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(Tentative Translation)

Towards a New East-West Relationship

Address by
Former Prime Minister NAKASONE
at the Berlin Japanese-German Center

16 September 1988

Governing Mayor of Berlin,
President of the Berlin Japanese-German Center,
distinguished guests,
ladies and gentlemen,

It gives me very great pleasure to be a guest speaker at this Hakone Conference here at the Berlin Japanese-German Center and to have this opportunity to say something of my thinking on international relations, in particular, East-West relations.

About three years ago, in fact, on May 5th, 1985, I visited Berlin after taking part in the Bonn Summit meeting. The distressing sight of the former Japanese Embassy, severely damaged in 1945, filled me with emotion. The magnificent neo-classical columns of the façade still stood, but there were sad gaps here and there in the walls. The Imperial chrysanthemum crest, which must once have shone golden in the light, had survived. In that sad scene, a rhododendron caught my eye. It was blooming sturdily beside the broken walls. Seeing that flower, I was deeply moved by the vitality of Nature, which lives through human struggles and their aftermath. How small and finite man's deeds are, and how indifferent to them and how infinitely Nature's life continues.

Moved by the emotion I have mentioned, I composed three haiku here in Berlin three years ago.

- Buds have sprouted out
of the rhododendrons
Against the walls marked by
the scars of bullet shots
- Through young foliage of spring green
the sun shines ubiquitously
Both in the West and East of the Wall

- Swim as he did
 across the water in vain
Besides his tomb
 a flower of violet blooms

During World War II, Japan and Germany fought in alliance, and both were defeated. Both reflected deeply on the actions of their former leaders. We resolved to pursue the eternal values of justice and the other ideals that flow as the mainstream of universal world history. We established new political systems on the ruins, recovering, phoenix-like. We are both determined not to repeat the mistakes of the past--militarism, ultra-nationalism, inhumanity. We are reconciled with the nations of the world. We may say that it is particularly appropriate that the former Embassy of Japan has started a new life as the Berlin Japanese-German Center. It is a centre for international exchange in culture, not only between and for our two countries but also for the Europe-Japan relationship, and for world peace. I rejoice at and celebrate most sincerely the birth of the Center, and would like to express here my most heartfelt thanks to the German Government, the City of Berlin and all concerned for their generous contributions to the rebirth of this splendid edifice and the birth of this invaluable new institution.

Ladies and Gentlemen,

On July 21st this year, I had the opportunity to address the opinion leaders of the Soviet Union at the

Institute of World Economy and International Relations of the Science Academy. Today here in Berlin, the crossroad between East and West, I would like to give you the gist of what I said, with some additional remarks to help to further explain how I see East-West relations well into the 21st century.

Looking back on the East-West relationship since the end of World War II, we see that its history is marked by changing trends of confrontation and collaboration. It is a history of conflict and compromise between the Stalinism and expansionism of the East and the policy of containment extensively pursued by the West. That is to say, in the great tide of history, there were, on the one hand, events which heightened tension, such as the lowering of the Iron Curtain, the Korean War, the Berlin Blockade, the Cuban crisis, the Afghan invasion, and, on the other hand, efforts which eased tension, such as the Partial Test Ban Treaty, the Non-Proliferation Treaty, the Antarctic Treaty, the SALT Treaty, the Helsinki Accord and, most recently, the INF Treaty.

But I believe we should bear in mind the fact that, even within the Soviet Union, one is beginning to hear criticism of Stalinism and the excessive Soviet defense policy of expansionism which destroyed the mutual trust between the East and the West immediately after World War II and resulted in a stand-off between the two blocs. I understand that the Soviet Union has started to talk in

terms of "reasonable sufficiency" with regard to its defense capabilities. At the same time, the rigid perception of the West which evolved from its policy of containment is also becoming obsolete. And so I think the opportunity is emerging to sweep away the remnants of those policies and to establish a new East-West relationship. The Helsinki Accord seems to be a milestone in Europe toward that end.

From this point of view, I appreciate the "new thinking" that has been advocated recently in the Soviet Union, and the concrete steps it has taken in its external relations, such as the conclusion of the INF Treaty and the withdrawal of its troops from Afghanistan. I hope that such positive actions will be further accelerated. No doubt Soviet awareness and reflection upon the deadly threat posed by nuclear weapons and the pressure on the national economy brought about by the excessive stockpiling of nuclear weapons to the point of overkill were behind the conclusion of the INF Treaty. I think, however, that the deployment of INF missiles in Europe to counter the SS-20s was in fact the key element in the implementation of the global double-zero option, and I referred to it as a historic fact in my speech in the Soviet Union.

I believe there are two important prerequisites, if we are to restructure the East-West relations constructively and safely.

First it is necessary to build up confidence between East and West, which should be verifiable. We must, as a first step, explore the possibilities for appropriate disarmament in the area of the conventional military capabilities of NATO and the Warsaw Pact Organization. Included must be effective and credible arms control measures, measures that take account of the response capabilities of the two sides to threats, particularly the character and mobility of the forces involved, and also the prohibition of chemical weapons. We must also work for a stable framework for global security that both East and West may be confident will function successfully, while we maintain the minimum deterrent necessary.

It is essential that the United States and the Soviet Union now make determined efforts to conclude a START Treaty, and that, to that end, Western solidarity and cohesion be strengthened in support of the United States. I hope, however, that even before that, indeed immediately, there will be progress in dialogue directed towards the early commencement of arms stability talks aimed at rational reductions in conventional forces so that the CSCE Accord may be fully implemented, and developed further. I also desire most earnestly to see the earliest possible agreement in the negotiations for a convention prohibiting chemical weapons.

The other important prerequisite is very considerable expansion of interchange between the Soviet Union and the East European countries and the countries of Western Europe, in the areas of information, people and the economic fields, with respect for each country's self-determination and for human rights. I greatly desire to see political freedom and democratic institutions independently chosen by the people established in Eastern Europe. In this context, I attach very great importance to the 'perestroika' and 'glasnost' now being pursued by the Soviet Union.

When we contemplate the future of the East-West relationship based upon the two prerequisites I have mentioned, there are three courses conceivable.

The first course would simply be the maintenance of the status quo.

The second would be the significant improvement of the relationship by building on the fruits already achieved through negotiation and dialogue.

The third course would be for the two sides to completely abandon their respective policies of Stalinism and containment and to realize a major worldwide reconciliation according to new principles and systems, and a normalization of the East-West relationship.

Although the second course is probably the most realistic one, I believe that we should work steadily to

create the momentum that will allow us to pursue the third course. Because in the long run, this is the course that will lead to the stabilization of the East-West relationship and the establishment of cooperation and interdependence in politics, economics, culture, and various other fields. Needless to say, since this path is a very difficult one, we must always proceed with our eyes fixed on the reality. Progress in achieving this new relationship must be supported by concrete action and must not be simply a question of mood, like "détente".

We should try and improve East-West relations through dialogue and negotiation; seek to solve various world problems and regional conflicts, without resorting to arms but in a harmonious manner through consultation; and dramatically strengthen relations of free international exchange and interdependence, while stressing the enhancement of economic rather than military capabilities and the improvement of the living standards of our peoples. For is it not precisely through endeavours in these areas that we might find a means of fostering a "Spirit of the Twenty-first Century", that is, a spiritual energy that would guide the world and provide the foundation for a new era.

I made these points in my Moscow speech, which I had the opportunity to summarize it on Soviet television. I

believe they struck a responsive chord among many people in the Soviet Union for the following reasons.

First, in the current international circumstances, it is apparent that the traditional concept of security has undergone changes. It cannot be denied that nuclear weapons have been effective as an umbrella of deterrence against nuclear war and large-scale conventional war which could lead to nuclear war. But their deterrent value is less evident when it comes to non-nuclear countries, as demonstrated by the conflict in Afghanistan and the civil war in Vietnam.

The influence of military power in international politics is waning. I believe that from now on, and into the twenty-first century, the political focus is likely to shift and home in on economic and social welfare issues, rising nationalism and the proper way to deal with it, and efforts to adjust to the high-tech information age. I am hoping that in implementing "perestroika", the attention of the Soviet leaders and people will be diverted from military capabilities to these other areas.

Secondly, the peoples of the Soviet Union and the East European countries are beginning to express their desire for greater political freedom, human rights, and the enhancement of democratic institutions which give them the opportunity to choose their own destiny according to their own will and values. I earnestly hope that, should

these activities gain momentum in the future, "perestroika" and "glasnost" will be developed in such a direction as to avoid a repetition of the various tragedies that resulted from oppression and military suppression in the past. It would seem that the most realistic approach would be through cautious and gradual changes for a "soft-landing."

In my meeting with General Secretary Gorbachev, last July, he declared, "the Soviet Union will walk along the path on which it set forth in 1917, and the reforms in the Soviet Union can only be implemented within the framework of socialism and on the basis of socialist values. That we will sooner or later abandon socialism is just an illusion entertained in the West." He also said, with respect to socialist countries other than the Soviet Union, "every country should be entitled to the right to choose its own form of socialism and to select its own way of developing its society." But in an interview with the Washington Post, Mr. Gorbachev expressed the view that interference from any side is impermissible, but that before the incidents occurred, there was interference of a different kind.

In any case, it is now of utmost importance to foster an international environment which guarantees to the people the right to make independent and free choices in the management of their national economy or in reforming

their political institutions. Outside interference of any kind in the domestic affairs of a nation must be avoided. And the most important factor in the future East-West relationship is the development of international opinion as well as an environment and arrangement which will prevent such interference. That is why I earlier suggested that a "soft-landing" approach, that is, one of gradual change, would be the most realistic.

In his famous speech in March 1946 in Fulton, Missouri, Sir Winston Churchill stated that an iron curtain had descended across the continent. If Sir Winston were alive today, I would be very interested to solicit his thoughts on improving the East-West relationship.

Ladies and Gentlemen,

I would, now, like to touch upon Japanese-German ties and cooperation.

After the Meiji Restoration of 1868, the Japanese Government actively promoted modernization, in such fields as the political system, the economy, military, and culture generally, being determined to catch up rapidly with the advanced countries of Europe and North America. Especially, we began work on a constitutional system, preparing for the creation of a national Diet, parliament. It was a German lawyer, Hermann Roesler, who

advised the Government on the drafting of a constitution. Japan established its national Diet and adopted a constitution of the German type. With the promulgation of the Constitution of Imperial Japan in 1889, Japan became the first constitutional monarchy in Asia.

Japanese, of who I am one, who received their high school and university education in the pre-war period grew up with a very marked influence from Germany in the areas of thought and the arts. I was tremendously impressed and influenced by German Idealism and Romanticism, expressed by Kant, Fichte, Schelling, and other thinkers and writers. In music, I was particularly charmed by Baroque and Classical music of Bach, Händel, Gluck, Haydn, Mozart, Beethoven, and by the German Romantic composers, such as Schubert. The dazzling impression those great philosophers and composers made on me in my youth still remains in my heart and soul.

The constituency I represent in Parliament is located about 150km north-west of Tokyo. It is in a prefecture of great natural beauty, one made up of mountainous, agricultural and industrial regions. The mountainous part includes an area 2,000 meters above sea level that is designated as a National Park. It contains a large hot spring, Kusatsu Spa, at the foot of the Shiga Heights, sometimes called the "Tyrol of Japan". It is a spa where one can enjoy skiing in winter and golf and walking in summer.

Kusatsu Spa became famous throughout Japan after Dr. Erwin Baelz, a German medical doctor, made the benefits of that hot spring widely known a little over a century ago. A music festival, the Kusatsu International Summer Music Academy, featuring mainly German music, is held there in August every year. Many people, music students, music teachers and musicians, gather there from all over Japan. For two weeks they enjoy practice sessions in German music; Baroque represented by Bach as well as classical and romantic. They also enjoy concerts and music lessons. I myself had the honour to welcome Their Imperial Highnesses The Crown Prince and Princess to Kusatsu for one of those concerts.

Every summer, outstanding musicians come to Kusatsu from all parts of Europe and give instruction to young musicians. Such visitors from Europe include Kôji Toyoda, First Concert Master of the Berlin Radio Symphony Orchestra, the pianist Gabriel Tacchino, the violinist Devi Erlie and the cellist Maurice Jeandron. You may be surprised to hear that German music and Berlin have such an intimate connection with a countryside spa in Japan. But there is such a link--one that grows closer every year. This year's Festival was the ninth.

Ladies and Gentlemen,

Differences between Orient and Occident have generally been discussed in terms of culture--thought,

way of life, and so on. I have myself often described the contrast between European culture and oriental culture, of which Japanese culture is part, using the terms "the culture of knife and fork" and "the culture of chopsticks". Western civilization, which has developed, principally, on the spiritual foundation of Christianity, which is monotheistic, and on the principles of individualism and democracy, gave birth to modern science and technology. Japan, on the other hand, is a society with an indigenous polytheistic religious tradition and with Buddhism and Confucianism as the main elements of its spiritual and intellectual foundation. The Japanese desire to live together with Nature, considering Man as a part of Nature. We have evolved a society which values the harmony, peace and order of the community, with a philosophy of Nature and a way of life that are in certain significant ways unique.

With this historical and social foundation, Japan then imported much of your culture, and has built today's modern nation, with its economy and technology, reconciling our own tradition and modern science and technology.

Germany has achieved, despite ordeals, truly marvellous recovery, with a renewed commitment to the universal values based on all that is best in the German spirit and solidarity. No one can fail to feel the most acute

sympathy for the people of Berlin, a city that still retains its postwar "international" status, more than forty years after the Second World War ended. No city can demonstrate better than Berlin the importance of liberty, democracy and peace. I would here like to pay tribute to the people of Germany and the citizens of Berlin, who have so consistently demonstrated their commitment to freedom, democracy and peace, and have achieved so remarkable a reconstruction, with the historical destiny and the ordeal that have gone with their being where East and West meet.

As we approach and enter the 21st century, there must be increasing mutual understanding, not only between Japan and Germany, or Japan and Europe, but among all nations. Berlin is a city which can quite appropriately provide the setting for such understanding among all the nations, just because of the uniqueness of its character and situation.

It is therefore meaningful that the Japanese-German Center was founded here in Berlin. I hope that the Center will be in every way a forum where all the nations and all cultures may meet for creative activities.

We find both differences and similarities among nations of the world. It is, above all, the human mind that ceates division or unity on the globe. As the earth becomes smaller and smaller, with advances in electronics and transportation, the ideal of a human race that sees

itself as citizens of one world is becoming increasingly 'real', one might even say, an "everyday" matter, in politics, the economy and culture generally.

The Japanese love and admire Beethoven's music. Every year in December, performances of his Ninth Symphony are given in an astonishingly large number of cities and towns, even villages, all over Japan. I am afraid I cannot tell you why a German masterpiece, the Ninth Symphony, especially the famous Choral section, should have become a regular feature of the year's end in Japan, but there is one thing I can say with certainty. We are especially moved by these words of the Chorus: "Alle Menschen werden Brüder, wo dein sanfter Flügel weilt. All men become brothers where your gentle wing rests." Every year literally tens of thousands of Japanese sing and hear these words, and think of Berlin.

Thank you.

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H A K O N E X

14-16 September 1988, BERLIN

EUROPEAN INTEGRATION: MOVING TOWARDS 1992

Dr Helen Wallace
The Royal Institute of International Affairs

- 1 The achievement of a single market by the end of 1992 is a serious objective. It is being pursued by a European Community (EC) which is in good shape. There is widespread recognition by both governments and economic actors that a more integrated economy in Western Europe is a long-overdue necessity. The Cockfield programme is sufficiently well-defined for people within both EC institutions and member states to believe that considerable progress along the route to 1992 can be made. The EC is helped by three propitious factors - more effective decision-making, resolution of many of the agricultural and budgetary disputes and a sense of shared identity vis-à-vis the rest of the world. Yet of course achievement of the whole package is constrained. And 1992 is not the whole story.

The context

- 2 There is nothing new in some senses about the 1992 programme. It represents business left unfinished since the completion of the customs union in 1968. The 'trick' performed by the European Commission in 1985 was to identify a mass of proposals for detailed and highly technical measures in terms which had political attraction and conviction and to tie these to a timetable which looked plausible. In so doing the Commission had learned much from experience over the previous fifteen years. It had found means of presenting proposals more flexibly to accommodate the differing needs and problems of the member states. It had listened more carefully than before to the voices of the business community and taken the

views of entrepreneurs carefully into account. It had paid considerable attention to analyses of what was required to make European industry (both manufacturing and services) more competitive internationally. It had caught the mood of a moving economic debate about global liberalization.

- 3 None of this would have resulted in the purposive approach which followed the White Paper of 1985, unless several other problems had also been addressed. A crucial step was the move to make EC decision-making more effective. The Single European Act (agreed in December 1985 and eventually implemented in July 1987) symbolises this. The SEA formally sharpened up the EC's capabilities to handle the 1992 agenda, both by the specific powers for handling internal market business and by adding in surrounding commitments to tie the 1992 objective to a wider set of goals. The result was to enable each member state to see the 1992 programme in terms which included other nationally cherished aims.

- 4 But the SEA is only part of this picture. The relative effectiveness of the EC in handling the 1992 programme also results from an accumulation of experience in negotiation. Even without the SEA the EC was becoming a more effective bargaining forum. The clearest evidence of this lies in the final agreement in February 1988 at the Brussels European council on the Delors package. This set of linked deals on agriculture, financing and the structural funds was born out of long and painful controversy. Many further decisions will be needed to carry the package through. But to have moved so

far towards a structural solution was both a necessary precondition of maintaining the momentum of the 1992 programme and evidence of the resilience of the EC's bargaining system.

5 One of the crucial factors (but by no means the only one) has been a heightened sense of collective identity. The 1992 goal is not simply a reaction to international competition, but it has been spurred by a shared sense of the need to ensure that Western Europe can maintain a vigorous role in the global economy. Concern has, of course, been fuelled by the behaviour of other major actors in the international trading system. Awareness of the strength of the Japanese economy and of Europe's vulnerability to the vicissitudes of the American economy has produced a determination to enhance Western Europe's own economic and industrial capabilities.

6 But the 1992 programme is only part of the story. The White Paper of 1985 dealt with many, but not all of the measures needed to create a fully unified market. It dealt with some, but not all relevant forms of taxation. It did not cover competition and merger policy or state aids, though subsequent proposals have since been made on some of these subjects. Significantly no accompanying document has yet been produced on the external trade consequences of a single market. The Commission had repeatedly made it clear that market liberalization must be accompanied by continued joint investment in European R&D to promote technological innovation and by measures to ease the social strains of

adjustment and restructuring. But not all member governments see this same triptych. Nor is there a single and united view about the link between 1992 and macro-economic and monetary policies at European level. Most policy-makers and entrepreneurs would agree that something like the 1992 programme is a necessary condition of what the EC economy requires, but far fewer would argue that it is a sufficient condition.

Progress so far

7. In assessing progress so far with the 1992 programme some care must be taken in identifying the criteria of 'success'. One criterion is the volume of legislation agreed. A second criterion is the quality or salience of the legislation achieved or in prospect. A third criterion is the effectiveness of the measures as implemented, not merely agreed. A fourth criterion is the political momentum achieved. A fifth criterion is the change observable in the behaviour of entrepreneurs.

8. First, then, the volume of legislation so far agreed is impressive. The 1992 agenda contained some 300 measures, now 'rationalised' down to about 280. After a sluggish start some [80] measures have actually reached the Community statute book. We know enough about the rhythm of decision-making in the EC Council of Ministers to know that it is technically possible for the rest of the list to be

processed. The speed and output of the Council have dramatically increased over the last 10 years.

- 9 However, crude quantitative assessment is an inadequate measure and needs to be counter-balanced by a second qualitative appraisal. Here the evidence is more mixed. Many of the items so far agreed are minor technical matters relevant only at the micro-level. On the other hand several watershed decisions have been reached of two kinds. In some cases a line of legislation has been set in motion by key directives, including: exemplary directives to demonstrate that the 'new approach' to European standards can work; and the precedent-setting directives, such as those to liberalize free movement for certain professions. In other cases single measures have been agreed at the macro-level, which are on their own worth more than a host of micro-measures: examples include the agreements on free movement of capital, or those on respectively air services and road haulage.
- 10 It is, however, equally clear that some key areas of liberalization are likely to prove elusive. Further harmonization of taxation (VAT and excise duties are both under discussion) looks immensely difficult. Opening up of public procurement is generally argued to be a necessity, but it is by no means clear that it will be delivered for all relevant products in a sufficiently extensive form. The Commission thus far has insisted that there must be no picking and choosing from the 1992 menu. But it is a moot point whether they will be able to hold governments to this

and the new Commission to take office in 1989 could take a different view. Moreover, a degree of influence is exercised by the priorities of individual national presidencies of the Council of Ministers.

- 11 Thirdly, it must be stressed that to agree the legislation is not enough. EC legislation, most of it in the form of directives for 1992 purposes, then has to be implemented by the member states. This requires two different forms of consequential action. One is to translate the directives into national law in a satisfactory form and to time. All the evidence to hand suggests that this will continue to be a problem for some member states on the whole range of legislation. And on each item there is always a risk that one or other member state may seek to recoup by flawed or delayed implementation what it has lost in the negotiating forum. But even if all member states have technically processed a directive properly, it still has to be enforced and to make a real difference to business behaviour. Again we have plenty of evidence to indicate just how difficult it is to achieve the level playing field intended. In this respect it is a great advantage to the EC to have a European Court of Justice with the powers and the vigour to be an effective enforcer. However, it can handle only those cases which are brought to its attention and it has constant backlog of cases to be processed. Nor does the Commission have enough staff to monitor thoroughly all relevant areas of legislation.

12 Much then depends on a fourth factor, namely the degree to which political momentum can be sustained. Thus far the high political profile of the 1992 goal has been an invaluable asset to the drafters and negotiators dealing with the details. Most governments proclaim the priority which they attach to maintaining progress, and both the Commission and European Parliament share this sense of purpose. To a surprising extent the endeavour has caught a wider public imagination and the attention of the media. It will not be easy to ensure that this political dimension continues to pervade the climate of negotiation, especially given the tedious character of some of the technical issues. However, the 1992 goal has become something of a touchstone for demonstrating the viability and credibility of the EC as a whole, which helps to retain political commitment. But, as will be argued below, rumbling beneath the surface are several issues which could generate serious political controversy within and between the member states.

13 The last and perhaps the most important factor which will determine the 'success' of the exercise is what happens at the business level. Much of the public discussion on this has been couched in terms of numerical surveys of the extent to which business leaders are aware of 1992, with many opinion polls published and more envisaged and information campaigns under way in several member states. Here the picture is patchy with French business people apparently far ahead of their counterparts in other member states who are only slowly catching up. However, discussion in these terms

does not do justice to what is happening on the ground. The 1992 programme would almost certainly not have got off the ground had it not been for the keen pressure from leading industrialists. The activity of the European Round Table of Industrialists is only one, albeit important, example of such pressure. Many large companies in all EC countries have for some time recognised the importance of being able to operate across Western Europe and indeed globally. Some smaller companies have established themselves, or can see the scope for establishing themselves, as niche suppliers and others have to operate internationally to find markets. Thus it is by no means a question of the business community simply following the 1992 legislation. Many are involved in defining the issues and negotiating the details. After all the 'new approach' to European standards precisely seeks to involve industrialists directly through CEN, CENELEC and national standards institutes.

- 14 However, beyond this is the question of long term changes in the business culture and corporate strategies. Here it is too soon to judge. For all the alertness of parts of the business community, many European entrepreneurs have lived in a parochial, blinkered and cushioned national environment. Long-term efficiency and competitiveness require new business strategies. Companies are making plans now which will bear fruit only in some year's time. The extent to which they plan on the assumption of completing the internal market will in itself make a difference to the viability of the exercise. At this stage the omens are difficult to read: some companies

are making great play of their preparedness for 1992; others are more discreetly pondering their strategies.

The problems to be confronted

15 A plethora of critical issues has to be addressed if the 1992 goal is to be achieved, even supposing that it is technically feasible. Most people assume that the full list of measures will not be agreed by 31 December 1992. The question is whether enough of those that count will be in place and the climate set for moving ahead, albeit more slowly, with the rest. The critical issues are broadly as follows:

- (i) how far the process of market unification in Western Europe should be by 'deregulation', ie. the reduction of legislation and rules, or how far by 're-regulation', ie. the replacement of regulatory measures at national level by detailed European legislation and rules, in other words touching some central questions of economic philosophy;
- (ii) where the boundaries should be drawn between the powers of the EC and the powers of the member states, a question which raises practical matters of efficiency and delicate matters of sovereignty;
- (iii) the extent to which the removal of economic barriers should imply or depends on the removal of physical controls at intra-EC borders, ie. touching difficult questions about instruments to control or contain problems of immigration, animal and plant health, drugs, terrorism, crime (eg. fraud) etc;

- (iv) whether, and if so how, the EC should bear a responsibility for easing the social (ie. labour market) adjustment which should logically be a likely concomitant of the intended process of industrial rationalisation;
- (v) the way in which perceptions and analyses evolve on how the benefits of integration are distributed, ie. not just the labour market, but regional, sectoral and country distribution of adjustment costs and efficiency or competitive benefits;
- (vi) the degree of progress achieved in related areas such as competition policy or macro-economic and monetary policy, where views differ as to which are necessary corollaries; and
- (vii) the kind of external trade policy appropriate for a unified EC market and the arrangements to be preferred for handling the EC's continuous dialogues with its major trading partners.

16 Some of these issues are already surfacing in the debate within the EC. Others remain latent. All of them could generate lively debate. Many of them will find opinions deeply divided in the EC, as much within as between member states. At one level the 1992 programme is a matter of technical alignment, with many practical benefits to be won but in terms which are policy-neutral as regards political and economic values. But at another level the whole exercise reaches deeply into the European body politic and thus touches

highly sensitive issues of political persuasion and economic doctrine.

17 Briefly then, each of these potential nodes of controversy needs to be spelled out. First, the issue of deregulation finds EC governments and political parties pulling in different directions. The global economy is becoming more integrated in ways which makes it increasingly difficult for individual countries, or even a tight-knit grouping such as the EC, to interpose regulatory barriers between itself and the rest of the economies of the liberal industrialized world. However, not everyone in the EC would accept the current British government's attachment to the free play of market forces, and even the position of the British government is not always consistent with its own doctrines. Of course there are left-of-center governments which take a more interventionist stance, but the debate is not a simple one between liberals and interventionists. The Spanish Socialist government is after all increasingly liberal and the coalition government in Germany remains cautious about the pace of liberalization. And the weight of the German economy makes its position especially important.

18 The appropriate division of powers between the EC and the member states is the oldest debate in the Community book. Much of the 1992 exercise rests on the assumption that a commonality of EC approach is desirable and unavoidable for practical economic reasons. But the methods used, not least legislation by directive, presuppose a continuing

partnership. In the discussion of tax harmonization the issue of sovereignty has arisen explicitly, even though this has somewhat distorted the debate about the practicalities of taxation. In her much-quoted radio interview of July 1988, Mrs Thatcher challenged the recently stated view of Jacques Delors that more and more legislation would have to derive from Brussels. This debate will continue.

19 Physical controls at borders within the EC have been an impediment to certain kinds of trade and certainly impose costs on European industry. Psychologically they do not promote a sense of shared European identity. Yet the ability to control its boundaries is a crucial prerogative of the state. Moreover many national policies and some national trade agreements (eg. quotas) agreed through the EC presuppose the continued existence of border controls. The odds are therefore that there will be in 1993 some continuing physical barriers within the EC, though administrative formalities will be much simplified. But one should not underestimate the extent to which surviving controls will result from habit rather than a reasoned assessment of efficient enforcement.

20 The social dimension has for some time been a controversial issue within the EC with views split on how much 'social engineering' is desirable or feasible. In the 1992 exercise two issues arise: first, how far alignment of company law may be required and if so with what component on workers' representation; and second, the extent to which some cushions

should be provided to ease adjustment, as they have been, for example, under the European Coal and Steel Community. This is partly a left/right issue and partly a question of carrying organized labour along with a process of economic change. Jacques Delors and a succession of Council Presidencies (Greek, Spanish, French) insist on the importance of an active social dimension. From among both some governments and many industrialists resistance will continue to be expressed.

21. The cool analyses of the likely consequences of 1992 suggest that the benefits and burdens will be widely spread and that overall the resulting growth prospects should benefit the EC as a whole. However, there are already within the EC considerable regional and inter-country disparities. It is understandable that there should be some voices raised in anxiety. The agreement to double the structural funds (reached in February 1988) has made the atmosphere calmer than might otherwise have been the case. But a watching eye needs to be kept on the potential for further disquiet, not least because it may be translated into heightened concern lest some companies with parentage outside the EC benefit more than some indigenous and indigent Europeans.

22. Policy-makers in the EC have to tread carefully the line between under-playing and over-playing the size of their ambition. It is almost certainly the case that the 1992 programme will disappoint, unless some other corollary measures are agreed: competition and merger policy provides

an instance of a need to develop and to an extent revise existing EC rules. Proposals are under discussion but much more remains to be done and here both effective enforcement and sensitive interpretation of the rules are required. Potentially of course the 1992 goal could be taken to cover macro- as well as micro-economic policies, but that in turn takes policy-makers into difficult waters. Though the debate on macro-economic policy and monetary policy will continue during the same time scale, if too close a link is made with the single market, it could backfire by slowing the pace of negotiations and complicating the discussion.

And so to trade

23 Where then does this leave the EC's relationships with its main trading partners? The bottom line is that the EC and its members do not make good trading partners or satisfactory markets, unless the West European economy is in good shape. 1992 is one part of an effort to secure this end. But the EC is also a powerful force in international trade negotiations and can use its bargaining power and trade instruments in ways that have important consequences. Broadly the key factors are as follows:

- (1) logically and practically some trade policy issues follow directly from the plan to unify the internal market, notably as regards surviving and separate national trade restrictions (as for example on textiles and automobiles), where the minimum sensible outcome would be to agree on an EC-wide set of arrangements,

though more radically abolition of such restrictions is in theory possible;

(ii) careful negotiations will have to take place about access to the desired 'level playing field' within the EC, where firms of clear European parentage will expect no discrimination, but there will be serious pressures to resist extending such access to all firms of non-European parentage, and to define a 'European' company is no simple task;

(iii) but this difficult debate is unavoidably linked to the issue of reciprocity and the character and mood of other international trade negotiations, where the EC will have a double concern, partly to maximise its bargaining power and partly to diffuse intra-EC tensions through external policy actions;

(iv) and meanwhile some countries or groups of countries are in the process of seeking to redefine their trade (and to an extent broader relations with the EC), notably the East Europeans and the EFTA countries, with several other countries in the wings (notably Turkey and the Maghreb).

24 It is difficult to predict how these difficult issues of external trade policy will be resolved. Within the EC there are three camps: the broadly liberal; the instinctively protectionist; and the waverers. None of the three can command a majority. The stance of the EC is not likely therefore to be sharply defined as either clearly liberal or clearly protectionist. Far more plausible is the scenario in

which the EC continues to have something of a split personality on trade issues, more liberal in some cases, more restrictive in others. Much of this continuing debate will be driven by political, economic, social and industrial pressures within the EC. But equally the debate will be shaped by both the pressures of global economic forces and the actions of the EC's trading partners.

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The Changing International Economy and
the Challenges for Japan and Europe

Akira Kojima

The world economy is presently suffering the worst case of structural imbalance since the end of World War II, as evidenced by the fall of the United States to the status of debtor nation and by the accumulation of debts by developing countries. But the problem is not confined to the United States or any other specific country. Indeed, the world economy as a whole faces a serious systemic crisis. In a broad historical context, the age of two superpowers--the United States and the Soviet Union--is over, and we are witnessing a hegemony shift in the global power structure.

Neither Japan nor Europe can afford to view the problems tormenting the United States and other countries as none of their affair. Europe is alive with the promise of full integration slated for 1992. Europessimism has been replaced by "Euro-dynamism." Nevertheless, Europe should not think itself immune to the effects of the U.S. economic troubles or the crisis of the dollar. The crisis is not in the United States alone; it is one that pervades the entire world economic system in the throes of hegemony shift.

Any notions of seeking to build "fortress Europe," I believe, could cause self-destruction. The United States has squarely faced the reality of the multipolar power structure, and adopted realistic domestic and foreign policies. Should Europe create an exclusive regional bloc, American realism might turn into narrow nationalism and unilateralism.

To avert such undesirable consequences, Europe and Japan should strive to make their economies as open as possible to the outside. In the course of hegemony shift, burden sharing is expected to emerge as an important issue among major countries. Deepening interdependence in the real sense with other countries and shouldering an increased share of burden in order to prevent the multipolarized world economy from collapsing are the responsibility--indeed the challenges--that Japan and Europe must undertake. Cooperation among the leading industrialized democracies will be of crucial importance in the coming five or ten years.

Implications of America's New Debtor Status

When the United States became a net debtor nation in 1985, the economic disequilibrium it had suffered became almost synonymous with the disequilibrium of the global economy as a whole. The U.S. trade balance, structurally in the red from the end of the 1960s to the beginning of the 1970s, led to President Nixon's New Economic Policy and the dismantling of the Bretton Woods system. If nothing is done about the current U.S. crisis, global trade and monetary systems will also totter. America's current accounts deficit of \$100 billion per annum and its net accumulated debt are unsustainable. In 1985, when the United States turned debtor, it was historically inevitable that American leaders should suffer "sustainability shock."¹ So was the Plaza Agreement of the Group of Five. Because it was historically inevitable, the agreement was endorsed at the Tokyo summit of seven advanced nations held the following year.

Never before in the history of the world economy has there been a case in which a key currency country became a debtor and still maintained its position as key currency country. That is what makes

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the crisis so serious. The U.S. dollar problem is not a mere currency problem caused by twin (trade and fiscal) deficits. It poses geopolitical problems as well as economic problems. Adjustments on the part of the United States alone are far from enough; the financial restructuring of Pax Americana, involving its major allies, is vital.² If a world economic crisis is to be averted, the snowballing of the American debt must be halted as soon as possible. Former U.S. Secretary of Commerce Peter Peterson described the situation as follows.³

The consequences for our trade performance have been direct and extreme. Back in the spring of 1981, supply-side optimists within the administration were forecasting a \$66 billion trade surplus by 1984. Instead, we ended up with a \$123 billion deficit in 1984, which grew to a \$170 billion deficit last year. In the manufacturing sector of our trade account, meanwhile, we have gone from a surplus of about \$20 billion as recently as 1981 to a \$140 billion deficit last year. This negative swing of about \$160 billion amounts to a stunning 4% of our nation's GNP, and about 20% of our manufacturing output. To put this swing into a global context, this swing is equivalent to about one-seventh of the world's manufactured exports.

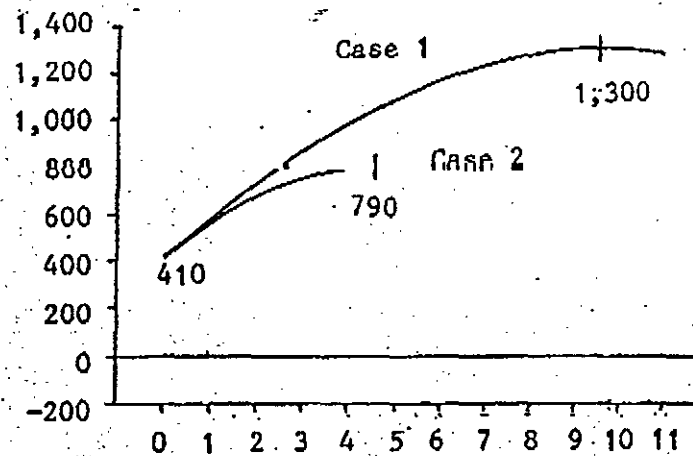
The gravity of the situation is illustrated in the graph below, taken from the report of the MITI Ad Hoc Committee on Options for the Nation (1988). If the growth of the U.S. debt is to be halted in ten years (Case 1), the United States must cut its trade deficit by \$24 billion each year. In this case, the debt will peak in ten years at \$1,300 billion. The amount of additional financing the United States will

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U.S. External Imbalance: Magnitude and Impact

Magnitude

(Unit: \$1 billion)



Case 1: Debt stops expanding in 10 years

Initial net external debt ... \$410 billion
 Interest rate ... 5%
 Initial current deficit ... \$150 billion
 Initial trade deficit ... \$170 billion

Annual amount needed to ameliorate trade balance: \$24 billion

Case 2: Debt stops expanding in 5 years

Initial net external debt ... \$410 billion
 Interest rate ... 5%
 Initial current deficit ... \$150 billion
 Initial trade deficit ... \$170 billion

Annual amount needed to ameliorate trade balance: \$42 billion

Impact (Unit: \$1 billion)	Case 1	Case 2
Annual amount needed to ameliorate trade balance	24	42
Accumulated debt at peak	1,300	790
Amount of additional financing needed	890	380
Trade balance (at outset)	-170	-170
(5 years later)	approx. -50	approx. 40
(10 years later)	approx. 70	
The range of improvement needed for trade balance to be reached	240	210

(Note: Trade surpluses of major surplus countries in 1986 [unit: \$1 billion]: Japan 92.8; West Germany 54.7; Taiwan 15.6; Canada 7.3; Total 170.4.)

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need will reach \$890. Even this simple forecast shows us clearly that the united States cannot achieve the necessary adjustments ALONE.

Hegemony Shift

Today the political and economic structure of the post-World War II period pivoting on the United States and the Soviet Union is rapidly changing. The trend first manifested by the "Nixon shocks" of 1971 became firmly established when the United States turned debtor nation in 1985.

Paul Kennedy is something of a phenomenon in the United States today. His weighty tome, The Rise and Fall of the Great Powers, is a top best-seller and his message has come to have profound influence on the U.S. leadership. He writes, for example, as follows:

The relative strengths of the leading nations in world affairs never remain constant, principally because of the uneven rate of growth among different societies and of the technological and organizational breakthroughs which bring a greater advantage to one society than to another.

. . . Once their productive capacity was enhanced, countries would normally find it easier to sustain the burdens of paying for large-scale armaments in peacetime and of maintaining and supplying large armies and fleets in wartime. It sounds crudely mercantilistic to express it this way, but wealth is usually needed to underpin military power, and military power is usually needed to acquire and protect wealth. If, however, too large a proportion of the state's resources is diverted from wealth creation and allocated instead to military purposes, then that is likely to lead to a weakening of national power

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over the longer term. In the same way, if a state overextends itself strategically, . . . it runs the risk that the potential benefits from external expansion may be outweighed by the great expense of it all--a dilemma which becomes acute if the nation concerned has entered a period of relative economic decline. The history of the rise and later fall of the leading countries in the Great Power system since the advance of western Europe in the sixteenth century--that is, of nations such as Spain, the Netherlands, France, the British Empire, and currently the United States--shows a very significant correlation over the longer term between productive and revenue-raising capacities on the one hand and military strength on the other.

The reliance of the postwar world economic system on the U.S. dollar and American economic strength was from the beginning unnatural. The situation that was sustained by the overwhelmingly immense economic and military strength of the United States alone may have been an abnormal one. If that is true, the decrease in relative U.S. strength would have to be viewed as a "return to normalcy." Still, for the United States itself, accepting its relatively more reduced strength as "normal" is psychologically very difficult.

During President Reagan's first term of office, the United States sought to ignore the reality of its declining relative strength, hoping to extend the dream of its superpower days once more. Its spurt of arms buildup and drastic tax cuts were tools to that end. The attempt to turn the historical clock backwards, however, was proven to have failed by 1985, and the Reagan administration revised its policies in due recognition of the realities.

The policies adopted for currency alignment and other measures in

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the months following the September 1985 Plaza Agreement, bore out that change of course.

1. The Baker plan designed to solve the accumulated debt problem of the developing nations
2. Self-initiation on the part of the federal government based on Article 301 of the Trade Act
3. Overtures for a new detente with the Soviet Union and the beginning of the U.S.-Soviet summits

The Soviet Union's superpower status had also declined, and this ushered in perestroika and brought Gorbachev to the negotiating table with Reagan.

The seventh and eighth chapters of Paul Kennedy's aforementioned book, which analyze the transformation of the bipolar structure, are said to be much discussed in the United States. Perhaps the "Paul Kennedy" phenomenon means that America has cast aside its unrealistic fantasies of continued superpower status and is beginning to confront the reality of hegemony shift.

The change of course in domestic and foreign policy begun in the latter half of Reagan's administration will no doubt be pushed much further by the succeeding administration. Whether the Republicans or the Democrats win in the coming presidential election, the fundamental course of policy is not likely to change appreciably. The new administration will probably pursue a realistic policy. Republican Senator Lugar has forecast the policy line of the new administration as follows:⁶

One of the most crucial tasks for the next president will be to negotiate much more successfully a redefinition of the roles that we and our allies must play and the accompanying

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allocation of resources to pay for those roles. Without such negotiation, the United States will fall victim to a piecemeal reordering of domestic spending priorities among legitimate demands for defense, for investment to modernize our competitive industries and social infrastructure, and for expenditures vital to the health, education, safety and economic security of American citizens. The gap between missions and means will become larger and the risks to collective Western security will increase substantially.

Similar budget and resource debates occur in every vital democracy, and the larger industrialized democracies are becoming more adept in advising each other on desired outcomes. Moreover, it is important to understand that greater burden-sharing is not confined to the defense sector. Failure to end disastrous agricultural subsidization and dumping policies, for example, can affect the political will of one ally to defend another.

The Soviet Union under Gorbachev, devoting itself earnestly to the restructuring effort under perestroika, proved itself no longer the "evil empire" and came to the negotiating table with Reagan. The new detente can be expected to be carried further under the new U.S. administration. The new government is bound to place particular stress in external negotiations on Japan and its allies in Europe. No doubt its catch phrase will be "burden sharing."

Burden sharing includes, of course, redistribution of the military burden. Defense Secretary Frank Carlucci advocates a strategy for U.S. "hegemony on the cheap" achieved by cutting back military expenditures and curtailing its geopolitical role in the world. As

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part of that policy, the United States will emphasize "geopolitical efficiency" and shift the burden and the responsibility for NATO defense to Europe.

But burden sharing is not confined to military affairs. It extends to economic cooperation, technological cooperation, macro-economic policy adjustment, opening of markets to U.S. products, protection of rights to intellectual property, and so on. Its consciousness--sense of reality--raised by the baptism of the Paul Kennedy phenomenon, the United States is sure to take a realistic approach to these matters.

The Omnibus Trade Act

The Omnibus Trade Act has come to force in the United States. But this is not an event we can really celebrate. This protectionist legislation will not inflict direct harm on other countries immediately; what arouses our misgivings is the unilateralist thinking that underlies it, as exemplified by the "Super 301" provision.

The Act itself may be relatively harmless, but how it is applied in the years to come is a matter of grave concern. Now that the law has gone into effect, Japan and Europe must influence the process of its application so that it will not do irreparable damage to world trade and the global economy.

The most effective means of achieving this is for both Japan and Europe to increase their function as absorbers of export products from various parts of the world. As observed in the report of the Ministry of International Trade and Industry's Ad Hoc Committee on Options for the Nation (1988) introduced earlier, the U.S. trade deficit ought to be drastically reduced every year. Otherwise, the United States will simply be applying the Trade Act unilaterally.

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Of course, if the United States manages to cut back its trade deficit each year and apply the brakes to its accumulation of debt, it means that the United States will cease to be the main engine propelling the world economy. In fact, this situation will generate deflationary impact. That impact should be absorbed by Japan, Europe, and the Asian NIEs.

Europe After 1992

The European countries are joining forces to create a new unity to begin in 1992. The world trade system will be profoundly affected by the kind of Europe its masterbuilders construct. Americans and Japanese fear that Europeans may be building an exclusive, self-contained fortress, and Europeans seem well aware of that.⁷

Any attempt by Europe to build an exclusive bloc would be self-defeating. It would only encourage American unilateralism, and lead ultimately to the emergence of other closed economic blocs elsewhere in the world. The greatest challenge and task European countries face is their responsibility to dismiss the thought of creating a "fortress Europe" and build an open economic zone.

No matter how stalwart a "fortress Europe" they might build, in any case, Europeans will not find themselves immune from the economic adjustments and disturbances going on elsewhere. Neither can they avoid the effects of hegemony shift. The United States no longer possesses overwhelming power and leadership in the Western world, and there is no country, actually or potentially, that might take over in that role. Nor is there a currency that could replace the dollar as a key currency. The possibility that the world might one day revolve around the European currency unit (ECU) alone seems very remote.

The hegemony shift is in steady progress, but little progress has

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been made among the major powers in adjusting responsibilities and burdens to conform to the new power structure. If Europe tries to create a closed bloc, the United States will probably respond in kind, by building "fortress America." The United States is now sounding out Japan and South Korea on the feasibility of free trade agreements. Details are not known. In all likelihood, a consensus has not even been reached among the Americans themselves on that matter.

I wonder what Europeans think of these moves on the part of the U.S.? They ought to see it, I think, as a reaction to the exclusive economic bloc Europe may be building.

The European countries have not told Japan or the United States much about the 1992 unity. Perhaps they think it is simply their own regional affair. But in this age of interdependence, few problems are so narrowly confined. The European countries should be more frank with other countries about what they are hoping to achieve in 1992.

Adjustments in Japan

Japan is in no position to even discuss any notion of "fortress Japan." Its very survival depends on interdependence with other countries. Adjustments in Japan are being made mainly through the market price mechanism. As the strong yen has become stabilized, changes are occurring in the behavioral patterns of both corporations and consumers. Import outlets have diversified, and the price and income elasticity of imports have visibly risen since 1987. To hasten the pace of such adjustments, it is necessary to increase the number of areas where market mechanisms could work, through further deregulation. With the stronger yen, the Japanese market is beginning to be fully linked to the global market for the first time.

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NOTES

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Inquiry

ENDAKA, JAPAN, AND THE WORLD

While international economic interdependence has started developing among Western countries long ago and has dramatically increased more recently, Japan's insertion in the World economy and subsequent exposure to international interdependence is a major, relatively new factor in international economic relations, likely to bring substantive changes, even though possibly slow, to their organization. Changes in the Japanese society, politics, and economic structure may also be considerable.

A major factor behind Japanese economic and foreign policy over the post World War II period is that of dependence vis-à-vis foreign sources of supply for needed raw materials and energy. The ability of Japan to prevent that dependence from implying vulnerability has been truly impressive. The consciousness of being dependent certainly played a major role in the development of a growth strategy based on exports of manufactured goods to the rest of the World. The success of that strategy has itself created a new form of dependence, that of a supplier vis-à-vis its customers. This could have been a source of weakness and vulnerability. The dramatic rise of the yen since march, 1985, has prompted a needed departure from an export-led growth strategy to a domestic consumption oriented one. The ability of Japan to adjust so swiftly to an adverse international environment has again impressed the world. The Japanese economy is becoming a very powerful and mature economy.

One should not however disregard or underestimate the profound changes that the evolution of the international economy have brought forward over the last 15 years, and their implications for Japan and its relationship with the world. Through the building up of huge current account surpluses, Japan has become the first world net creditor, and projects its wealth and

economic strength all over the world. At the same time, the links thus created with the rest of the world have become vital for the Japanese economy. That interdependence is forcing Japan into a twofold reaction: greater reliance on its domestic economy, and some kind of "defensive leadership" in world economic affairs. One question often raised in one form or another regarding Japan, is how fast defensive leadership of that sort is eventually likely to turn into assertive behavior. A related question regards the ability of Japan to become a dominant world power, exerting political influence and economic leadership.

This paper, written from a non-Japanese point of view and with likely Western prejudices, will first address Japan's economic achievements in the face of a strong yen. It will then briefly speculate over the related implications, before addressing the broader question of Japan's role in international economic relations.

1. Endaka : the strong Yen revolution.

To be convinced that the period since 1985 can be described as initiating a new stage for the Japanese economy, one just needs to observe the evolution of the yen/dollar rate on the one hand, and of the yen's effective exchange rate on the other. Both show a dramatic departure from their historical patterns, which is not the case for the currencies of other developed countries, whose value rises back in line with past experiences. In real terms, Japan has suffered a drastic competitiveness shock vis-à-vis the United States and other industrialized countries as well. Bilateral terms of trade (measured as the relative wholesale price index, in terms of dollars) with the United States have jumped a staggering 70% since february, 1985. Effective real exchange rates for the Japanese currency also exhibit a very sizeable appreciation.

The sector of the Japanese economy most affected by that shock is of course that of export oriented firms. Here, however, we find a revealing example of the way Japan can cope with external disturbances. While wholesale prices and the value added deflator in Japan, relative to the rest of the world and expressed in a common currency (these are different possible measures of the Yen real effective exchange rate), have jumped by more than 30% since the dollar began its decline in February, 1985, the relative export price for manufactured goods has increased much less. This may of course reflect export price increases by foreign exporters, notably American, but also more likely indicates a substantial effort by Japanese exporters to safeguard market shares through squeezing their profits, thus absorbing a large part of the external shock.

That reaction however could not be sustainable other things staying equal. Exporting firms have been able to compensate for lost profits, or losses, in their sales abroad by increased activity and profit making in the home market, indicating a successful reorientation of the Japanese economy towards the domestic market.

Incidentally, the Japanese domestic market has always played a fundamental role in the Japanese impressive economic expansion. One may lose this perspective when one focuses only on the net export contribution to economic growth. There has indeed been a conspicuous success in the export sector of the economy. But the main contributor to real growth has been domestic private demand, in every year since 1968 with the exception of 1974, 1980, and 1981. Since 1968, in average, private demand has contributed 4.3% of GNP to real growth, public demand .9%, net exports .7%, totalling 5.4% total growth. Over the 1975-1987 period, private demand in average still contributes 2.7%, public demand .5%, net exports .7% .

The main departures that occurred since 1986 thus concern the relative contribution of domestic and external demand to the growth of GNP. Indeed, external contribution to growth has become negative, indicating that in spite of compensatory export pricing by Japanese firms, and along with domestic macroeconomic adjustment measures, the real appreciation of the Yen has worked powerfully. The annual rate of growth of real imports has increased from zero in 1985 to around 10% in 1987; that of real exports has been negative in 1986, but has since recovered to around 5% in 1987. This quantity adjustment has allowed for a long awaited nominal adjustment in the trade balance, as indicated by the monthly trade figures since 1986. However, the Japanese trade surplus remains sizeable, and likely to elicit renewed pressures from Japan's partners.

A very strong expansion of domestic demand altogether promoted growth of imports and of domestic production. That adjustment was successfully induced by the price and income effects of higher terms of trade on the one hand, and of course by the deliberate impulse given by fiscal policy in the second half of 1987, with the injection of 6000 billion Yens into the economy. In turn, the income effects of higher growth help sustain the volume of imports. Many observers indeed today herald a dramatic surge in imports and, more profoundly, in importing behaviors.

Does this so far successful adjustment indicate superficial reaction or does it instead announce a more profound change? Many hints would tend to privilege the second interpretation. The ability of the Japanese economy to maintain a high rate of growth despite the high yen has, paradoxically, contributed to make the high yen desirable. Induced by the new competition from imported goods, (notably from Asian Nics), price cutting has become fashionable, still adding to the income effects aforementioned. As is generally the case with a strong currency and

the effects of international competition, the Japanese industry reports sizeable efficiency gains. Productive investment exhibits healthy real growth, now taking the lead over private consumption to sustain economic growth. The Japanese enjoy their buying power abroad, at all levels of economic agents, firms or individuals. Last, but not least, a decline in the value of the Yen would now be associated with the risk of inflation. Not only has Japan learnt to live with endaka, but it also enjoys it and might try to stick to it. This makes even more likely that the adjustment we have seen so far is the beginning of something like a societal change. Lasting impact can already be identified within Japan, as well as with regard to the Japanese world posture and relations with other countries.

2. Issues of adjustment.

It is impressive to notice the extent to which the Japanese government and establishment seem to support and actively promote economic adjustment when it appears needed, while Western countries have established a definite tendency to rather try to delay it. It is not only today a matter of appropriate reaction to temporary economic conditions, but also a conviction that the time has come to redefine the posture of Japan worldwide. The domestic implications have been highlighted by the two Maekawa reports, which define a long term structural program for economic policies. Among the key recommendations are : a strengthening of domestic demand, the reduction of working hours (to an objective of 1800 hours a year by year 2000), the five-day-week, and a steady continuation of opening measures and liberalization. These reports had met a great deal of scepticism in foreign countries; the impressive debut in their implementation is all the more noticeable. They indicate a definite willingness by the Japanese government to aim at consolidating the Japanese economy, consecrating its maturity and equal footing with that of the most industrialized countries, and notably the United States. As

in the case of Europe moving towards 1992, the transition needed in Japan is now well engaged and probably irreversible. But it will not come along without entailing real pain for some sectors of the economy. This may or may not fuel some political instability and will certainly require hard political bargaining, as already exemplified by the debate over the tax reform proposal.

Already, comments abound on the cultural consequences of such a transition. A new "class" of young Japanese is said to have developed, prone to adopting "western" styles and values in their consumption behavior, ready to rent rather than own their housing, and gradually presiding over a significant societal change. On the other hand, the successful land owners or asset holders is also said to exhibit the attributes of their immense wealth with an old Japanese lack of discretion. It may indeed be the case that the Japanese society will live through a period characterized by the rise of individualism, threatening the traditional social cohesion that has stricken foreigners so much. It seems however much too early to analyze this hypothetical trend further.

Besides the cultural consequences of that transition, there are specific problems that will encumber its path: One is that of infrastructures, notably housing and land. Land scarcity has fed an uncontrolled speculation resulting in sky-rocketing prices for land and housing. While this may contribute to domestic demand expansion through the related wealth effect for land owners, this does certainly not facilitate adjustment. Another difficulty has to do with the government's fiscal stance. The 1987 program marked a visible departure from earlier caution, and from the diminishing trend formerly established in public deficits. While this departure was highly desirable from a domestic as well as an international standpoint, the basic fiscal equation remains

unaltered : The Japanese government has to contain the expansion of an important public debt, while demographic projections draw attention to the speed and extent of the ageing of the Japanese population. It is therefore likely that the expansionary fiscal stance will not be maintained.

The focus of attention has now shifted in Japan from the demand side to the supply side. Here lay additional sources of growth and dynamism; one may also argue that the Japanese economic expansion will run into inflationary problems short of a significant liberalization and deregulation, notably in the fields of agriculture, distribution, construction, transportation and communications. Market opening and deregulation have become the new avowed objectives. This comes from a qualified understanding of national interests, but is also designed to please the World outside.

3. Japan and the World

Another key recommendation of the Maekawa reports concerned the necessity to preserve a free-trading, stable, international environment, implying an appropriate response by Japan to the numerous pressures received from abroad, as well as a successful containment of conflictual situations between Japan and its partners, most notably the United States. This indicates that Japan has fully understood the implications of international interdependence.

While this should obviously be the case for other industrialized countries as well, it is impressive to notice that, in fact, Japan is the only country which tries so hard and so candidly to integrate the international dimension into its policy-making processes. It is the only country where one identifies such a

concern about how to define and assume international responsibilities. This has become a major theme in discussions with Japanese analysts as well as policy makers. Certainly, Japan is not forgoing its national interest, however defined; rather, taking international interdependence into account, with its economic and political dimensions, is understood to belong to the definition of these interests. Of course, such a posture is also designed to please other countries, to show that Japan is ready to bear its part of the burden of international adjustment. But it is increasingly apparent that this is not only a cosmetic feature in the recent declaratory practice in Japan.

A major characteristic of Japan's insertion into the World economy relates to the immense financial wealth derived from the substantial accumulation of net external assets since the beginning of the 80s. Of course, the pace of such an accumulation is slowing due to the levelling off and gradual diminution of the Japanese current account surplus. But Japan's net external asset position is still likely to increase in the foreseeable future. One first consequence is obviously the overwhelming financial leeway it gives Japanese investors worldwide. Japan has become a prime actor in all major financial markets, heavily contributes to financing the United States' current account deficit, plays a major role in the wave of mergers and acquisitions worldwide. Japanese financial institutions have acquired an international posture and strength that simply defies one's imagination. While one may speculate over Japan's role and responsibilities, the facts are there already: Japanese institutions and companies have indeed become major actors in international markets, and this trend is steadily accelerating.

One further consequence of Japanese international asset accumulation is the formidable expansion of Japanese direct investment abroad, to such extent that it is sometimes compared to the direct foreign investment boom by American companies

during the first half of the 60s. Japan's direct investment abroad began surging in 1986, jumping from 5 to 6 billion dollars a year on average to 14.5 billion in 1986, and 33 billion in FY 1987. This is indeed correlated with the state of Japan's current account; but many other explanations help explaining this investment boom, on top of the intrinsic advantages of localizing production where it is going to be sold: First of all, this trend corresponds to the growing internationalisation of the world economy, as amply illustrated by the globalization of financial activities, but also by the increasingly international horizons of industrial actors worldwide; Secondly, the protectionist tendencies have been more acute in the recent past, inducing from Japanese companies direct investment strategies designed to protect their markets by local production. One knows that this has prompted some hostile reactions from host countries, notably in the EEC where legislation on so-called "screw-driver" operations has been tightened. Thirdly, the conflictual situation highlighted by the Japanese current account surplus, as well as the employment problem that worries many industrialized countries, notably in Europe, make foreign direct investment a natural and often welcomed contribution by Japan to others' problems. Finally, the Yen's appreciation makes foreign direct investment more attractive for Japanese investors, both because acquiring a participation in foreign companies is relatively cheaper, and for relative costs-of-production reasons. Despite the likely diminution of the Japanese current account surplus, and while portfolio investment has come back into fashion, these factors seem to indicate that the expansion of direct investment abroad by Japanese companies is likely to continue.

As is well known, foreign direct investment is a very sensitive political issue. On the host country side, the benefits of job creation, of potential technology transfers, of hypothetical balance-of-payment later improvements, are mitigated by the perceived political costs of losing "national control" over

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domestic production. On the investing country side, direct investment abroad may be seen to provoke unemployment problems, as a counterpart of job creation in foreign countries. The debate that took place in the United States in the 60s amply illustrates this point. Similar concerns might well recur today over Japanese foreign direct investment. There is a widespread agreement that foreign investment is mutually beneficial for the host and investing countries; but its expansion will be subject to tense and intense negotiations, likely to shape the relations of industrialized countries with Japan in a foreseeable future, be it bilaterally or through a (preferably) multilateral approach.

4. Towards a more active international economic diplomacy.

Japan's insertion in the world economy is characterized by the strong bilateral ties established with the United States. The United States of course plays a major role in Asia in terms of political and strategic stability, as well as of economic development. These ties are of vital importance to Japan. That they would continuously generate some bilateral conflict is natural and unavoidable. Recently, and certainly since 1986, such conflict has become more frequent and more intense. The United States hardly admits that Japan now enjoys continuing economic prosperity, while it does not fully share the burden of providing for the security of the area. Moreover, The United States of course reacts very sensitively to the increased Japanese competition home. Anti-Japanese feelings in the United States are said to have increased as a consequence of the huge American bilateral trade deficit, while anti-American feelings in Japan have been reinforced by American reactions. But one should always analyze these conflictual situations in view of the fundamental interests involved. Besides intricate financial ties (notably of the debtor-creditor nature), the North American market continues to attract Japanese companies (as many others) for strategic reasons related to size, marketing and access to

research and technology. Moreover, the economic weight of Japan's relations with the United States is likely to continue tilting its international economic policy toward preserving these relations, even reinforcing them. One has an illustration with the continued expansion of Japanese direct investment in the United States, certainly linked to the market interests of Japanese exporting companies threatened by American protectionist tendencies.

Japan will certainly work to maintain its relations with the United States. But - and this is the real change taking place -, it seems to develop some interests in other parts of the world as well. At this stage, diversifying economic relations and ties appears quite a sensible strategy, all the more since the economic and financial means are there to implement such a strategy. Now more conscious of its huge economic power and eager to uphold its role correspondingly, Japan seems on its way to develop a new sort of economic diplomacy, more sensitive to other areas of the World, and using more extensively existing multilateral frameworks.

Europe has recently been angered by bilateral US-Japan agreements that basically appeared to constitute a de facto G2 managing the world economy irrespectively of Europe's role and interests. The United States may incidentally be using such agreements as a way to put European countries under pressure to adopt desired strategies. The American initiative to propose a US-Japan free trade agreement for example might be partly intended to defuse the "fortress Europe" 1992 perspective, a concern that Japan undoubtedly shares. The prospect of 1992, however, has rejuvenated European economies and restored American and Japanese interest after a period marked by the "sclerosis" syndrome. Thus, Japanese direct investment in Europe has dramatically increased, both because of renewed perceived protectionist risks and because of brighter economic perspectives. It is in the European

countries' interests that non-Europeans and particularly Japanese take part in their economic and technological development. This is again a sensitive issue, where intra-European agreement may be hard to achieve, but which will shape the relations between Europe and Japan in the future. Both Japan's and Europe's interests seem to be to reach some kind of code of conduct in the field of direct investment and market access. Obviously, these will have to be negotiated on a reciprocity basis.

The relations between Japan and its Asian partners, notably the Asian NICs, have recently exhibited renewed dynamism. Tighter economic interdependence within the area has been fostered by the more or less common success in terms of economic performance. Japanese foreign direct investment in Asian countries has surged, indicating renewed interest in the economic development of the area together with cost-induced delocalisation of production in the face of a strong yen. At the same time, exports from Asian countries to Japan have significantly increased, notably in the field of consumer electronics, thus displacing Japanese companies in the Japanese market, or sometimes constituting of Japanese products made elsewhere in Asia. This trend has prompted renewed interest in the potential of the Pacific Basin to further its economic integration. Historical legacies, cultural factors, and economic development disparities may well in fact keep such a prospect at good distance. But the fact that economic relations have developed considerably is undeniable, as is the fact that Japan now devotes part of its economic diplomacy to promoting its interests in the area. Moreover, in this respect, Japan has been keen to appear as an advocate of Asian countries' interests in multilateral negotiations, as for example in the Toronto summit in June 1988. This may be interpreted as a claim by Japan for a specific, Asia-centered role among the G7 club, and indeed as a sign that Japan is willing to assume a political role in the area on top of its considerable economic influence. A new division of labor is

emerging in Asian countries, with a three level organization : on top, Japanese financial and technological supremacy, now being delocalized; at an intermediate level, the Nics, which are steadily graduating to technological proficiency and can therefore use Japanese capital imports to produce sophisticated goods more cost-efficiently than Japan; finally, the Asean countries, whose successful economic development makes them candidates to displace from the Nics the production of manufactured goods of intermediate technology. That this new division of labor will generate competition and conflict is obvious. One can therefore expect as well a tightening of cooperative efforts as a way to defuse conflict. At least, Japan seems fully aware of it.

Japan has also stepped up its economic assistance to developing countries, notably through an increase of foreign aid flows, as can be, and has been, expected from a surplus country. There is further scope for Japan to redirect financial flows to debt ridden developing countries. One should however keep in mind in this respect, that the Japanese surplus is mainly generated by private agents, and that redirecting it through public flows is not as obvious as it may appear. Clearly, foreign official aid belongs to the government budget management. Alternative ways exist to redirect capital towards developing countries, such as guaranty mechanisms for private foreign direct investment. But heavily indebted developing countries are not the most obvious candidates for Japanese private investment flows.

Altogether, it is clear that Japan will use its huge financial capabilities to foster economic adjustment worldwide and gain economic and political influence, probably through a very active, but low key, Japanese style, diplomacy.

Much is expected from Japan in terms of its contribution to international economic management. Trade, aid, and monetary

management are the top concerns. Japanese domestic adjustment measures including further opening and deregulation contribute to lessening the trade imbalance problem. Japan has also clearly stated its commitment to the new round of multilateral trade negotiations. Keeping in mind that the current account imbalances are not only, and perhaps not essentially, the reflect of trade restrictions, but also of savings/investment imbalances, domestic demand management policies, as well as exchange rates fluctuations, much still needs to be done, but mainly by other countries, first of all of course the United States.

The aid question refers to the participation of Japan in multilateral aid institutions. Japan has stepped up its support to regional multilateral development banks. The director of the new World Bank multilateral investment guarantee is a Japanese. Japan has stated its willingness to increase its contribution to the World Bank's capital endowment. But this increase in the role of Japan is met with ambiguous welcome: The United States' administration supports a general capital increase of the World bank, but is reluctant to reduce its share of the capital endowment. Hence, the question of a larger Japanese participation stumbles over a conflict for influence, as one could indeed expect.

Japan also supports the G7 cooperative stance. While this is at best a partial cooperation the effectiveness of which may be questioned, one hardly sees what additional contribution Japan could make. Over time, the yen will become more internationalized, as Japan's creditor status and market forces will support its development. But international monetary management is a collective problem that one country alone certainly cannot solve. The weight of the United States' domestic policies still appears predominant.

Let us leave entirely open the question of Japan's future accession to the restricted club of hegemons. The originality of Japan's current posture is that it is based on economic power only. Does a world hegemon need to develop military power as well? The answer is not that clear. In today's world, economic influences may be overwhelming, while military power increasingly lacks a proper doctrine of use. Japan has increased the share of its GNP devoted to defence spending, which places it, due to the size of its GNP, among the top military spenders. In relative terms, however, this effort remains limited in size and scope. It is certainly not clear that Japan would like it to be different.

International economic relations in the 1990s will be characterized by a pervasive influence exerted by Japan on all aspects of the world's economic management, and based on its economic, industrial and financial strength. Part of this influence will have to be institutionalized. This is likely to entail continuing conflict and cooperation. Domestically, Japan has entered a period of profound transition, whose ultimate outcome still appears uncertain, even if the start has been impressiv

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JAPAN AND EAST ASIA: TOWARDS A NEW DIVISION OF LABOUR
A VIEW FROM JAPAN

By Susumu Awanohara

The coming of the Pacific Era was heralded some years ago. Judging from all the recent talk in Japan, that era has finally arrived -- at least in the minds of some of its local proponents. In contrast with dire predictions -- prevalent at times of intense "Japan bashing" -- about continued US-Japan economic friction or Japan's ostracism from an inefficient and jealous world economy, the notion of the Pacific Era is profoundly optimistic.

Essentially, the proponents of the Pacific Era believe that a "Pacific economy" will emerge as the most dynamic growth pole in an otherwise slow-moving world economy; that Japan will be a driving force in this process but at the same time, Asia's newly industrialised economies (NIEs), members of the Association of Southeast Asian nations (ASEAN), and probably China, too, will play positive roles and profit from it; and that the division of labour among these economies, already beneficial to the poorer as well as richer players alike, will become progressively more horizontal and equitable in nature. Furthermore, the intractable US-Japan economic problems can be resolved in the broader context of the Pacific economy, the theory goes.

This short piece is an attempt to explain what the Japanese mean when they speak of the Pacific economy and why they think the region and the individual countries within it have so far succeeded, and will continue to succeed in future, in their development efforts. Problems that the Japanese foresee for the Pacific economy are also discussed, followed by an

exposition of a set of comprehensive economic policy recommendations for the region which a group of Japanese opinion leaders put together recently.

I

When speaking of the Pacific economy, Japanese proponents often point to the fact that trade among the nations surrounding the Pacific Ocean has surpassed cross-Atlantic trade or that for the US, its west coast trade with Asia has surpassed the east coast trade. ¹

They go on to marvel at the feats of individual economies in East Asia. The sharp appreciation of the yen from yen 240 to the US dollar in 1985 to roughly yen 130 to the US dollar in 1987 has nearly doubled Japan's GNP in dollar terms to \$2.4 trillion, more than half of the US GNP. In per capita income and in tangible fixed assets, Japan has now surpassed the US. Japan today is also the world's biggest net creditor nation and reflecting this, Japanese institutions have come to dominate the world financial market. The "decline of US hegemony" is often taken as fact, although the arguments are borrowed from discussions in the US and no one seriously argues that Pax Japonica has come or is on its way to replace Pax Americana. ²

Similarly, impressive figures are cited from the Asian NIEs (South Korea, Taiwan, Hongkong and Singapore). It is pointed out, for example, that by 1985, their respective manufacturing sectors accounted for 24-36% of the NIEs' domestic outputs, which is substantially higher than the average for developed economies. The combined exports of the NIEs jumped from 1.6% of total world exports in 1965 to 6.5% in 1986 while on the import side, the the NIEs' share grew from 2.1% to 5.6% of world imports during the same period. The NIEs' exports of machinery grew to account for 24-36% of their

total exports by 1985, fast approaching the developed countries' average of about 40%.³

Most of Asean is still "developing" rather than "newly industrialised" and is grappling with such typical development issues as industrialisation, rural reform, employment creation and manpower development. (Asean is made up of Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand but Singapore is considered one of the NIEs.) The Asean economies exposed their vulnerability and fell decisively behind the NIEs in the mid-1980s when prices of oil and commodities collapsed and threatened the Southeast Asian countries' external positions. Yet the Japanese proponents of the Pacific economy have remained bullish about Asean; they feel that Asean countries are going in the right direction, following the NIEs' footsteps, and are particularly encouraged by the growing economic links between the NIEs and Asean. There is frequent discussion as to whether Thailand or Malaysia will become the next newly industrialised economy.

Despite China's socialist economy and uncertainties over its future course, China is usually considered an integral part of the Pacific economy by the Japanese. Peking's economic reform and open door policies seem resilient, a reflection that enough Chinese have come to prefer uneven development to sharing of poverty. Apparently, the leadership in Peking is sticking to the plan to quadruple the Chinese economy between 1980 and the year 2000 and is particularly eager to learn from the NIEs' experience.

The collective performance of these individual economies is often also highlighted in discussions on the Pacific economy. The region's growth rates are among the highest in the world, and according to the proponents, will remain so in future. It is projected, for example, that by the year 2000,

the per capita real GDP of developing Asian countries would reach those of South Korea and Taiwan in 1980, the figures for South Korea and Taiwan in 2000 would reach those of the higher-income Hongkong and Singapore in 1980, which in turn would surpass the per capita real GDP of Japan in 1980. Even China will close the gap, its per capita GDP in 2000 approaching the 1970 South Korean level.⁴ Together the Pacific economy will become one gigantic engine of growth, facilitating global adjustments and alleviating debt problems.

II

Naturally, attempts are made to account for such remarkable achievements of the Pacific region's economies. Former Foreign minister Saburo Okita has identified effective government policies "buttressed by close cooperative efforts by government, industry and academia" as one major reason for their success. More specifically, such government policies, observed in many countries in the region, include (1) export-oriented growth policies, (2) maintaining high investment rates, (3) allowing an active and aggressive private sector to operate within what are essentially market economies, (4) improving the agricultural sector, and (5) making structural adjustments to avoid excessive indebtedness and stem inflation.⁵

Elaborating, Okita stresses that, aside from bringing in vital foreign exchange, the export-oriented policies have had the effect of exposing domestic industry to world-class competition and thus fostering efficient industries; high investment was crucial in pushing the export-oriented policies, whether it was largely financed through domestic savings as in Taiwan and Thailand or through foreign capital as in South Korea and the Philippines; the prevailing price mechanism spared many East Asian

economies uneconomical investments and inefficient management; the increased per capita food production in East Asia -- striking compared to records in Africa where that index has declined -- underpinned the growth of many of the region's economies; and an examination of the Latin American example should bring into relief the generally prudent management of the Pacific economies.

There are also non-economic explanations for the success of the region's economies. In particular, the recent remarkable advance of the Asian NIES has rekindled interest in Confucianism as a possible factor. Until recently, Japan was the only really successful industrial economy outside areas touched by the "Protestant ethic," but now several other economies in Northeast Asia, all sharing a vaguely-defined "Confucianist tradition," have joined the ranks. No one seems quite comfortable with the theory that Confucianism, to a large extent, explains East Asian economic growth. For one thing, China, which produced Confucius, has so far not succeeded in development. For another, the theory will have difficulty as soon as the Malaysian or Philippine economy takes off. (The theory's adherents will no doubt agree that Thailand, with a strong and well-assimilated ethnic Chinese community, is within the Confucianist tradition.) And the theory has an exclusivist implication that countries outside the Confucianist tradition cannot hope to develop - which will not be popular in these countries.

Yet the Confucianist theme attracts great interest. There is no obvious reason to assume that all countries will eventually go the NIEs' way towards industrialisation or that, put differently, NIEs will not remain a small minority of success cases, some argue.⁶ The link between Confucianism and economic development of East Asia is one of several topics

to be studied by the East Asia Comparative Study Project, a grandiose programme involving about 100 top Japanese scholars and being financed by the Ministry of Education. Mineo Nakajima of Tokyo University of Foreign Studies, who heads the overall project, is obviously attracted by the Confucianist theory and speaks of a "Confucianist economic sphere." 7

International causes for economic success are also sought, along with the domestic ones, and one in particular is found to be of great importance. This is the division of labour among the region's economics which the Japanese trust has been uniquely benign. Without such a system of interdependence, the individual national economies could not have done as well as they have, the Japanese say.

The Japanese have long identified a "flying geese" pattern of development in the region which they were convinced was quite different from two other more common patterns of international division of labour, namely the vertical and horizontal divisions of labour. The former prevailed in the 19th century between industrialised suzerain countries and their resource-supplying colonies, while the later is seen typically in the European Community with its trade in manufactures among industrialised countries.

With diverse stages of economic development, horizontal division of labour so far has not been possible in East Asia. The flying geese pattern represents a vertical relationship, but one in which there is competition as well as complementarity and which is more dynamic than in a typical vertical division of labour, the argument goes. In this vertical relationship, Japan follows the US and tries to catch up, first in non-durable consumer goods, then durables and eventually in capital goods. The NIEs likewise follow Japan while Asean economies follow the NIEs. The

great advantage of the flying geese pattern is that in it, the vertical relationships are never rigid or permanent. ⁸

Obviously this is a convenient theory for the Japanese and its earlier versions were indeed enlisted during the war years to rationalise the idea of a Greater East Asia Co-Prosperity Sphere. But the theory has had enduring appeal in Japan, not just because it puts the Japanese in good light but no doubt also because it seems to fit aspects of the region's reality rather well.

In a more recent rendition of the flying geese theory, Toshio Watanabe of Tokyo University of Technology has identified a "multi-layered chase process" in which the NIEs chase Japan and the Asean economies chase the NIEs. Watanabe stresses that the gaps between Japan and NIEs and between NIEs and Asean are being narrowed progressively so that the three groups are now linked in a continuous order. This is in sharp contrast with the still discontinuous relationships which obtain between the US and Latin America or between Western Europe and Africa, Watanabe says.

Watanabe has devised a two dimensional diagram where industries, starting with the lowest-value-added industries and moving to the higher-value-added ones, are lined up along the horizontal axis, and the initial level and change over time in the competitiveness of each industry is indicated along the vertical axis. A comparison of diagrams, one for South Korea and another for Thailand, for example, shows graphically how the former country has been losing (or only moderately gaining) competitiveness in the lower-value-added industries and making great gains in higher-value-added sector, while the latter country has been making great strides in lower-value-added items and small or no gains in higher-value-added areas. ⁹

Watanabe answers criticisms that the unequal economic relationship between Japan and the NIEs -- where the NIEs are compelled to buy capital and intermediate goods from Japan and chronically suffer large trade deficits with Japan (because Japan produces just about everything and does not import enough from the NIEs) -- is unjust and unalterable. To Watanabe this trade pattern represents a short and necessary phase in the progress towards NIEs' industrial sophistication and a more horizontal division of labour.

The NIEs were able to gain developmental momentum, initially exporting low-value-added consumer products and investing in Japanese machinery (with embodied technology) and intermediate goods to upgrade their exports. The next round would start with the NIEs exporting higher-grade products and importing more advanced Japanese equipment and inputs. Thus NIEs' imports and investment increased along with exports. But the NIEs were not going in circles just to survive; they were moving up the ladder of industrial sophistication, Watanabe says. The Japan-NIEs trade pattern is far from self-perpetuating. The NIEs are now able to produce by themselves many of the hitherto imported capital and intermediate goods. Watanabe sees an impending reversal of the Japan-South Korea trade balance, and goes on to predict that an EC-style horizontal relationship will increasingly become the norm in East Asia, particularly in Northeast Asia. 10

III

There is a general feeling that the latest developments in East Asian economies, including the sharp appreciation of yen, the NIEs' rapid advance into high-technology and Thailand's pursuit of the NIEs have vindicated the flying geese postulate. In particular, the yen appreciation after the

Plaza agreement of September 1985 seems in fact to have speeded up structural changes towards a more horizontal division of labour, at least between Japan and the Asian NIEs.

The higher yen has finally blunted Japan's export growth. Exports in yen terms began to decrease in 1986, though in dollar terms it has continued to grow. Imports in dollar terms declined slightly but that was to a considerable extent because of the fall in oil prices. The volume of imports has increased, particularly in manufactures. The NIEs, Asean and China have been the principal beneficiaries of increased Japanese purchases of manufactured products.

Behind these statistics experts see a changed Japanese consumer behavior. Whereas in the past, the Japanese tended to import only small quantities of up-market or top-brand items, more recently supermarkets and retail chains started importing and marketing standard-quality consumer items in large quantities. And the range of products being offered to the consumers through these channels has widened drastically, to include electric and electronic goods and other consumer durables. The high yen has also prompted Japanese companies to procure intermediate goods outside Japan. Heavy engineering companies, for example, very quickly changed their policy after the Plaza agreement, replacing Japan-made inputs with those manufactured outside Japan. Japan may yet become a serious importer as a result of the yen appreciation. ¹¹

The high yen has made domestic production of many items untenable and resulted in a sharp increase in Japanese investment overseas. In 1986 Japanese direct foreign investment (on approval basis) jumped more than 80%, the bulk of it going to the US and the Asian NIEs. Japanese

investment in South Korea and Taiwan in that years increased 117% and 74% respectively over the previous year and Japan became the biggest investor on a cumulative basis in all the NIEs and Ascan countries except the Philippines. The trend has continued into 1987 and 1988. In the first half of 1987, investment to Thailand reached Baht 2.5 billion, which was more than the total for all of 1986.

A few points stand out about the current investment boom, compared with earlier booms of 1972-73 and 1978-81. First, the concentration of investment in the US and East Asia, already evident in the past, is more marked this time. Secondly, this time the major investors are either procuring more parts, components and other inputs locally, or bringing along a whole host of inputs suppliers from Japan to invest in the same host country for local production. Thirdly, and related to the second point, more medium and small scale Japanese companies are investing abroad this time, which will presumably result in broader industrialisation and greater overall value added in the host countries. ¹²

Finally, whereas many Japanese investors in the past set up operations aimed at local markets (which were usually heavily protected under import substitution policies), this time there is more emphasis on exporting, not just to the US but to Japan itself. This is significant. Having production units elsewhere to satisfy demand in domestic and developed country markets, major Japanese companies were often uninterested in their East Asian subsidiaries upgrading quality for the world market. Now many of these companies have no other choice. These new investment trends should bring greater foreign exchange earnings and technology transfer for the host countries, supporting their shift to an export orientation. Some Japanese experts regard foreign investment as the most important channel

for transferring the dynamism of the Japanese economy to the rest of the Pacific region.

IV

The Japanese believers of the Pacific economy are not without worries, in spite of the encouraging recent trends. First and foremost, the US-Japan economic friction remains a major concern. An apparent rise of bilateralism in the US is another worry; that, coupled with the probable rise of American protectionism, could spoil the prospects of a Pacific economy. If the EC becomes an economic bloc in 1992 and the US creates its own blocs, what will happen to Japan?, some Japanese ask. The Pacific economy proponents do not rule out Japan itself becoming protectionist, if the impact of the NIEs' assault on the domestic market proves too great. Finally, whether and how China will fit into the Pacific economy preoccupies some Japanese experts.

Until Black Monday there was much debate between those Japanese who advocated accomodating US pressures to correct bilateral trade imbalances and those who, blaming the US for the huge imbalances, argued that only the US could rectify the situation. After Black Monday, the Japanese are more convinced that whatever contribution they themselves may decide to make towards global adjustment, they must firmly demand that the US puts its house in order by reducing its bulging twin deficits. The US-Japan imbalance is seen as arising largely from Washington's macro economic policies -- a combination of a massive military buildup, a major tax cut, tight monetary policy and a deliberately overvalued dollar -- and not from "unfair Japanese trade practices." The Japanese who follow such topics are more convinced than their American counterparts that the US must now reduce

its current account deficit (or net foreign borrowing) by either reducing aggregate (private sector and government) investment, increasing aggregate saving or both. That means, among other things, restrained spending -- by the public and the by Pentagon -- tax increases.

Two implications of such a US adjustment are particularly troubling to the Japanese. One is its global deflationary effect; the Japanese are well aware that the boom of the Pacific economy in the 1980s was export-led and half the increase in world exports went to the US. The other unpleasant implication is greater pressure on Japan to share the burden of maintaining security in the Asia-Pacific region. It is an uncomfortable thought not just because of the costs entailed but also because of the region's inevitable reaction against any regional military role for Japan.

A second Japanese concern is the possible rise of US bilateralism, at the expense of its vaunted multilateralism. The increasingly shrill US demands and actions to restore bilateral trade balance has been disquieting enough. The fear of US bilateralism intensified when the US-Canada free trade agreement was being finalised, at one trough of US-Japan relationship, and talk that Europe may become a self-contained and self-centred economic bloc in 1992 fed the fear. It is not just a fear of exclusion; understandably, the Japanese at this stage sincerely believe that multilateralism is best for them -- and for the world. Thus they have been reacting negatively to US overtures for a US-Japan free trade arrangement, saying that any arrangement they might consider must be wide open for Japan's trading partners in East Asia to join.

The recent interest among some of Japan's pacific economy proponents in creating an OECD-like organisation in the region is related to the

multilateralism-vs-bilateralism discussion. Not surprisingly, the Foreign Ministry and the Ministry of International Trade and Industry have rival concepts and former prime minister Yasuhiro Nakasone has his own. Those who belong to the Japanese committee of the Pacific Economic Cooperation Conference (and are incidentally close to the Foreign Ministry) floated the idea of gradually transforming the PECC, essentially a private organisation, into an OECD-like official organisation at a recent general meeting.

The idea was generally unpopular among non-Japanese members of the PECC who feared Japanese domination, among other things, and the idea was withdrawn for the time being. But many Japanese still believe that there is a growing need for exchange of economic information and coordination of economic policy in the region as interdependence increases. Less obviously, those who advocate setting up a Pacific equivalent of OECD seem to split into two groups, the first aiming to check the US impulse towards bilateralism by using collective pressure against it, and the second group wanting to see the "Pacific OECD" develop into a Japanese bloc, in case the world is indeed divided up into groups and Japan is excluded from major blocs formed around the US or EC.

A third concern among the Pacific economy proponents is the possibility that the Japanese would adopt protectionist attitudes themselves. Up till now, accomodating US pressures on the Japanese to open up the domestic market, save less and spend more or even to work fewer hours were more or less congruent with the interests of the long-suffering Japanese salaried men and housewives. Happily, striving towards "international harmony" tended at the same time to raise the domestic quality of life. This may

explain why US attacks on Japan provoked as little nationalistic reaction as they have.

But what happens when Japanese companies feel more and more threatened by NIEs competitors in the US, and even home, markets could be a different story. A while ago, before the sharp yen appreciation and the current rush of outward investment, the Japanese used the fear of a "boomerang effect" to explain their reluctance to invest abroad. Now many Japanese companies have no other choice than to invest but there is much talk of a "hollowing out" of Japanese industry resulting from relocation overseas of industries. While the resource-poor Japan could never afford to isolate itself, isolationist impulses do exist and could affect the course of events.

A fourth Japanese concern is whether and in what way China will fit into the Pacific scheme of things. Last year's 13th party congress reconfirmed that reform and open door policies were still very much effective. But obviously there are domestic resistances to these policies. The Japanese are wondering how China will cope with the new, and often unanticipated, problems created by the reform and open door policies, including the bifurcation of rich and poor particularly in the countryside, price increases (resulting from price reform as well as inflation) and unabashed materialism among the populace. Shortage of capital is an abiding condition which can only be overcome through changed attitudes towards foreign funds but some China experts sense that a struggle, or at least a competition, is intensifying between the reforminists led by party leader Zhao Ziyang and what they feel constitutes a group of Soviet-influenced orthodox Marxists, notably prime minister Li Peng and deputy prime minister Yao Yilin. 13

V

In March this year, the Japan Forum on International Relations, a recently formed private research council, completed its first study, on "The Structural Adjustment of Economies of Japan, the US and Asian NICs," accompanied by a set of policy recommendations. The forum -- made up of representative "internationalists" from academia, business, the press and from among influential ex-bureaucrats -- is chaired by Okita and the task force for this specific study was led by economist Watanabe.

The study's premise is that "the world economic system is not a given condition for the growth of Japan anymore. Japan is now in a position where she should devote herself to the reformation and evolution of the world economy." 14

There are 13 policy recommendations in all. The first, of course, calls for macro-economic adjustments between the US and Japan. The US must curtail its fiscal deficit while Japan should continue efforts to stimulate domestic demand. In a separate recommendation the forum calls for Tokyo's hasty implementation of emergency measures promised mid-last year for boosting domestic demand.

The second recommendation is for "maintaining a trade regime which is free, multilateral and indiscriminatory." In the background elaboration, the forum says "there would be a cause for concern if the United States conducts bilateral trade negotiations, stressing too much on the 'reciprocity principle.'" Instead of taking retaliatory measures, the US should invest in new plant and equipment to regain international competitiveness, the forum says.

The following several recommendations are about "strengthening support for

the Western Pacific developing countries." Japan must help "release the dynamism" of the NIEs, Asean and Chinese economies, the forum exhorts. One way to achieve this is to "normalise" the flow of Japanese funds. Too much is now going to the US for dollar assets; more funds, both private and official, should flow to developing countries, in East Asia and elsewhere. Another way is for Japan to become an "absorber" of developing country exports as well as a supplier of capital and intermediate goods. Crucial in this process is the "out-sourcing," or offshore procurement by Japanese manufacturers. Inter-industry and intra-industry division of labour in the Western Pacific, particularly in the machinery industries, is also desired, which amounts to abandoning the "full-set principle" in Japan's industrial policy -- that is, maintaining a closed integral structure and producing just about every thing from start to finish. The full-set principle is behind Japan's "wrong elasticity"; even when incomes and prices move in the right direction, Japanese imports do not grow as much as is hoped for. But already elasticities of imports from the NIEs are growing considerably. 15

"Acceleration of the acceptance of foreign nationals into the Japanese labour market" is the single controversial recommendation flowing from the group's study, which helped the study to get the little press coverage it got.

The forum's recommendation to the NIEs is to become "a new growth axis comparable to Japan" through trade liberalisation and currency revaluations, and to enhance the growth of Asean countries and China. NIEs are thus expected to become absorbers and investors in their own right. Asean countries are asked to develop export-oriented and support industries, making it easier for foreign funds to contribute to that

process. Inclusion of China into the Asia-Pacific sphere is strongly recommended by the forum which asks China, for her part, to "clearly state that the open door policy would not be subject to short-sighted manipulation" and to "ease state control of foreign trade and investment."

VI

Unlike the much shorter and more general Maekawa report on "economic structural adjustment for international harmony" published two years before, the forum study did not become a subject of heated debate and was not much noticed by the press, in Japan or abroad. Nor has the study had as much influence on policy as the Maekawa report did. But there are similarities between the two documents. Neither is brimming with revelations or radical recommendations.

They do integrate, however, pulling fragmented knowledges together to offer a view on how these are inter-related, and both contain recommendations which, if actually implemented, would make a difference. Each document involved a large number of Japanese elites in its preparation. In fact elite consensus building was as important an objective as uncovering of new truths in both cases. And the two documents represent more or less reasonable internationalist approaches to challenges facing Japan.

That said, the theory of Pacific economy is still largely a happy hypothesis. It remains for its proponents (or opponents) to become more quantitative. A few crucial questions which could usefully be asked are; how much will US imports have to decline, or slow down, to reduce the twin deficits by given amounts in a given period? How much of the slack can Japan absorb without creating undue pressure on domestic interests? How much can South Korea and Taiwan absorb?

Perhaps another task of the Pacific economy theorists is to bring some politics into the picture. Will South Korea stay on course after the Olympic games? How will the economies of Taiwan, Hongkong and indeed China fare, if China gets tough or simply blunders on the unification issues with the two NIEs? Will President Corazon Aquino's regime in Manila succeed in its land reform efforts, or indeed in surviving attacks from the Left and the Right? How will deteriorating race relations affect Malaysia's economic performance?

US-Japan friction, too, has a political dimension as well as the economic. Politically, the US, and particularly the Congress, has been pushing Japan toward greater burden sharing in regional security. The Japanese are reluctant and most of the rest of East Asia is loathe to see Japan moving in that direction. Even some Americans are beginning to question the wisdom of pushing Japan beyond a certain point. So the Japanese are hoping that they will be allowed to contribute in their own way - economically -- towards security. But in Washington there is a growing feeling that allowing Japan to contribute only economically would make it too popular -- and powerful -- in the world. Indeed some Japanese are beginning to say they want to share the power, too, if they are to share the burden.

Introducing political factors will no doubt complicate the analysis. Yet abstracting from politics is not realistic since it does not look to be a smooth ride all the way to a blissful horizontal division of labour in East Asia. On the other hand, after some politics is taken into consideration, the Pacific economy proponents may turn out to have been correct in their optimism for the region.

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3. Watanabe, Toshio, "Nishi taiheiyo no jidai'no nichibei-NICs" 'Japan-US-NICs in the Western Pacific Era', Shukan Toyo Keizai, May 20, 1988.
4. Shinohara, Miyohai, "NICs ni takamaru jishin to sekinin no jikaku" 'Rising confidence and awareness of responsibility among the NICs', in Special Feature; "Ajia taiheiyo no jidai ga yattekuru" 'The Asia-Pacific era is coming', Ekonomisuto, June 14, 1988.
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6. Iida, Tsuneo, "Jukyo kasetzu to NICs" 'The Confucianism hypothesis and the NICs', Special Feature: "Ajia Taiheiyo keizai no 1988 nen" '1988, the year of Asia-Pacific economy', Keizai Seminar, January 1988.
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13. Nakajima, "Taiheiyo jidai."
14. Japan Forum on International Relations, "The structural adjustment of economies of Japan, U.S. and Asian NICs", March 1988.
15. Kitamura, Yuichi, "Taiheiyo toriangru boeki no dainamizumu" 'Dynamism of Pacific triangular trade', in Special Feature: "Taiheiyo keizaiken to nippon" 'Pacific economic sphere and Japan', Shukan Toyo Keizai, August 21, 1988.

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**Changing International Relations
and Japanese Responses**

by Masashi Nishihara

Japan's Two Broad Concerns

Two broad areas of concern for Japan in the international political and security arena today are: (1) to identify its own national interests in the current changing East-West relations, and (2) to determine how to share responsibilities among the Western partners in international security and political stability. The former is the matter of assessing the new Soviet Union and its resulting relations with other big powers such as the U.S. and China, while the latter is related to the matter of "burden-sharing." The burden-sharing has to do with how to share the Western-wide burden both in coping with the Soviet and other military threats and in assisting the political stability and economic viability of the non-Communist Third World. An emerging phase of international relations today affects Japanese policy priorities. Inversely, with Japanese power being large enough, the consequence of its behavior can affect the character of international

relations.

Despite initial reservations expressed by mass media, Prime Minister Noboru Takeshita has so far demonstrated his abilities to handle Japan's international relations much better than he had been expected to. Since he took office, he has settled major visible bilateral trade issues with the U.S. such as citrus, beef, construction, etc. Much of his credit should go to his own work style that emphasizes preliminary informal talks among those parties concerned before formal negotiations take place. Takeshita, for instance, had visited all of his Summit Conference partners before the Tronto Summit within about half a year after he took his office in November 1987. His success can also be accounted for by his preference in respecting the scenarios of work laid out for him by bureaucrats. His "internationalist" style also fits into the current growing public acceptance of Japan's larger world role.

A question then is: Is Japan responding fast enough to the fast changing world, where U.S.-Soviet relations have improved a great deal, where Japan's economic power grown so large is causing political tensions with the U.S. over defense burden-sharing, and where many regional conflicts such as Afghanistan are changing their faces fast? Japan has made slow responses to all of the issues: It has welcomed the current changing relations between the Soviet Union and the United States, symbolized by the INF Treaty (December 1987) and by the exchange of visits by Gorbachev and Reagan (December 1987 and May 1988). But it has been

little enthusiastic, compared with ~~Western Europe and the United States~~, about Gorbachev's "perestroika" on domestic economic and political problems and "new thinking" on external relations. This Western Pacific power has also made restrained decisions as to the role it can play in bringing about political stability and regional security in the different parts of the world. Each issue requires a brief analysis of the problems involved and the debates taking place inside Japan.

Japanese Assessments of Gorbachev

The Japanese public in general favors the dynamic, innovative leadership that Gorbachev is displaying. The government officially welcomes Gorbachev's new dynamic initiatives for domestic and external innovations. Informally, however, the Foreign Ministry and Japanese specialists on Soviet affairs are skeptical about Gorbachev's "perestroika." They tend to emphasize the systemic difficulties which will hinder any efforts for sweeping economic reform. The continuing centralized control of economic planning, they say, cannot promote the principle of self-reliance by individual enterprises. The strong resistance of Nomenkulatura to any reform, they argue, will impede Gorbachev's attempts. His book, Perestroika, has sold quite well in Japan, but has failed to win many supporters there. A noted government party member of the Diet recently described perestroika as "a preview of a movie that has actually not been filmed,"¹ meaning that

there is only talk on reforms. Similarly, although the "new thinking" on the Soviet relations with foreign countries has borne fruit in the form of the INF Treaty and the Afghanistan settlement, most Japanese Kremlinologists argue that there is no substantial change in Soviet foreign policy under Gorbachev, as far as the Asia-Pacific region is concerned.

Those Japanese concerned with Soviet affairs tend to criticize Gorbachev's "new thinking" by looking at Soviet military postures in Asia and the Pacific. According to the latest Defense White Paper of 1988, published in August, Moscow has increased the quantity and quality of its military deployments in the Western Pacific. In the region, while the Soviets still have about 160 SS-20 missiles, they have deployed additional air strengths in the form of MiG-29s, MiG-31s, Su-24s. For their naval strength, a new Akula-class nuclear-powered attack submarine equipped with cruise missiles (SSN-21) is in the Western Pacific waters, with the increasing number of shooting practices.² The Soviet Naval Infantry forces are also reportedly equipped with hovercraft, which would facilitate amphibitious landings against Japan.

These deployments led Prime Minister Takeshita to argue at the Tronto Summit that there was no "new thinking" reflected on Soviet military policy toward Asia. These deployments also tend to reinforce Japanese suspicions of Soviet diplomatic "peace offensives" in the region. The Soviets are, for instance, active in trying to promote

economic relations with the countries in the region, including China, South Korea, and the ASEAN nations. They have organized a Soviet National Committee for Pacific Economic Cooperation, headed by Y. M. Primakov, Director of the Institute of the World Economy and International Relations (MEMO), in order to seek full-membership status in the semi-official Pacific Economic Cooperation Conference (PECC). The U.S. and Japan objected the Soviet Union joining the PECC with a full member status, in its general meeting held in Osaka, May 1988. However, the Soviet Union is now planning to sponsor a seminar on Pacific economic cooperation by inviting people from the member nations of the PECC. Such attempt by the Soviets would undermine the PECC activities.

President Reagan subtracted his early unkind remarks on the Soviet Union referred to as "the evil empire," and instead during this visit to Moscow in May this year called his Soviet counterpart as "a good friend." Prime Minister Thatcher spoke in public to the effect that the West should encourage Gorbachev to carry out his domestic reforms. Prime Minister Takeshita has not spoken of Gorbachev so favorably in public. The latter has never visited Japan. For that matter, no Soviet party secretary has.

Japanese Interests in Relations with Moscow

A major stambling block to the Japanese-Soviet relations, the territorial issues, remains unsettled. For

the Japanese, this is a test case for Gorbachev's "new thinking." Kovalenko, Deputy Head of the International Department of the Party, being in charge of Japanese matters, still remains in the same position, although Gromyko and other key foreign policy personnel have been replaced. Few Japanese expect an early change in Soviet policy toward Japan, as long as he is in that position.

With Foreign Minister Shevardnadze's visit to Japan in early 1986, the Japanese concerned were hopeful about the improvement of Tokyo-Moscow relations. They became even more hopeful, when Gorbachev spoke so favorably about the binational relations in Vladivostok in June that year. His remarks included:

"Signs are emerging indicating a turn for the better here as well. It would indeed be a positive development if the turn did take place. The objective position of our two countries in the world demands profound cooperation on a sound and realistic basis, and in a calm atmosphere free from problems of the past. A beginning was made this year. Foreign ministers exchanged visits and an exchange of top-level visits is on the agenda."

However, the relations failed to improve thereafter. Only recently, in July 1988, when former Prime Minister Nakasone visited Moscow and had a productive meeting with Gorbachev, there emerged signs of possible progress.

The Japanese government has made such a big diplomatic issue out of the territorial disputes that it cannot improve its relations with Moscow without the latter modifying their past position. With the Soviets needing Japanese capital and technology in order to develop their Asian section, Japan has gained a more favorable negotiating position, although they claim that they can develop their Asian section by

themselves. Gorbachev apparently wishes to improve relations with Japan anyway in order to bring about a better international climate that will facilitate his country's domestic economic development, particularly that in Siberia.

There are some unofficial signs that the Soviet side might compromise on the territorial issue. During his recent visit to Moscow, for instance, Nakasone's television talk, which referred to the territorial issue, was broadcast without censorship. This was only the second time that such Japanese views on the territorial disputes went on the air in the Soviet Union.⁴ Or at one of the recent Japanese-Soviet symposia held in Tokyo, the Soviet side agreed to include the territorial issues among the discussion topics.

In actuality, the existence of the territorial issue between Japan and the Soviet Union has narrowed the range of Japan's diplomatic activities in other fields and other regions. Tokyo has sought not to promote economic relations while political issues, namely, the territorial issue, remain unsettled. Nor can Tokyo discuss closely with Moscow on the Korean issue or other regional issues such as Indochina and Afghanistan. In the meantime, Sino-Soviet relations have improved remarkably to the extent that a summit talk between the two Communist powers is now thought to be in sight. If Japan wishes to play a larger international role, it needs to improve its relations with the Soviet Union.

Japanese Interests in West-West Relations: Burden-Sharing

Compared with Japan's cautious attitudes toward the new Soviet Union, the Japanese are slightly more positive in thinking about what their country should do as a member of the West. For some years Japan has been encouraged or even pressured by the United States and some European nations to do more for its own defense and to make a more positive contribution to the economic development, political stability, and regional security of the Third World. What is distinctive today is the fact that Japan, the world's largest creditor nation, is depending upon the U.S., the world's largest debtor nation, for national security. Burden-sharing issues have become particularly prominent in the last few years for Japan as well as other U.S. allies.

The concept of burden-sharing may be seen in three categories: defense, political, and economic. Defense burden-sharing is primarily to cope with the Soviet military threat and to prevent the military actions in the Third World (e.g., terrorism by Libya, attack on oil tankers by Iran) from threatening Western interests. Political burden-sharing is mainly to take joint or coordinated positions (support, opposition, etc.) to participate in diplomatic negotiations on international issues of mutual interests such as the East-West arms control and regional conflicts. Economic burden-sharing aims at sharing financial costs to assist the economies of the Third World countries and to coordinate macro-economic policies among the major advanced industrial powers. Assisting the Third World is a North-

South problem, but it is also a burden-sharing issue within the North (meaning the West). All of these three burdens exist to be shared among the industrial democracies of the West today. In this regard, they are the matters of West-West relations, or exercises of cooperation among the members of the West.

Nakasone's distinctive contribution in this regard was to evolve Japan from the tier of economic burden-sharing to those of political and defense burden-sharing. His support of the deployment of American INF missiles at the 1983 Williamsburg Summit was a case for political burden-sharing, whereas his decision to adopt a policy of dispatching Japanese naval ships to support Japan-bound U.S. ships in wartime, a policy which had previously been considered as unconstitutional, was a case for defense burden-sharing. His decisions to eliminate budgetary ceilings on defense and to participate in SDI research can also belong to the latter category.

Japanese participation in defense burden-sharing has been still weak, however. In the past, Japan argued that it could not play a military role on the international scene because of strict legal and political constraints. The Law on the Self-Defense Forces is interpreted to prohibit the overseas dispatch of the Self-Defense Forces. The Diet resolution of 1954 confirming this interpretation is still effective.

A serious test came in the summer and fall of 1987, when the U.S. and major West European powers sent their

naval ships to the Gulf to ensure the safety of commercial oil tankers. Japan was caught between the U.S. pressure for sending naval ships as a gesture of Japan's defense burden-sharing among the Western partners and the lack of the legal base at home for dispatching naval ships overseas. Intense debate apparently took place within the Foreign Ministry and also in the Prime Minister's Office. Nakasone at one point (August 27) reportedly maintained that he could send a SDF contingent with minesweepers to exercise Japan's constitutional right of self-defense. He rightly reasoned that minesweeping operations alone do not constitute "combat actions." Several other alternative measures were also considered, including the desperate idea of dispatching a contingent of the civilian Maritime Safety Agency (equivalent to the U.S. Coast Guard) with patrol boats.⁵ At the end, the government was settled with the decision to provide moderate Arab nations along the Gulf with a navigational aid system and economic aid.

Some U.S. Congressmen, in the meantime, maintained that Japan should cover the cost of the U.S. naval operations that in effect protected the safe supply of oil to Japan. One proposed figure was \$14 billion.⁶ Instead, in addition to technical and economic aid to the Arabs, Japan plans to increase its share of the financial costs (\$6 to \$6.5 billion a year) needed to maintain the U.S. bases in the country. In FY1987, the U.S. was to spend ¥530 billion (about \$4 billion), whereas Japan was to spend ¥260 billion (some \$2 billion). The ratio was 2 to 1. Tokyo intends to

share the cost on an equal basis, with \$3 billion each, in the future, when the current terms of the bilateral agreement concerned are renegotiated to that effect.⁷

As this case has shown, Japan has tended to compensate what it can not do in the category of defense burden-sharing by political and economic burden-sharing. Similar patterns are observed by the current government.

Takeshita's Attempts at Political Burden-Sharing

Prime Minister Takeshita, since his nomination in November 1987, has taken positive steps toward what may be termed as political and economic burden-sharing among the Western partners. He stresses a slogan of "A Japan That Contributes to the World," and has given, among others, positive speeches in London (May 1988), New York (May 1988), and in Tronto (June 1988), noting Japan's willingness to cooperate for international peace. In December 1987 he chose the Philippines to be his first country to visit as Prime Minister. In Manila, by pledging to extend a substantial economic loan (¥94.2 billion or about \$700 million to the Philippines and ¥270 billion or \$2 billion over three years to the six ASEAN nations), he stated that the stability of the Philippines is important to the stability of the Asia-Pacific region. While he did not relate the aid to the financial aspects of the U.S. bases, it is obvious that the Japanese are conscious of the relevance, if indirect, of their economic role to the continuous existence of the bases. This is one way of sharing with the U.S. the

political as well as economic burden of Pacific security, particularly of the U.S. bases in the Philippines.

Since Takeshita assumed his office, several regional conflicts have begun to be settled, requiring the presence of international cease-fire observation teams and substantial economic aids, and thus needing Japanese participations. With the cease-fire agreement becoming effective in Afghansitan, the Takeshita government has dispatched a civilian to join the U.N. cease-fire observation team, while assuming some 10 percent of the financial burden for those U.N. operations. Japan takes the view that under the current constitution and the Diet resolution it cannot dispatch members of the Self-Defense Forces to the U.N. activities. This is the first time that the Japanese government sends its national to work with the U.N. peace-keeping forces. This is again a case of taking up a political and economic burden-sharing in place of defense or military burden-sharing. Similarly, as Iran and Iraq entered the truce on August 20, two Japanese civilians, again diplomats, were send to join the U.N. military observation groups (UNIIMOG) in these two countries. If Namibia should gain independence from South Africa in the course of the withdrawal of Cuban troops from Angola, it would need to conduct a national plebscite under a U.N. supervision, to which Japan plans to contribute about 30 civilians.

What is more, the Cambodian conflicts also have begun to show signs of political settlement, perhaps being influenced

by the settlement in Afghanistan. In a June meeting with the ASEAN foreign ministers, Foreign Minister Sosuke Uno proposed a peace plan aiming at creating a non-aligned, independent Cambodia with the U.N. troops present for a certain period. The idea was not very different from the various ASEAN and Japanese initiatives proposed previously. But the point is that Japan, which has been a shy power player, has now become more forceful in presenting its views. In early August the Japanese government invited Sihanouk to Tokyo to discuss measures to bring about a political settlement in Cambodia and what Japan can do for its economic rehabilitation. This is the first time Sihanouk came as a guest of the Japanese government in recent years. The fact that he has come to Japan under the current circumstances demonstrates the recognition on the part of the Prince of the usefulness of Japanese power in settling the conflict. When all Vietnamese troops are withdrawn from Cambodia, Tokyo is likely to resume economic assistance for Vietnam as well. This is also a case of Japan sharing the political and economic burden which the U.S. would not very much wish to assume at the moment.

The Japanese would feel much less confident in undertaking diplomatic activities in the Middle East. Yet Japan has been one of the few countries of the West that have successfully maintained diplomatic contacts with both Iran and Iraq during the war years. Foreign Minister Abe visited their capitals in August 1983, although his mediating role bore little fruit. But Japan has tried to

expand political contacts with both moderate and radical Arab nations. In 1985 Abe was in Syria, Jordan, and Saudi Arabia, too. In this trip he also had a meeting with Arafat of PLO. Abe's successor, Uno, visited Teheran and Baghdad in July this year. He then became the first Japanese foreign minister to visit Israel after Japan shifted its policy from a pro-Israeli to a pro-Arab stand in 1973.

Japan's political role may be still limited there, but it seems that there is a growing recognition among the Japanese that their country should become a player in the international relations of the Middle East. Japan seems able to play an increasingly effective role by using its economic and technological assistance, which most of the nations in the region need so badly. With its increased diplomatic involvement in the region, Japan may be contributing to the political stability and thus regional security of the Middle East. Here is also Japan's modest attempt to share the political burden that the West assumes.

The Takeshita government appears willing to share greater economic assistance burden for the Third World. Japan is the largest aid donor for most of the Asian countries, including the Philippines, Indonesia, Thailand, and China. In August 1988, Takeshita, for instance, pledged a loan of ¥800 billion (about \$6 billion) to be provided over five years to China.⁸ (Japan is also a significant donor for Egypt and Turkey.) These aids have played important parts in promoting the political stability of the region. This economic burden-sharing is likely to grow more

in the future, as was seen in Takeshita's another proposal at the Tronto Summit, which was to cancel the external debts owed by the poorest nations up to \$1 billion.

Issues Ahead for Japan

The Japanese government, however, faces a more basic issue of whether the country can respond fast enough to the changing international relations. What should be Japan's strategy in the midst of the U.S.-Soviet and Sino-Soviet detente? How can Japan share the burden of the West in maintaining an overall balance of power in its favor? How best can it use its own large economic power? Japan seems to lack in an overall design of what kind of world it wants to see built and how it wants to go about creating it.

For Japan, stable and close Atlantic security relations are a vital factor for its own national security. A solid and credible NATO serves as an important factor in coping with the Soviet Union both for Western Europe and Japan. In this sense, Japan and Europe should consult closely with each other and with the U.S. on the position to be taken regarding a comprehensive conventional arms reduction which the Soviet Union has proposed. As in the case of INF talks, Soviet conventional arms should be reduced on a "global" base. If those arms reduced in the European theater were to be transferred to the Asian section, it would only create more political and military tensions in Northeast Asia. Or such arms transferred to Asia may be retransferred back to

Europe at a time of crisis. This would not help stabilize East-West relations.

Recent cross-Atlantic polemics over the "near erosion" of the NATO's basic strategic doctrine of "flexible response" presents a factor of apprehension for Japanese security. They would simply weaken U.S. positions vis-a-vis the Soviet Union on arms control negotiations. A weakened U.S. position would not favor Japanese security. Japan may seek to consult more closely with the U.S. and Western Europe on how arms reduction talks should be conducted.

As much as Japan considers weakened Atlantic security ties to be harming its security interests, Atlantic partners may regard a weak Japanese defense posture to be against their security interests. In this regard, Japan's primary role in sharing the defense burden of the West should be to build credible defense capabilities. Also, Japan may be able to contribute to the development of conventional defense initiatives (CDI) technology.

accelerate Soviet apprehensions

In the field of contributing to the U.N. peace functions, Japanese efforts are far from impressive. Sending only one civilian to the U.N. peace-keeping team of about 100 members in Afghanistan, and only two civilians to the U.N. team of 350 members from 24 countries are too modest or meager for a nation that its prime minister claims will contribute to the international peace in correspondence to its economic power. Japan is in urgent need to train more personnel qualified to work for such U.N. functions.

In order to play a more effective political role, Japan

will have to overcome domestic political elements of constraints. As long as Japan argues that because of domestic legal and political constraints it cannot send its forces to the Gulf or any other places where its own security interests are at stake, it cannot work closely with the other Western partners. It constitutes a clear hindrance to the defense burden-sharing. Naturally, this does not mean that sending its forces overseas should be an automatic decision for Japan. The wisdom of opting out a military involvement should be respected, but the categorical denouncement of military participations even at a time when national security interests are threatened would not only narrow the range of Japanese policy options but also options that the Western partners can expect to take effectively.

A Japanese dilemma, however, is that a Japanese policy that sends its forces overseas would invite a strong criticism from the Asian neighbors, not to mention that from the opposition parties at home, and that ignoring such unfavorable repercussion might jeopardize Japan's political and even economic relations with them. Tokyo will have to have a clear understanding with its Asian neighbors about Japanese intentions, although that is also highly difficult.

In the process of responding to and playing a part in the East-West and West-West relations, the two broad areas of concern mentioned at the outset, Japan is quickly evolving from an economic power to a political power. However, its tendency to play a political role as a substitute for a military role narrows the range of Japanese options, when

Japan is expected to play a military role albeit limited. Nevertheless, under the present circumstances it has little choice but to seek to expand its political role or burden-sharing within this constraint.

Japan's sharing of an economic burden is the most prominent among its three categories of burden-sharing. Japanese ODA (official development aid) now amounts to about \$10 billion or 0.3 percent of GNP. In a broad sense, Japan has done significant contributions to Asia-Pacific security through substantial economic aid.

Thus, how Japan can combine the three categories of burden-sharing to seek its enlightened national interests as one of the Western partners is an important issue for the stability of international relations. Japanese responses to changes in international relations will continue to be slow, but such responses are likely to be steady and positive.

Notes

1. Motoo Shiina's remarks in a discussion forum on Gorbachev. See Gekkan Jiyu Minshu, August 1988, p.60.
2. U.S. Department of Defense, Soviet Military Power 1988, p.38; and Sankei Shinbun, May 1, 1988, morning edition.
3. Speech by Mikhail Gorbachev in Vladivostok, July 28, 1986 (Moscow: Novosti Press Agency Publishing House, 1986), pp.30-31.
4. Asahi Shinbun, April 30, 1988, evening edition.
5. Sankei, October 2, 1987, morning edition.
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