



# Background

The Heritage Foundation • 214 Massachusetts Avenue, N.E. • Washington, D.C. 20002 • (202) 546-4400 • Telex: 440235



21

December 28, 1984

## THE REAGAN — NAKASONE SUMMIT : DEVELOPING THE SPECIAL RELATIONSHIP

### INTRODUCTION

Japanese Prime Minister Yasuhiro Nakasone meets with President Ronald Reagan in Los Angeles on January 2, 1985. The main purpose of this first summit of the new year is to enhance the friendship and the cooperative relations of Japan and the U.S.

As the world's two largest free enterprise, democratic countries, they account for more than one-third of the world's annual output of goods and services. That these two countries exchange nearly \$100 billion worth of goods and services annually in itself demonstrates the benefits of the free enterprise system. Their continuing close economic, political, and security relationship is critical not only to Americans and Japanese, but to prosperity, peace, and security worldwide.

Probably no two nations today share a wider range of common interests and attitudes than the U.S. and Japan. The term "special relationship," which once correctly described U.S.-British ties, now accurately characterizes those between Washington and Tokyo. Both nations enjoy vigorous, expanding economies and living standards; both share an optimistic vision of the future; and both are linked by shared security responsibilities in the Pacific Basin. There are few areas of discord between the two. Yet Washington and Tokyo occasionally disagree on a number of relatively minor and a few major bilateral matters. These disputes sometimes erupt when issues become overly politicized and when the general health of the relationship is obscured.

The Nakasone visit, therefore, coming just after his own election to a second term as Prime Minister and on the eve of Ronald Reagan's second inauguration, is an opportunity to celebrate the two nations' special relationship and to stress the importance of resolving their differences.

## AN INTERNATIONAL PARTNERSHIP

### USSR

Tokyo has begun to work more closely with Washington to check the military threat to the Pacific Basin posed by the Soviet Union. Japan opposed and condemned Soviet aggression in Afghanistan and the Soviet-assisted Vietnamese invasion of Cambodia. Japan boycotted the 1980 Moscow Olympics and strongly condemned the Soviet Union's unprovoked destruction of a civilian Korean airliner in September 1983. Furthermore, Japan supports President Reagan's most recent proposal for U.S.-Soviet disarmament talks.

### Korean Peninsula

Japan has contributed to the economic development of the Republic of Korea (ROK) and supported the U.S. security commitment to the ROK. Japan also has quietly assumed the role of sounding board between North and South Korea in an effort to reduce the tension on the Korean peninsula and to promote North and South unification talks.

### People's Republic of China (PRC)

Although Japan for years strongly had supported U.S. policy toward Beijing, Japanese leaders were extremely wounded by the secrecy and insensitivity of the 1971 Nixon-Kissinger negotiations with the PRC. Tokyo was barely advised of this matter, which affected Japanese interests enormously. There have been no similar shocks in recent years, but Tokyo remains nervous about possible U.S. military cooperation with the PRC, particularly with regard to the sale of weapons.

### Republic of China (ROC)

While the Japanese government has supported U.S. foreign policy toward the PRC, the Japanese private sector also has strengthened its relationship with the Republic of China on Taiwan. In recent years, Japan has become the ROC's second most important trading partner and investor after the U.S.

### Middle East

Here, the U.S. and Japan share many interests, including strong support for the security of Israel. Limiting Soviet influence to protect access to oil supplies is a primary consideration. Japan emphasizes economic and technical assistance programs rather than military assistance. Japan also supports U.S. peace initiatives in the region and continues to urge peace between Iran and Iraq through diplomatic channels.

### The Third World

Japan has been a major contributor to Third World economic development. In 1984, Japanese grants to developing countries exceeded \$4 billion or nearly 0.4 percent of Japan's GNP, compared

to U.S. contributions of about \$8 billion or 0.25 percent of U.S. GNP. In recent years, Tokyo has been expanding assistance to neighboring countries and to Egypt, Pakistan, Sudan, Somalia, and the Caribbean states. Japan is and continues to be the world's second biggest contributor to refugee assistance (after the U.S.) and has sent \$170 million in emergency food aid to Africa. On the critical matter of Third World debt, Japan has granted emergency loans to the Philippines, Brazil, and other nations facing financial crisis. Japan is the largest contributor-shareholder in the Asian Development Bank and the second largest shareholder in the World Bank (again, after the U.S.).

Japan's Generalized System of Preferences (GSP) has helped to increase the flow of imports from Third World countries. With Washington, Tokyo has given priority to the economic development and political stability of Third World free market nations.

#### Pacific Economic Cooperation

Japan strongly supports Reagan Administration efforts to spur Pacific economic cooperation. A Japanese program stresses the development of human resources (such as managerial and training), technical assistance, satellite communication networks, and energy development. For example, Japan will soon launch a "coal flow" project and extend low-interest loans to Pacific nations to help them build coal power plants and ultimately increase their imports of U.S. coal. It is expected that accelerated U.S.-Japanese efforts in forging Pacific Basin cooperation will be high on Nakasone's agenda when he meets Reagan.

#### SECURITY ISSUES

The Japanese islands stand in the way of the movements of the Soviet navy and air force into the Pacific and Southeast Asia. Japan could play a pivotal military role in Northeast Asia.

In recent years, Japan has become increasingly concerned about the Soviet Union's mounting military activities in the East Asian region. In response to this, Tokyo boosted defense expenditures about 8 percent per year during the 1970s. By contrast, during this same period, Western Europe increased defense outlays only 2.5 percent, while the U.S. decreased its defense expenditure by 2 percent in real terms. During the last two years, the Nakasone government increased Japan's defense budget around 7 percent, despite the government cuts in other important national programs. This year, Tokyo will spend approximately \$12 billion on defense. At the same time, Japan has taken on more responsibility for defending the sealanes within 1,000 nautical miles.

Japan contributes more than \$1 billion per year toward the upkeep of the 49,000 U.S. troops based in Japan. But in West Germany, Bonn contributes only \$1.3 billion for the 250,000 U.S. servicemen stationed there.

In addition, Japan has sought to improve weak areas in its defenses, such as command and control, communications, and integrated air defense, and at the same time has upgraded its collaboration with the U.S. in joint exercises and the operation of joint bases. Increased cooperation with the U.S. in developing new defense technology is another current goal, especially in electronics, telecommunications, and maintenance and production techniques.

For all of this, there still is a legitimate question of whether Japan is carrying its fair burden of defense costs and whether it is receiving too much free coverage from the U.S. military umbrella. In political terms, this leads to the question of whether or not the Japanese should boost defense expenditures more rapidly.

It is clear that the Japanese public supports only a gradual increase in military spending. It also is generally believed that the public does not want Japan to spend more than one percent of GNP on defense. This is about what Japan says that it currently spends, although by NATO's method of calculation, Japan is spending 1.6 percent of GNP on defense, while the U.S. spends 6.5 percent. Most Japanese political leaders recognize that the public may not support a more rapid increase in military outlays. The trouble is that the current pace of Japanese defense measures fails to keep up with the mounting Soviet threat in the Pacific.

Reagan and Nakasone will surely address this matter. It is expected that Reagan will push his guest to do more for defense. Still, Reagan is aware that Nakasone must take a number of delicate factors into account when it comes to military spending. Among them are a strong opposition in Japan to what is called "militarism" and strong opposition to Japanese rearmament on the part of other Asian nations.

#### ECONOMIC RELATIONS

After Canada, Japan is the second largest market of the U.S. This year it will buy more than \$24 billion worth of American products, equal to American exports to France, West Germany, and Italy combined.

Japan will buy more than 64 percent of U.S. beef exports this year, and 80 percent by 1987, making the Japanese the American farmers' best overseas market. Japan also is the largest single customer for U.S. coal and a major market for U.S. manufacturing goods, buying much more than West Germany. Japan is the first or second largest market for a wide range of manufactured goods such as chemicals, commercial aircraft, photographic supplies, medical and scientific equipment, and pharmaceuticals. In addition Japan buys more than \$10 billion worth of American services annually, giving the U.S. an annual surplus in services trade.

### The Trade Deficit

U.S. exports to Japan are increasing steadily each year and are up around 10 percent this year. But there is a tension between the two countries, because U.S. imports from Japan have been increasing even faster. There are a number of reasons for this. For one thing, rapid economic growth in the U.S. has increased its demand for Japanese goods. For another, the strong U.S. dollar also increases U.S. demand for Japanese goods. All this has swollen the U.S. trade deficit with Japan to \$30 billion, some 50 percent more than the 1983 figure.

This voracious American appetite for imports is not limited to Japanese goods. The demand for goods from some other parts of the world has grown even more dramatically. In 1982, for example, the U.S. had a \$7.7 billion trade surplus with the European Common Market; this is projected to be an \$11 billion trade deficit this year. The 1983 U.S. \$2.4 billion deficit with Latin America, meanwhile, has grown to a projected \$17.6 billion this year. By comparison, the 50 percent increase in the Japanese trade deficit is relatively moderate.

### Capital Inflow From Japan

When economists evaluate bilateral economic relations, they look to the capital movement between two countries. Estimates by the Irving Trust Company indicate that Japanese corporations, individual citizens, and the government invested about \$25 billion in the American economy in 1984. In other words, while Americans bought \$30 billion in such Japanese goods as Toyota automobiles, Nikon cameras, and Seiko watches in exchange for U.S. currency, the Japanese sent back to the U.S. an amount nearly equivalent to the trade deficit. This money is invested in the U.S.; it helps lower U.S. interest rates, modernize American factories, and reduce the American unemployment rate. Long-term capital investments in American manufacturing sectors by Japanese companies have improved American competitiveness and boosted economic growth. In the long run, this could reduce American imports from Japan.

### Political Aspects of Trade Deficit

From the political viewpoint, the \$30 billion trade deficit has come to symbolize what some observers see as Japan's economic advantages over the U.S. Because trade-related industries are facing serious challenges from Japan and other countries, the deficit has mushroomed into a political issue in the U.S. As a result, trade-related industries are pressing Washington to seek Japanese cooperation in attempts to reduce trade imbalances. These pressures include calls for internationalization of the Japanese yen, opening the Japanese market to American goods, and extension of so-called voluntary automobile import restrictions.

There has been movement on some of these issues. The U.S. Treasury Department, for example, has convinced Tokyo to liberalize Japanese capital markets and to internationalize the Japanese currency. How far Tokyo moves on this will signal how serious Japan is in its efforts to comply with Washington's requests.

For the trade-oriented sector of the U.S. economy, the dollar's high value presents a problem. The strength of the dollar stems from such factors as the strong U.S. economy, the stable U.S. political system, the level of U.S. interest rates, and the dollar's role as the dominant international currency. If currencies such as the Japanese yen are internationalized, the burden on the dollar will be lightened, and the value of the yen will appreciate. Yet internationalization of the yen will take a long time; in the near term, therefore, the dollar is likely to grow stronger as capital outflows increase from Japan to the U.S. Once the yen starts climbing, however, U.S. exports to Japan should rise, and imports from Japan should fall.

A critical matter is U.S. access to the Japanese market. Some American industries are demanding quick action to open up these markets to their products. Yet Japan now has the lowest average tariff rate in the industrialized world. A State Department report notes, moreover, that in many respects Japanese markets are already quite accessible to American products.

This is not the case, however, for some items. Examples:

- 1) Tobacco products. Although Japan's primary source of tobacco is the U.S., few American-made cigarettes are sold in Japan. The reason is that Japanese-made cigarettes are protected by high tariffs and restrictive distribution systems. This is caused in large part by the Japanese government's ownership of the Japan Tobacco and Salt Public Monopoly Corporation. This organization is to be transferred to private ownership on April 1, 1985. Then, sales of U.S. cigarettes in Japan should increase.
- 2) Telecommunications equipment. Limited access for U.S. telecommunications manufacturers to the Japanese market is caused primarily by government ownership of the Nippon Telegraph and Telephone Public Corporation (NTT). This too is heading for private ownership on April 1, 1985. In addition, a second private telephone company is being formed in Japan. These developments are expected to increase substantially the accessibility to Japanese markets for American products--if the Japanese do not erect new obstacles.
- 3) Agricultural products. Japan is the largest importer of U.S. farm products, including beef and citrus. American agricultural economists estimate that, even if Tokyo eliminates its current quotas on beef and citrus, increased imports from the U.S. are unlikely.

- 4) Standards and certification. Many American goods have been excluded from Japan by a labyrinth of rules and standards governing imports. Some critics argue that such rules are designed precisely to keep out foreign competition. Relief in this area may be in sight, however. The Japanese government recently passed legislation simplifying import certification processes and product standards, albeit implementation has yet to be achieved.
- 5) "Voluntary" automobile restrictions. For four years, under intense pressure from Washington, Japanese automakers have imposed voluntary limits on their shipments to the U.S. The current agreement expires next March 31. While U.S. automakers have benefitted handsomely from this, as have Japanese firms which now sell their cars in the U.S. at premium prices, the victims have been millions of U.S. consumers who end up paying much higher prices for American as well as Japanese cars. It is estimated, in fact, that Americans this year are paying about \$5 billion extra for cars because of the "voluntary" quotas. Facing large trade imbalances, Reagan will ask Nakasone to extend the quota agreement beyond next March. The Japanese are well aware of the issue's political sensitivity, and for this reason, are more than likely to concede to the U.S. request.
- 6) Stimulation of Japanese domestic demand. One reason for the large U.S. trade deficit with Japan is that Japan's economy has been growing more slowly than America's--5 percent this year for Japan compared to 7 percent for the U.S. Reagan thus may encourage Nakasone to stimulate Japan's economy. But Nakasone will warn that this could lead to higher inflation and a large budget deficit.

. How Nakasone handles these issues in his talks with Reagan depends in large part on the current state of domestic politics in Japan.

#### JAPANESE DOMESTIC POLITICS

President Reagan was reelected for his second term by a historic landslide; he will lead the U.S. for four more years. Prime Minister Nakasone also gained reelection in 1984; the ruling Liberal Democratic Party (LDP) last October voted to keep him as its President for two more years. But not only is his tenure shorter than Reagan's, it is also not guaranteed; his government could fall at any time.

Japan has maintained Asia's most democratic political system since World War II. It has not succumbed, for example, to India's brand of dynastic democracy. Under Japan's constitution, the power of the Prime Minister is extremely fragile and potentially short-lived; indeed, Nakasone is Japan's 17th postwar Prime Minister, and his party lost 28 seats in last December's election

for the House of Representatives. In addition, he has come under sharp criticism in recent months.

To bolster his power, Nakasone may be tempted to dissolve the Diet and hold a House of Representatives election sometime this coming year. Among other vital issues, his management of the sensitive U.S.-Japanese economic situation will have a significant impact on the outcome of such an election.

#### CONCLUSION

Looking ahead, the United States and Japan will continue to develop close security and economic ties. At the same time, the two countries will face a number of relatively minor and a few major disagreements on bilateral issues.

Rather than blaming the other, each side needs to make compromises. Japan must open more of its markets to the U.S., but the U.S., for its part, must not push Nakasone and his conservative government beyond the point at which further concessions become politically unrealistic.

In dealing with individual issues, both countries must keep their common interests and the overall importance of the relationship at the forefront during any negotiations. An unacceptable level of friction can and should be avoided. Strained relations between the two countries would be detrimental to the economic growth and the health of democratic government in the free nations of the world.

For these reasons, the coming summit between Prime Minister Nakasone and President Reagan offers a great opportunity to consolidate their common goals and to further them worldwide in continued goodwill and mutual trust.

Katsuro Sakoh, Ph.D.  
Senior Policy Analyst