

April 25, 2002

**Towards a Year of Brighter Prospects
- Recovery of Confidence and Establishment of Governana -
Chairman's Address for the 2002 Annual Meeting**

Yotaro Kobayashi
Chairman, Keizai Doyukai

A year and a half has already passed since the announcement of Keizai Doyukai's 21st Century Declaration, in which we affirmed the importance of a new nation-building process for the 21st century and our determination to participate fully in this undertaking as business executives. We are now also approaching the end of the first year of the Koizumi Cabinet, which came into office trumpeting the battle cries "no growth without reform" and "structural reform with no sanctuaries," stirring up great expectations not only in Japan but throughout the world as well.

In reviewing the past year, I would like to share with you my thoughts on some of the challenges that face our nation, as well as the various types of activities that Keizai Doyukai intends to pursue in the new fiscal year.

Introduction: The Koizumi Cabinet after Year One

Did Japan make any concrete progress in the past year? Let me be blunt in my answer. In reviewing the last 12 months, I am hard pressed to find many positive stories to tell regarding progress made in the areas of politics, the economy, and government administration. In fact, the year just past was marked by numerous difficulties and hardships. It is only recently that we have started to see some improvement in the outlook for corporate performance. However, unemployment and corporate bankruptcies remain at very high levels. As for the problem of non-performing loans and the return of sound management to the nation's financial institutions, while Japan was able to weather the so-called March Crisis, the impression left behind is that we have not yet solved all the problems we face.

Unfortunately, the glimmer of emerging hope for economic recovery has been deflected by a series of events that have seriously undermined trust and confidence in the corporate sector. These include the falsification of the place of origin of products in the food industry and the systems trouble that occurred in a merged bank. As corporate executives, we must take these events very seriously. Turning to the world of politics, the series of problems involving the management of money, the employment of aides to Diet members, and other scandals have shocked us with the realization that Japan's political culture has not changed at all from the old "1955 system." We are left with only one conclusion - unless Japan's political arrangements are fundamentally reordered, there is no hope for regaining the public's confidence in the political system. At the same time, we have once again been made painfully aware of the weighty responsibility given to each member of the electorate in choosing our politicians. Turning to the positive results of the Koizumi Cabinet, I believe the most significant achievement is its style of decision-making. Transparent discussions have been held in a manner that is open to the public, and the Cabinet's leadership has been fully demonstrated. As a result, various proposals have been developed for changing Japan's existing framework in areas that were off limits in the past, including the reform of special public corporations, the three businesses of the postal system, reform of the health insurance system, and the review of the relations between politicians and bureaucrats. In this context, I believe that the Council on Economic and Fiscal Policy has played an extremely important role. Various position papers developed by the Council have been approved by the Cabinet and have come to constitute the basic framework for the realization of structural reform. These include the Guidelines for the Formulation of the Fiscal 2002 Budget; the Basic Policies for Macroeconomic Management and Structural Reform of the Japanese Economy; Structural Reform and Medium-term Economic and Fiscal Perspectives; and the Reform Schedule.

The Koizumi Cabinet has also registered significant results in its active participation in the global alliance against terrorism that has emerged from the events of September 11. A Special Measures Law was enacted allowing the dispatch of Japan's Marine Self-Defense Forces and fleet to the Indian Ocean; and more recently, the Diet has been deliberating on a series of laws for national emergencies. These initiatives can be seen as the first steps in Japan's effort to become a so-called "normal country." However, all such future initiatives must

be taken with extreme caution and only after due consideration. Needless to say, we must continue to examine carefully the status of the nation against the provisions of the Constitution, while also considering the relevance of changing international conditions.

There are those who argue that tangible economic results have failed to materialize and that the public has been disappointed by the lukewarm reforms that have emerged due to the strong resistance that has confronted the reform process. But reform requires a gestation period before it shows results. This is unavoidable, insofar as structural reform represents a reformation of essential processes. However, in taking up the challenge of certain policy issues that have never before been broached, and in bringing about change that is by no means insignificant, the Koizumi Cabinet is to be lauded, I believe, for taking the first steps towards reform. In the new fiscal year, we look to Prime Minister Koizumi to exercise more effective leadership at a time when the true value of his administration will be gauged by his ability to implement real reform. As in the past, we shall continue to extend our unstinting support and cooperation to the reform programs of the Koizumi Cabinet.

Were I permitted to present my "wish list" to Prime Minister Koizumi, I would mention the following three points. First, I would ask the prime minister to present us with a clearer vision of where he wants to take the nation with his reforms. I would like to see the prime minister speak more frequently and use his own words to tell us what the specific objectives of reform are, and why he is pursuing them. Second, I believe it is necessary for Prime Minister Koizumi to couch his words in such a manner as to directly appeal to the people and companies of Japan, calling on them to give full expression to their potentialities and their energies. And third, I would remind the prime minister that while the act of destruction can be accomplished by a single individual, creation - or building something anew - cannot be done alone. We certainly would like to see a higher level of teamwork in the Koizumi Cabinet.

1. Establishing Corporate Governance: Awareness and Implementation by Executives

Looking back on the events of the year that has ended, I would like to strongly emphasize the importance of regaining the public's confidence in the corporate sector. Japan must engage in a painful process of reform if it is to open new

paths to a brighter future, and it is the corporations, politicians, and bureaucrats that must lead the way. If those at the forefront fail to win and maintain the public's confidence, then certainly there is little hope in gaining the support and empathy of the public for the difficult road ahead. Whereas our intention is to support the Koizumi Cabinet, the frequent recurrence of scandal in the corporate sector may well cause us to become a hindrance to the Koizumi reforms. The most important and basic challenge that we have before us today is to once again review our own organizations and to engage in activities for regaining the public's confidence and trust.

In the United States, the Enron affair has shaken the public's confidence in the American-style market economy and has focused widespread attention and criticism on corporate governance and corporate accounting, as well as the role of accounting firms and auditors. As we observe this event, we should not be satisfied with merely criticizing the American system. Rather, the Enron affair must be viewed as a problem rooted in universal issues of corporate and social governance and we must be prepared to learn from the speedy response taken in the United States to revise and improve the system in order to build better structures and arrangements.

In December 2000, we announced our 21st Century Declaration, at the beginning of which we made the following statement regarding our resolve:

"... we must work toward strengthening the bonds of mutual trust between society and the corporate sector, always bearing in mind that our enterprises have a social presence that exerts a tremendous and ever-increasing impact on the values and lifestyles of the people."

Having made that statement of resolve, we have advocated the actualization of a "market evolution" that has as its basis a combination of economic, human, and social values. Likewise, we have continued to call for the rebuilding of corporate governance. As corporate executives, we must once again turn our eyes to the aims and objectives of the 21st Century Declaration and make it our duty and responsibility to work towards the realization of its goals.

Specifically, I believe we must take urgent action in the following three areas in order to rebuild corporate governance.

The first challenge is to strengthen the auditing functions of corporate boards of directors. The revised Commercial Code offers two major alternatives. Individual corporations must exercise due speed in devising and strengthening the systems of governance that best suit their needs.

In the second challenge, corporate executives must accept as their responsibility the duty to develop systems and arrangements that will create a heightened awareness of corporate ethics and compliance. Any statement to the effect that "it is impossible for the board of directors to check the facts when the people on the spot conspire to systematically hide the facts" is an excuse that amounts to a dereliction of duty on the part of executives. In order to carry out this responsibility, executives must appoint qualified persons to undertake this task, and they themselves must frequent the line to confirm with their own eyes the mode of execution.

The third challenge is the need to achieve heightened levels of transparency. Corporations have the duty to disclose information and to maintain proper levels of communication, not only with investors, but also with consumers and all other groups of stakeholders.

The challenge of rebuilding corporate governance is of course a matter of systems-building. At the same time, however, it is also a matter that pertains to our will and implementation as executives. Needless to say, if there is an absence of personal governance on the part of executives, even the most intricately devised systems of corporate governance will prove spineless and ineffective.

2. Establishing National Governance: Promoting Political Reform

The next issue is the recovery of confidence in the political system. What is required here is an unflinching commitment to the separation of powers and to the improvement of transparency in government. Those must be the keys as we immediately embark on a political reform effort that is focused on the following three points.

First of all, Japan must return to the starting point of democracy. It is important for Japan to reaffirm the most basic principle of democratic government, which can be stated as follows: The reins of government are delegated to the political party that wins a majority in a general election, and the electorate passes judgment on the performance of that party in the next general election when a decision is made on whether or not to transfer the reins of power to another party. To actualize that basic principle, the disparity in the value of a vote in lower house elections must be rectified, and Japan must examine the possibility of a bold transition to a system of single representative electoral districts.

Second, greater disclosure of information in politics must be promoted. The IT revolution presents us with a diverse range of very simple methods for the disclosure and dissemination of information. There is an urgent need to develop new legislation concerning the disclosure of political information, including disclosure methods regarding information on political contributions. In the implementation of this process, I believe there are important lessons to be learned from the American system of political lobbying. That is, Japan should consider instituting a system that provides for the full disclosure of all lobbying activities involving the presentation of policy demands, requests, and petitions to the executive branch, to politicians, and to political parties. Democracy is in effect a mechanism for coordinating policy demands. Efforts to restrict the presentation of policy demands may ultimately weaken the performance of democratic functions. I believe it is appropriate to institute the full disclosure of both political contributions and policy demands and to allow the public to evaluate this information and to reach its own conclusions.

Third, relations between the Cabinet and the ruling parties must be fundamentally reformed, and the current arrangements of bi-centric political power must be eliminated as quickly as possible. For this purpose, new arrangements should be immediately instituted whereby leaders of the ruling parties are appointed to Cabinet posts. At the very least, the chairman of the Policy Research Council or other key policymakers of the ruling parties should join the Cabinet as state ministers for policy coordination.

Given the pressing nature of these needs, Keizai Doyukai will submit these questions for further deliberation by its Committee on Political Affairs and will publish its views on political reform in the near future.

While I have refrained from touching on the moral standards of politicians, there is no doubt that the same rule that applies to corporate executives should also apply to politicians. That is, reform of the political system cannot be attempted without reference to the personal governance of politicians. Because they are our elected representatives - to whom the affairs of state have been delegated - politicians must, more than anyone else, engage tirelessly in burnishing their code of "personal governance."

3. Macroeconomic Policy Issues of Immediate Concern: Supporting and Stimulating the Positive Efforts of Corporate Executives through Tax Reform and Deregulation

Next, I would like to address certain macroeconomic policy issues of immediate concern. Today, the Japanese economy has arrived at a moment of truth. While the U.S. economy is exhibiting very strong signs of recovery, the outlook for the second half of the year and beyond is by no means clear. Turning to Japan, we can see that a glimmer of light is beginning to appear in corporate performance, and there is a growing sentiment that the economy has arrived at a cyclical bottom. In order to translate those positive signs into a private-sector-led revitalization of the economy, corporate executives must adopt a positive and forward-looking stance in their management strategies, including such areas as the creation of demand and the promotion of technologies and research and development. Quite clearly, full-fledged economic recovery is impossible without corporate growth. The key to supporting the positive business stance of corporate executives and promoting economic revitalization lies in the implementation of tax reform and deregulation, as well as the return of financial institutions to sound management and international competitiveness.

On the question of tax reform, measures must be taken that help release the full potential of individuals and corporations, which together comprise the private sector. Of course, tax reform must be predicated on the drastic cutback and more efficient use of expenditures, and the fiscal resources needed for implementing tax reductions for economic revitalization must be, in the first instance, derived from cutbacks in fiscal expenditures. As such, tax cuts need not be income-neutral in the narrow sense. In this context, I believe that we should adopt the following view: The use of tax cuts as a lever for achieving economic revitalization will lead to a self-sustained economic recovery that will, in the long run, result in the steady increase of tax revenues. Regarding corporate income taxes, there is a pressing need to maintain global tax competitiveness and to devise new tax systems that will contribute to the promotion of new businesses and investments. As for personal income taxes, I believe that it is important to transform the system in the direction of promoting the individual's "self-reliance and independence." In the past, Keizai Doyukai has formulated numerous series of proposals and recommendations concerning taxation, including the series of proposals submitted to the Koizumi Cabinet last

year. We look forward to reformulating our past proposals and announcing, as soon as possible, a new set of proposals regarding specific issues and general directions in tax reform.

On the question of deregulation, we note the important role that has been played by the Council for Regulatory Reform in pursuing cross-sectoral deregulatory initiatives for economic revitalization, including deregulation targeting the creation of new businesses, the vitalization of businesses in government-controlled markets, and the development of business and lifestyle infrastructures. Further to this, the Council for Regulatory Reform is considering the establishment of special deregulated zones, the success of which will, it is hoped, provide a breakthrough in regulatory reform. Keizai Doyukai will tender its full support and cooperation to all such activities.

No economy can function properly in the absence of a sound financial system. Action must be taken to resolve the problem of non-performing loans, to restore Japan's financial institutions to health, and to strengthen their international competitive position. The sense of lingering insecurity and instability must be eliminated as soon as possible, both within Japan and throughout the world. We look forward to the continued efforts of the principal parties and all related persons.

4. Challenges Facing Keizai Doyukai

I would like to comment briefly on the activities of Keizai Doyukai during the past year and those we plan to engage in over the next 12 months. The *raison d'être* of Keizai Doyukai lies in the fact that ours is an organization in which corporate executives participate as individuals. As such, our mission is to provide a forum for discussion and debate that rises above the specific interests of individual industries and companies; and our task is to give expression to views from the perspective of the overall national economy. Herein lies the significance of Keizai Doyukai, and that significance is on the rise. As we strive to function as the conscience of the business community, society's expectations of us will be all that much greater. Therefore, I believe that the key questions we must put to ourselves are: Do we, as corporate executives, have the courage and high aspirations to rise to the occasion? And, does Keizai Doyukai have the strength to respond to the expectations of society?

In order to respond positively to this challenge, we have made a number of changes in the organization and management of Keizai Doyukai, in order to energize the necessary activities. I can state with confidence that we have actively and energetically explored all avenues of change through our Committee for Revitalization of Keizai Doyukai. And those efforts have begun to bear fruit. For instance, as a result of various changes made in the Board of Trustees, including the scheduling of meetings, the number of participants has increased and we have been able to enjoy a far more active exchange of views than in the past. The revisions to the Articles of Association that were adopted today appoint Trustees as the legally appointed Trustees, and allow for an increase in the number of vice chairpersons. These revisions, combined with the proposed changes in committee structures outlined in the Operations Plan, will promote the development of a framework for the active and open management of our organization. Taking full advantage of these new arrangements, Keizai Doyukai will continue, as it did last year, to present its position on such questions as new nation-building, new corporate models, the relationship between corporations and politics, and corporate governance. Indeed, we look forward to effectively communicating our views by developing positions that are rational and well thought out and then presenting those in the form of concrete and easy-to-understand messages.

During the new fiscal year, we shall pay special attention to the development of the concept of "market evolution" advocated in our 21st Century Declaration. In order for the Japanese economy and Japanese companies to stand shoulder-to-shoulder with their competitors in the global marketplace, the functions of the market must be effectively reinforced. In order to link this to the creation of a better Japan and to regain the confidence of society, we must develop market structures that go beyond the assessment of economic value alone; they must also be capable of including social and human elements as part of an overall estimation of corporate value. For this purpose, our companies and executives must not be satisfied with playing a passive role, whereby they merely react to social change. Rather, they must play the important role of taking the initiative to present their convictions to the market and to act positively on the market.

We will also over the next fiscal year continue to undertake activities such as fiscal reconstruction programs and radical reforms in the relationship between central and local governments. The All Keizai Doyukais' Conference on Fiscal

and Administrative Reforms of Local Governments, which represents a joint project of the local Keizai Doyukais throughout Japan, is scheduled to arrive at its conclusions during the current fiscal year.

Keizai Doyukai will continue to adopt an even more active stance as a policy-formulating and policy-proposing organization of corporate executives. For this purpose, we will be calling on our members for their active participation and cooperation in our activities.

Closing: Towards the Re-establishment of Personal Governance

Keizai Doyukai's 21st Century Declaration contains the following expression of our resolve:

"Now is the time that leaders from all social groups and strata must work towards gaining a common feeling of accord amongst the people regarding the necessity for reform, as well as the new possibilities that such reform will bring, so that new energy can be generated from this awareness. To this end, we have to take the initiative to engage in reform ourselves, mustering the high aspiration and strong determination to go forward to meet the momentous challenge, and to have the courage not to shrink from creative destruction."

As I have often said, the establishment of personal governance and the recovery of trust and confidence stand as the most essential elements in making firm the foundations of corporate and national governance. We must ask ourselves: What good can result from the best and strongest systems of corporate and national governance if the will to utilize these structures is missing in the individual? Thus, the establishment of corporate governance requires a personal commitment on the part of corporate executives to a code of conduct that places top priority on high aspiration and ethical standards. As for national governance, this requires that our politicians and bureaucrats adhere to a high sense of mission and morality in the pursuit of their functions. Finally, in order to establish social governance, each of us must nurture and act with a well-developed sense of public-mindedness as we function in our roles as citizens - in other words, as consumers, employees, voters, or as individual components of society. Indeed, as members of Keizai Doyukai, we shall continue at all times to remind each other of our allegiance to an organization of corporate executives whose key characteristic is its strong sense of public-mindedness.