emphasised in 2009, and the Energy Strategy 2030 targets for the three countries' total shares were set as 22–25 percent for oil and 19–20 percent for gas (Table 6).²⁵

Russia's major SOC — Gazprom²⁶ — has also projected the targets for the ESFE gas production and Asia-oriented exports. Comparing the ES 2030 targets with those in Gazprom's Eastern Gas Program, the latter look more ambitious (Table 7).

Facing difficulties in developing new gas deposits in ESFE (for different reasons, among which there are both domestic, such as a very limited regional gas demand, and external, such as various setbacks in entering the Asian gas markets),

Table 5 Comparison of Russia's Energy Strategies

	ES 2020	ES 2030	Draft ES 2035*
Primary goal	maximised efficiency in energy resource exploitation and in the use of fuel-energy complex's potential for the purpose of economic growth and improvement of quality of living standards	2020 (+ sustainable economic growth) creation of innovative and efficient energy sector meeting the needs of growing economy and allowing Russia to strengthen its foreign economic status	2030 + development of domestic energy infrastructure (overcoming imbalance in favour of export infrastructure); improving the availability and quality of energy products and services; supremacy of principles of sustainable development in energy governance at corporate and national levels
Regional policy (RP), with focus on ESFE	creation of a single energy space through the development of inter-regional markets and infrastructure, optimization of regional energy demand-supply structure; development of new large gas producing centres in ESFE; development of (domestically oriented) gas infrastructure in ESFE	2020 + coordination between federal energy programmes and regional programmes for socio-economic development; implementation of innovative and capital-intensive (export-oriented) energy projects in ESFE;	2030 + development of system of indicators for monitoring a region's energy security (RES)** and analysis of RES; prioritised development of energy infrastructure in ESFE with more accentuated focus on domestic/regional needs;
Foreign energy policy (FEP)	strengthening position in the global energy markets, most efficient utilisation of FEC export potential, increasing competitiveness; utilisation of Asia Pacific markets potential (share in export by 2020: 30% (from 3% in 2003), gas — 15%)	main challenge — price volatility in global energy markets; strengthening Russia's position in global energy markets through improved competitiveness; geographic and product diversification of exports; further promotion of common Eurasian energy market; increasing role of Asia Pacific markets (26–27% of energy exports in 2030)	main challenge — increasing global competition; 2030 + adaptation of FEP to new trends in development; strengthening position in LNG global market; stable energy relationships and development of dialogues with traditional partners; adaptation to structural and institutional changes in the European markets; rapid entry to the Asia-Pacific markets (region's share in oil exports — 32%, gas — 31%, total energy — 28% in 2035); enhanced energy dialogue with Asian partners; finalising gas negotiations with China

Notes:

* The complete version of the Draft of Energy Strategy 2035 was not available at the time of writing (February 2014). The comparison is based upon the Draft Energy Strategy of the Russian Federation to 2035 (<http://minenergo.gov.ru/documents/razrabotka/17481.html>) (in Russian)

** Conceptual provisions of the Draft of the Energy Security Doctrine of the Russian Federation are available at (www.labenin.z4.ru/Docs/en_bezop_project.doc) (in Russian)

Table 6 Excerpts from ES 2030 on Gas Production in Eastern Siberia and Russian Far East

	Phase 1: 2013–2015	Phase 2: 2016–2020/22	Phase 3: 2021/23–2030
total gas production, bcm including:	685–745	803–837	885–940
Eastern Siberia (ES)	9–13	26–55	45–65
Russian Far East (RFE) including:	34–40	65–67	85–87
Sakhalin	31–36	36–37	50–51
gas production in ES and RFE, % to total	7–8%	12–14%	15%
total gas export, bcm	270–294	332–341	349–368
share of Asia Pacific in total export, %	11–12%	16–17%	19–20%
LNG export, % to total export	6–7%	10–11%	14–15%

Source: composed by author based on data from pp. 102 and 111.

Table 7 Excerpts from Gazprom's Eastern Program,²⁷ 2007

	2010	2015	2020	2030
total gas production in ESFE, bcm including:	27	85	150	162
Eastern Siberia	5	50	55	57
Far East	22	35	95	105
gas consumption in ESFE, bcm	13	18	41	46
export, bcm	14	23	71	78
pipeline export, bcm	—	9	50	50
LNG export, bcm	14	14	21	28

Source: composed by author based on data from original document.

Gazprom has been regularly revising its Eastern Program targets. While LNG production and export — for which Gazprom's CEO Miller always very willingly (but unjustly) credits his company — progresses, other goals remain unattained largely due to Gazprom's failure to finalise the pipeline deal with China.

3.3.2. Institutions

NEA has no institutions of any comparable with those in the EU scope. In NEA, Russia's gas links are supported by bilateral frameworks mainly of ad hoc format. What appears to be important is that the Russian government encounters no perceptible inconsistency at the institutional level with the NEA states. Weak intra-regional cooperation in the energy realm — result of the overall rather complex geopolitical environment in the region — is to a certain degree beneficial to Russia, which takes advantage of existing space for a manoeuvre when negotiating the deals with each country separately. Another specific component of Russia's energy policy towards NEA is that in order to implement the *Asian (or Eastern) Vector* and

facilitate gas development in Eastern Siberia and the Far East (ESFE), which is extremely challenged by a variety of natural factors (climatic, geographical, geological, etc.) translating into high costs of gas production, the government introduced a system of region-specific incentives (such as tax breaks, export duty exemptions, etc.). This is perceived as an essential policy provision aimed to initialise hydrocarbon production in the ESFE.

What are the institutions serving the purpose of Russia's energy cooperation with the NEA countries and how much coherence at the institutional level is being indeed observed? In general, it is the national institutions that Russia and the NEAs are employing to foster their energy ties. Nonetheless, several specific aspects seem to be of importance here.

First, owing to their own rather recent development experiences,²⁸ the NEAs demonstrate more tolerance about state's direct intervention in a certain industry or the economy as a whole. This perfectly matches Russia's contemporary approach to energy governance, which can be best described in the categories of state capitalism.²⁹ The Russian and the NEAs' governments have always played a crucial role in laying out the groundwork for energy cooperation, as well as in sorting out the matters of argument in their bilateral energy ties. In the NEA context, it is a normal practice that the governments work in close connection with the businesses and their efforts tend to intensify when a controversial question arises. There were various illustrations of the latter, to name a few, such as the 2006 Gazprom's entry to the Sakhalin-II, the dispute between Gazprom and Sakhalin-I operator ExxonMobil with regard to the IOCs and Rosneft's China-oriented gas export plans, the case of oil price dispute in the ESPO-I Daqing Spur to China, the Rosneft — TNK-BP deal, Gazprom — CNPC negotiations on the routing of gas pipeline and the terms of supply, etc. The official bilateral frameworks were indispensable in all those cases and were repeatedly activated to foster these business to business agreements or settle the disputes.

Although the decision making in Russia's energy sector formally lies with such agencies as the Ministry of Energy, Ministry of Natural Resources and Ecology, Federal Agency for Subsoil Use, etc. a number of indirect or even somewhat informal arrangements prove to be more influential in reality. There is an intense competition among the agencies involved with the energy policy making in Russia. That is to say, the powers of the Governmental Commission on the Fuel and Energy Complex and Regeneration of the Mineral and Raw Materials Base established in 2005³⁰ are being challenged by the Presidential Commission for Strategic Development of the Fuel and Energy Sector and Environmental Security since it was created in June 2012.³¹ Chaired by President Vladimir Putin with Rosneft's CEO Igor Sechin acting as an executive secretary, the Presidential Commission has an extensive mandate embracing tariff, tax and price policy for petrochemicals, gas and electricity and investment, all of which is of binding power for other authorities. In turn, the Governmental Commission (currently chaired by Deputy Prime Minister Arkady Dvorkovich) has effectively become a body for running mainly coordinating activities. The Presidential Commission and the Government Commission often confront

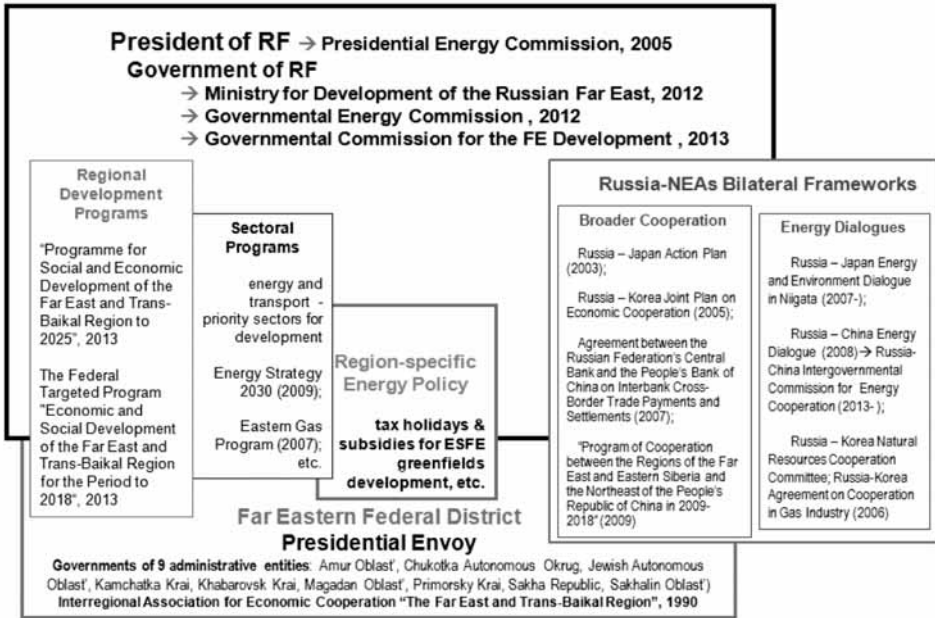
each other on the most principal issues of the national fuel energy complex development.

Longtime debate about the necessity of the fuel energy sector's privatization and the government's withdrawal from the BoDs in the SOEs³² has so far not resulted in any concrete steps towards that. While Prime Minister Dmitry Medvedev, who fathered the idea at the time of his presidency, refereed to 2016 as the year by which privatisation of the SOCs and streamlining of decision-making may start materialising, this looks increasingly unrealistic. The CEOs of major SOCs, such as Gazprom, Rosneft and Transneft, remain closely involved with the energy policy making in Russia. Frequently, it is performed in the form of the direct petitions to the President or lobbying in the federal government entities (Ministry of Energy, Ministry of Finance, etc.) for a more favourable regulation to be extended to the SOCs concerned. The SOCs customarily ground their reasoning for an exceptional treatment (like tax breaks, simplified procedure of licensing for new deposits, etc.) to be granted upon their complaints about prohibitively high costs of the development of the greenfields in Russia's North and East both inland and offshore.³³ Expectedly, such lobbying often leads to a conflict of interests of, say, the entities assigned with conducting the policies directed at oil and gas production growth (the Ministry of Energy) and the entities assigned with the fiscal functions (the Ministry of Finance). To be objective, in the recent years, there have been growing consolidation among the industrialists themselves (e.g., under the Union of Oil and Gas Producers of Russia) and strengthening coordination of their attempts to present the government with their insights into the sector's most acute problems and their visions about the appropriate ways to cure the sector's, by many estimates, critical situation.³⁴

Second, Russia's energy policy towards NEA embraces a number of specific arrangements enacted in the Far East for the purpose of rapid development of oil and gas resources located in the region (Figure 2). This, in fact, allows distinguishing a region-specific pattern in Russia's contemporary energy policy (Shadrina 2013a). The regional component nonetheless needs to be understood correctly: there is no delegation of authority to the regional level. Likewise, there are no discretions open to the regional governments over the matters involving the development of the resources located in the RFE. The region-specific pattern within Russian energy policy is deliberately established and strictly controlled by the central government through the system of fiscal, licensing, tariff, foreign investment, etc. regulation and implemented through the government's reliance on the SOCs: Gazprom in gas sector, Rosneft in oil industry and Transneft in oil export transportation. In a sense, the RFE is a mere recipient of the transplanted policy mode with very limited capabilities to participate in energy policy formulation and its implementation, despite it directly relates the region's natural resources.

Addressing the bilateral frameworks in the area of oil and gas cooperation, Russia has established energy dialogues with each of NEA-3. Also, as Figure presents, there are various bilateral agreements on closer economic cooperation between Russia and the NEA countries for the development of the ESFE, including its

Figure 2 Components of Region-Specific Energy Policy: the RFE



Source: composed by author.

oil and gas sectors. While the latter address more practical issues, two other frameworks concern gas cooperation in all-NEA format and attempt contributing to gas policy-making in the region. Under the UN auspices, for instance, the Intergovernmental Collaborative Mechanism on Energy Cooperation in North-East Asia (ICMECNEA) was established in 2005.³⁵ One of the deficiencies of the ICMECNEA is that Japan, a significant gas consumer and importer, is not its member. Another rare example of all-NEA framework for gas cooperation is the Northeast Asian Gas and Pipeline Forum (NAGPF),³⁶ a non-profit organization consisting of five member countries including Russia (represented by Asian Pipeline Research Society of the Russian Federation), China (Asia Gas and Pipeline Cooperation Research Center of China (AGPRCC), Korea (Korea Pan-Asian Natural Gas and Pipeline Association), Mongolia (Petroleum Authority of Mongolia) and Japan (Northeast Asian Gas and Pipeline Forum of Japan). Since its foundation in 1997, the NAGPF has been promoting natural gas development in the NEAs through the international conferences and joint research projects. Japan has been actively utilizing this platform in articulation of its interest in regional pipeline links.

On the whole, the multilateral frameworks play a very limited role in the development of energy cooperation in NEA. The bilateral schemes are of more use, as in rather disintegrated context of NEA they prove to be more expedient mechanism in facilitating the projects and solving the issues whenever such arise. The NEAs assess rather positively the Russian state's profound involvement with the gas sector development in the RFE. Moreover, this is perceived as a certain level of

guarantee which the Russian government ensures to its Asian partners. Within Russia itself, however, this model of energy governance in the RFE is criticized as disadvantageous for the national economy (this aspect is addressed in the concluding part of the article).

4. Discussion: How Much Consistency does Asia Offer?

Russia's gas policy towards NEA is influenced by a range of factors. Certainly, geopolitical environment defines the dynamics of Russia's gas links with NEA. Particularly, a very slow progress in pipeline projects originates primarily from this sort of concerns. But there are also other aspects that Russia needs to be especially attentive while mastering its gas ties with the NEAs. Among those major trends there are the ongoing structural transformations in the gas markets triggered by the increasing unconventional gas production in North America, the shifts in NEAs' national gas strategies towards further diversification of their supplies, the NEAs' growing ambitions to expand the share of indigenous gas through unconventional gas production (CBM, SNG and shale gas in China) or edge-cutting technologies (methane hydrate and clean coal technologies in Japan and Korea).

There are also clearly spelt priorities for the liberalisation of domestic gas markets. Speaking of China's gas pricing reform,³⁷ it makes the prospects for the future imports somewhat ambivalent: it may signify the opportunities for additional volumes of more expensive supplies, but it may also result in larger domestic production, because the Chinese producers will be more motivated to expand their gas production, thereby lessening the need for imports. Under the tenets of Abenomics, Japan looks increasingly resolute to introduce more competition into the domestic electricity market,³⁸ which in turn would result in a greater number of LNG importers. This could be a positive change for the Russian exporters, which now deal almost exclusively with Japan's ten large electricity utilities. Also, in the Fukushima aftermath the demand for LNG imports grows. As of 2012, LNG, which substitutes for the halted nuclear reactors, occupies a significant 48 percent share in electricity generation (from 29 percent in 2010).³⁹ By all measures, Japanese LNG demand (already the world's largest) stands to increase further. The world's second largest LNG importer — Korea — may also be seen as offering more opportunities for the LNG exporters, since the government lowered its targets for nuclear power generation (Table 2).

Nonetheless, it is overall becoming increasingly apparent that it is not only China, but Korea and Japan, which are seriously concerned about the price of the future supplies. It is therefore a principal matter for Russia while competing in one of the largest regional segments of the globalising LNG business and observing self-benefit to proffer commercially attractive offers to the NEA gas buyers.

Russia's gas cooperation with NEAs would inevitably require the Japanese and Korean NOCs' and other IOCs' investments. The Chinese-Russian NOCs' loan-for-gas schemes would be as important as those in the area of bilateral oil ties (Shadrina 2013b). Overall, the Chinese companies demonstrate their sheer interest to Rus-

sia's equity gas. Given the specifics of the NEA states' energy diplomacies (which in most general form can be described by the Chinese "going out — bringing in" version), Russia can no longer neglect their interest in gas equities. Seeking the state-of-the-art technical capacities to develop geologically challenging gas deposits in the ESFE and technological capabilities to produce high value-added petrochemical products in the ESFE, Russia has no realistic alternative but to adopt a more foreign investment friendly legislation and allow the IOCs' and NOCs' entry to the Russian gas value chain.

Speaking of NEA's institutional setting, so far the international cooperation (trade and investment, for instance) in gas sector has been run exclusively upon the bilateral agreements. However, there are some recent attempts to introduce multi-lateral arrangements for the Asian gas markets. Among those are the IEA-led joint study on the establishment of natural gas trading hub in Asia, Japan — India study group on pricing of LNG in the Asia Pacific market, Japan's initiative to list the U.S. dollar-denominated LNG futures at the Tokyo Commodity Exchange and establish a price benchmark for LNG by March 2015, etc. These sundry moves demonstrate that the Asian gas markets have started evolving towards being more efficiently structured and better coordinated by the regional gas buyers. The latter, as is known, have all along been especially discontent with the Asian premium resulting in LNG prices in Asia being times above the Henry Hub (HH) benchmark. As far as such features as a destination clause and the overall predominance of long-term contracts over spot trade (which regional LNG importers consider as the disadvantages of the Asian LNG markets) are concerned, Russia has been showing some flexibility⁴⁰ and therefore managed to establish credible reputation with the NEA buyers. Because it is unlikely that concerned about security of their gas supply 100 percent import-dependent Japan and Korea and 30 percent import-dependent China would opt for import based solely on spot trade, Russia may have a room for manoeuvre within a balanced portfolio of long-term and spot gas contracts with the NEAs.

5. Conclusion and Policy Recommendations: Or or And?

Russia has certainly progressed towards its goal of gas exports diversification (Table 8). However, this result is entirely due to the Sakhalin II's LNG plant operation, which remains the only gas project Russia managed to implement in the RFE. In this case, participation of foreign capital under the PSA scheme needs to be recognised as critically important.

Speaking of Russia's future plans in the Asian gas markets, there is a great number of projects Russia aims to launch (Table 9). Provided Russia is successful in their implementation, the country stands to significantly strengthen its profile, growing from the current niche of just under 5 percent of the global LNG production to about 10 percent by 2020.⁴¹

What are the conditions to succeed? The most generic ones can be formulated as to think strategically and act sharply. Meanwhile, recently revealed draft of the

Table 8 Russia's Gas Exports Distribution: Actual and Projected in the Energy Strategy 2030, %

Region	2005	2008	2012	1 ph.	2 ph.	3 ph.	2030 against 2008*
Europe	62.5	64	69.9/63.0**	57.8	56.9	56.1	– 8
CIS	37.5	36	30.1/27.1**	31.6	26.6	23.7	– 12
Asia Pacific	0	0	– /9.9**	10.6	16.3	20.2	+20

Source: developed by the author based on the Strategy 2030, BP Statistics 2013 and Shadrina (2010b).

Notes:

data for each phase are averages based on the Energy Strategy 2030's scenarios;

column marked with * presents the overall change (“–” decrease; “+” increase) in geographical structure of gas exports by 2030 against 2008;

data for 2005, 2008 and 2012 are factual and serve for the “target-achievement” comparison;

two-data set (**) reflects share of a region in Russia's export of pipeline gas/share of a region in Russia's total gas exports with LNG included.

Table 9 Russia's Actual and Projected Gas Exports to NEA, bcm/y

Projects	2012	2017	2019	2030
Sakhalin II LNG plant (Gazprom Sakhalin Holdings B. V. 50% +1; Shell Sakhalin Holdings B. V.)	14.99	15	15	15
Yamal LNG (16.5 Mt, Novatek 60% & Total 20% & Sinopec 20%)		4.14	4.14 + “X”	4.14 + “X”
Vladivostok LNG (Gazprom & Japan Far East Gas Co. ⁴²)			13.8/20.7	13.8/20.7
Sakhalin II LNG plant 3rd train			6.9	6.9
RN LNG plant in Sakhalin (Sakhalin III, plant construction Rosneft & ExxonMobil & General Electric; Sakhalin I, long-term sales contracts btwn Rosneft & Marubeni and Rosneft & SODECO ⁴³)			20.7	20.7
Power of Siberia pipeline, aka Eastern Route (Sila Sibiri, Power of Siberia) [Irkutsk-] Yakutiya — SKV)			38	61
Altai pipeline*, aka Western Route				30
Total	15	19	99/105 + “X”	152/158 + “X”

Source: composed by author based on various sources.

Note:

“X” denotes unknown/ undecided quantities of gas supply to NEAs.

* Russian Government Ordinance on The Roadmap of Territorial Planning in the Russian Federation in the Area of Federal Transport (in the Part of Pipeline Transport) (Schema territorialjnogo planirovaniya Rossiiskoi Federatsii v oblasti federaljnogo transporta (v chasti truboprovodnogo transporta) No. 1416-r, August 13, 2013.

ES 2035 gave domestic energy experts⁴⁴ plenty of reasons to assess the document as the one proving that strategic thinking in Russia's energy policy is yet largely lacking.

What appears to be absolutely essential for Russia is to think about the ways of energy policy optimization. Russia's policy towards NEA needs to incorporate the long-term vision and adopt a more comprehensive approach. The dimensions for policy optimization embrace the domestic and external scopes. Domestically, there is a great number of critical issues which are interconnected and need to be

addressed systematically. To name but a few possible directions, Russia could:

—revisit the region-specific sub-pattern within Russian energy policy towards a broader approach (e.g., liberalisation of foreign investment; incentives for small- and mid-sized oil and gas producers; etc.). This appears to be especially important for the development of new gas deposits, because commercial terms in both schemes — pipeline gas and LNG exports — are likely to be determined by the format of NEA capital participation (loans vs. investment) in Russia's ESFE gas projects;

—accentuate policy incentives on geological prospecting and advanced technologies implementation;

—implement (fiscal) reforms enforcing economically rational (cost-reducing) behaviour of SOCs. Economic performance of Gazprom (heavily indebted, the company lost 2/3 of its capitalisation in 2012 alone) demands the government's attention and action. Rosneft's financial results also increasingly concern the analysts⁴⁵;

—more fully utilise rapidly multiplying opportunities in NEA. Russia needs to be well-equipped to respond to quickly maturing markets of NEAs (e.g., growing competition among gas suppliers (North American shale gas, East African — Kenya, Tanzania, Mozambique — LNG); Japan's initiative for LNG futures and LNG price benchmark; progressing at an unprecedented pace development of renewable energy; etc.); etc.

There is a range of areas, such as environment, technologies and innovations, where cooperation with NEAs is critically important to Russia. As a recognized geopolitical actor in NEA, Russia is responsible for living up to the expectations of the states in the region in the matters of the DPRK stalemate. Energy cooperation, as the author argued in her doctoral thesis,⁴⁶ is such a way towards closer integration in the region. Settling the bilateral disputes, developing intra-regional frameworks for energy cooperation and expanding them to connect with other nations in Asia (to embrace the ASEAN+3 format, for instance), this is the strategy Russia needs to follow. In short, Russia should make "Europe AND Asia", as opposed to "Europe OR Asia", a pivotal principle of its national energy policy.

Notes

- 1 Eastern Siberia includes such regions as Buryat Republic, Irkutsk Oblast', Krasnoyarsk Krai, Republic of Khakassiya, Tuva Republic and Zabaikalje (Trans-Baikal) Krai. Another abbreviation used throughout this work is RFE, which stands for the Russian Far East, a region consisting of nine territories: Amur Oblast', Chukotka Autonomous Okrug, Jewish Autonomous Oblast', Kamchatka Krai, Khabarovsk Krai, Magadan Oblast', Primorsky Krai, Sakha Republic, Sakhalin Oblast'.
- 2 The geographical boundaries of NEA remain loose and are often interpreted variously depending on a purpose of a specific inquiry. This study centres on NEA as being informed by the Russian Federation, Japan, the People's Republic of China (China) and the Republic of Korea (Korea). The latter three are frequently referred to as NEA-3.
- 3 Based on the World Bank's data on oil and gas revenues.
- 4 Theses of Minister of Energy Novak A. V. Speech "Priorities of the Russian energy policy" at Brookings, USA, December 6, 2013 and Draft Energy Strategy of the Russian

- Federation to 2035 <<http://minenergo.gov.ru/documents/razrabotka/17481.html>>
- 5 For details on methodology of composing the Resource Governance Index visit web-site of the Revenue Watch Institute <<http://www.revenuewatch.org/rgi/methodology>>.
 - 6 NIE is relatively young, but increasingly popular with the scholars area of knowledge. For more see web-page of the International Society for New Institutional Economics <<http://www.isnie.org/>>
 - 7 The term is frequently misunderstood; “institutions” are often interpreted as only formal arrangements or even more mistakenly as the organisations or frameworks (example could be found in Harris, 2008).
 - 8 For more detailed discussion on relevant terminology (institutions, rules, transaction costs, property rights, etc.) refer to: Chapter 19 “Introductory Observations”, pp. 381–422; Ostrom, E., 1986. *An Agenda for the Study of Institutions*. Chapter 21, pp. 429–451; Menard C., Chapter 25 “Markets as Institutions versus Organisations as Markets? Disentangling Some Fundamental Concepts” pp. 496–517 in: C. Menard (Ed.), 2004. *The Foundations of New Institutional Economics*. The International Library of the New Institutional Economics.
 - 9 See: Groenewegen, J., Spithoven, A., Berg, A., 2010. *Institutional Economics*. Palgrave Macmillan. p. 25.
 - 10 See: Chapter 7 “A Theory of Institutional Change: Concepts and Causes”, 2004, pp. 125–147 in: C. Menard (Ed.) *The Foundations of New Institutional Economics*. The International Library of the New Institutional Economics.
 - 11 See: Mueller, D., 1988. *Public Choice II*, Cambridge: Cambridge University Press; Wolf, C., 1988, *Markets or Governments: Choosing Between Imperfect Alternatives*, Cambridge, MA: MIT Press.
 - 12 Concept of State Energy Policy in New Economic Situation (Government Resolution No. 26, September 10, 1992); Principal Provisions of Energy Strategy of the Russian Federation till 2010 (Government Resolution No. 1006, October 13, 1995); Principal Provisions of Energy Strategy of the Russian Federation till 2020 (Government Approval No. 39, November 23, 2000); Energy Strategy of the Russian Federation till 2020 (Government Ordinance No. 1234-r, August 28, 2003) ; Energy Strategy of the Russian Federation till 2030 (Government Ordinance No. 1715-r, November 13, 2009)
 - 13 See: <http://www.bp.com/conversionfactors.jsp>
 - 14 Kanter, James and Andrew E. Kramer. 2013. Europe Threatens Gazprom with Antitrust Action. *The New York Times*, October, 3 <http://www.nytimes.com/2013/10/04/business/international/europe-threatens-gazprom-with-antitrust-action.html?_r=0>
 - 15 Gazprom slishkom privyazan k nefti. *Kommersant*, February 10, 2014 <<http://www.kommersant.ru/doc/2404296?isSearch=True>>
 - 16 Presidential Address to the Federal Assemle, December 13, 2013 <<http://www.rg.ru/2013/12/12/poslanie.html>> (in Russian), <<http://eng.kremlin.ru/news/6402>> (in English)
 - 17 Chung, J., 2014. South Korea cuts future reliance on nuclear power, but new plants likely. Reuters. January 13 <<http://news.yahoo.com/south-korea-cuts-future-reliance-nuclear-power-plants-034049040--finance.html>>
 - 18 For the PSAs history and developments see: Krysiek, T., 2007. *Agreements from Another Era: Production Sharing Agreements in Putin's Russia, 2000–2007* Oxford Institute for Energy WP34. November <<http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/WPM34-AgreementsFromAnotherEraProductionSharingAgreementsinPutinsRussia2000-2007-TimothyFentonKrysiek-2007.pdf>>
 - 19 In 2006 Russia pressured the Sakhalin II consortium prompting the foreign companies

- operating the project under the PSA to sell control of the project to Gazprom (Bradshaw 2008). The reasoning on the part of the Russian Government was to gain control over the costs of the project that had more than doubled, to ensure more of the revenues from the project would come to Russian parties, and to have a direct say in the project's export marketing strategy. Put more bluntly, neither President Putin nor Gazprom could accept that a foreign consortium was delivering Russia's first LNG to the Asian market. See: Shadrina and Bradshaw 2013.
- 20 Upon the provisions in the Federal Law No. 117-FL "On gas export", 2006
 - 21 As of now, only four companies Rosneft, Novatek, SOCs Zarubezhneft and Gazprom met the government-set criteria and are eligible for LNG exports. According to the law, only those companies which have more than 50 percent of state ownership and secured their plans for LNG plants' construction before January 1, 2013 will be granted such a right. The liberalisation can be called partial not only because of a very limited number of eligible exporters, but also because the government set up a coordination mechanism (to prevent competition among Russian LNG exporters in external markets), which requires the exporters to submit their export plans to the Ministry of Energy. The newly endorsed law on LNG export liberalisation requires the amendments to Article 3 of the Federal Law "On Gas Export" and Articles 13 and 24 of the Federal Law "On the Principles of State Regulation of Foreign Trade."
 - 22 Presidential Address to the Federal Assemle, December 13, 2013 <<http://www.rg.ru/2013/12/12/poslanie.html>> (in Russian), <<http://eng.kremlin.ru/news/6402>> (in English)
 - 23 Blagov, S., 2010. Russia Plans Far Eastern Energy Drive. *Eurasia Daily Monitor*. 7 (130).
 - 24 *Energeticheskaya Strategiya Rossii na Period do 2020 Goda*. 2003. p. 34 <<http://www.domenergy.ru/files/Files/strategy.pdf>>
 - 25 *Energeticheskaya Strategiya Rossii na Period do 2030 Goda*. 2009. p. 9 <www.kuzesc.ru/laws/Rasp_Pravit/RP_1715.doc?>
 - 26 Even though Gazprom is constantly losing out to independent gas producers, it still produces 73 percent of gas.
 - 27 The Program of Creation of Unified System of Gas Production, Transportation and Supplies in East Siberia and the Far East with Possibility of Exporting Gas to China and other Asia-Pacific Countries (Eastern Gas Program). The initial document was adopted by the Ministry of Energy of the Russian Federation, Order No. 340 of September 3, 2007, but it saw some amendments in 2011 and 2013 <<http://bestpravo.ru/rossijskoje/rx-normy/r9n.htm>>
 - 28 See: for instance Samuels, 1987.
 - 29 Shadrina, 2013a.
 - 30 See: <http://government.ru/docs/333> or <http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102103701&backlink=1&&nd=102330030>
 - 31 See: <http://www.kremlin.ru/news/15656>
 - 32 In 2010, for instance, the federal government's officials were represented on the companies' BoDs as follows: Gazprom — First Deputy Prime Minister (chairman), Minister of Industry and Trade, Minister of Economic Development, Special Representative of President for International Cooperation; Rosneft — Deputy Prime Minister (chairman), Head of the Federal Agency for State Property Management; Transneft — Minister of Energy (chairman); Zarubezhneft — Minister of Energy (chairman); RZD — Deputy Prime Minister (chairman).
 - 33 Fedorov, P., 2013. Vse krupneishie kompanii obratilisj v Minenergo za polucheniem ljgot. February 7 <<http://www.rusenergy.com/ru/news/news.php?id=64531>>

- 34 See publications on the web-page of the Union of Oil and Gas Producers of Russia (<http://www.sngpr.ru/tribune.php>)
- 35 For more detail see the Five-Year Strategy (2010–2014) to implement the Intergovernmental Collaborative Mechanism on Energy Cooperation in North-East Asia. Available at http://www.unescap.org/ESD/Energy-Security-and-Water-Resources/energy/trade_and_cooperation/cooperation/documents/FiveYearStrategy-ECNEA.pdf, accessed 5 October 2013,
- 36 For more information refer to the NAGPF web-page. Available at http://www.nagpf.info/introduce/about_us.htm, accessed 5 September 2013.
- 37 For more detail see: Gas Pricing and Regulation. China's Challenges and IEA Experience. OECD/IEA. 2012 and Kushkina, Ksenia and Edward Chow (2013) "Golden Age" of gas in China. Is there still a window of opportunity for more gas exports to china? Yegor Gaidar Fellowship Program in Economics. USRF. IREX.
- 38 For more detail on planned electricity market reforms in Japan see: The Policy on Electricity System Reform. Cabinet Decision. April 2, 2013 (http://www.meti.go.jp/english/press/2013/pdf/0402_01a.pdf); Yamazaki, T., 2013. *Electricity Market Reform in Japan*. Electricity Market Reform Office, METI Agency for Natural Resources and Energy September 11 (http://www.eu-japan.eu/sites/eu-japan.eu/files/Session2_Yamazaki.pdf); Sheldrick, A., Tsukimori, O., 2013. Japan passes law to launch reform of electricity sector. Reuters, November 13 (<http://www.reuters.com/article/2013/11/13/us-japan-power-deregulation-idUSBRE9AC08N20131113>)
- 39 For some relevant data refer to (http://www.eu-japan.eu/sites/eu-japan.eu/files/Session2_Yamazaki.pdf)
- 40 Learnt from personal communications with Russian and Japanese practitioners.
- 41 Kuzjmin, V., Krug Eksportyorov Rasshiren. Rossiiskaya Gazeta. 31.10.2013 (<http://www.rg.ru/2013/10/30/gaz-site.html>)
- 42 A consortium of five Japanese companies, including Itochu Corp., Japan Petroleum Exploration Co. (JAPEx) and Marubeni Corp.
- 43 Sakhalin Oil and Gas Development Co. — a consortium established in 1974, unites JAPEx, JOGMEC, Itochu Corp. and Marubeni Corp.
- 44 Milov, V., 2014. Glavnaya Problema Energeticheskoi Strategii v tom, chto ee pishut ne Vizionery, a Technokraty (<http://www.rusenergy.com/ru/comments/comments.php?id=72488>); Mitrova, T., 2014. Generaly TEK Gotovyatsya k Proshedshim Voinam (<http://www.rusenergy.com/ru/comments/comments.php?id=72458>)
- 45 Mukhin, A., 2014. Lukavye Tsifry Rosnefti (<http://www.rusenergy.com/ru/comments/comments.php?id=72710>)
- 46 Shadrina, Elena (2009) Energy Cooperation in Northeast Asia: Insight into Impact on Region Formation. Unpublished PhD Dissertation. Graduate School of Modern Society and Culture, Niigata University, Japan.

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Risk Management Policies for Mega-Cities: Lessons from Tokyo on March 11, 2011

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Abstract

The Tokyo Metropolitan Area is known as the largest metropolitan area in the world. The city has been facing severe disasters like the Great Kanto Earthquake in 1923, as well as more routine typhoons and floods. There have been significant losses caused by these disasters, however, because of their consistency, risk management policies have accumulated over time. The complex disaster on March 11, 2011 caused by the Great East Japan Earthquake, and subsequently the tsunami and damage to the Fukushima nuclear plant, gave a huge impact on Tokyo, 400 kilometers away from the epicenter. However, Tokyo in 2011 offers us some visible success of several risk management policies that have been refined over the past century. On the other hand, fragility has been exposed particularly to whom rely on the highly developed urban infrastructure of the mega-city. Reviewing these lessons learnt from the events of March 2011 in Tokyo, some implications to enhance the risk management policy are sought. One outlier is Roppongi Hills, which was not affected by the disaster at all and became a base to serve for the neighborhood upon the disaster. While Roppongi Hills provides several best practice lessons, it is a relatively small area compared to the whole Metropolitan Region. To understand the current level of risk management measures for disasters in Tokyo, strengths and weaknesses that correspond to the four stages of crisis management are presented. This aims to be a template to provide references in setting the risk management policies for the emerging mega-cities especially in Asia.

Keywords: Great East Japan Earthquake, urban risks, Tokyo Metropolitan Area, mega-city, risk management policies

Introduction

According to UN-HABITAT, half of the population of the world lives in urban areas and this ratio is expected to increase to 70% by the year 2050. Meanwhile, the total urban area occupies only 3% of the surface of the earth.¹ Urban concentration in this small area is now driven by the mega-cities, which hold millions of people. Although urbanism provides various benefits, it should be noted that the high population density and the concentration of wealth in these tiny spots on the globe increases the exposure of such places to risk. Nowadays, many people are loudly linking natural disasters to climate change, and cities that have been considered safe

hitherto are at risk. Simultaneously, complex disasters, such as a combination of floods, plant accidents, moral hazard, and pandemic diseases, can be triggered by a single natural disaster. The employment of risk management policies that are unique to the mega-cities seems to be an urgent matter as the growth of cities accelerates.

The Greater Tokyo Area, composed of the capital Tokyo and the three surrounding prefectures of Kanagawa, Chiba, and Saitama, is known as the largest metropolitan area in the world with a population of 35 million and a GDP of US\$1,479 billion. Although mega-cities in the emerging countries are expected to achieve significant growth in the coming decades, Tokyo will remain top in 2025 both in terms of its population² and its GDP.³ Domestically also, Tokyo is dominant. For example, the three prefectures, Iwate, Miyagi, and Fukushima, which were most affected by the Great East Japan Earthquake, make up 4% of the national population and the nation's GDP, while the Greater Tokyo Area accounts for 28% of the national population and 32% of the nation's GDP. (Figure 1)

Tokyo, formerly known as "Edo," has been developed as a capital city since 1590. The city was designed with a castle at its center and with the downtown in a circle around the center. This unique concentric structure has been maintained into the modern period. A modern infrastructure, such as railways and highways, is laid out on this urban form, and the accuracy and successful operation of these seamless services allow people to live together in this huge city and enjoy a high quality of life. Supported by a mature economy and a developed infrastructure, Tokyo also enjoys high exposure as a tourist destination, as well as being a global center for innovation. For instance, its overall position in the Global Power City Index has been fourth, following the three world famous cities of New York, London, and

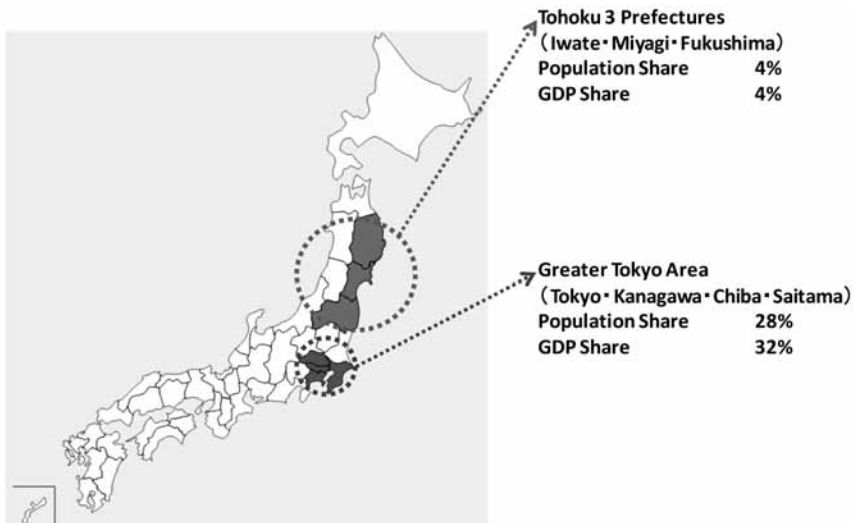


Figure 1 Comparison between Greater Tokyo Area and Seriously Damaged 3 Prefectures in Tohoku

Paris.⁴ Tokyo not only functions an engine for Japan, it also plays a critical role as a global hub.

The Great East Japan Earthquake was the largest earthquake to hit Tokyo since the Great Kanto Earthquake in 1923. Although, unfortunately, some casualties were reported, there was also an opportunity to examine the risk management policies that had been put in place over the decades since the Great Kanto Earthquake. Elaborating on Tokyo's successes and failures, which were revealed while the city was coping with the series of risks that were triggered by the March 11, 2011 event, provides a reference for the establishment of risk management policies in the emerging mega-cities of Asia.

1. The Physical Damage to Tokyo from the Earthquake

Casualties and Damage to Property

The complex disaster due to the earthquake in Northeast Japan on March 11, 2011, which was followed by a tsunami and a nuclear plant accident, caused some damage to Tokyo. The scale of the crisis can be imagined when it is compared by combining three disasters in the United States, the San Francisco Earthquake of 1906, Hurricane Katrina in 2005, and the Three Mile Island nuclear disaster of 1979.⁵ 400 km away from the epicenter of the M9 earthquake, the tremor in central Tokyo was measured at level 5+ out of the 7 levels in the Japan Meteorological Agency's measurement system.⁶ While the Tohoku region near the epicenter recorded level 7, which is equivalent to the level in the center of Kobe city by the Great Hanshin-Awaji Earthquake in 1995, tremors in downtown Tokyo were relatively low. Nonetheless, around ten houses collapsed and seven people were killed in the downtown area of Tokyo. It is important to note that the limited amount of damage constitutes an improvement on the seismic performance of Tokyo's buildings since the Great Hanshin-Awaji Earthquake in 1995. Also, there were no casualties caused by fire in Tokyo while more than half the 100 thousand deaths in the Great Kanto Earthquake were caused by the quake-triggered fires. The introduction and distribution of the system 'my-com-meter,' which senses a quake and shuts down the gas supply in each unit of a residential building helped to prevent fires.

Commercial buildings in Tokyo were not seriously damaged by the Great East Japan Earthquake either. For instance, out of 100 properties managed by the Mori Building Company, which is a major property holder and manager in Tokyo, 70 were damaged by the quake. However, most of the repair work that was needed as a result was limited to minor repairs to the exterior or interior walls and surface finishes.⁷

While most of the casualties resulted from the tsunami in the Tohoku region, Tokyo was not affected by a tsunami this time. The highest wave at Tokyo's Harumi waterfront was reported to be 1.5 m. The levees along the Tokyo shoreline are from 4.8 m to 8.0 m high, and they are designed to withstand the kind of flooding that came with the Ise Bay Typhoon in 1959, which is known to be one of Japan's worst post-war disasters.⁸

Damage to the Infrastructure

The impact on the infrastructure, such as bridges, highways, and railways, was also less visible. This reflected the work done to reinforce the infrastructure, which had been carried out since 1995. Train systems on a 30 km radius from the center of Tokyo station suspended their service at once, but 40% recovered within the day, and this percentage reached 95% the next day, after due inspections had been carried out.⁹

Utilities, such as electricity, gas, and water supplies, were not seriously affected by the quake. The conventional steel gas pipes buried underground have been replaced with flexible and durable polyethylene pipes. Water pipes have also been switched to a seismic-resistant system, so no leaks were reported this time. Tokyo, as of March 11, 2011, offers us visible signs of the success of several risk management policies that have been refined over the past century, and specifically within the past 15 years.

However, even though there were no casualties, severe soil liquefaction was reported in the Tokyo Bay area, especially in Chiba prefecture. The total liquefied area approached 42 square kilometers, which is the largest area of liquefaction ever.¹⁰ As a result, 30 houses collapsed and over 1,000 houses were damaged in Chiba. The main reason for the liquefaction being concentrated in Chiba was the method that had been used to reclaim the land. To protect the environment, sand under the bay was re-used, and this resulted in an unstable foundation for the reclaimed land. On the other hand, the reclaimed land where the ground had been treated and improved with the sand compaction pile (SCP) method was not liquefied. In response to the 1964 Niigata Earthquake, where the collapse of buildings due to liquefaction occurred in Japan for the first time, the Building Standards Act was amended in 1978 in order to enforce ground improvement methods for land reclamation, but most of the areas liquefied in Chiba had been established before this act.

2. Socio-Economic Issues Exposed by the Earthquake

Stranded Persons

While no major infrastructural damage occurred and the number of deaths was limited, Tokyoites still faced serious inconvenience. This was particularly so for those who rely on the highly developed urban system in the center of the city.

The earthquake struck at around 3 p.m. on Friday. Initially, people in offices and schools thought they could go home as usual. Tokyo is equipped with one of the most sophisticated train systems in the world, and this system maintains a gigantic urban structure that allows 10 million people to commute systematically and every day in and out of the city boundaries of Tokyo. Right after the quake, all the lines were shut down because of the need to monitor possible damage from the quake. 40% of the lines, which were mostly subways, recovered within the day, but the other lines stayed down until the next day. This caused an unprecedented phenomenon, the overflow of people around the city. The major terminals, such as Tokyo

Station and Shinjuku Station, which usually accommodate over 1.5 million passengers each day, asked people to leave the stations, which closed their shutters, and this meant that people then had no place to stay.

Consequently, people started to use the lines that had restored their service and made detours. Some people walked several hours back to their homes, others bought and rode a bicycle home or got picked up in the family car. Others still returned to their offices, or stayed at the refuge areas that were set up at public facilities and shopping centers. There were no riots and things remained organized. However, the lines of people walking along the sidewalks did not disappear until the morning. (Image 1) The total number of stranded people is estimated at 3.52 million by the Tokyo Metropolitan Government.¹¹



Source: Yomiuri Shimbun News

Image 1 Stranded Persons walking back home

This experience made people realize the risk of their daily long-distance commute, and since this event occurred a lifestyle of living quarters-workplace proximity has attracted people's attention. Risk management policies aimed at stocking foods and supplies at offices and schools in the case of an emergency have been highlighted, and the Tokyo Metropolitan Government enforced a new ordinance to secure these measures in March 2012.

Urban Threat from the Nuclear Plant Accident

More inconvenience resulted from the accident at a nuclear plant. This caused new hardships for Tokyoites. Electricity shortages occurred after all Japan's nuclear plants were shut down. This resulted in a reduced number of trains and shut off barrier-free facilities in public spaces, such as the escalators. Many elderly people and families with infants found their access to the city restricted. The government ordered each family to reduce their use of electricity, so people tried to save energy by turning off lights and by carefully controlling the temperature of their air condi-

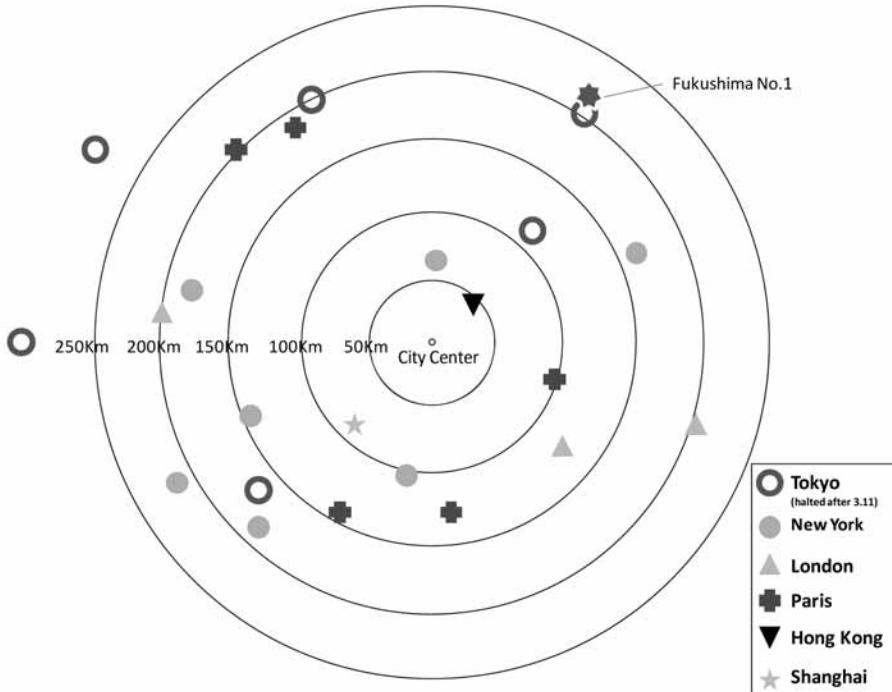


Figure 2 Active Nuclear Plant Locations relative to City Centers of Major Global Cities

tioners. People suffered a certain amount of discomfort and stress as a consequence. Furthermore, there was a shortage of general supplies, with shelves at “Convenient Stores,” which are usually full of groceries 24 hours a day, becoming empty. One of the worst problems was the pollution caused by the irradiation of the tap water. Even though official announcements regarding the pollution levels declared that these levels had no affect on the human body, people rushed to stores to hoard bottled water and this caused a shortage of supplies for infants for whom such water is essential. As such, the comfortable urban life of Tokyoites, which results from dense, systematic and progressive urbanization, was threatened. All this inconvenience made Tokyoites lose their confidence about living in the largest mega-city in the world.

The nuclear plant accident was repeatedly described by government officials as an “Unexpected Accident.” However, after it happened, people recognized that there is nothing “Perfect” about man-made systems. Figure 2 shows the location of the active nuclear plants around the major cities relative to the center of each city. “Global Cities,” with a high accumulation of functions within the city, should remember that they are not totally free of the risk of nuclear accidents, even though their nuclear plants lie outside the city’s boundaries.

3. Implications for Risk Management Policies for Mega-Cities

Modern Seismic Performance

The breakthrough in improving the seismic performance of buildings was triggered by the 1978 Miyagi Earthquake in Northeast Japan. The Building Standards Act was amended due to the serious collapse during the earthquake of buildings with a “Piloti Style” first floor, and structural design criteria were dramatically tightened. Following the 1995 Great Hanshin-Awaji Earthquake, the Act for the Promotion of Renovation for Earthquake-Resistant Structures was implemented, and in 2000 the Building Standards Act was amended again to introduce performance-based design to buildings. The Earthquake Building Code Scandal in 2005¹² also resulted in the acts becoming stricter regarding structural design when a peer check system and stronger penalties were introduced. In this way, and as a result of lessons learnt from past experience, seismic building design standards have rapidly improved. In the 1995 Hanshin-Awaji earthquake, 24% of the reinforced concrete buildings constructed before the 1981 amendment collapsed or were severely damaged. Most of the older buildings that collapsed were built under pre-1981 standards or were wooden structures without sufficient earthquake proofing, such as adequate cross-bracing. No buildings with prefabricated walls collapsed in the 1995 earthquake.¹³ Currently in Tokyo, 80% of the residential buildings and 87% of the elementary and junior high schools are earthquake-resistant¹⁴, but it is highly desirable that the remaining residences and schools be brought up to standard as soon as possible.

Meanwhile, the Great East Japan Earthquake on March 11 tested the seismic performance of the high-rise buildings in Tokyo, which are relatively recent in the history of Japan’s construction industry. In central Tokyo, there are approximately 400 high-rise buildings that are over 100 meters high.¹⁵ One shake of a high-rise building during an earthquake is said to be of long duration. This can resonate with a long-term oscillation of between 2 and 20 seconds. Damping devices were proved to be effective both in preventing resonance and in protecting the buildings. The introduction of damping technology to high-rise buildings became popular in the 2000s in Japan, and its installation in buildings is now critical for seismic performance. The 223-meter-high Shinjuku Center Building was built in 1997 and was renovated in 2009 in order to install damping devices. In the March 11 quake, the maximum displacement of the building was 54 cm, with these devices limiting the tremor of the building by 22%.¹⁶ The 238-meter-high Roppongi Hills Mori Tower was built with a damping system and this was shown on analysis to reduce the displacement at the top of the building after the quake by nearly half.¹⁷ In fact, there was no damage reported to Roppongi Hills Mori Tower after the March 11 quake, while Tokyo Metropolitan City Hall experienced substantial damage, such as collapsed office ceilings. Consequently, the city hall was renovated in order to install a damping system.

Redundant Energy Supply

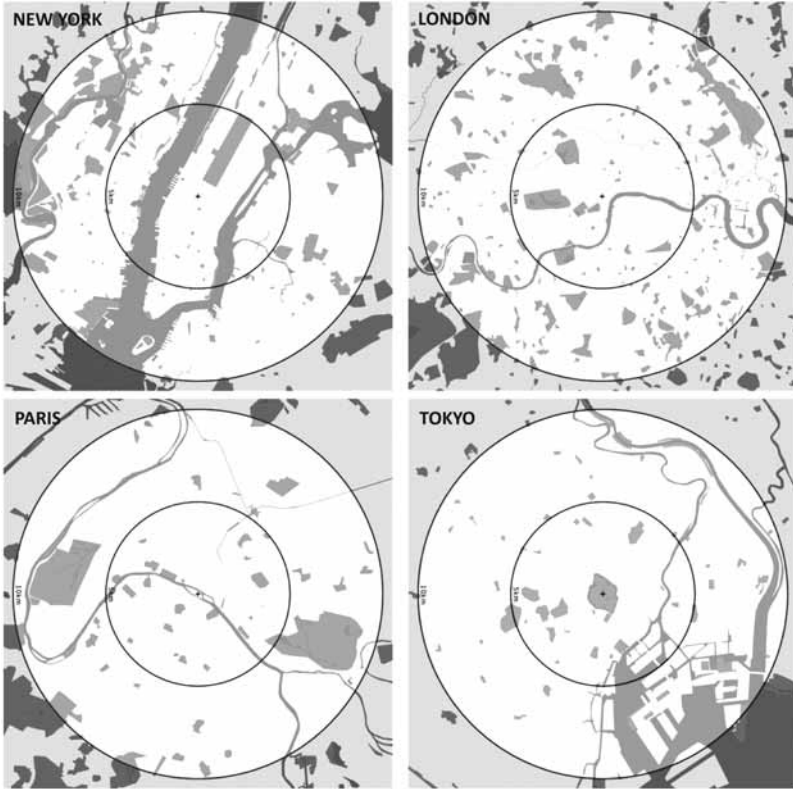
The Great East Japan Earthquake also revealed the vulnerability of Tokyo's energy supply in such an event, because of planned blackouts and the restrictions on electricity usage in the summer, both of which were ordered by the government for the first time in 37 years. A redundant supply of energy, which offers alternative energy sources and providers, has become important when it comes to maintaining a mega-city's ability to cope with a disaster. At the time of the March 11 quake, Roppongi Hills was the only complex which was operating its own power plant in Tokyo. In 1995, the Electricity Business Act was amended to enable private companies, besides the major electricity companies, to produce and supply electricity for business purposes. Upon the development of Roppongi Hills, the Roppongi Energy Service Company was established to run an exclusive LNG (Liquefied Natural Gas) power plant to supply electricity to the entire Roppongi Hills complex. Since this power plant is sustained by gas from the Tokyo Gas Company, it was not affected by the power blackout by the Tokyo Electric Power Company after the earthquake. To preserve this redundancy, Roppongi Energy Service also has a contract with the Tokyo Electric Power Company, in case of an emergency, in order to receive electricity. However, after the March 11 earthquake, Roppongi Energy Service provided the residual electricity of Roppongi Hills to the Tokyo Electric Power Company.¹⁸

Since the earthquake, Roppongi Hills has attracted the attention of overseas corporations especially because of its ability to carry on business operations in a crisis. Learning this lesson, as part of the public sector, the Tokyo Metropolitan Government initiated a policy to realize a redundant energy supply. Tokyo has been relying for about 80% of its electricity on production based outside Tokyo, including the nuclear plants in Fukushima.¹⁹ To increase the level of self-sufficiency in energy became a serious issue, and the local government sought to build a new LNG power plant in the Tokyo Bay area. The electricity produced by the plant could be about 1 million KW, which almost equals the energy produced by one nuclear reactor. This action enhanced the creation of a city-wide redundant electricity supply system.

Safe Urban Blocks

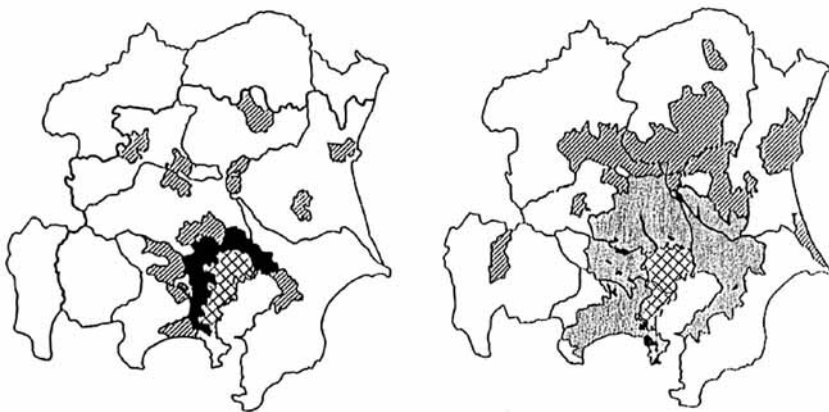
Since the March 11 quake, the contrast between safe and unsafe places in Tokyo has become clear. Tokyo is a city that has fewer open green spaces than other major global cities. (Figure 3) It is also rare in that the total area of open green space decreases the further one moves out from the center of the city into the suburbs.

In 1958, the government created a plan to introduce sustainable urban growth in the national capital area by referring to the Greater London Plan. The government tried to introduce a Green Belt around Tokyo's city center. However, the policy was not properly implemented due to opposition from the land-owners in the areas designated to be part of the Green Belt. These areas were consequently developed as urban areas. In the end, the government gave up the idea of a Green Belt and removed the policy with the revision of the National Capital Area Master Plan in



Source: Global Power Inner City Index 2010, Institute for Urban Strategies, The Mori Memorial Foundation

Figure 3 Comparison of Green Open Space for Tokyo and Three Major Global Cities



Source: National Land Agency

Figure 4 National Capital Region Master Plan (1958 left and 1968 right); Black zone is the planned Green Belt



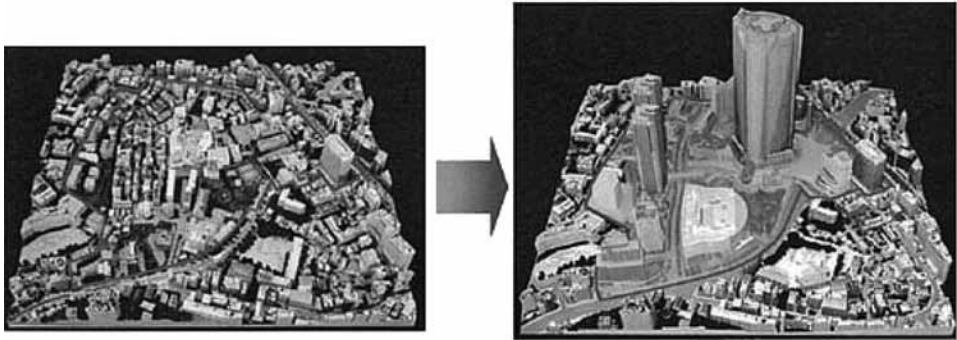
Source: Headquarters of the Governor of Tokyo,
Tokyo Metropolitan Government

Figure 5 Zones Expected to receive Detrimental Damage in the Case of a Disaster

1968.²⁰ (Figure 4)

Since then, Tokyo has been developed aggressively with no attention being paid to maintaining open green spaces, which are essential from the point of view of disaster management. Open green spaces not only prevent fire from spreading but they also serve as a base for fighting fires and for accepting refugees. Figure 5 shows a map created by the Tokyo Metropolitan Government, which highlights the “Zones expected to receive detrimental damage in the case of a disaster.” The total area of these zones is 7,000 ha, which is 11% of the total area formed by the 23 wards of Tokyo. 1.8 million people currently live in these zones, which have barely any open green space and are congested with wooden houses. These zones are not slums, however. In fact, many are moderately wealthy; there are just no incentives for property owners to redevelop the neighborhood, including their own properties, to create new open spaces to make their area safe.

Meanwhile, the central area of Tokyo can be seen from this map to be safer. One reason is that the redevelopment of the central area is more advanced than the suburbs. Since 2002, Urban Regeneration projects have been carried out as a matter of national policy, and a lot of new mixed-use complexes, based on towers and open spaces, have emerged. Roppongi Hills in Figure 6 represents this style of development, and it has been followed by other mega-complexes, such as Tokyo Mid-Town. These complexes, developed in the 2000s, clearly appear, after the March 11 quake, to be safer. In fact, Roppongi Hills was not only unaffected by the earthquake, it also accommodated thousands of refugees who were not able to go home by providing ample stocks of food, water and blankets. As has been shown, while Roppongi Hills can provide several best practice lessons, and is the largest privately based develop-



Source: Mori Building

Figure 6 Roppongi Hills before (left) and after (right) the development

ment in Tokyo, it covers a relatively small area, compared to that of the entire megacity region.

Resilient Government, Communities, and Individuals

The March 11 earthquake was not an “unexpected” disaster for Tokyo, even though the metropolis experienced its largest tremor since the Great Kanto Earthquake. Even the appearance of stranded people had been predicted, responses, such as opening up government facilities and public schools for those people who had been stranded, was promptly carried out by government staffs. In fact, many measures in the plans and manuals served to provide resilience to the city.

The Business Continuity Plan (BCP) for the Tokyo Metropolitan Government may be among the most sophisticated in the world in terms of its countermeasures in times of disaster. The plan designates 1,061 of the government’s 2,884 services as a priority in terms of the provision of continuity in Tokyo’s services and facilities. It specifies target times for the recovery of these services after an earthquake, taking potential understaffing into consideration. Tokyo has also created the Post-Earthquake Recovery Manual, which presents roadmaps for recovery for each of its districts, based on the scale of damage expected, and the city annually holds disaster drills, which are tied into the manual.

Meanwhile, communities complement government efforts in disaster preparation through the formulation of district continuity plans (DCP). Businesses around Tokyo Station have formed the Neighborhood Community Association around Tokyo Station for Disaster Management, which seeks to address the challenges posted by the expected stranding of 600 thousand commuters around the station after a large earthquake centered on Tokyo.²¹ These challenges cannot be tackled by any single company, so the association’s network aims to cope with a major quake in a cooperative way. They can effectively gather information on the safety of individuals, guide commuters who are trying to walk home, distribute food and water, and perform other crucial community tasks. The organization is thus an example of putting into practice the view that in a disaster, community resilience,

based on the concepts of self-help and cooperation, is more effective than waiting for public assistance.

Finally, each individual has to be resilient and act responsibly during a disaster. Along the coastal area in the Tohoku region, a legend has been passed on from previous generations which instructs people, when a tsunami arrives, to immediately escape from the coast without glancing anywhere else but the hills and not to care about other people. This may sound slightly barbaric, but the expectation is that everybody can finally meet on the hill if everyone followed this rule. It is estimated that there were about 500 thousand people in the tsunami-flooded area at the time of the earthquake on March 11 in the Iwate, Miyagi, and Fukushima prefectures, and that the casualties totaled approximately 20 thousand. If there had been no experience with tsunamis, including frequent evacuation drills, the casualty figures could have been one digit larger. However, in a mega-city, the situation might be slightly different because of the high population density. For instance, right after the quake, people rushed to the stations to reach their homes as soon as possible in order to confirm the safety of their families. As the stations were shut down, a massive number of people could not find their way home and they overflowed onto the plazas and streets, raising the chance of moral hazards. Even in this situation, no rioting or looting took place. People in Tokyo have been trained to share space in congested trains, streets, and sidewalks since the period of high economic growth during the 1970s. Thus, the experience and morality of each individual, especially in dense urban spaces, is important in a disaster if everyone is to survive. Daily preparedness for disasters by creating resilient individuals is a primary measure.

Conclusion

Risk management policies in Tokyo have been polished as a result of its record of disasters in history. However, the Great East Japan Earthquake on March 11, 2011 proved that these policies were not sufficient. Forecasts show that there is a 70% chance of a great earthquake occurring in or near Tokyo within the next 30 years.²² Therefore, just like after the earthquake in 1995, urban systems need to continue to implement risk management policies.

To understand the current level of risk management measures for disasters in Tokyo, Figure 7 has been created to easily identify strengths and weaknesses that correspond to the four stages of crisis management: Mitigation, Preparedness, Response, and Recovery.²³ Tokyo's strengths can be seen in its high design standards regarding seismic and fire performance, which are physical aspects, together with the well-organized Tokyo's Business Continuity Plan and the Post Earthquake Recovery Manual, which represent certain operational aspects. On the other hand, the weaknesses, such as the existence of the congested wooden house zones, which result in the lack of open space for egress and firefighting, are clearly negative factors. To properly cope with the next earthquake, even though the timing of that earthquake is uncertain, policies to confront these weaknesses and change them into strengths should be implemented. In particular, the redevelopment of the zones

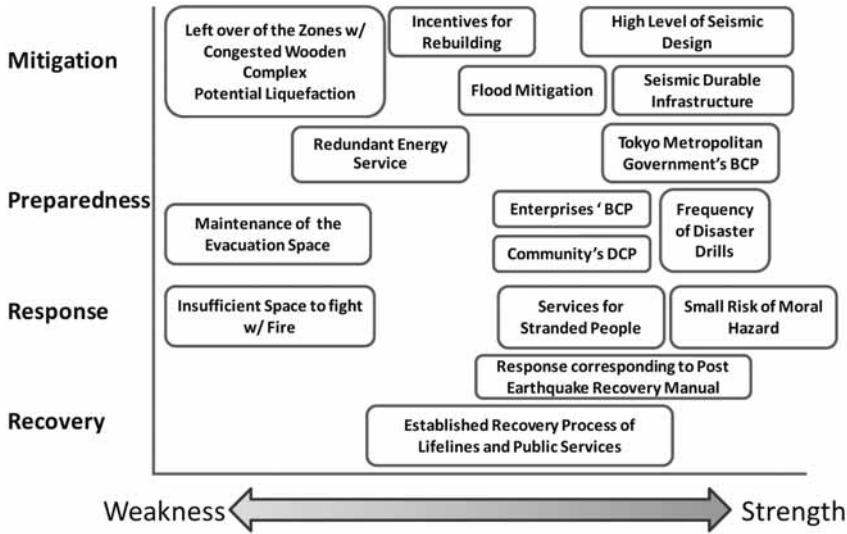
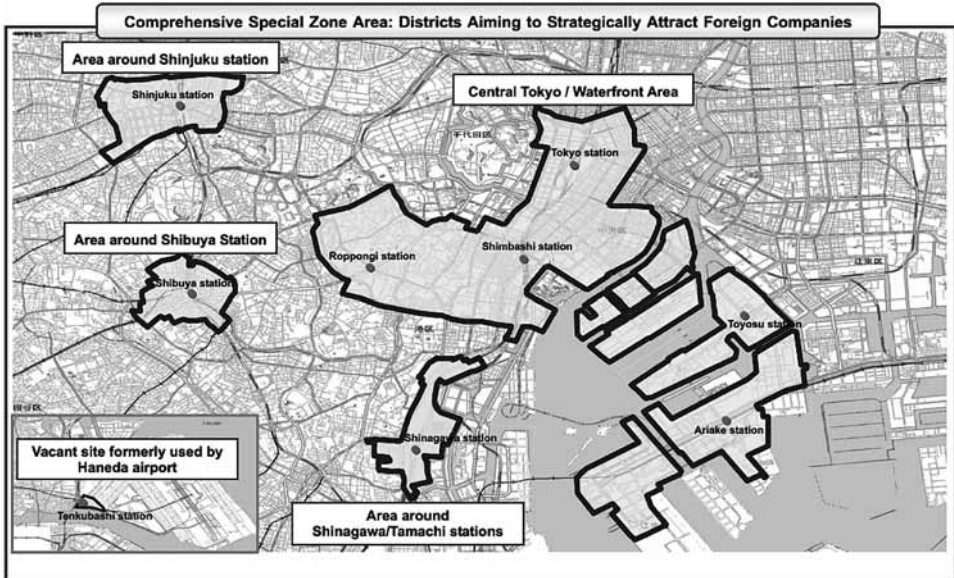


Figure 7 Strengths and Weaknesses of the Risk Management Measures corresponding to the Four Stages of Crisis Management

where detrimental damage in a disaster can be expected, as designated by the Tokyo Metropolitan Government, is an urgent measure that needs to be implemented as soon as possible. Within the entire Tokyo region, the city center is relatively safe, but, since most of the nation's central functions, such as its parliament, its ministries, and the head offices of its major companies are concentrated in the central core, the level of safety should be further enhanced. Once there was an argument to relocate the capital's functions to other regions outside Tokyo. However, this has not been realized after studies compared the overall benefits against all the disadvantages that would result from such a relocation. In fact, it has been recognized that there is no place that is 100% free from an earthquake even if earthquake engineering has made remarkable progress in recent times. Tokyo has no choice but to squarely face the challenges presented by the world's largest metropolis and its massive conglomeration of people, communities, businesses, and infrastructure.²⁴ The Japanese Government decided to introduce new "Special Zones" in central Tokyo to accelerate urban regeneration to mitigate future disaster risks and to provide international urban platforms that can attract people, companies, and investment in order to sustain the zones.²⁵ (Figure 8) These zones are expected to be models that showcase a livable urban environment with a robust infrastructure.

There are many important lessons to be learnt from Tokyo by other Asian mega-cities. Understanding that Tokyo is still developing its risk management measures, each city's risk management measures can be reviewed using the four categories above and the level of their performance could be compared with Tokyo's. Comparative analysis will reveal the strength or weakness of each measure, and then people can discuss what policies should be implemented as a result.

The scope of risk management in cities seems to be expanding these days with



Source: Headquarters of the Governor of Tokyo, Tokyo Metropolitan Government

Figure 8 Comprehensive Special Zone Area designated by the National Government and Tokyo Metropolitan Government

the attention being given to global climate change and diverse social conflicts. Since the mega-cities are frequently regarded as the major urban platforms for sustaining the world's economy over the next few decades, contemporary risk management policies need to be updated progressively since we are located in a place in which we co-exist with disasters.

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A Study of Management Style of “Japan’s Small-Medium Sized Enterprises”: From the View of ‘Fixed Accounting System’

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Contents

1. Introduction
2. Customer and product segments
3. Research design
4. Outcome of research and analysis
5. Conclusion

1. Introduction

Small and medium enterprises (SME) account for 99.5 percent of all Japanese companies.¹ We tend to think of large companies such as Sony and Panasonic as representative of Japanese businesses, but, in fact, such name brands are supported by SMEs. Despite their size, many Japanese SMEs have a long history, with some deliberately staying small to maintain manageability and enjoying solid performance. Such features have allowed many Japanese SMEs to adeptly overcome numerous economic upheavals, such as the oil crises of the 1970s and the collapse of Lehman Brothers in 2008.² Some of the well-known features of Japanese-style management include such movements as “5S” and “Kaizen (improvement),”³ which are quality-management initiatives based on the uniquely Japanese manufacturing culture, but less known is the fact that many leading SMEs employ management accounting. Even small Japanese businesses make active use of management accounting in their business decisions. In this study, we will look at “fixed revenue accounting,” a new style of management accounting developed in Japan, and look at how a Japanese SME uses this accounting tool.

Fixed revenue accounting is a form of management accounting centered on the idea that a company is operating stably when its fixed costs are covered with revenues from regular customers. In fixed revenue accounting, the profit where a company covers its fixed costs with regular revenues is referred to as fixed operating profit (Asada, Suzuki, & Kawano, 2005, pp. 3-8). Put simply, if a business can cover its fixed costs, such as salaries and office rents, with the revenues it generates from a stable, repeat customer base, the company is not likely to go bankrupt easily. Fixed revenue accounting is a new management accounting tool that makes this

concept measurable, visible and communicable. There are many management accounting models,⁴ but the prominent characteristic of fixed revenue accounting is that profitability can be gauged in terms of the customer relationships that a company has. By contrast, conventional management accounting concepts most commonly measure profitability from the volume of sales or the number of units sold. For example, in the widely known cost-volume-profit (CVP) analysis, a graph similar to the one in Chart 1-1 is used, where the Y axis represents revenues and costs and the X axis represents sales volume or units sold in order to arrive at the break-even point (BEP) represented by P_2 . However, in Chart 1-2, which illustrates fixed revenue accounting, the X axis is divided into parts representing sales from discrete customer segments. Also, fixed revenue accounting pays close attention to P_1 , focusing on fixed operating profit where sales from regular customers cover fixed costs, while P_1 is hardly a matter of discussion in CVP analysis. In other words, fixed revenue accounting is built on the hypothesis that a company can stabilize its business operations by achieving a fixed operating profit at the break-even point represented by P_1 . This is the fundamental principle of fixed revenue accounting.

In order to consistently achieve the break-even profit of P_1 , a company needs to increase the number of its regular customers, as shown on the X axis in Chart 1-2. Given that customers are the only source of revenue, it goes without saying that the very foundation of corporate strategy is the tireless effort to acquire new customers and turning such customers into a stable, regular client base. The concept of fixed revenue accounting aims not only to measure profitability but also looks to stabilize business operations through incentives to create new customers and to turn such customers into regular customers. Fixed revenue accounting works toward the creation of customers and the expansion of regular clientele. This concept is compatible with a quote from Peter F. Drucker (2001, p. 15): "The purpose of business is to create and keep a customer."

Today, the business climate in Japan is becoming increasingly severe, and there

Chart 1-1 CVP Analysis

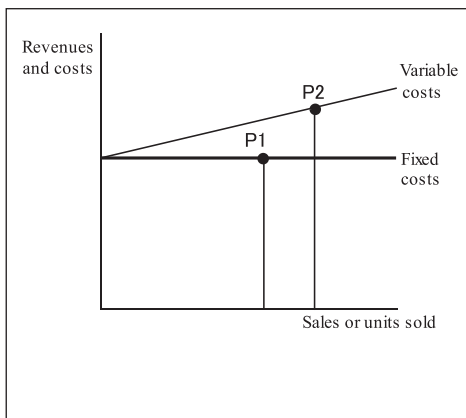
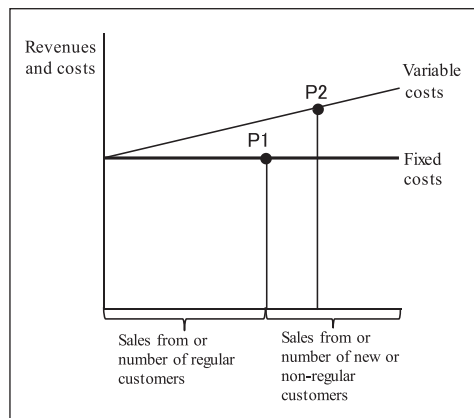


Chart 1-2 Fixed Revenue Accounting



Charts by the author

is no end of serious challenges facing Japanese companies. Domestically, there are the problems of the lost two decades after the collapse of the bubble economy, the hollowing out of industries amid intensifying global competition and the wild fluctuations of currency exchange rates. And the outlook of the world economy has remained uncertain since the all but unprecedented turmoil following the collapse of Lehman Brothers and the European debt crisis. On the political front, there are trade issues arising from territorial disputes, and major natural disasters, such as the Great East Japan Earthquake and widespread flooding in Thailand, dealt a heavy blow to already weakened corporate earnings. Under such harsh circumstances, the electronics industry remains particularly sluggish and finds itself in a state of disarray. The dramatic decline in competitiveness and staggering losses incurred by major Japanese electronics firms, which have long been the main driver of the Japanese economy, serves as a stark symbol of the difficulties confronting Japanese companies today. Company A, which we will look at in this study, is an electronics firm in the thick of such difficulties. It is also an SME, and as a small business with a weak capital base, it goes without saying that the company finds itself in a very tough business environment.

Nevertheless, Company A has overcome numerous challenges using fixed revenue accounting, constantly posting positive operating incomes with the exception of the year that saw the demise of Lehman Brothers. Just how is Company A employing fixed revenue accounting in its business operations? In the presence of many uncertain parameters, if there is one form of management accounting even suggestive of a positive impact on corporate profitability and growth, then it is worth taking a close look at. In this study, we will examine how fixed revenue accounting can influence performance from the viewpoint of the profitability of Company A, a business that practices fixed revenue accounting.

In Chapter 2, we will look at Company A's customer segments and product segments. In fixed revenue accounting, defining segments, meaning customers are broken down into new, regular, non-regular and lost, and products are categorized according to the company's business demarcation, is the basis for any further discussion. In outlining such segments it is necessary to shed light on the history of Company A and the background of its move to introduce fixed revenue accounting. In Chapter 3, we will discuss the study's research design. Research questions, research methods, research site, and research data will be described. In Chapter 4, we will look at the outcome of profitability analysis in accordance with the new, regular, non-regular and lost customer segments of Company A, made available by ten years of data taken from the company's transactions with 845 customers. In Chapter 5, I will summarize the findings from above, and discuss the study's outcome, limits and issues.

2. Customer and product segments

In this chapter, we will look at how Company A defines its customer and product segments. In fixed revenue accounting, the client base is broken down into new

customers, regular customers, non-regular customers and lost customers, upon which profit figures are computed separately with a view to determining the profitability of each segment. Without proper segmentation, fixed revenue accounting as a measure of profitability does not function. Defining and determining customer segmentation is the very first step in fixed revenue accounting and a very important procedure indeed. Meanwhile, products are separated according to the company's product lines and it is relatively simple to determine the segmentation compared with customers. Usually, products are categorized in accordance with their makers, markets and intended uses, and individual product lines are sorted by sales volume or profitability within each segment. The practice of product segmentation also helps us understand what the company's core business is.

As can be seen here, defining customer segments and product segments is a crucial step in fixed revenue accounting, but determining the segments of a company alone is not enough. It is equally as important to know why the company came up with the segmentation. In order to study a company in a more appropriate way, we need to look into its history and industry characteristics as well as the background to its decision to adopt fixed revenue accounting. We need to understand the sample company's customer and product segments, and analyze its profitability and growth potential based on such understanding.

2-1 *Industry and business overview*

The target of this study, Company A, is what is known as a specialized trading company, or a trading company that deals in electronic components with an emphasis on semiconductors. In recent years, however, it has also operated a maker division engaged in designing and manufacturing electronic components, in addition to the original trading division. Its annual sales on a stand-alone basis amount to 5 billion yen, and to 7 billion yen on a group-wide basis. Company A was established in 1979 as a trading arm of Company S, a manufacturer of semiconductors, and for many years mainly distributed Company S's semiconductors to specific domestic customers. Its main products include diodes, transistors and MOSFET⁵ and other devices.

In the wake of the late 1970s oil crisis triggered by turmoil in the Middle East, the following 1980s saw consumer-market products such as TVs and VCRs become increasingly inclined toward energy efficiency, and electronic components used in those products became thinner and smaller with semiconductors being the mainstay of such components. Later, similar trends occurred with white goods such as refrigerators and air conditioners, and semiconductors, with their instrumental role in enabling enhanced energy efficiency, came to be called "the rice of industry," meaning they were now the very staple of the Japanese manufacturing industry. Further, semiconductors made their way into automobile control systems, and, in the 1990s, became an invincible presence as semiconductor-loaded personal computers spread among the public. With such trends, semiconductor-specialized trading companies established themselves as a relatively stable business sector, thanks to the all but guaranteed client base from their association with a semiconductor manufacturer.⁶

Many semiconductor makers formed contractual relationships with specific trading companies, where the latter would act as dealers or agents, thus ensuring a stable supply of products and in return maintaining control over pricing. The semiconductor makers were making use of what is known as the inventory holding function of trading firms to maintain their sales network.

However, starting in the mid-1990s, makers from South Korea, Taiwan and other emerging countries began to erode the Japanese makers' stronghold in the world market share with their cost leadership strategy. In the meantime, the Japanese work force had long passed the so-called Lewisian turning point⁷ and labor costs were stuck at high levels, and it had become difficult to reduce manufacturing costs. It was at this point when semiconductor manufacturing equipment increasingly became commoditized, making it possible to produce semiconductors of equal quality in any country, and this led to a dramatic decline in prices. It also coincided with the strengthening of the yen, and semiconductor makers rapidly lost international competitiveness. In the same vein, many assembly makers of appliances like TVs and refrigerators that use semiconductors started shifting production to countries with low labor costs, such as ASEAN countries and China, in response to globalized competition, and the Japanese manufacturing industry increasingly hollowed out in the early 2000s.

It was under such circumstances that, in 2003, two giants, Hitachi Ltd. and Mitsubishi Electric Corporation, integrated their semiconductor operations and established Renesas Technology Corp. Later, Renesas Technology merged with NEC Electronics Corporation to form Renesas Electronics Corporation, which came to be called the "*hinomaru*" semiconductor maker after the Japanese national flag. But even the merger of three major domestic makers did not reverse the decline in competitiveness, and the new company posted a net loss of 62.6 billion yen in the business year ending in March 2012. In a similar case, Elpida Memory Inc., originally created from the 1999 merger of the DRAM⁸ operations of Hitachi Ltd. and NEC Corporation, faced a serious financial crisis in 2009 and was bailed out by the Ministry of Economy, Technology and Industry. The company continued to suffer lackluster performance and filed for protection under the Corporate Reorganization Act in 2012, with an outstanding debt exceeding 448 billion yen.

The drastic change in Japan's industrial structure had an impact not only on semiconductor makers but also on semiconductor-specialized trading companies. Due to the mergers of semiconductor makers, such trading firms were faced with sudden changes in their suppliers and were deprived of their guaranteed position in the distribution channels. More than a few trading companies lost their place in the market and eventually went out of business. To make matters worse, assembly makers shifted their production bases overseas in droves and increasingly used semiconductors produced by overseas makers, such as Korean and Taiwanese brands, as part of their cost-cutting efforts. Moreover, a drastic change occurred in the distribution channels as assembly makers made expanded use of Supply Chain Management (SCM)⁹ and increasingly purchased components directly from makers. Simply put, there was no place for trading companies.

Semiconductor makers lost international competitiveness. Their integration caused drastic changes in the distribution channels. Assembly makers became rapidly globalized, shifting production overseas. Caught in the midst of such drastic changes, both on the supplier and customer ends, semiconductor trading companies faced rapidly dwindling profits and a weakened *raison-d'être* as their primary function as inventory holders came to an end. The author's MA thesis (2004) titled "Core Business of Semiconductor Trading Companies and their Financial Performance" categorized the changing profiles of such companies' core operations as follows: the first generation, conventional trading firms as inventory holders; the second generation, trading firms which also design semiconductors on their own; and the third generation, trading firms which perform manufacturing functions using electronics manufacturing services (EMS)¹⁰ or making their own brand of components. The thesis compared the financial standing of the first-generation firms with the second-generation and third-generation firms, and demonstrated that conditions of the latter were generally superior to those of the former. It foretold that semiconductor trading companies would find it difficult to sustain their operations unless they succeeded in flexibly transforming their core business structures in a fiercely competitive market.

As if to demonstrate the hypothesis put forward in the author's 2004 thesis, Company A transformed its core business from the first-generation model to the third-generation model. With a view to survival, the company launched in 2002 a strategy to shift its business model from a trading firm's to a component maker's. In 2002, it established a design and manufacturing division for power supplies¹¹ and an overseas subsidiary in Hong Kong, and started up a maker of special optical components as a group firm. In 2006, it founded a subsidiary maker of special inductor parts, thus stepping up its manufacturing function, besides its trading firm capacity, in the course of five years.¹² It made a conscious move to concentrate its management resources into manufacturing functions instead of its traditional trading. As a result, Company A is recognized in the market today as not only a trading company but also an electronic device maker.

2-2 Background to the adoption of fixed revenue accounting

As Company A transformed itself from a semiconductor trading firm into an electronic component maker, the move necessitated a reinforcement of its business strategy to withstand the resultant changes. The company believed that its success rested not on a simple expansion of its business arena but on strengthening its management base, or constructing management control for its strategic aims. In 2004, in a move emulating Western business strategy concepts, Company A formulated the management principles, vision and strategy upon which to base its management control, and built a system for budgeting, profit planning and budget variance analysis, with an aim to quantify its business strategy measures over a three-year period based on a medium-term business plan. At the same time, under the slogan of "For the customers," Company A established a new marketing function where it analyzed products and markets by SWOT and 4P methods¹³ and clarified its target

customers to promote its new proprietary products. All these measures were essential elements in management control, but Company A had yet to address them. In a move to solidify the foundation of its management control, Company A established codes of corporate conduct for compliance with ethical standards and laws, something parallel to a company constitution, and created product quality management manuals pursuant to ISO 9000 and environment management systems pursuant to ISO 14000, guidelines corresponding to laws and regulations. In order to further improve management efficiency, it carried out a thorough implementation of rationalization, streamlining, and Kaizen and 5S initiatives regarding its internal processes through a review of the value chain, thus achieving improved productivity and a significant reduction in overhead costs.

Along with management control, Company A reformed its organizational structure from a hierarchical style to a flatter structure and introduced corporate social responsibility (CSR) programs, such as community cleaning activities, donations to areas affected by disasters, and student internships. In order to boost customer satisfaction (CS), the company introduced a web-based scheme to respond to inquiries around the clock. To enhance employee satisfaction (ES), it started paying full salaries to employees on maternity leave up to a year and a half after giving birth and providing an allowance of 20,000 yen for every child up to six years old. As a way of providing training and self-improvement opportunities to employees, it established an in-house college and introduced a scholarship program. Company A also implemented a series of strategic, tactical and supportive measures. Many of such measures worked to enhance the relative quality, costs, delivery times and development capacity, known as QCDD, of Company A. In other words, the adoption of management control enabled Company A to differentiate its products in the market and ultimately helped to improve the company's management quality. And such a virtuous cycle led to innovation as seen in the development of special spherical transformers, a patented product which Company A developed to differentiate itself as a component maker.

However, how can such a business strategy centered on management control be shown to have been effective for Company A and its bid to increase company value? A non-financial concept like management control alone is inadequate when discussing the effectiveness of a business strategy, hence the need to measure and analyze accounting-based data to gauge whether or not management control has been appropriately applied. As described earlier, Company A launched new operations in 2002 and introduced management control in 2004. However, the company was not capable of measuring the effectiveness of its management control with financial data. It was possible to compute financial ratios, such as ROA and ROI, from its annual reports, but such figures provided only financial accounting perspectives. In order to project future earnings and develop management strategies, there had to be a new management accounting scheme that went beyond budgeting, profit planning and budget variance analyses. In 2006, Company A adopted fixed revenue accounting, a management accounting model that made it possible to assess the company's profitability and growth potential from the perspective of customer relationships.

Asada, Suzuki, and Kawano (2005, p. 4) referred to the practice of placing fixed revenue accounting at the center of management control as fixed revenue management and defined it as follows: "Fixed revenue management is a style of management where a strategy founded on establishing customer relationships is carried out in a planned manner, and progress is evaluated based on a management accounting system." As a result, fixed revenue accounting worked to enhance customer relations and helped boost financial stability, safety and growth potential for companies (Asada et al., 2005, pp. 7-16). Without a doubt, Company A clearly carried out fixed revenue management.

2-3 Definition of customer and product segments

Saki and Suzuki (2012, p. 25) described the concept of customer segments as follows: New customers are those with which a company has newly started doing business within a pre-defined period of time; regular customers are those with which a company conducts business with a certain level of regularity; non-regular customers are those which lack a certain level of regularity; and lost customers are those which have ceased bringing any business. These are the larger categories in fixed revenue accounting, and each company needs to determine its own detailed criteria for segmenting customers.

We will begin by looking at Company A's definition of new customers. Company A defined new customers as those within three years of the first transaction with Company A, and brought business on a regular basis. The company defined "regular" as doing at least one transaction per year in the course of those three years. Three years was made the threshold for new customers due to the length of the company's medium-term business plan that spanned three years, and the company viewed customers not foreseen at the time of formulating the business plan as new customers. Customers which continued to do business from the fourth year onward were regarded either as non-regular or regular customers, and lost customers that returned were regarded as new customers.

Next we will look at the distinction between regular customers and non-regular customers. Generally, regular customers are considered those which bring regular business during a certain period of time and provide a certain level of sales or profits. Company A defined regular customers as those acquired through its own marketing efforts, had brought business on a regular basis for three years or longer, and continued to conduct at least one transaction a year. Then the question arises: If a customer brings business only once a year and provides only a modest level of sales or profits, does it really deserve to be classified a regular customer? If a customer can be relied on doing business once a year, does it merit being defined a regular customer? The question is not unique to Company A, but is a common problem in determining customer classifications for fixed revenue accounting. To deal with this problem, Company A divided regular customers into regular customers (a) and regular customers (b). Regular customers (a) were those from which Company A made gross profit margins above its target, and regular customers (b) were those from which it made gross profit margins below target. Simply put, it was a dis-

tion based on whether customers bought high or low.

Also, Company A applied the non-regular classification to customers which had done business regularly for three years and were in the fourth year or later. Generally, non-regular customers are regarded as those which bring business on a continuous basis, but provide sales or profits or number of transactions that are relatively modest. In the case of Company A, it derived its distinction from industry-specific thinking. In the electronic component industry, it is a common practice that semiconductor makers take charge of marketing and consign transactional operations to trading firms. The reasons vary from credit management to the inventory holding function of trading companies, but such cases cannot be considered as customers acquired through trading companies' own marketing efforts. Company A classified such cases as non-regular customers.¹⁴

Lastly, we will look at the definition of lost customers. Lost customers are, in principle, those which have completely stopped bringing any business. The question is how long does a customer stay inactive before it is categorized a lost customer? Depending on the industry, this period can be as long as three years. In the case of Company A, customers with no activity for one year were regarded as lost customers. Whether new, non-regular or regular, if a customer was totally inactive in the course of a business year, it became a lost customer. The definition also applied to cases where the customer ceased operation due to bankruptcy or other similar reasons.¹⁵ Table 2-1 summarizes the customer categorization definitions applied by Company A.

Table 2-1 Company A's Customer Segmentation

		Frequency of transactions	
		At least one transaction a year for less than three years	At least one transaction a year for three years or more
Marketing	External	New	Non-regular
	Internal	New	Regular

Table by the author

And now, we will look at Company A's product segmentation. Company A divided its products into five segments. The first was products by Semiconductor Maker S, the major supplier in Company A's trading company division. The reason for the top listing was that products by S accounted for 60 percent of Company A's sales, and it was also based on Company A's management philosophy that its manufacturing function was founded on its stable footing as a trading firm. The second segment was products by Company A's manufacturing division, the proprietary electronic components designed and manufactured by Company A. The third was electronic components made by Company B, a subsidiary of Company A; the fourth was electronic components by Company C, another subsidiary; and the fifth was the remaining products procured from other sources. Table 2-2 summarizes Company A's product segmentation.

Table 2-2 Company A’s Product Segmentation

1	Products by Company S	Trading firm division	Electronic components supplied by Company S
2	Products by Company A	Manufacturing division	Electronic components designed and manufactured by Company A
3	Products by Company B	Manufacturing division	Company B is a subsidiary maker
4	Products by Company C	Manufacturing division	Company C is a subsidiary maker
5	Others	Trading firm division	Electronic components and others supplied by other firms

Table by the author

3. Research design

The purpose of this chapter is to clearly describe the way the study was conducted. Here I would like to discuss the research questions, research methods, research site, and research data in that order.

3-1 *Research questions*

Fixed revenue accounting is a management accounting model that aims to help a company stabilize its operations by covering fixed costs with fixed revenues. Asada et al. (2005, p. 4) assert that by putting fixed revenue accounting at the center of management control, a company can improve its customer relations in an effective way. Here they also refer to the practice of applying fixed revenue accounting in management control as fixed revenue management and define it as follows: “Fixed revenue management is a style of management where a strategy founded on establishing customer relationships is carried out in a planned manner, and progress is evaluated based on a management accounting system.”

Further, by helping to enhance customer relations, fixed revenue management provided positive effects in three areas: financial benefits of stability, safety and growth potential, construction of a superior competitive foundation, and improvement in employee satisfaction (Asada et al., 2005, pp. 7–16). In this study, I have focused on the first of the above propositions and examined the financial fruit — earnings — of fixed revenue accounting.

3-2 *Research methods*

In fixed revenue accounting, there is a unique income statement format that enables profitability to be analyzed. In this section, I will conduct a profitability analysis and take a close look at the effects of fixed revenue accounting on company performance. First, in fixed revenue accounting, profitability is analyzed in an income statement form, as shown in Chart 3-1. As seen in the chart, the columns display the sales figures for each of the new, regular, non-regular and lost customer

Chart 3-1 Income Statement Format for Fixed Revenue Accounting

			Total	New customers	Regular customers	Non-regular customers	Lost customers
Sales	Division 1	Product 1					
		Product 2					
		Product 3					
		Product 4					
		Product 5					
	Division 2	Product 1					
		Product 2					
		Product 3					
		Product 4					
		Product 5					
	Division 3	Product 1					
		Product 2					
		Product 3					
		Product 4					
		Product 5					
Number of customers							
Total							
Cost of goods sold							
Gross operating profit					①		
Segment-unique variable costs							
Margin profit							
Segment-unique fixed costs			②				
Contributive profit							
Segment-common fixed costs			③				
Operating profit							
Fixed operating profit ④=①-(②+③)			④				

Format by the author

segments, while the rows represent sales per product segments and smaller categories of products. This way, the income statement format is designed to help grasp the composition of sales from the perspectives of customer and product segments. Finally, the costs of goods sold for each customer segment are entered to arrive at segment-by-segment gross profits.¹⁶

Costs are broken down into unique variable costs, unique fixed costs and common fixed costs, and are allocated to the appropriate segments according to the company's accounting policies.¹⁷ In this study, I have divided the total variable costs by the total number of customers for the period under study to arrive at the variable cost per customer, and then multiplied the figure by the number of customers belonging to each segment to arrive at the unique variable costs by segment. Sundry expense items incorporated in this computation were traveling expenses, entertaining expenses, meeting expenses, transportation expenses and sales charges. Gross profit minus unique variable costs makes marginal profit.

Unique fixed costs consist of employee salaries and bonuses, legal welfare expenses, employee benefit expenses, utility expenses, communication expenses and rents. Marginal profit minus unique fixed costs makes contributive profit. Common

costs are those costs applied to overall operations, namely, overhead costs such as those related to the headquarters which are the remainder of selling, general and administrative costs minus unique variable costs and unique fixed costs. Contributive profit minus common fixed costs makes the operating profit from each customer segment. From the segmented operating profits, we can determine which customer segment contributes to the company's earnings more than the others.

Further, by deducting unique fixed costs and common fixed costs from the gross profit for regular customers, we can arrive at the fixed operating profit. Fixed operating profit represents the difference in revenues from regular customers (i.e., fixed revenues) minus fixed costs such as salaries. If the fixed operating profit is positive, the company is covering its fixed costs with fixed revenues alone, indicating that its business is stable. Achieving a positive fixed operating profit is the foremost financial objective of fixed revenue accounting and the most important aim.

In this study I looked at Company A's fixed revenue accounting income statements and examined changes in the operating profits by customer segment, total operating profit, and fixed operating profit over a period of ten years. And on regular customers, I followed Company A's distinction and divided them between regular customers (a), those above the targeted gross profit, and regular customers (b), those below. As for analysis by product segment, I looked at the percentage shares of new products in total sales and gross profits.¹⁸ I also looked into the percentages of products by Company A's manufacturing division in total sales and total gross profits. The aim was to analyze to what degrees new products and proprietary products were contributing to each of the customer segments. Focusing on the percentages of new products and proprietary products should allow a broader view of the effects of fixed revenue accounting on Company A's earnings.

3-3 Research site

As stated earlier, many Japanese companies are faced with serious challenges arising from economic and political uncertainties, the most typical example being the electronics industry where many firms are suffering from rapid declines in international competitiveness and posting massive losses. The focus of this study, Company A, is an SME that belongs to such an electronics industry, and it is not hard to imagine the tough conditions it faces given the unstable business foundation of many SMEs. Notwithstanding all this, Company A has weathered the hard times, consistently posting positive earnings with the exception of the business year that saw the collapse of Lehman Brothers. How has Company A been using fixed revenue accounting and fixed revenue management? The ten years from 2002 to 2011 were marked with crises exceeding the imagination, starting with the 9/11 terrorist attacks, an unstable world economy, the demise of Lehman Brothers, the European debt crisis and the Great East Japan Earthquake. Company A survived such upheavals, and it is worthwhile to analyze the role of fixed revenue management, the management accounting system that underpinned the company's management strategy.

Also, Company A belongs to the electronic component subcategory of the electronics industry, and its main customers are electronic machinery makers. Its

business model is what is known as business to business, or B to B, and all its transactions can be ascribed to specific customers. By comparison, with retail businesses such as department stores, whose transactions are business to customer, or B to C, it is difficult to identify the transactions for the legions of customers. Many studies of fixed revenue accounting have targeted companies with the B to C business model, such as department stores. From this point of view as well, it is worthwhile to analyze the customer segments of Company A, a B to B company with all its transactions identified, for the advancement of fixed revenue accounting studies.

3-4 Research data

The data used in this study are Company A's profitability figures over the last decade, its financial statements and customer-identified transaction data between fiscal years 2002 and 2011.

4. Outcome of research and analysis

In this chapter, we will look at the outcome of the study conducted according to the research design above and examine the outcome from the perspective of profitability. I have laid out the profitability figures for the ten years from 2002 to 2011 in a line chart. From the fixed revenue income statements, as the one shown in Chart 3-1, I have compiled ten years of operating profits by customer segment, total operating profit, and fixed operating profit in Chart 4-1. Also, from the aspect of product segmentation, I have listed the historical percentages of new products and Company A's proprietary products in total sales and total gross profit.

4-1 Profitability analysis

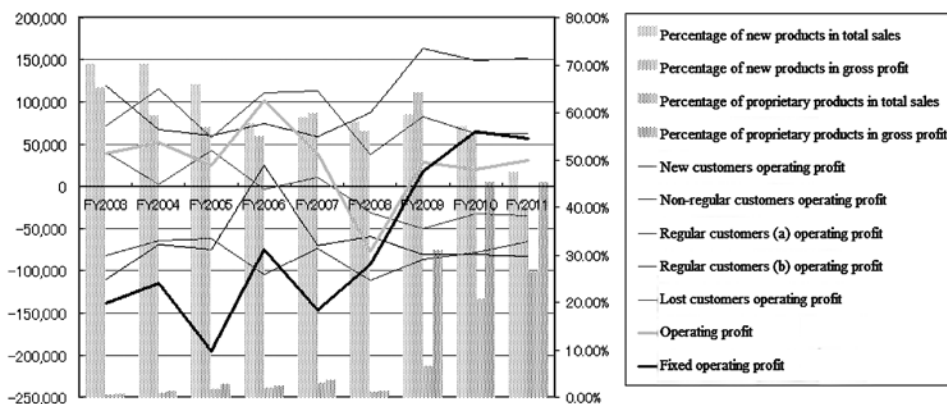
Let us start by looking at the new customers operating profit. From Chart 4-1, we can see that this segment operated continuously in the red, except for fiscal year 2006. It can be interpreted that Company A was either not very keen on acquiring new customers, or acquired only those who provide very poor sales and profits. However, it can also be said that new customers generally do not bring large volumes of sales and by definition do not add very much to profits. Either way, Company A continuously lost money in the new customers segment, and whether this situation is regarded as a problem to address or a result of active investment to turn such customers into regular customers will depend on the policy of the company.

Next, operating profit from non-regular customers showed considerable changes in the last decade. The segment largely produced a positive operating profit up to fiscal year 2007, but abruptly turned unprofitable in fiscal year 2008. For Company A, non-regular customers are not customers acquired by their own marketing efforts. Company A saw sales to such externally-introduced customers sharply decline starting in 2008. In the meantime, the company's overall fixed operating profit turned positive after that same fiscal year. It can be assumed that such externally-introduced customers cost more money but brought less profit than those marketed internally. Such observations would not be possible from an analysis of changes in

Chart 4-1 Historical Profitability Analysis

(unit: ¥1,000)

	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011
New customers operating profit	-110,207	-68,900	-74,304	24,466	-69,675	-59,404	-80,346	-80,361	-83,193
Non-regular customers operating profit	39,691	2,102	42,529	-3,104	10,669	-30,624	-49,450	-31,968	-34,752
Regular customers (a) operating profit	119,758	66,910	59,726	74,313	59,166	87,224	163,183	148,688	151,255
Regular customers (b) operating profit	71,567	115,989	58,131	111,000	113,394	37,284	82,300	62,158	62,176
Lost customers operating profit	-82,043	-63,839	-61,270	-104,890	-74,089	-111,118	-87,168	-78,170	-64,979
Operating profit	38,766	52,262	24,811	101,785	39,465	-76,637	28,519	20,347	30,507
Fixex operating profit	-139,031	-115,311	-195,703	-74,314	-146,993	-92,670	17,347	65,224	57,299
Percentage of new products in total sales	70.05%	70.08%	65.97%	57.67%	58.86%	57.89%	59.68%	56.97%	47.27%
Percentage of new products in gross profit	65.22%	59.43%	56.89%	54.85%	59.71%	55.95%	64.31%	55.26%	40.15%
Percentage of proprietary products in total sales	0.46%	0.78%	1.64%	1.83%	2.94%	1.00%	6.43%	20.65%	26.26%
Percentage of proprietary products in gross profit	0.67%	1.24%	2.81%	2.33%	3.65%	1.27%	30.92%	45.16%	45.31%



Charts by the author

operating profits alone. Through analysis based on fixed revenue accounting, we are able to see that Company A weaned itself from externally-marketed customers and shifted its focus to internally-marketed customers over the course of the ten years.

We will move on to the analysis of regular customers operating profit. Regular customers (a), the group of customers that brings gross profits above Company A's target, provided positive operating profits more or less constantly. Notably, operating profit from this segment from 2009 on was generally double the average figure for the years before then. To understand why, it is effective to look at this from the perspective of product segments. The segment of Company A's proprietary products regularly represented 1 to 2 percent of total sales up till fiscal year 2008, but

the ratio soared to 26.26 percent in fiscal year 2011. Moreover, the ratio of such products against total gross profit climbed from just 1.27 percent in fiscal year 2008 to 45.31 percent in fiscal year 2011. In other words, with the jump in sales of proprietary products, such products came to provide nearly half the company's entire gross profit. Fixed revenue accounting analysis made it possible to quantitatively grasp the transformation of Company A from a trading company into a maker. In the meantime, regular customers (b), which provide gross profits below Company A's target, provided more or less stable positive profits throughout. However, even though the regular customers (b) segment was consistently in the black from fiscal year 2007 on, it did not show movement in tangent with the growth of proprietary products the way regular customers (a) segment did. Company A's manufacturing division did not make a noticeable difference in regular customers (b). From this observation, we can infer that regular customers (b) contributed more to the sales of the company's trading division than to the manufacturing division.

The lost customers division consistently showed negative profit throughout the decade. By definition, lost customers are those which brought no transactions in the respective fiscal years, so it may be an expected result. Still, from the fact that the section incurred losses of comparable volume every year, we can surmise that there were similar incidences of customer losses year after year. As stated before, the electronics industry in Japan has been in dire financial straits and seen numerous closures of domestic factories and businesses as production moved overseas. It may be that high levels of customer losses persisted due to these circumstances. Do we consider such situations as something unavoidable? The outcome of the lost customers analysis by fixed revenue accounting laid bare the severe economic situation and tough problems that Japanese businesses face.

Lastly, we will look at fixed operating profit. The line chart for fixed operating profit shows a contrast between the significant losses up till fiscal year 2008 and the positive figures from fiscal year 2009 onward. It is thought that this contrast occurred in correlation with the significant increases in the percentages of Company A's proprietary products against total sales and total gross profits starting in fiscal year 2009. Fixed operating profit turned positive in fiscal year 2009, while at the same time the percentage of proprietary products in total sales jumped from the previous year's 1 percent to 6.43 percent, and the percentage in total gross profit from 1.27 percent to 30.92 percent. Company A, by boosting sales in its proprietary manufacturing division, succeeded in turning around its fixed operating profit.

In the above profitability analysis, it is of particular note that the company's fixed operating profit turned positive starting in fiscal year 2009. The collapse of Lehman Brothers in September 2008 triggered a global financial crisis that plunged the entire world economy into turmoil. It was immediately after this incident that Company A achieved a positive fixed operating profit, or put differently, came to cover its fixed costs with fixed revenues. It was in fiscal year 2006 that Company A adopted fixed revenue management with the focus on fixed revenue accounting. And in its 2006 medium-term business plan, it set its strategic sights on improving profitability by measures such as aiming to turn more new customers into regular

customers. We can feasibly point out that a major factor in Company A's success in producing a positive operating profit in the immediate aftermath of Lehman Brothers' demise was its efforts to turn more new customers into regular customers and boost profitability with the help of fixed revenue accounting.

Further, even in fiscal year 2011, immediately following the Great East Japan Earthquake, Company A posted a positive operating profit and fixed operating profit, and we can assume that the company's business strategy based on fixed revenue accounting helped to turn new customers into regular customers and improve profitability, and ultimately to stabilize business. Incidentally, though Company A posted an operating loss in fiscal year 2008, the year that saw Lehman Brothers' collapse, it managed to report a positive pretax profit thanks to proceeds from the cancellation of an insurance policy. Put differently, its performance was stable enough as to be propped up with insurance cancellation, and with that kind of resilience it has been able to withstand the spate of crises that continues to punish the electronics industry, such as the global financial crisis, the Great East Japan Earthquake, the European debt crisis, flooding in Thailand and the territorial dispute over the Senkaku Islands, and has continually reported stable operating and fixed operating profits. A study of Company A alone is not enough to identify the effects of fixed revenue accounting on profitability, but at least in the case of Company A we can safely state that fixed revenue accounting was effective in promoting the move to turn more customers into regular customers and boost profitability, or in other words, to stabilize business performance. As an answer to 3-1 Research questions, we can conclude that fixed revenue accounting is effective in boosting profitability.

5. Conclusion

In the final chapter, I will summarize the study and look at its effectiveness, limits and issues. The purpose of the study was to examine the effects of fixed revenue accounting on company performance. The target of the study was Company A, an electronic component maker and trading company which introduced fixed revenue accounting in fiscal year 2006, and its financial data over ten years from 2002 to 2011 were analyzed from the perspective of profitability.

In Chapter 2, we saw an overview of Company A's history as well as industry trends and went on to define the company's customer segments and product segments. Company A characteristically distinguished between customers acquired through its own marketing efforts and those externally introduced which did not give Company A any say in the choice of products, such as the case of EMS, defining the former as regular customers and the latter as non-regular customers. Also, Company A regarded as new customers those within three years of the first transaction and brought business on a regular basis. From the fourth year on, such customers were divided into either regular or non-regular customers. Lost customers were those which did not bring any business during the year under study. Further, regular customers that brought gross profits above Company A's target were defined as regular customers (a), and those below were defined as regular customers (b). In

the meantime, products were divided into five segments, the larger categorization being trading division and manufacturing division.

In Chapter 3, we looked at the research design centered on profitability analysis as used in fixed revenue accounting. As for research questions, the study looked at the discussion by Asada et al. (2005, pp. 7–16) and focused on examining the effects of fixed revenue accounting on company performance. As for research method, the study conducted a profitability analysis using the company's fixed revenue accounting income statements, scrutinizing the changes in operating profit for each of the customer segments, total operating profit and fixed operating profit over ten years. Notably, fixed operating profit is the most important measure of stability, as a positive figure here indicates that fixed revenues alone cover fixed costs. The percentages of Company A's proprietary products against total sales and total gross profits were also looked at. And the research site was Company A, an SME that belongs to the Japanese electronics industry which confronts a rapid decline in international competitiveness. While many SMEs suffer from an unstable operating foundation and face severe business conditions, Company A has consistently posted positive operating profits, with the exception of the business year that saw the collapse of Lehman Brothers. Of especial note was that the ten years from 2002 to 2011 saw numerous global crises, starting with the aftermath of the 9/11 terrorist attacks, the fall of Lehman Brothers and subsequent global financial crisis, the European debt crisis, and the Great East Japan Earthquake. The study looked at Company A, which adopted fixed revenue accounting in fiscal year 2006, and shed light on the effects and roles of fixed revenue accounting. The research data comprised profitability figures obtained from Company A's financial statements over the past ten years.

In Chapter 4, we examined the outcome of the profitability analysis. Company A's new customer segment chronically posted operating losses, and it depended on the company's judgment whether to take issue with this or regard it as an investment toward turning such customers into regular customers. Next, operating profit from non-regular customers stayed positive till fiscal year 2007, but turned negative from fiscal year 2008 on. This was thought due to the sudden decrease in sales to externally-introduced regular customers. Given that Company A's fixed operating profit turned positive in fiscal year 2008, we can see that Company A's sales focus shifted from externally-introduced customers to customers acquired through its own marketing efforts, which were customers that brought more profitability. As a matter of fact, operating profit from regular customers (a) had consistently been positive, but the profit figure doubled from fiscal year 2009 on compared to the years leading up to then. At the same time, the percentage of Company A's proprietary products in total sales soared from the 2 percent level till fiscal year 2008 to 26 percent in fiscal year 2011, testifying to the correlation between regular customers (a) and proprietary products. By contrast, operating profit from regular customers (b) had been positive but did not show a correlative relationship with the increasing sales volume in Company A's manufacturing sector. Finally, we analyzed the fixed operating profit. This figure had shown significant losses till fiscal year 2008, but turned positive from the next fiscal year on. It can be thought that the increase in

sales and gross profit from proprietary products starting in 2009 was the major contributor. We can see from here that Company A succeeded in continuously posting a positive fixed operating profit, in other words, stabilizing its operation, by boosting sales in its proprietary manufacturing division. While it is premature to make a definitive statement based on this study alone, we can conclude that, in the case of Company A, fixed revenue accounting had a certain level of impact on increasing fixed revenues and stabilizing business operations.

I believe that this study has succeeded in attaining a certain level of insight through demonstrative analysis. The conclusion is that fixed revenue accounting had a strong impact on profitability improvement at Company A. In the tumultuous ten years from 2002 to 2011, where such unimaginable events as the collapse of Lehman Brothers and the Great East Japan Earthquake occurred one after the other, fixed revenue accounting with its primary target of producing positive fixed operating profits, or stabilizing operations, supported the business strategy of Company A. As we can see from this case, Japanese SMEs are making active use of a new model of management accounting. Japanese SMEs are showing unparalleled resiliency, even on a global scale, and such resiliency can be demonstrated from the perspective of management accounting. I plan to continue to study Japanese SMEs and their use of management accounting.

Notes

- 1 According to the "2009 Economic Census for Business Frame" by the Ministry of Internal Affairs and Communications, there are 4.201 million SMEs in Japan, and they account for 70 percent of all Japanese employment. An SME is defined, as stipulated in the Small and Medium Enterprises Basic Act, as a manufacturing business with paid-in capital of 300 million yen or less or workforce of 300 or less, a wholesale business with paid-in capital of 100 million yen or less or workforce of 100 or less, a retail business with paid-in capital of 50 million yen or less or workforce of 50 or less, and a service-sector business with paid-in capital of 50 million yen or workforce of 100 or less.
- 2 Oil crises here refer to those in 1973 and 1979, when upheavals in the Middle East set off a surge in crude oil prices and turmoil in the global economy. It dealt a particularly hard blow to resource-poor Japan. The collapse of Lehman Brothers in 2008, triggered by the deterioration of the U.S. sub-prime mortgage market, in turn led to a global financial crisis.
- 3 "5S" refers to five fundamental behaviors of *seiri* (organization), *seiton* (tidiness), *seiso* (cleaning up), *seiketsu* (cleanliness), and *shitsuke* (discipline) characteristically practiced by Japanese manufacturers. Kaizen, also known as the Toyota Way, is a concept which aims to improve quality by encouraging five iterations of asking why.
- 4 Such models include CVP analysis, ABC analysis and EVA analysis.
- 5 "Semiconductor" generically refers to electronic components, made from silicone or other materials, used to control electrical current or voltage.
- 6 Semiconductor trading companies are mainly located around Akihabara in Tokyo and Nipponbashi in Osaka, where black markets for electric parts operated in the period immediately after World War II.
- 7 In the process of economic development where rural population supplies cheap labor to

- manufacturing and gives rise to the expansion of secondary industry, there is a point where the labor supply from the agricultural sector dries up and growth in the manufacturing sector slows down. This idea was proposed by the British economist Arthur Lewis (1915–1991).
- 8 DRAM stands for Dynamic Random Access Memory, a semiconductor device used to store data.
 - 9 SCM refers to a concept of comprehensive management of the flow of goods from manufacturing to distribution and sales. It is mainly applied when makers attempt to shed excess inventory. Due to the spread of SCM, direct dealing between component makers and assembly makers increased.
 - 10 EMS is a service where electronic components, such as electronic substrates, are manufactured on a commissioned basis.
 - 11 Power supply units convert alternate current power to direct current power or vice versa.
 - 12 Here, optical components refer to xenon discharge tubes, and special inductor parts refer to spherical transformers.
 - 13 SWOT is a popular marketing technique where projects are analyzed in terms of strength, weakness, opportunity and threat. 4P is another marketing technique that analyzes product, price, place and promotion.
 - 14 Company A categorizes makers that specialize in electronics manufacturing services (EMS) as non-regular customers. EMS companies manufacture electronics components like substrates on a commissioned basis, and basically have no say in determining which components to produce. Also, cases where Company A conducts hardly any marketing activity and where secondary distributors determine the deals do not qualify as internally created sales. Company A regards those customers not acquired through its own marketing efforts as non-regular customers.
 - 15 A bankrupt customer that continues operation under legal protection such as the Civil Rehabilitation Act is not regarded as a lost customer. In the case of mid-term bankruptcy and business interruption, sales from the customer up to that point go into the calculation. If purchases are returned from a lost customer, the corresponding figures are deducted from the sales figures. In this study, I used figures after such adjustments.
 - 16 "The number of customers" found on the form is for information purposes only; the number of customers does not enter in the computation of fixed revenue accounting profit figures.
 - 17 According to Asada et al. (2011, p.73), unique fixed costs include advertisement expenses pertaining to respective product lines and depreciation costs of machinery and equipment attributable to respective segments, while common fixed costs include overhead costs such as headquarters expenses that relate to all products and segments.
 - 18 Company A defines those products as new that are within three years after they were first adopted by customers, in addition to products within three years of development. Electronic components are not finished products, and commodity parts can be adopted for new markets or new use. In such cases it is appropriate to count such components as new products.

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