Chapter 4

Phoenix Arisen?

Trials and Tribulations of a 'Future Hegemon' (1974-1989)

By the late 1980s, such was the speed of its economic development that Japan came to be regarded as a hegemonic successor to the ailing US. Although lacking the necessary military capability to usurp the role of its pan-Pacific ally in the grand anti-Communist alliance, prolonged rapid economic growth and the increasing size of its economy led to a belief that Japan would soon takeover the economic functions of the hegemon. This new role for Japan in IPE was a reaction to its success under the auspices of the US economic and military role after the Second World War. For Japan, the faster growth relative to its contemporaries in the 1970s and 1980s seemed to reinforce the perception of inevitable US decline and Japanese succession. By the 1980s, the capitalist world seemed on the cusp of another hegemonic succession, with much of the IPE literature predicting Japan's rise as the pre-eminent global trading and banking state.

The increasing size of its economy brought calls for greater responsibility in the international political economy, especially from the US. The continuing and growing macroeconomic problems encountered in its bilateral relations with the United States meant that Japan was expected to play two increasingly incompatible roles: to help the US maintain its economy and global security posture through continuing economic problems as well as act to maintain the vitality of its own economy. The Yoshida Doctrine had enabled Japan to avoid choosing a postwar direction which followed both

US strategic and economic interests. But, as the roles reversed from the postwar period and the US came under further financial strain, especially during the late 1970s and early 1980s, Japan came to be increasingly pressured to increase its responsibility to the regional and international political economies. As Chapter 3 demonstrated, US policy towards a Japanese role and its leadership in the international system was very much geared towards fulfilling US interests in East Asia. Japan had a role as a supporter of the hegemonic system that the US had constructed after the Second World War. It was in US interests for Japan to become an ally that was not only economically powerful but also maintained a strategic component that aided the global struggle against the spread of Communism.

As noted in the previous chapter, the US conception of that role and the fulfilment of its regional interests was hindered, not only by Japanese opposition to such an active role in the postwar period but also by the East Asian countries that had been at the mercy of Japanese autarchy. Japan's legitimacy as a potential active participant in regional affairs was de-legitimised by this recent history and the hasty conduct of the postwar order and reparation process. As a result of internal political constraints as well as the terms of its alliance with the US, Japan's regional involvement was limited to trade and aid, which had begun through bilateral reparations agreements. This economic relationship did grow substantially after 1960, but the scope and speed of Japanese integration with the raw-materials producers in Southeast Asia and its former colonies in Northeast Asia were very much limited by a lack of trust and a fear of motives.

So, as far as the region was concerned and as made clear during the Tanaka Riots, Japan had an economic role through trade and aid, but very little else. But, from this position, the region grew to see Japan as a potential, if fraught, source of regional leadership. From the mid-1970s, in the aftermath of the 'Long Boom' driven by its increasing economic status and the economic and geopolitical changes in Southeast Asia, Japan moved towards a more comprehensive foreign policy that concentrated on issues beyond Japan's limitations on its economic diplomacy, even using the region as a hedge against US demands for increased responsibility. Starting with the Fukuda Doctrine in the late 1970s and the Japanese reaction to the Tanaka Riots, regional diplomacy came to see Japan as a partner in assisting regional economic development. As its growth story continued at a renewed pace in the 1980s, Japan's success not only offered the capitalist states of East Asia a model of economic development for emulation, but also a regional partner and sponsor that could help them achieve this through increased mutual trade and investment. Japanese *shido* and active encouragement offered a mutually beneficial outcome to two partners that realised the limitations of Japan's foreign policy agency.

This period, between the upheaval of the Nixon Shocks and the end of the Cold War, reinforced the roles that the US and East Asia placed on Japan. However, first Japan needed to overcome a major domestic problem – what would its goals be once it achieved economic parity with the US? Moreover, what impact could this have on the wider regional and global economy? These questions were to be answered in a way that reinforced the pre-existing concepts of Japan's role and responsibilities in the IPE.

Japan's success: its own perspective

From the beginning of this period, Japan and the world was recovering from the higher energy costs that the First Oil Shock of 1973-1974 delivered. Although it depended heavily on OPEC-oil, Japan quickly recovered from the initial shock, albeit at a slower pace than previously, as seen in Table 4.1. Despite the enormity of the Oil Shock, there were other reasons for this deceleration. The Japanese economy had 'caught up' to the West.[1] A mature Japanese economy could no longer take full advantage of its postwar recovery to attain concessions from the US; it would have to take its position in international society as an increasingly successful and independent developed state.

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[1] Y. Murakami, 'The Japanese Model of Political Economy', in K. Yamamura and Y Yasuba (eds.), *The Political Economy of Japan, Volume 1*, Stanford University Press, Stanford, 1987, p. 72 and 74.

Table 4.1: Average Annual Growth Rates of GNP and Productivity in the Advanced Industrial Economies, 1960-1985

	Growth in GNP		Growth in Productivity	
Country	Period	Percent	Period	Percent
United States	1965-73	3.8	1960-73	2.9
	1974-79	2.8	1974-84	2.3
	1980-85	2.2		
West Germany	1965-73	3.6	1960-73	5.9
	1974-79	2.4	1974-84	3.7
	1980-85	1.2		
France	1965-73	4.8	1960-73	6.4
	1974-79	3.1	1974-84	4.8
	1980-85	1.2		
Japan	1965-73	8.7	1960-73	11.0
	1974-79	3.7	1974-84	6.9
	1980-85	4.4		

Source: Bank of Japan, *Kokusai hikaku tokei* (International comparative statistics), Tokyo, 1985 in D. Okimoto and G. Saxonhouse, 'Technology and the Future of the Economy', in K. Yamamura and Y Yasuba (eds.), *The Political Economy of Japan, Volume 1*, Stanford University Press, Stanford, 1987, p. 386.

However, it was a state now bereft of a driving vision that could rival 'catch-up' growth, the policy that had gained a national consensus and provided the societal backbone behind 'the miracle'. Technological and economic advances could not take the place of the overriding theme that had been part of Japanese society since the early 1950s at the latest. Other aspects of Japan's postwar miracle were seen to be of less use for the upcoming economic and societal challenges that would face the nation.

> More specifically, most of the parapolitical nexus of administrative guidance, such as Japanese industrial policy, or the Japanese financial system, will be impracticable because of the lack of preceding examples, the increasing entry of foreign firms and the mushrooming of venture businesses. Moreover, target policies led by the bureaucracy may not only be unnecessary but even harmful because of the current uncertainty…over which industry is to be targeted…Perhaps all we can do is to prepare sufficient room for creative adventures, technological as well as social, without being afraid of the possible risks involved.[2]

There was a need to envisage a future role and capacity for Japan to act in after the pressing requirement of redevelopment during the 1950s. It needed a new dynamic from which to grow and prosper during the next century.[3] Having caught up, that option was unavailable; Japan now needed to lead from the front. Implicit in this desire (increasingly prevalent in responses by US pundits) for Japan to take the lead was for

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[2] Y. Murakami, 'The Japanese Model of Political Economy', p. 84.
[3] K. B. Pyle, 'Japan, the World and the Twenty-first Century', in T. Inoguchi and D. I. Okimoto (eds.), *The Political Economy of Japan, Volume 2*, Stanford University Press, Stanford, 1988, p. 446. The most used

Japan to follow in and emulate the footsteps of the US grand hegemonic project. Japan needed to deregulate and internationalise its economy and join the US to manage the international liberal economy.

The vision that Japan offered for the future of the post-industrial economic age was prefaced on its pre-existing strengths in new manufacturing industries, including computers and robotics. According to the economist Murakami,

> this 'twenty-first century system, the system of so-called high technology' will bring with it an entirely new 'paradigm': novel behaviour patterns in using the new technology; new groups of specialists engaged in producing and operating the new technology; a hitherto unfamiliar set of infrastructures, including large and multi-purpose cables, huge databases, and a new educational system; and a transformed social system.[4]

The chosen method to achieve this goal was by emulating the reform policies of the Western neo-conservatives such as Thatcher and Reagan, instituting deregulation and embracing the mantra of 'small government'. The problem that Nakasone faced lay in convincing the public to embrace liberalism, a task that was to prove more than difficult.[5] The past proved to be a stronger motivating force in the direction of Japan's economic development than the future possibilities of information technology (IT). That this model constituted what many saw as Japanese economic leadership was important to the way debates about economic development in the region progressed throughout the 1980s and 1990s. This had regional implications for Japan's model of economic development, which Chapters 5 and 6 address in depth.

While some debated the future, many others were caught up in the present triumph of Japan's successful development into one of the world's leading economic states. In 1984, it negotiated an increase in its IMF shareholding to become the second largest behind the US, passing Britain, Germany and France. The 1984 MITI White

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phrase used to describe Japan's future was as that of an 'information society', pushed during the Nakasone years, where information was the centre of economics and social interaction.

[4] K. B. Pyle, 'Japan, the World and the Twenty-first Century', p. 449.

[5] Y. Murakami, 'The Japanese Model of Political Economy', p. 86.

Paper foresaw Japan's emergence as the world's financial power and leading capital exporter, following in the hegemonic footsteps of Britain and the US.[6]

> Such a role is seen as seen as resulting from inevitably recurrent Japanese trade surpluses because of such inherent structural strengths as technical innovation, productivity and high savings that will always give Japanese manufacturers an edge over those of Japan's trading partners.[7]

Amongst the optimistic claims that this economic success could translate into leadership, were others preaching the likelihood of more prosaic outcomes. Prime Minister Ohira's Comprehensive National Security Study Group in the late 1970s worried about the effects a strengthening Japan and weakening United States might have on their security relationship.

Japan as an unlikely hegemon

These particular views fell within a growing domestic discourse searching for a new development paradigm for Japan. This was accentuated by Japan's comparative economic vitality compared to the relative decline of the US.[8] The economic triumphalism that followed this success lead to the belief that the days of US hegemony and leadership were nearing their end. As explained in Chapter 2, the question of international leadership in the years since the end of the Second World War became strongly attached to the concept of the hegemonic state and its presence during the early 1970s. Ironically at a time when they themselves and policymakers were concerned with its absence, Kindleberger and Gilpin were the first amongst many to delve into the capabilities and responsibilities of the hegemon within liberal IPE. This mission was to provide active leadership in three wide areas: security, trade and monetary matters. Hegemonic leadership, if conducted correctly, would enable costs and collective goods to be shared amongst many nations. Without such leadership by the hegemon, the international political economy would revert to a less certain and stable security politico-

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[6] K. B. Pyle, 'Japan, the World and the Twenty-first Century', p. 449.
[7] K. B. Pyle, 'Japan, the World and the Twenty-first Century', pp. 449-450.
[8] K. B. Pyle, 'Japan, the World and the Twenty-first Century', pp. 457-458.

economic environment, where specific national interests would compete with each other and constrain the optimal growth and success of the overall economic system. During the Cold War era in which a rival ideology threatened the existence of the liberal international order, the success and survival of US hegemony was critical.

Given that US economic supremacy was under threat during the 1970s and 1980s, it became clear to Gilpin and Kennedy that the US had fallen victim to the pyrrhic victory that is international hegemonic leadership. Gilpin remarked that a hegemonic leader must be able to put the long-term success of its economy over short-term interests, yet it was clear that the temptation to abuse its dominant position within the international political economy grew over time.[9] Although the hegemon formed the international economic system for both selfish and 'altruistic' reasons, the system was responsible over time for draining it of resources, explained in Chapter 2 through the principle of the free rider. Amsden, amongst many others including Kennedy, Gilpin and Kindleberger, referenced the current relationship to the earlier transition of economic and financial power at the beginning of the twentieth century. They also noted that Japan was a potential hegemonic successor should the US begin to suffer from systemic entropy.

> The competition in the late twentieth century between Japan, the quintessential learner, and the United States, the greatest economic power, unmistakably parallels a competitive relationship of the past. The United States has been challenged by Japan just as Great Britain was challenged a century earlier by the United States - on anew competitive front, using a new institutional framework.[10]

Gilpin already noted that since 1979, Japan had surpassed West Germany and the United Kingdom, taking over the role as the US financial underwriter that the latter had held previously.[11]

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[9] R. Gilpin, *The Political Economy of International Relations*, pp. 364-365.
[10] A. Amsden, *Asia's Next Giant*, p. 319.
[11] R. Gilpin, *The Political Economy of International Relations*, p. 380.

However, as was noted in Chapter 2, Japan faced obvious limitations that crippled its ability to be a US-styled hegemon.[12] Both reliant on the US market and security framework, coupled with the difficulties of Japan reforming itself to US standards made such a possibility an unlikely transition.[13] With this (amongst other things) in mind, former MITI counsellor Amaya Naohiro argued that Japan should get used to being 'Number 2', acting in a supporting role to its Pacific partner. He argued that world leadership required: military and economic power; a set of ideals with universal appeal; a system to export these ideals; and a distinct, viable and transferable culture. Although Japan could compete on the first of these levels, it was not yet in a position to provide the latter three.[14] The US was still the ultimate strategic and economic guarantor of the IPE and from the US view, Japan's role was to assist in the maintenance of that order. The existing role it fulfilled, called the *Nichibei* partnership by Gilpin, during the late 1970s and 1980s was increasingly seen as inadequate by US administrations. While a role of partner fulfilled basic mutual interests, it became clear that Japan was required to use its resources to increase the management of areas in which the US perceived there was not enough burden sharing.[15] As a result of its comparative economic success from the 1960s onwards, US perceptions of Japan's leadership increasingly followed the ebb and flow of IPE. When the US faced increased economic pressure, Japan was expected to follow US perceptions of what an alliance partner should do under those circumstances.

The politicisation of Japan's regional role

Since the 1970's, as seen by the increasing amount of US *gaiatsu*, expectations that Japan would assume more of a leadership role became stronger. The potential for an increased

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[12] R. Gilpin, *The Political Economy of International Relations*, p. 376, 377, 392.
[13] R. Gilpin, *The Political Economy of International Relations*, pp. 380-381.
[14] K. B. Pyle, 'Japan, the World and the Twenty-first Century', pp. 450-451.
[15] M. Kohno, "In Search of Pro-active Diplomacy: Increasing Japan's International Role in the 1990s," CNAPS Working Paper, [http://www.brookings.org/fp/cnaps/papers/1999_kohno.html], Accessed 18/3/2000.

role came to be recognised, albeit slowly, by the Japanese public and the policy-making community. Such demands historically not only faced internal constraints but also demands and constraint in areas that regional partners wanted Japanese activism. From a political and military perspective, Japan had to countenance the historically 'unpalatable' postwar proposition that it gain increased political influence in the region. As Welfield argued, US policy towards Japan since 1945 aimed at pushing a greater regional political and security role on it. Japan, through initial rejections from Yoshida onwards, discarded US initiatives on sending its troops overseas or joining wider attempts at actively containing Communism around the region. Japan was also prepared to economically assist states in the region but it was not "prepared to underwrite their military security".[16] However, Japan was happy for others to accept a greater security burden, hence it offered territory for US bases and moderately re-armed itself for self-defence. The two leaders subsequent to Yoshida, Hatoyama Ichiro and Ishibashi Tanzan, were as firm on these points, rejecting any claim that Japan increase its political and security ties with the region. The most pro-American Prime Minister of the postwar era, Kishi Nobusuke, attempted to increase Japan's regional role in 1960, but was defeated by internal LDP, wider domestic, as well as East Asian opposition.[17]

Whilst the US was barely content with Japan's offering of minor concessions to the wider fight against Communism in the region from 1950 onwards, Japan was content with the pre-Nixon Shock era as long as the alliance did not compromise its own perceived political and military interests. The interests of the two partners began to publicly diverge with the advent of the first 'Nixon shock' in 1969, US force commitments to East Asia were scaled back. Welfield argued that the original purpose of the Nixon Doctrine of 1969 was to encourage greater regional responsibility from Japan. When this failed, a rapprochement was sought with China.[18] In the early 1980s,

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[16] J. Welfield, 'Some Diplomatic and Strategic Aspects…', pp. 9-10.
[17] J. Welfield, 'Some Diplomatic and Strategic Aspects…', p. 11.
[18] J. Welfield, 'Some Diplomatic and Strategic Aspects…', p. 12.

Welfield argued that there were some limits to what Japan would accept and if US demands breached these limits, Japan would seek out other foreign policy options. This was, in part, driven by the breakdown of the postwar conservative compromise that had coalesced into the LDP. The same internal groups that favoured the San Francisco system; the business community, the bureaucracy and farmer's organisations, were the same groups that were feeling increasingly frustrated with their part in the alliance and increased US *gaiatsu* in this area.[19]

Whilst the alliance remained at the core of Japanese foreign policy, Japan acted to hedge its exposure to US policy changes. A more coherent and independent foreign policy became a necessary adjunct to its increasing economic presence in East and Southeast Asia. The Tanaka Riots of 1974 highlighted and reinforced regional tensions and perceptions of Japan's regional role. The suggested exploitation of Southeast Asian natural resources was a prime example of the poor perception that the region had of Japan. Added to the US withdrawal from Vietnam, fears of a reduced US presence under the Nixon Guam Doctrine undermined confidence in one of the main arguments for the US-Japan alliance, that it would suppress renewed Japanese military adventurism. Issues such as these confronted the alliance partners as the relative power differential within the bilateral relationship continued to shrink.

Greater Responsibilities: Japan, the US alliance and internationalisation

Through a re-emphasis on national goals and old alliances by nationalist leaders such as Nakasone, active and independently-constructed initiatives within Japan's foreign policies became less prevalent than they had before. There were a number of reasons for this. As scholars from Johnson to Reischauer to Dower had noted, a domestic policy consensus was a highly valued policymaking result. For large sections of the postwar era and before, such policy initiatives were formulated and sorted through a bureaucratic consensus designed to foster wider domestic and internal LDP cohesion. Needless to

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[19] J. Welfield, 'Some Diplomatic and Strategic Aspects…', p. 37.

say, most LDP policymakers saw following the US as the default position for Japanese foreign policy. Previous policy during the 1960s and 1970s, as has discussed above, defaulted to US foreign policy. Some saw this as a result of a lack of ambition and of rent-seeking, curious and atypical for a state that had reached major power status. This contradicted the ideal characterisation of great powers and their application of force and influence. Calder referred to Japan's use of influence as being 'reactive',[20] especially in comparison to other middle economic powers in Europe and elsewhere. He noted that Japan tended to be more reactive to *gaiatsu*, particularly from the US in matters of finance, trade and investment.[21] Japan was more cooperative with the US than West Germany, prepared to accept and adapt to US positions on monetary and fiscal policy from the Smithsonian Conference of 1971 to the Plaza Accords in 1985.[22] Calder noted the duality entailed within the reactive Japanese state.

> On the one hand, it finds independent initiatives difficult. Yet, on the other hand, it is often pragmatically flexible under outside pressure, particularly in sectors such as finance and high technology where market forces are strong, bureaucratic strength is waning and domestic interest groups are relatively weak.[23]

Although simplistic, this analysis reflected the dominant US perception that Japan and leadership were diametrically opposed. Japan was unable to define its interests itself and required tutelage in affairs, meaning that Japan needed to follow the policies of a major state.

Japan's position as a loyal alliance partner strengthened during this period due to a number of international and internal Japanese factors. Changes in Japanese foreign policy also took into account the change in geopolitical conditions. Japan effectively ended attempts at greater policy independence in 1979 with the end of superpower

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[20] K. E. Calder, 'Japanese Foreign Economic Policy Formation: Explaining the Reactive State', *World Politics*, 40(4), July 1988, p. 519.Calder defined a 'reactive state' as one that "fails to undertake major independent foreign economic policy initiatives when it has the power and national incentives to do so and secondly, it responds to outside pressures for change, albeit erratically, unsystematically and often incompletely".
[21] K. E. Calder, 'Japanese Foreign Economic Policy Formation', p. 521.
[22] K. E. Calder, 'Japanese Foreign Economic Policy Formation', pp. 523-524.
[23] K. E. Calder, 'Japanese Foreign Economic Policy Formation', p. 537.

détente between the US and USSR.[24] It realised that the alliance continued to be crucial to Japan's regional and global position. Hence, during the 1980s, questions of a role for Japan as a regional leader were subdued even as its economic growth outpaced the US economy. The most outward sign of growing economic confidence, especially during the postwar period, discussed how to combine a healthy US relationship with Japanese foreign policy.[25] The major proponent of this was Nakasone Yasuhiro, Japan's Prime Minister between 1982 and 1987, who attempted to internationalise and 'normalise' the Japanese debate on role and political and strategic policy, both on a regional and global level. Nakasone was instrumental, Funabashi notes, in changing the Japan's own perception of itself in international relations. One particular instance saw Nakasone visit Theodore Roosevelt's Long Island residence after a 1985 UN meeting.

> With his own similar global aspirations, he could identify with Roosevelt, a reform conservative in the age of America's rapid rise to world power, as noted by one State Department official. Teddy Roosevelt's inaugural address on 4th March 1905 seemed to describe the Japan of 1985: 'We have become a great nation, forced by the fact of its greatness into relations with the other nations of the earth, and we must behave as befits a people with such responsibilities'.[26]

In keeping with this hubris, Nakasone began to mould the nation to fulfil this notion of greater responsibility. By doing this, Nakasone considered actions many US administrations had tried to encourage Japan into since the start of the reverse course. And, following what conservative LDP politicians and the US had demanded for years, the main concentration of this modernisation was Japan's security policies. Military spending above the conventional figure of 1 percent of GDP, a figure deemed by Yoshida in the 1950s to be a compromise between regional concerns about re-armament and US concerns of free-riding. Article 9 in the Constitution was again reinterpreted to end the ban on the export of arms and related military hardware in 1984, as well as joining President Reagan in support of the 'Star Wars' anti-ballistic

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[24] J. Welfield, *An Empire in Eclipse*, p. 446.
[25] M. Kohno, "In Search of Pro-active Diplomacy: Increasing Japan's International Role in the 1990s."
[26] 'Kironitatsu Nichibei' (United States and Japan at the Crossroads), *Asahi Shimbun*, 18th September 1987, cited in Y. Funabashi, *Managing the Dollar: From the Plaza to the Louvre*, 2nd Ed., Institute for International Economics, Washington, 1989, p. 92.

missile project.[27] Such US-friendly measures were needed, considering the amount of pressure Japan was under, a factor that could be seen in the increasing trade surplus (see Table 3) with the United States. Finally, Nakasone tried to expand the scope of Japan's international role, such as through the failed attempt to mediate the between Iraq and Iran War in 1983-1984.[28]

Japan as an international economic power

Underpinning Nakasone's movement towards increasing regional and global responsibilities was the continuing growth, size and influence of the Japanese economy. As noted earlier, Japan's self-image of itself as a small, vulnerable nation gradually changed as its economic success continued. Its inclusion into the Group of Seven (G-7) in 1975 helped change this perception, which was further changed in the 1980s as it became the world's largest creditor and Tokyo became the third leading global financial centre (behind New York and London).[29] Vogel pointed to the three main areas that were then the basis of Japan's continued economic success: its revolutionary methods in manufacturing technology (automation through robotics and laser technology); concentration on the service sector and the expansion of R & D.[30]

Seen through Tables 4.1 and 4.2, the figures behind the perceptions show an economy that outperformed its Western peers. With growth in Gross National Product and Productivity nearly doubling the figures of its economic contemporaries over 25 years, Japan was at the forefront of economic dynamism in the global economy. Equally impressive was its export performance, in terms of Japan's relative global share, quadrupling its export share as a proportion of total Western exports between 1955 and 1982. In addition, Japan tripled its ratio of total Western exports of manufactures, increasing its level to 12.5 percent of the global market in the same period. Similarly,

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[27] D. B. Smith, *Japan since 1945: The Rise of an Economic Superpower*, p. 143.
[28] K. E. Calder, 'Japanese Foreign Economic Policy Formation', p. 525.
[29] Y. Funabashi, 'Japan and the New World Order', *Foreign Affairs*, 70(5), Winter 1991/1992, p. 59.
[30] E. F. Vogel, 'Pax Nipponica?' in E. R. Beauchamp (ed.), *Dimensions of Contemporary Japan: A Collection of Essays*, Garland, New York, 1998, p. 118.

although to a much greater extent, it radically increased its proportion of total western exports of machinery from 1.7 percent in 1955 to 18.4 percent in 1982. Such figures emphasised Japan's achievements and the potential and expectations for future growth, both of its economy and its ability to use its economic size for political means.

Table 4.2: Japanese Exports, 1955-1985 (percent)

As share of	1955	1960	1965	1970	1975	1980	1982
Total Western exports	2.4	3.6	5.1	6.9	7.1	7.1	9.1*
Total Western exports of manufactures	4.2	5.9	8.1	10.0	11.3	11.8	12.5
Total Western exports of machinery	1.7	3.9	6.7	9.8	12.5	16.3	18.4

Source: Bank of Japan, Statistics Office, *Kokusai hikaku tokei* (International comparative statistics), Tokyo, various issues.
*figure for 1983

Following the Plaza Accord and *endaka* (the period of the high yen) in September 1985 as part of, increasingly through foreign direct investment (FDI). As the 1980s continued, following the Latin American Debt Crisis, the healthy economic position of Japan contrasted starkly with the fragile state of the US economy.

In light of Japan's success, the pressure to maintain the success was added to by a growing sense of obligation to the US through fulfilling systemic responsibilities. The policies that Japan's policymakers used to not only maintain economic dynamism but reduce the threat of US retaliation was to begin to reduce barriers to trade and investment. Although domestic financial markets had been isolated/protected from outside interventions by foreign capital since 1931, a slow process of liberalisation, starting initially in the early 1960s, gained speed in light of growing US pressure through the 1970s and 1980s. Nakasone and like-minded policymakers saw liberalisation of this areas as the best "means of transforming Japan into an 'international state' suitable for global leadership".[31] These reforms were pursued by both banks and by younger

[31] Some experts (like Calder) have argued that this liberalisation was in response to US pressure and led to the 1980 revision of the 1949 Foreign Exchange and Foreign Trade Control Law and the May 1984 yen-dollar agreement between US Treasury and MOF. Although this pressure no doubt had a formal catalytic

'internationalists' in MOF "who saw financial liberalisation as a key to the continuation of Japan's increasing global economic and financial importance".[32]

The key factor in persuading this change in policy was the aforementioned growth of Japan's international creditor status. Before 1980, Japan was a net borrower of funds. However, due to a preponderance of excess savings after 1981 and a decrease in the size of government deficits, it became a net creditor, rising to the largest net creditor globally by 1985. A key component of this were increasing trade surpluses with the developed world and with the US in particular.

Table 4.3: Japan-US Merchandise Trade, 1974-89 (millions of US$)

Year	US Exports to Japan	Imports from Japan	Balance with Japan
1974	10679	12338	-1659
1975	9563	11268	-1705
1976	10145	15504	-5359
1977	10522	18550	-8028
1978	12885	24458	-11573
1979	17581	26248	-8667
1980	20790	30701	-9911
1981	21823	37612	-15789
1982	20996	37744	-16778
1983	21894	41183	-19289
1984	23575	57135	-33560
1985	22631	68783	-46152
1986	26882	81911	-55029
1987	28249	84575	-56326
1988	37723	89802	-51793
1989	44494	93553	-49002

Source: US Department of Commerce, *Survey of Current Business*, various issues and US Census Bureau, "US Trade Balance with Japan," [http://www.census.gov/foreign-trade/balance/c5880.html], Accessed 11/8/2001.

Table 4.3 reveals the trade deficit the US faced increased by over 29 times between 1974 and 1989. This surplus fed into wider international economic wealth; by 1990, Japan's external assets were valued at US$328 billion.[33] With Japan's rise as a creditor nation, the

effect, the decision is also a sign of internal decision making evolving out of purely domestic concerns. The reform process had started a number of years earlier and reforms did little to "dismantle the basic tool of the Japanese government's administrative guidance system: foreign exchange monopoly of the special foreign exchange banks. It was, as Pauly observed, a 'symbol largely for foreign consumption'". L. Pauly, *Regulatory Politics in Japan: The Case of Foreign Banking*, Cornell University East Asia Paper No. 45, Ithaca, NY, 1987, p. 14. cited in E. Helleiner, *States and the Re-emergence of Global Finance: From Bretton Woods to the 1990s*, Cornell University Press, Ithaca, 1994, p. 152.

32 E. Helleiner, *States and the Re-emergence of Global Finance*, p. 153. see also Y. Funabashi, pp. 88, 90-91.
33 E. Helleiner, *States and the Re-emergence of Global Finance*, p. 154.

prime beneficiaries of the exporting of Japanese funds were the Japanese financial institutions, allowing them greater international influence at the same time. By the late 1980s, aided by *endaka*, some of these institutions became the largest controllers of international assets "and the four largest securities houses consistently found themselves among the top six Eurobond underwriters".[34]

Japan's importance to international finance, although by no means hegemonic as the US dollar remained the international basis of exchange and US bond markets remained the market of last resort, had increased to the point where it was central to the overall structure of international finance and trade. Not only was the US heavily reliant on Japan's recycled capital exports, but its institutions were increasingly influential. As Helleiner notes,

> …Tokyo's Stockmarket had become increasingly incorporated in world markets and because of its growing size, foreign financial analysts were forced to follow its movements more closely; by the late 1980s, it accounted for a larger share of world stock market capitalisation than the New York stock market. The growing international importance of Japan's financial institutions had been demonstrated only two months before the crash, when a syndicate of Japanese banks helped the Bank of America out of its financial difficulties by purchasing a significant share of its subordinated debt. In 1988, Japanese financial institutions occupied the top twenty-five positions in one ranking of the size of the world's financial institutions measured by market capitalisation.[35]

Although this strength did prove transitory, Helleiner at the time saw the reform process and its internationalisation of Japan's financial markets as a process that could deepen Japan's long term financial strength in international finance.[36]

This strength was constantly compared to that with the US, whose institutions had hitherto enjoyed global financial predominance. The ability of the US economy to survive the debt crises of the 1980s came through the ever-increasing purchase of US Treasury bonds by the Bank of Japan and MOF, in order that the US could continue to maintain domestic spending and tax levels. From 1982, the US had been using

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[34] E. Helleiner, *States and the Re-emergence of Global Finance*, pp. 154-155.
[35] E. Helleiner, *States and the Re-emergence of Global Finance*, p. 185.
[36] E. Helleiner, 'Japan and the Changing Global Financial Order', *International Journal*, 47(2), Spring 1992, pp. 430-432.

expansionary fiscal policies to generate growth and instituting a policy 'benign neglect' in relation to the overvalued dollar for most of its first term in office, a series of actions otherwise known as 'Reaganomics'. Policies that compromised this policy combination, such as a 1985 MITI proposal suggesting the imposition of capital controls on outgoing funds, was extinguished with purchases of US bonds and securities in mind.[37] The enormity of policy decisions and their wider international implications became clearer as the 'twin' US trade and fiscal deficits grew larger.

Reaganomics and a overvalued dollar led the trade balance to flow heavily in Japan's favour.[38] Given the size of the trade deficit, Reagan made it clear that under his administration, as those of Eisenhower, Kennedy, Johnson and the early years of Nixon had done before him, that the relationship with Japan would be strengthened and consolidated. As before, Reagan outlined the "high expectations of Japan's political, economic and military role in world affairs" that reinforced its role as an integral alliance partner.[39] As the size of the deficit became ever larger, it became clearer what expectations the US would have for its Pacific ally. With influential US economists such as Martin Feldstein arguing that the Japanese were free-riding the postwar system for its own economic advantage, an increasingly outraged congressional response drove US demands for Japanese reform to assist in managing the US deficit.[40] Blaming the imbalance on Japan's closed domestic market and its unofficial market restrictions, such responses often called for further liberalisation in the Japanese market and domestic stimulation (albeit, without similar US action).[41] Japan questioned the quality and desirability of US goods exported to Japan, while the US highlighted 'structural impediments' in market access.[42] There were enough sectoral impediments in the

[37] E. Helleiner, *States and the Re-emergence of Global Finance*, p. 154.
[38] R. Leaver, 'Restructuring in the Global Economy?', p. 432.
[39] J. Welfield, 'Some Diplomatic and Strategic Aspects…', p. 2.
[40] M. Feldstein, 'American Foreign Policy and the World Economy', *Foreign Affairs*, 63, 1985, pp. 995-1008 in R. Gilpin, *The Political Economy of International Relations*, p. 377.
[41] J. Welfield, 'Some Diplomatic and Strategic Aspects…', p. 38.
[42] K. Fukushima, 'Japan's Real Trade Policy', *Foreign Policy*, 59, Summer 1985, p. 37. As Fukushima noted, "the Japanese economy, like the rest of Japanese society, is often governed by unwritten rules and mutual

Japanese economy to give the impression, at the time, that even if trade disputes were to be settled, new ones would begin.[43]

The inability to profitably invest in Japan accentuated perceptions of a closed market.[44] This rhetoric was inflamed by the description of Japan as a 'developmental state' by Chalmers Johnson; a phrase quite similar to the geopolitical speak used by George Kennan to describe the Soviet Union and its society.[45] However, as noted by Flath in Figure 4.1, in terms of tariff barriers, Japanese domestic industries were at least as open as their US counterparts during this period.

understandings that foreigners with scanty knowledge of the Japanese language and culture find difficult to master".

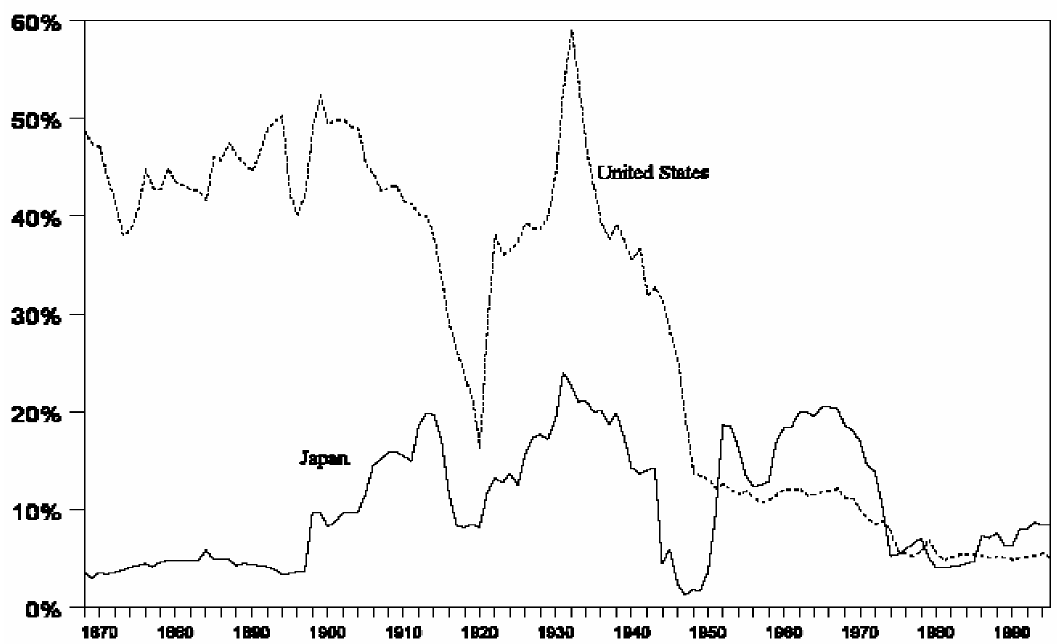
[43] J. Welfield, 'Some Diplomatic and Strategic Aspects…', pp. 17-18.

[44] see R. Wakasugi, 'On the causes of low levels of FDI in Japan', in Edward Chen and Peter Drysdale (eds.), *Corporate Links and Foreign Direct Investment in Asia and the Pacific*, Harper Educational, Pymble, 1995, pp. 112-128 and M. Mason, 'Japan's low levels of inward direct investment: causes, consequences and remedies', in Edward Chen and Peter Drysdale (eds.), *Corporate Links and Foreign Direct Investment in Asia and the Pacific*, Harper Educational, Pymble, 1995, pp. 129-152. Both look at the problem of low FDI in Japan, at least up to the early 1990s. Wakasugi highlights economic factors, such as the increase of the yen vis-à-vis the US dollar, as opposed to structural impediments and poorly targeted foreign products. Mark Mason emphasises structural impediments (from government regulations to keiretsu conglomerates) as opposed to economic or marketing factors.

[45] R. Leaver, 'Restructuring in the Global Economy', p. 433.

Figure 1: Annual average tariff rates*: Japan and the United States, 1868-1995

*Annual average tariff rates (Customs duties divided by dutiable imports)



Sources: Japan: LTES, vol. 14, table 22, p. 252; and *zaisei kinyū tokei geppo* (no. 389, Sept. 1989 and no. 534, Oct. 1996). US: US Bureau of the Census, *Historical Statistics of the United States*, from Colonial Times to 1970; and *Statistical Abstract of the United States* (annual) in David Flath, "A Perspective on Japanese Trade Policy and Japan-US Trade Friction", October 1998, [http://www-1.gsb.columbia.edu/japan/pdf/wp151.pdf], accessed January 2004.

Ironically, without the solid macroeconomic policies of the Japanese government and the huge trade surplus Japan enjoyed with most countries, the US economy might have been in an even worse state. The US internal deficit during the 1980's was financed by the Japanese purchase of short-term US Treasury bonds, keeping its interest rates artificially low at a time when the international financial system was in crisis.[46] This close relationship extended beyond maintaining the cycle of US consumption and Japanese exports. Fukushima highlighted the growing level of Japanese direct investments and capital flows using the US market (not to mention technological transfers, as discussed in Chapter 3, which were the complete reverse of the early 1950s).[47]

Dependable Allies?

While the US moved to manage trade and its relationship with Japan, on the global stage, these policies coincided with an ongoing US desire to 'liberalise' the governance

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[46] R. Leaver, 'Restructuring in the Global Economy', p. 434.
[47] K. Fukushima, 'Japan's Real Trade Policy', p. 22.

of the international liberal political economy, hoping to relinquish what it saw as the burdens of its centrality in the IPE onto Japan and West Germany. Beginning with the creation of the G-2 (US and Japan), G-3 (US, Japan and West Germany), and G-5 (with the addition of France and the UK) in 1975, a successor to the unilateral mandate of Bretton Woods was sought in order to coordinate . The US saw this as an opportunity to act as a CEO of the liberal international economy by delegating responsibility to others. Funabashi notes that the then Treasury Secretary James Baker himself defined a new perspective of looking at US leadership, one that differed from the scholarly concentration on hegemony.

> Our leadership has taken a form different from that of recent historical experience. The recent model has been one of national dominance in an international economic system – as represented by the United States in the aftermath of World War Two, or by Britain in the latter half of the 19th century. Our new leadership is more in the manner of an architect and builder, patiently and tenaciously pursuing a vision of economic growth and prosperity – trying to persuade others what may be accomplished while contributing our fair share.[48]

Within the new managerial approach to IPE, the US desired to keep its role as the arbiter of the global economic framework, with other countries like Japan following roles as supporters of US policies.

This approach ran into problems at a very early stage. The systemic problem of US deficit spending led to a macroeconomic policy response not seen since the Bretton Woods system. By the mid-1980s, the rapidly growing current account deficit began to worry Japanese and European that the US was not doing its 'fair share'. All realised that such deficits were unsustainable over the long term and that the foreign investment in US Treasury bonds would only be marketable within certain limits.[49] However, the implications of a reduced deficit were also worrying for Japan. A cut in the US budget would affect the G-5 countries in terms of reduced security (US military spending) and economic growth; a cut in spending would enact a global slowdown that would reduce

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[48] James A. Baker III, 'Remarks before the Chicago Economic Club', 11 December 1986, in Funabashi, *Managing the Dollar*, pp. 244-245.
[49] E. Helleiner, *States and the Re-emergence of Global Finance*, p. 183.

Japanese exports and growth.[50] The answer to this was the Plaza Accord, which was an attempt to reduce the trade deficit through a devalued US dollar and expansionary fiscal policies in Japan and West Germany.[51] The success of the Plaza Accord and other subsequent efforts at collective action by the G-5 and G-7 to support the US were tied to US efforts to reign in the budget deficit, seen internationally as the main factor behind the current account deficit. When it became clear that this was not going to be achieved, the markets reacted badly, causing, in part, the Stockmarket Crash of October 1987.

Macroeconomic policy coordination and the level of support Japan was prepared to give the US went against popular realist concepts of international statecraft. Major Powers usually acted selfishly to protect their strength, rather than Japan's supporting behaviour. Japan's actions also belied what was perceived as the inherent unworkability of collective action on a global stage. The problem of collective action of domestic policy, where national interests did not converge, meant that such a system had serious flaws. As Funabashi suggested, this ad-hoc process lay prone to backsliding, over-commitment, or reneging, inherent problems since most deals were done within the G-2/G-3 and delivered for broader agreement at G-7 level.[52] Funabashi notes that the inability for Baker to be able to take guarantees of action on fiscal policy (without the prior approval of Congress and the President) into meetings made it more difficult for Japanese and West German participants to agree on their own fiscal policies.[53] These pragmatic attempts at forming a consensus were by their nature frail and required some form of architecture that encouraged and enforced policy coordination. Such a

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[50] Y. Funabashi, *Managing the Dollar*, p. 1.
[51] For an in depth view of the bargaining process centred round the Plaza Accord and the discussions at the G-5 concerning the health of the international economy, see Y. Funabashi, *Managing the Dollar*, especially p. 4, 9.
[52] Y. Funabashi, *Managing the Dollar*, pp. 245-246.
[53] Y. Funabashi, *Managing the Dollar*, pp. 205-206.

framework did not exist beyond US expectations that West Germany and Japan in particular would continue to play supportive roles to US centrality in IPE.

From this period, questions of Japan's leadership role reached their apex. The influence of Japanese financial support for the US in the late 1980s was critical both in the Wall Street Crash and the solution to it following the Tokyo Stockmarket crash. Along with BIS-affiliated central banks increasing liquidity in global securities markets, it was MOF in late 1987 that "instructed the four principal Japanese securities firms to halt the Tokyo stock market's fall".[54] This, coupled with an agreement by the Reagan administration and Congress to cut the deficit (inspired by Japanese threats) and aggressive central bank interventions, regained international financial stability. As noted earlier, Gilpin was more enthusiastic for the *Nichibei* economy to succeed sole US responsibility, whereas Susan Strange saw Japanese financial strength as a transitory phenomenon before the US would re-assert itself. She saw Japan's strength as relational power, power that came from its status as largest creditor and aid donor nation. This could not compare with the structural power of the US, the power to define what areas of international finance states could accumulate power in; in other words, to define the parameters and rules of international trade and finance.[55] The US was the nation whose financial institutions led the world in financial innovation and held controlling votes in regimes that defined the extent and limitations of state intervention.[56] Japan's yen was not going to be used as a universal currency of any note while the US dollar was the incumbent and Japan's financial markets were still not as open or attractive as their US or European counterparts.[57]

Academic analysis of Japan's weakness compared to the US in the end missed the point. As theory suggested in Chapter 2, capability needed to be complemented by a will

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[54] E. Helleiner, *States and the Re-emergence of Global Finance*, pp. 184-185.
[55] S. Strange, 'Finance, Information and Power', *Review of International Studies*, 16, 1990, pp. 259-274.
[56] S. Strange, 'Finance, Information and Power', p. 265. Such regimes are the IMF, ADB and BIS.
[57] S. Strange, 'Finance, Information and Power', pp. 267-269 and E. Helleiner, 'Japan and the Changing Global Financial Order', p. 423, 426. In 1980, 34% of Japan's capital outflow ($10.8 billion) went to

to lead. Evidence from the late 1980s demonstrated that Japan pursued what could be termed a hedging course in its relations with the US, whether because of continued feelings of vulnerability, its relative inexperience in global financial affairs or of a sense of obligation due to the postwar reconstruction. Whilst increasing its voting position in international financial organisations, Japan used its newfound power to largely support, rather than supplant the financial dominance of the US. During the Latin American Debt Crisis of the 1980s, despite large investments in the region, Japan allowed the US to assert primacy and Japanese banks followed US policy more closely than US banks did.[58] It did act to rein in US current account deficits, with Japanese officials, supported by Nakasone and his cabinet, leading a limited disengagement from the US bond market in mid-1987 (which led to the Wall Street Crash).[59] However, as seen earlier, Japanese policymakers used their financial clout to stop the market panic before systemic stability was threatened.

Macroeconomic policy coordination and the health of the bilateral relationship were both threatened however. The lack of a power differential between the two Pacific powers led to tension as to where compromise should prevail and support should be given. Demonstrated at the Plaza and Louvre Accords, the tension continued through to the United States-Japan Working Group on Financial Markets in April 1988 three years later. Debate within the ADB between the two Pacific powers became increasingly heated, especially over conditionality and other policy conditions offered by the bank to developing nations. In 1989, after four years of supporting an expansive monetary policy in response to US demands that Japan stimulate domestic demand at increasing risk to its own economic health, Japan's central bank rapidly (and without market warning) increased interest rates, demonstrably to curb a dangerous spike in land prices.

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financing the US deficit. By 1987, this had grown to 46% of total outflow or $133.4 billion (a 12-fold increase).

[58] E. Helleiner, 'Japan and the Changing Global Financial Order', p. 432. Japan also hinted at watering down their support of the US dollar, speculating that Special Drawing Rights (SDRs), European Currency Units (ECUs) and the yen in particular were better choices for international reserve currencies.

However, as a result, this policy also acted in reducing the flow of Japanese capital into the US, a potentially globally destabilising policy.

With existing problems came the potential for a rapid escalation of bilateral tensions and instability. As fearful perceptions of Japan taking over control of IPE were calmed, fearful perceptions of the instability in bilateral relations arose. Would Japan be content with supporting an ally prone to hubris and non-negotiation? Isaac Shapiro noted that Japan was experiencing a renewal of nationalism that could see it become a thornier customer for US governments to deal with, much like France had become since the mid 1950s.[60] And Japanese initiatives, such as the 1988 Miyazawa Plan calling for a "more growth oriented approach" to the Latin American Debt Crisis, were credited to the US. After attacking the plan up to March 1989, given the long standing policy of 'laissez faire' debt arrangements between sovereign states and (largely) US banks, Secretary of the Treasury Nicholas Brady claimed the plan as that of the US.[61]

The economic relationship not only placed pressure on but also reinforced long standing tensions in the continuing security relationship. Throughout the 1970s, the nature of the alliance was one of the largest and most controversial domestic issues, despite the glowing terms it was portrayed in official communiqués. As Green and Samuels note, "Even as late as 1981, Foreign Minister Masayoshi Ito was forced to resign for having allowed Prime Minister Suzuki to use the word “alliance” *(domei)* to characterise the US-Japan relationship".[62] The strategic alliance continued to be of central importance to both parties although Japan maintained the appearance of being diplomatically unhindered by its close alignment to US security policy. Interestingly, one

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[59] E. Helleiner, 'Japan and the Changing Global Financial Order', pp. 434-435.
[60] I. Shapiro, 'The Risen Sun: Japanese Gaullism?', *Foreign Policy*, 41, 1980-81, pp. 62-81.
[61] E. Helleiner, 'Japan and the Changing Global Financial Order', pp. 435-436 and S. Katada, "Collective Management of International Financial Crises: The Japanese Government in the Pacific Rim", *Columbia International Affairs Online*, Columbia University Press, January 1999. [https://wwwc.cc.columbia.edu/sec/dlc/ciao/wps/kas01/], Accessed 23/11/2000.
[62] M. Green and R. Samuels, 'Recalculating Autonomy: Japan's Choices in the New World Order', *NBR Analysis*, 5(4), December 1994, p. 6.

of the ways that this potentially destabilising issue was handled, with use for both domestic and regional audiences, was through the creation of the concept of 'comprehensive security'. A broad policy, it sought to: alter the external environment to mitigate threats; achieve Japanese self-reliance; achieve solidarity with allies; and it tried to re-assure those frightened by the prospect of renewed militarism that another paradigm was available to guide Japan's strategic thinking.[63] Whilst this policy allayed neighbourly concerns, it also raised the prospect that Japan may be laying the foundations for a revision of its policies at a later date. The policy's broad applicability also gave the impression of vagueness, an attribute that led to uncertainty as to how Japan could accomplish these goals. Amongst the reasons for concern was the potential for Japan to return to old ideas of how to achieve thee goals of 'comprehensive security', rebuilding an exclusive postwar economic bloc, a modern equivalent of GEACS.

As the US-Japan partnership struggled under the weight of coordinating shared responsibilities demarcated by the US, questions arose to whether Japan would be content to be a leader without leadership. Japan, Helleiner argued, would be better able to fashion an international system that would be more efficient as well as one that would be equitable to the developing nations, especially in East Asia. Helleiner made it clear that he believed that Japan would be a better leader than the US because of its sensitivity to regional concerns and markets. And unlike the US, it could not use security concerns to abuse international finances for its own purposes.[64] Japan's approach to finance was different, taking a more interventionist approach in the marketplace, seeing it as a 'public good' that required bureaucratic management to prevent a 'tragedy of the commons'. Japan's integration into the global economy, and its long standing economic success, encouraged emulation which Japan eagerly allowed. With capitalist East Asian states looking to boost national sovereignty through encouraging national economic

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[63] M. Green and R. Samuels, 'Recalculating Autonomy', p. 6.
[64] E. Helleiner, 'Japan and the Changing Global Financial Order', pp. 438-439.

development, Japanese-inspired late industrialisation offered a rapid process through which they could accomplish this primary goal. Despite the power differential between the smaller states of East Asia and Japan, Japan was vulnerable to their perceptions of Japan's leadership role, a fact underlined through its dependence on East Asian raw materials and, as regional Japanese FDI increased, East Asian labour.[65]

East Asia and Japan's regional role

After the Tanaka Riots throughout the region, the US Guam Doctrine and the impact of higher fuel prices after the First Oil Shock, Japanese foreign policy required a substantial rethink. The potential for US withdrawal had the effect of upsetting a number of elements underlying Japan's security. While the Yoshida Doctrine had served the country well through its economic re-development, growing independence from US required Japan to pursue its national interest with greater diplomatic activism. From Tanaka onwards, Japanese foreign policy sought to balance increased economic clout with a new focus on regional diplomacy. Hoping to appear more responsive to both US and East Asian interests, Japan sought to pursue a role whereby it no longer required US patronage to interact with the region and yet still be trusted as a partner in regional affairs.

As noted in Chapter 3, this process of rebuilding diplomatic ties had started late. Japan organised a series of bilateral reparations agreements with the region starting in the mid to late 1950s. For various reasons,[66] this process was slow to start, was drawn out and dealt in amounts that were lower than many regional nations desired. However, there were important national interests that drove Japan and East Asia to slowly resolve their disputes. Japan's main concern, as it had been since the late 1950s, was in gathering raw materials from the region, that they could then transform and sell as manufactured

[65] E. Helleiner, 'Japan and the Changing Global Financial Order', pp. 440-441.
[66] The influences included pressure from the US for a speedy conclusion of negotiations as well as Japanese businesses eager to re-establish links to the region as a whole without being liable for their role in Japanese autarchy.

goods, primarily to the US and other developed countries. These policies were labelled 'resource diplomacy', which implied "the development of closer political and economic ties with countries that provide Japan with the raw materials it needs to operate its industries and maintain the standard of living of the Japanese people".[67] Although 'resource diplomacy' had been a part of Japan's regional engagement, the late 1970s saw the beginning of direct political involvement, moving beyond relations between Japanese businesses and regional governments. This can be seen in a number of Prime Ministerial trips between 1978 and 1980, when Fukuda travelled to the Middle East and Ohira visited Australia and New Zealand during 1979. As mentioned previously, given the uncertainty regarding the global economy and US East Asian policy, Japan hedged its interests in economics with those to increase its regional political role, a position given qualified support by Southeast Asia.

Suspicious of ulterior motives for a greater political or strategic role for Japan given its legitimacy deficit, regional conceptions of a role for Japan were very much tied to facilitating regional economic growth and development. While this was largely conducted through trade, this period also saw a greater role for Japanese aid and investment. Although undertaken with US support, the extent and growth of these linkages led to increased fears of Japan constructing an economic sphere of influence in the region to the exclusion of other states. Arguments over the merits of Japanese-led 'flying geese' product cycles, Japanese industrial guidance and Japan's centrality to the regional economy exacerbated existing bilateral tensions between the US and Japan.

The growing importance and coherence of ASEAN as an organisation in Southeast Asia was an important of Japan's regional strategy. ASEAN, the predominant regional political organisation in Southeast Asia, wanted Japan to engage itself in the region's economic development and make its commitments concrete rather than promise vague responses to broad economic issues through reducing trade deficits with

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[67] Isaac Shapiro, 'The Risen Sun: Japanese Gaullism?', p. 74.

its members. Before this re-evaluation, MOFA and both Prime Minister Sato and Tanaka had a low opinion of the regional body since its creation in 1967. The recently concluded feud between Indonesia and Malaysia, as well as other disputes between the original 5 members of this grouping seemed to offer a gloomy prognosis for organisational unity.[68] Sato, although he favoured multilateralism, did not think that ASEAN could function as an organisation amongst the many other bodies (an increasing number pushed and sponsored by Japan) clamouring for regional support at that time. Sporadic official efforts started with the creation of the Association for Overseas Technical Scholarship (AOTS) and the Thai-Japan Promotion Association (TPA) in the early 1970s.[69] These were constructed in part to diffuse growing trade tensions between the two entities. ASEAN's neutrality in the Cold War constituted another element that Japan was wary of; fearing a close relationship with an organisation hostile to foreign military bases would adversely impact Japan's own security relationship with the US.[70]

Japan, the Fukuda Doctrine and ASEAN

Despite earlier misgivings, Japan implemented its hedging policy of engaging the region through the Fukuda Doctrine. Prime Minister Fukuda came to power in late 1976 and moved with surprising speed, after centralised decision-making and MOFA engaged in *nemawashi* (laying the groundwork). Japan proposed to act "with the determined purpose of playing a political role" in the evolving politics of Southeast Asia.[71] The Fukuda Doctrine could be distilled into three major areas:

> 1) Japan's unprecedented experiment as a great economic power without military power, 2) the interdependent world community and Japan's responsibility to it, and 3) a sense of the world economic crisis and Japan's contribution to the world

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[68] M. Ikema, 'Japan's Economic Relations with ASEAN', in R Garnaut (ed.), *ASEAN in a Changing Pacific and World Economy*, Australian National University Press, Canberra, 1980, p. 471.
[69] R. F. Doner, 'Japanese Foreign Investment and the Creation of a Pacific Asian Region', in J. A. Frankel and M. Kahler (eds.), *Regionalism and Rivalry: Japan and the United States in Pacific Asia*, Chicago University Press, Chicago, 1993, p. 188.
[70] M. Shibusawa, *Japan and the Asia Pacific Region*, p. 102.
[71] S. Sudo, 'The Road to Becoming a Regional Leader: Japanese Attempts in Southeast Asia, 1975-1980', *Pacific Affairs*, 61(1), Spring 1988, p. 49.

> economic recovery and toward solving the North-South problems. Of the three, the first had been a long-cherished policy since his days as Foreign Minister.[72]

To combat perceptions of continued Japanese economic exploitation and future political ambitions, Fukuda and the two subsequent prime ministers (Ohira and Suzuki) wanted to strengthen non-economic ties between the two, promoting cultural exchanges and other so-called 'heart-to-heart' ventures.[73] For instance, Japan began its 'heart-to-heart' diplomacy with ASEAN from March 1978, contributing ¥5 billion to an ASEAN Cultural Fund. This was the first attempt at 'active cultural diplomacy' by Japan in Southeast Asia. Although lacking in short-term results, it was hoped that "its effect in the long run will bring about a significant change in Japan-ASEAN relations", mollifying the image of an exploiter of regional assets, hopefully enabling it to build closer political relations within the region.[74] Diplomatic engagement with its neighbours was not as difficult as it might have been considering the legitimacy deficit. From a governmental view, the 'honouring of consensus' in its foreign policy decisions worked well in the context Southeast Asian politics, where notions of national unity through consensus were crucial to state legitimacy.[75] This followed similar practice in domestic politics.

This new diplomatic interest in the region had greater use to Japan's leaders than just 'community building' in the Asia Pacific. Fukuda envisaged an enhanced relationship whereby Japan would seek comprehensive engagement with its southern neighbours.[76]

> Hence for the first time Southeast Asia became an integral part of Japan's endeavour as the White Paper on diplomacy in 1978 clearly showed. The role of Southeast Asia in enhancing Japan's international leadership thus became one of the fundamental tasks of Japan's diplomacy.[77]

After bilateral meetings with other states and international summits where ASEAN members were not invited, Japan made efforts to include ASEAN nations in the matters

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[72] S. Sudo, 'The Road to Becoming a Regional Leader', p. 34.
[73] R. F. Doner, 'Japanese Foreign Investment and the Creation of a Pacific Asian Region', p. 188.
[74] S. Sudo, 'The Road to Becoming a Regional Leader', p. 48.
[75] T. Kimura, 'Japan-US Relations in the Asia Pacific Region', p. 56.
[76] T. Shiraishi, 'Japan and Southeast Asia,' p. 185.
[77] S. Sudo, 'The Road to Becoming a Regional Leader', p. 39.

being discussed, as happened after Prime Minister Ohira's visit to China during 1979 and the G-7 Bonn Summit of July 1978.[78] Similarly, a trip by Fukuda to the US to meet with the Carter administration saw him use leverage to get both Japan and the US to ASEAN place at the centre of their regional foreign policies.[79]

As noted in Chapter 3, Japan's wartime legacy constituted a powerful barrier to increased trust with the region. Japan attempted to mitigate its legitimacy deficit throughout this period. Japan made clear during 1977 that it would not seek to become the next military power the region or replace the US as the regional security 'enforcer'.[80] For a region that keenly felt the occupation of their countries during the Second World War, this aided Japan's attempts to re-integrate into regional affairs. The idea of mutual benefit was an emphasised aspect of this new policy, yet each side had different ideas for the meaning behind the rhetoric.[81] If Japan was to increase its role in regional affairs, economics, rather than Fukuda's concentration on 'deep engagement', was ASEAN's prime focus. Aid, increased imports of ASEAN goods (as well as a preferential trade and tariff regime), the stabilisation of export earnings (through the STABEX facility), the extension of concessionary financing for ASEAN projects and a broader commitment to ASEAN's economic development were the main issues raised as areas requiring Japanese attention.[82] ASEAN collectively successfully pressured Japan on the dumping of synthetic rubber in world markets in 1973-1974, leading to Japanese concessions and administrative assistance for the natural rubber industries in Malaysia, Indonesia and Thailand.[83] For Japan, this caused problems within the domestic policymaking process, with individual ministries vetoing liberalisation attempts in their

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[78] S. Sudo, 'The Road to Becoming a Regional Leader', p. 49.
[79] S. Sudo, 'The Road to Becoming a Regional Leader', p. 33.
[80] T. Shiraishi, 'Japan and Southeast Asia,' p. 186.
[81] R. Stubbs, *Rethinking Asia's Economic Miracle*, Palgrave, New York, 2005, pp. 156-158 and S. Sudo, 'The Road to Becoming a Regional Leader', p. 36.
[82] S. Sudo, 'The Road to Becoming a Regional Leader', pp. 37-38 and C. Morrison and A. Suhrke, *Strategies of Survival: The Foreign Policy Dilemmas of Smaller Asian States*, University of Queensland Press, St. Lucia, 1978, pp. 284-285.
[83] C. Morrison and A. Suhrke, *Strategies of Survival*, p. 284.

policy areas. As a result, proposals for a specific trade regime with Southeast Asia was unanimously rejected; the spectre of Japan becoming involved with a trade bloc threatened US support and could lead to a trade war between the two.[84] The US did not want Japan to establish an economic sphere of influence from which US influence was excluded or highly diluted.

What ASEAN saw as leadership through Japan's increased economic role in the region would be seen by the US, not only as Japan's attempt to form an exclusive trade bloc, but also as diverting funds away from financing US deficits. Japan's inability to accede to the region's economic requests meant that the political aspect of this 'special relationship' was emphasised. Not only would Japan listen to Washington but to Bangkok, Kuala Lumpur and Jakarta as well. In an effort to placate its neighbours, Japan offered $1 billion to finance industrial projects within ASEAN instead of supplying this money for existing projects. Each country would have their own project, avoiding competition amongst members.[85] However, out of the six members, only Indonesia and Malaysia had projects as part of this initial offer completed. Thailand still had not found a site for its industrial project and The Philippines and Singapore had yet to develop plans past planning stages.[86] In terms of improving the balance of trade in the regions favour, measures to even the ledger were made, although not to the extent that ASEAN hoped.

As Table 4.4 shows, with the prominent exceptions of the oil-exporting Indonesia and Malaysia, the other members of ASEAN (as of the late 1970s) still faced sizeable deficits, despite the diplomatic initiatives pursued during this period. And

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[84] S. Sudo, 'The Road to Becoming a Regional Leader', p. 38. MOF rejected rapid increases in aid disbursements or FDI, whilst MAFF rejected any agricultural liberalisation and MITI was not ready for increased liberalisation of Japanese markets for manufactured goods.
[85] R. Stubbs, *Rethinking Asia's Economic Miracle*, p. 159 and S. Sudo, 'The Road to Becoming a Regional Leader', p. 38.
[86] S. Sudo, 'The Road to Becoming a Regional Leader', p. 47.

despite assurances of action, trade balances of Thailand and Singapore remained stubbornly in the red with their larger north-eastern neighbour.

Table 4.4: ASEAN's Balance of Trade with Japan, 1974-1989*

Year	Indonesia	Thailand	Malaysia	Singapore	Philippines
1974	2838.3	-355.7	-201.6	-842.6	8.5
1975	1654.4	-425.3	-161.0	-907.7	-148.5
1976	2079.8	-390.3	306.3	-777.8	-446.9
1977	2671.8	-805.9	179.9	-1048.9	-341.0
1978	2550.0	-815.9	233.0	-1528.0	-584.7
1979	5088.0	-717.5	838.0	-1638.0	-296.4
1980	7380.0	-970.6	487.0	-2751.0	-111.3
1981	7427.0	-1418.0	-340.0	-3064.0	-355.0
1982	6914.0	-1052.5	-652.0	-2782.0	-512.8
1983	5885.1	-1855.3	-580.0	-2867.0	-358.4
1984	7044.8	-1837.0	78.0	-3006.0	183.3
1985	5949.1	-1499.0	951.0	-2338.0	126.0
1986	3515.9	-1161.0	1036.0	-3147.0	-35.0
1987	3797.2	-1644.0	754.0	-4077.0	-169.0
1988	4660.8	-2948.0	-239.0	-6238.0	-88.0
1989	5420.1	-4314.0	-1422.0	-6784.0	-593.0

Source: IMF, *Direction of Trade Statistics*, various issues.
*Figures exclude Brunei.

Yet, ASEAN was still unhappy with the pace of access, an area of disappointment mentioned by leaders of this era talking of Japan's economic cooperation towards the region. Japan's traditional practice of extracting raw materials to domestically refine them also upset countries like Indonesia and The Philippines, who argued that such neo-colonial policies did little to boost regional development or engender closer political or economic relations.[87] After the Tokyo Round of GATT in May 1978, Japanese tariffs on items such as shrimp, plywood, palm and coconut oil were reduced and efforts were made to stabilise the prices of major commodities (such as tin, rubber and sugar).[88]

Another central aspect of the new partner role Japan defined for itself was its political involvement in ameliorating tensions between Cold War adversaries. By doing so, Japan was fulfilling both US and East Asian interests in peace and stability. In particular, Japan made efforts to engage Vietnam after the US withdrawal and the collapse of the South Vietnamese regime in 1975. After a failed attempt in the previous

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[87] C. Morrison and A. Suhrke, *Strategies of Survival*, pp. 217-218 and 257-258.
[88] S. Sudo, 'The Road to Becoming a Regional Leader', p. 48.

year to institute a region-wide organisation in Southeast Asia, MOFA convened the Conference of East Asian Councillors during March 1976, from which Japan came away with two commitments.[89] The first stated that Japan should help strengthen the resilience of ASEAN as a group; the second that Japan would aid efforts to build cooperation between ASEAN and Indochina. However, as Morrison and Suhrke point out, ASEAN rejected Japanese overtures to expand the relationship too far into the political sphere, rebuffing Japan's earlier attempt to widen the dialogue on rubber.[90]

Despite its alliance with the US, Japan made it clear that it was autonomous from the US, not wanting to hinder relations with Communist nations before in-depth talks could begin. In acting as a negotiator between Vietnam and ASEAN, Japan tried to establish dialogue and inter-governmental links between them, using reconstruction aid as a bargaining chip to scale back the threat of military escalation in the region.[91] Japan made similar attempts to mediate during the Vietnamese invasion of Cambodia in 1979, siding with ASEAN and China against what was seen as Vietnam destabilising the status quo.[92]

Flying Geese economic development? Japanese investment in East Asia

The outstanding economic features of the 1980s were all inter-related: the Latin American Debt Crisis; fluctuations in oil prices; the huge US twin deficit; and a return to pre-Second World War currency fluctuations. All impacted on Japan, the US and East Asia differently and each had a different reaction. Fighting a potential collapse of its banking system and trying to reduce the imports that fed its twin deficit, the US looked for Japan to accept a role with greater systemic responsibility. In US terms, this meant: higher values for the yen to reduce its export competitiveness (and reduce its sizeable trade surplus with the US, seen in Table 4.3); Japanese action to stimulate its economy;

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[89] S. Sudo, 'The Road to Becoming a Regional Leader', p. 28.
[90] C. Morrison and A. Suhrke, *Strategies of Survival*, p. 285 and 337.
[91] S. Sudo, 'The Road to Becoming a Regional Leader', p. 31 and 37.
[92] S. Sudo, 'The Road to Becoming a Regional Leader', p. 46.

and increased Japanese financing of US deficits. For East Asia, the Second Oil Shock and the Latin American crisis not only reduced demand for their exports but affected their capacity to borrow money from the international market. Japan was expected to act in a role of greater regional systemic responsibility, offering it greater access to difficult-to-access domestic markets to reduce the trade imbalance as well as increasing its investment in regional resources. Japan, as a country relatively protected from these shocks to the global economy, was expected to satisfy both. For East Asia, the above combination of factors in the global economy led to the arrival of Japanese investment in their countries in amounts that led to inflated expectations and doubts.

ASEAN was recovering from an economic slump and wanted to balance the trade relationship (as seen in Table 4.4, it was still very much in Japan's favour) as well as receive more of Japan's Foreign Direct Investment (FDI). Japanese FDI, a rare commodity before the 1980s due to MOF restrictions on capital shifting offshore, became increasingly apparent during this decade as increasingly protectionist trade measures and *endaka* forced Japanese producers to move their operations to Europe, North America and East Asia to maintain cost competitiveness.[93] With the Plaza Accord of 1985, the value of the Japanese yen appreciated by 40 percent over its previous rate near ¥240 to the US dollar, accelerating the need to maintain competitiveness for Japanese companies and the overall economy.

> Spearheaded by Japanese banks and securities corporations, Japanese FDI in 1986 was nearly double that of 1985. By 1988, the figure had doubled once again. It peaked in 1989 at $67.5 billion, some five times higher than it had been just five years earlier. While the bulk of this investment went to North America, roughly a quarter was targeted on Asia. Between 50 and 60 percent of Japan's new Asian investment was in manufacturing, and numerous firms, particularly in consumer electronics and automobile industries, began moving toward an expanded, intra-industry division of labour throughout the Asian region. The growth of Japanese investment in Asia during the 1980s was phenomenal. Thus, in 1989, Japanese firms invested four times as much money in Taiwan as they had in 1985, five times as much in Malaysia and South Korea, six times as much in Singapore, 15 times as much in Hong Kong, and 25 times as much in Thailand.[94]

[93] W. Hatch, "Exporting the State: Japanese Administrative and Financial Guidance in Asia."
[94] T. J. Pempel, 'Gulliver in Lilliput: Japan and Asian economic regionalism', p. 18.

Unlike the 1970s, Japanese foreign investment in the 1980s throughout Southeast Asia was concentrated on Japanese manufacturing and service industries as the need to continue operating exclusively at home diminished as the costs of investing abroad dropped dramatically in yen terms.[95]

Table 4.5: Japanese Foreign Direct Investment in Asia and the proportion of investment in Manufacturing (US$ billions)

	Year	Total amount invested	Amount in manufacturing (%)
World	1985	83.7	24.4 (29.1)
	1987	139.3	36.0 (25.8)
	1990	310.8	81.6 (26.3)
NIEs	1985	7.6	3.3 (43.4)
	1987	11.7	4.8 (41)
	1990	23.3	7.7 (33)
ASEAN	1985	11.2	4.0 (35.7)
	1987	12.8	4.9 (37.8)
	1990	20.8	9.9 (47.6)
China	1985	0.3	0.1 (33.3)
	1987	1.7	1.0 (58.8)
	1990	2.8	2.8 (100)

Source: Ministry of Finance, Japan. S. Urata, 'Changing patterns of direct investment and the implications for trade and development', in P. Drysdale and R. Garnaut (eds.), *Asia Pacific Regionalism*, Harper, Sydney, 1994, p. 273. Newly Industrialising Economies (NIEs) are composed on Hong Kong, South Korea, Taiwan and Singapore.

Certainly, this can be seen in Table 4.5 and 4.6. The growth of Japanese investment increased quite substantially after the macroeconomic changes set at Plaza, so much so that its share of regional FDI increased rapidly. Important too to note is the effect that Plaza had on the export competitiveness of NIEs.

[95] T. J. Pempel, 'Gulliver in Lilliput: Japan and Asian economic regionalism', p. 18.

Table 4.6: Foreign Direct Investment in East Asia (US$ millions)

Host / Source	Japan	US	Korea	Taiwan	Hong Kong	Singapore	Total
Thailand							
Up to 1987	2773	1910	9	675	445	351	11536
1988-1989	4431	570	66	530	278	408	7868
Malaysia							
Up to 1987	1741	202	0	34	262	594	4200
1988-1989	967	179	49	1314	138	231	3690
Indonesia							
Up to 1987	5928	1244	222	144	1876	299	17284
1988-1989	1304	783	728	1126	867	489	11159
Philippines							
Up to 1987	377	1620	-	-	-	-	2830
1988-1989	71	98	-	-	-	-	275
Korea, 1984-1988	1857	876	-	-	-	-	3648
Taiwan, 1984-1988	1343	1251	-	-	-	-	4170
Singapore, 1984-1988	2200	2814	-	-	-	-	6529

Source: P. Petri, 'The East Asian trading bloc: an analytical history', in R. Garnaut and P. Drysdale (eds.), *Asia Pacific Regionalism*, p. 120.

In the cases of both NIEs and ASEAN, both received a huge amount of their FDI after the Plaza Accord and a large proportion in most cases sent from Japan. For FDI in Indonesia, Malaysia and Thailand, Japanese investment was more than double of the US, raising US suspicions about future Japanese motives given the size and speed of growth for Japanese regional investment.

Throughout this period, US *gaiatsu* continued to assist Japan's economic relations with the region while at the same time castigating Japan for not reducing the size of the bilateral trade deficit. The US pushed Japan to stimulate domestic economic activity and increase foreign assistance, in an effort to decrease exports to the US. The level of US efforts to manage trade with Japan grew with the deficit, leaving Japan increasingly resentful of US blame tactics and notions of responsibility.[96] Fears of increased protectionism in the US encouraged Japan to look to Asia for opportunities to limit their reliance on its primary market. MITI encouraged the idea that a horizontal labour linkage be formed with its neighbours as this would both expand the regions industrial capacity and national growth whilst promoting Japanese exports to the region and "reducing the destabilising impact of Japan's economic self-sufficiency".[97] The regional economy grew increasingly interlinked as Japan shifted operations to the NIEs and Southeast Asia, bypassing, during this period, of US restrictions on Japanese goods.

As well as changing government regulations to take advantage of the rapidly increasing amount of FDI entering the region, Thailand, South Korea and Malaysia tried to emulate the Japanese development experience (to varying levels of success; South Korea has been the most successful with its *zaibatsu*-like *chaebol* system and system of administrative guidance). Each country tried to implement this through closer public-private collaboration; Malaysia went so far as to urge its workforce to emulate the Japanese work ethic. The efforts in Thailand and Malaysia, however, were undermined by the internal dynamics of each country (for Malaysia, antagonism between the Chinese capitalists and the Malay government; for Thailand, problems in divulging power away from the military government).[98] The leadership of Japan as a model of economic development, fed what some were to see as a 'trade-investment nexus', a mutually-reinforcing combination of trade, FDI and growth fuel widespread and durable economic development.[99] Different from the Western/IMF position on the relationship between state and market, regional support for state involvement in economic growth fitted in with regional circumstances of post-colonial self rule and the need for rapid economic development. Japan's success with this method and its regional involvement through trade, investment and aid came to be seen as an important part of its wider movement towards increasing its credibility for leadership, both in the region and the world.

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[96] R. Leaver, 'Restructuring in the Global Economy?', p. 448. and R. F. Doner, 'Japanese Foreign Investment and the Creation of a Pacific Asian Region', p. 188

[97] R. F. Doner, 'Japanese Foreign Investment and the Creation of a Pacific Asian Region', p. 188.

[98] R. F. Doner, 'Japanese Foreign Investment and the Creation of a Pacific Asian Region', p. 192.

[99] P. Petri, 'The interdependence of trade and investment in the Pacific', in Edward Chen and Peter Drysdale (eds.), *Corporate Links and Foreign Direct Investment in Asia and the Pacific*, Harper Educational, Pymble, 1995, p. 29.

Japan as Economic Model

The 1970s and 1980s saw an intensification of debate, regionally and internationally, on economic development in East Asia. After the economic development of the Newly Industrialising Countries (NICs), South Korea and Taiwan in particular (both entrepot city-states, Hong Kong was of a laissez faire style, whilst Singapore was a case of a more state-controlled economy/society), were both cited for their use of neoclassical economics, which stressed the importance of limited government intervention in the economy and the market allocating resources. In what was to be another case of 'catch-up' East Asian scholarship, Robert Wade and Alice Amsden demonstrated in the late 1980s the importance of Japanese-style methods in the process of late industrialisation in Taiwan and South Korea during the 1960s and 1970s.[100] Wade pointed to Governed Market (GM) theory, whereby the government would encourage the market to invest in *strategic industries*, as the method whereby Japan regained its place as one of the world's economic drivers (the 'capitalist developmental state' that Johnson referred to- see Chapter 3).[101]

In this explanation of the Asian 'miracle', the Japanese 'model' designed to boost economic development in the 1950s and 1960s became the 'textbook' for two of the tiger economies, Taiwan and Korea in the 1960s and 1970s. The areas of similarity between them included:

> redistributivist land reform, post-reform ownership ceilings, restrictions on financial institutions, a bank-based financial system able to sustain high debt/equity ratios, exchange rate controls, protection, direct foreign investment controls, export promotion, and selective government leadership in investment and technology.[102]

In addition, MITI was the model for their counterparts in these countries, who followed similar roles both in and outside of bureaucracy; Taiwan in particular followed the

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[100] See R. Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialisation*, Princeton University Press, Princeton, 1990 and A. Amsden, *Asia's Next Giant: South Korea and Late Industrialisation*, Oxford University Press, New York, 1989, especially Chapters 3 and 4.
[101] R. Wade, *Governing the Market*, p. 25.
[102] R. Wade, *Governing the Market*, p. 326.

widespread Japanese practice of *amakudari*, whereby senior bureaucrats would become employed by private interest groups lobbying the government on policy matters. The relationship with South Korea was more informal and balanced with memories of Japanese occupation before the Second World War. Japan was an unofficial model for Korea under the leadership of President Park Chung Hee (1960-1979), with similar policies towards exports, investment and exchange rates used.[103] This is not to say that they were exact replicas. The relationship between businesses, the state and the structure of the state differed between Japan and its neighbours, as did the macroeconomic conditions that late industrialisers faced.[104] Being a model didn't mitigate regional fears of a return to past Japanese domination. For instance, South Korea increased restrictions on Japanese goods and investment after it gave Japan diplomatic recognition as part of the normalisation of relations after the treaty of 1959.[105]

It was the more difficult times that faced those undertaking late development that demonstrated the role that Southeast Asian states desired of Japan. The economic development of the NIEs and their expansion into light, medium and heavy industries were facilitated by growing markets for these goods and a rapidly growing world economy, growing at around 4% per annum up until the early 1970s. Raw materials were relatively cheap, especially oil. Those attempting development in the 1980s did not have these factors in their favour with the additional problem of a fluctuating exchange rate.[106] The region desired of Japan a role similar to that played by the US to Japan after the Second World War: acting as a market, source of technology and economic opportunity.

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[103] A. Amsden, *Asia's Next Giant*, p. 51. Such factors included the willingness of the US to accept manufactured exports and the higher cost of energy, amongst others.
[104] R. Wade, *Governing the Market*, p. 327.
[105] A. Amsden, *Asia's Next Giant*, p. 74.
[106] R. Wade, *Governing the Market*, p. 347.

The Politics of Japanese Aid

During the 1970s and 1980s, foreign aid moved to the front of Japan's foreign policy. The 1970s saw the evolution of this policy where aid was used to placate the US and was used throughout the decade for this purpose.[107] It also became one of the few foreign policy tools whereby it could gain diplomatic leverage in regional and international affairs, given Japan's unique regional role(s) and its legitimacy deficit.[108] The method in which Japan decided the amount and direction of aid became important to the US considering the success of *gaiatsu* to shape the decision-making process within the bureaucracy.[109] Japan could aid countries and regimes, increasing the amount of aid going to US-sponsored countries with no drain on US coffers. Some instances of aid donation were made in areas where Japan had little interest, suggesting US involvement in the process. This gave rise to the suggestion that "sometimes Japanese interest lies in simply placating Washington's requests".[110] As noted earlier, after the invasion of Afghanistan, Japan began to introduce the aspect of 'comprehensive security' into their aid policies. Until then, the aid process was driven by more idealistic concerns and US-led Cold War attempts to improve the progress of development in the Third World (for example, in an attempt to stop Soviet influence taking root).[111] The aid policies to East Asia, as mentioned in Chapter 3, were also related to the messy process of postwar US-sanctioned reparations that Japan entered into during the 1960s.

Aid played an important part of the perception of Japan as a developmental model and supporter of East Asia. As mentioned earlier, despite regional pressure, Japan failed to reform its domestic market to allow free market access. However, on the

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[107] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, p. 110.
[108] A. Rix, 'Japan's Aid Program A New Global Agenda', p. 2.
[109] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, p. 3. and M. Beeson, *Competing Capitalisms*, Macmillan, London, 1999, p. 77. Foreign pressure does have its limits on policy as it largely depends on a local or domestic interest becoming involved. As Schoppa (*Bargaining with Japan*, Columbia University Press, New York, 1997) argues, where the US has no internal support, its pressure has little impact on decisions made.
[110] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, p. 113.
[111] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, pp. 111-112.

other hand, Southeast Asian states did benefit from two economic options more palatable to Japanese policymakers: aid and FDI. Aid, in particular, was specifically focused on East Asia throughout the period. Orr noted that it was during the 1970s that MOFA tried to distribute aid on a proportional basis of 7:1:1:1, with Asia being the main beneficiary.[112] Japan pledged up to US$65 billion (up to 1992) to be disbursed amongst Japan's ODA agencies and the IFIs, to be used as loans, grants and debt relief to countries around the world. Asia was targeted in these programs; China and ASEAN remained at the top of Japan's aid policies.[113] Between 1973 and 1989, more than 60% of its aid went to the region. Demonstrated through Table 4.8, although Asia declined as an aid destination from 98% in 1970 to 62.8% in 1988, the size of Japan's aid budget increased by approximately twenty times. In terms of size, demonstrated in Table 4.7, Japan became the largest global aid donor, surpassing the US for the first time in 1989.

Table 7: Net Global ODA, 1970-1989 ($US Millions)

Year	US	Japan
1970	3153	458
1974	3674	1126
1975	4161	1148
1976	4360	1105
1977	4682	1424
1978	5664	2215
1979	4684	2685
1980	7138	3353
1981	5782	3171
1982	8202	3023
1983	8081	3761
1984	8711	4319
1985	9403	3797
1986	9564	5634
1987	9115	7342
1988	10141	9134
1989	7677	8965

Note: US figures for 1990, 1991 and 1992 include in debt forgiveness
Source: OECD, Reference DAC Statistical Tables, Global ODA Net, 1950 - 2002, [http://www.oecd.org/dataoecd/43/24/1894385.xls], Accessed 22/2/2004.

[112] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, p. 55.
[113] A. Rix, 'Japan's Aid Program: A New Global Agenda', Australian International Development Assistance Bureau, *International Development Issues*, No. 12, April 1990, p. 32 and 37.

The figures also demonstrate the rapid rise of aid disbursement after the Plaza Accord and the impact that neoliberal arguments against unconditional aid had on the amount of aid donated by the West and the US in particular.[114]

The politics of aid gained in symbolic importance as the debate about US decline and Japanese success gained momentum in the 1980s. It achieved such significance for a number of reasons. First, following on from reparations programs in the 1950s and 1960s, aid maintained activity and influence in a region which was quick to be wary of political interference. With the US concerned about Japanese economic activities that could lead to closed regionalism and the Constitution limiting the array of foreign policy tools it could, aid donation was a largely accepted aspect of the regional political economy. The concentration of aid to Southeast Asia, argued Yatsutomo amongst others, was also an indication of foreign policy interest and of Japan's desire to be a regional leader.[115]

Second, the actual use and composition of aid was question, specifically because of the long-standing practice of using aid as aid to start construction of projects used by Japanese affiliates. The private sector was both a catalyst and magnet for aid, with the contribution of Japanese government seen as 'seed' money for private sector investment in either resource development or establishing new plant and capital. Japan's private sector was also involved through the *yosei shugi* system of aid deliverance. By making aid available on recipient request rather than through Japan specifying specific projects, Japan avoided regional fears that aid could be used as a neo-imperial tool. With the necessary project coordination skills initially lacking in regional countries, Southeast Asian states often required help from Japanese businesses, linking Japanese economic expansion with regional development.[116] After increasing pressure from regional

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114 Yoichiro Sato, "Toward a Non-threatening US-Japan Alliance".
115 D. Yasutomo, 'Why Aid? Japan as an "aid great power"', *Pacific Affairs*, 62, Winter 1989/90, pp. 499-500 and W. J. Long, 'Non-proliferation as a Goal of Japanese Foreign Assistance', *Asian Survey*, 39(2), March/April 1999, p. 329.
116 R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, pp. 59-60.

governments to stop this collusion, Japanese aid reformed to the point where most aid financing were delivered as untied programs rather than projects and were opened to non-Japanese contractors. By 1988, 45% of all contractors were from Less Developed Countries (LDCs) whereas Japanese made up 27% of the total. This was in contrast to figures of 24% and 57% in 1982 respectively.[117]

Thirdly, a debate existed about how much of Japan's aid could be truly be said to be aid. Orr argued that Japan's need to prove themselves as internationally responsible as well as demonstrating an 'emotional commitment to Asia' underlay this policy.[118] However, the US claimed that Japan was not acting responsibly or without conditions, calling into question any credit it could gain through aid. Additionally, given that Japan only became an aid donor in response to US pressure, according to this argument, Japan's efforts were not as altruistic as they would at first appear. The pragmatic mercantilist purpose of aid has been one of the continuing criticisms of Japan's aid policies, with Arase suggesting that discussions of aid concentrated on the foreign policy relationships and the security aspects but neglected the mercantilist element of Japanese aid.[119] The debate over tied and mixed credits during the mid-1980s is a good example of the use of *gaiatsu* in Japanese aid. The US had complained of the mercantilist tones in Japanese aid for a decade before this incident,[120] but the continuing growth in the US balance of payments deficit with Japan set the embers ablaze. Seen in Table 4.8, this perception was no doubt fuelled by a tripling of aid funds to Asia during the 1980s. The majority of Japanese aid going to Asia frightened the US, seeing this as a potential precursor to an attempt at a Tokyo-led closed regional economic system.

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[117] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, pp. 64-68.
[118] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, p. 5.
[119] D. Arase, *Buying Power: The Political Economy of Japan's Foreign Aid*, Lynne Rienner, Boulder, 1995, p. 2.
[120] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, p. 125.

Table 8: Japan's Bilateral Aid to Asia, 1980-1988 ($ millions)

	1980	1985	1986	1987	1988
Asia	1383 (70.5%)	1732 (67.8%)	2494 (64.8%)	3416 (65.1%)	4034 (62.8%)
- Northeast Asia	82 (4.2%)	392 (15.3%)	490 (12.7%)	577 (11%)	724 (11.3%)
- Southeast Asia	861 (44%)	962 (37.6%)	1169 (30.4%)	1866 (35.6%)	2196 (34.2%)
- ASEAN	703 (35.9%)	800 (31.3%)	914 (23.8%)	1680 (32%)	1930 (29.9%)
- Southwest Asia	435 (22%)	375 (14.7%)	831 (21.6%)	970 (18.5%)	1109 (17.3%)
- Unspecified	5 (0.3%)	3 (0.1%)	4 (0.1%)	3 (0.1%)	3 (0.1%)
Global Total	1961 (100%)	2557 (100%)	3846 (100%)	5248 (100%)	6422 (100%)

Source: MOFA, *Japan's Official Development Assistance, 1988: Annual Report* in Orr, *The Emergence of Japan's Foreign Aid Power*, pp. 70-71.

There was an element of double standards in this attack on the policies that the Japanese used to designate their placement of aid as other major countries skewed their aid donations to particular areas. British and French aid flows predominantly to countries in the Commonwealth and former colonies respectively. During the 1980s, 40% of US aid went to two countries: Israel and Egypt.[121] Japan tried to counter this perception with a greater multilateral effort (within the Development Assistance Committee of the OECD and other international bodies such as the ADB) and a greater political involvement in Asian affairs. However, the continuing problems with tied aid and a Japanese methodology that looked at the expansion of aid rather than its quality (and its bias towards Japanese commercial interests) undermined this role.[122] Japan's dual role complicated its foreign policy, causing tensions that would inevitably lead to difficult choices in the years ahead.

While the region gained from the bilateral tension between the US and Japan in the 1980s, the impact of Japan's increasing success became a regional problem as well. Regardless of how much Japan tried to recycle funds received from the US trade surplus, the US desired Japan to reconfigure its structural advantage and take on greater

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[121] R. M. Orr, *The Emergence of Japan's Foreign Aid Power*, p. 69.
[122] A. Rix, 'Japan's Aid Program: A New Global Agenda', p. 2.

responsibility. Japan began to use commercial banks to become involved in the recycling of the trade surplus through lending to Asian states. Masao Fujioka, a former high ranking official of MOF, noted that the government preferred portfolio investments commercial bank lending to direct investment, since "direct investment could, if mishandled, create friction and conflicts between investing and investment-receiving countries".[123] While Japan became ever more cautious about the balance of economic power between it and the US, the US was increasingly unwilling to shoulder the burden of East Asian production through its consumption.

The US became less tolerant of its burgeoning trade deficits with East Asian exporters, let alone Japan. Japan and NIEs were targeted under section 301 of the revised US Trade Act (1984) when the notion of 'reciprocity' was included in trade relations as a way of reducing the trade imbalance.[124] Such measures and the increasing difficult conditions led Chen and Haggard to suggest that East Asia would have to pluralise and liberalise its economies and societies in the coming years, at a time when Southeast Asia was looking to read and follow 'the textbook' of Japanese development. Japan, with its strong presence in the global economy and multilateral fora, such as the IMF and ADB, became a regional advocate of state-directed development at a time when this method of development was increasingly derided by the largely Western neoclassical economic fraternity as protectionist and anti-competitive. This ongoing debate continued with increasing zeal into the 1990s, as we shall see in Chapters 5 and 6. After failing to reduce the trade deficit through currency manipulation and threats, the US moved on to what it called 'structural impediments' in East Asia. The difficulty in selling US products to these markets became the latest in a long line of attempts at externalising the adjustment of the 'twin deficits'.

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[123] S. Katada, "Collective Management of International Financial Crises: The Japanese Government in the Pacific Rim."

[124] T. Chen and S. Haggard, 'Newly Industrialising Asia in Transition: Policy Reform and American Response', *Policy Papers in International Affairs*, 31, Institute of International Studies, University of California (Berkeley), 1987, pp. 78-79.

Conclusion

By 1989, the US perceived Japan to be abusing its role as the world's second largest and most responsible state in IPE, given the size of the trade deficit. US perception of Japan's leadership role remained tied to the potential for Japan to further the US's own exclusive interests. Yet, despite the US wanting Japan to contribute more to international causes and overcome its passive postwar foreign policies in the region, its attempts to fulfil its obligations were not accepted as being reasonable or consistent with their increasing prosperity. From the US point of view, burden-sharing was acceptable where Japan undertook greater economic and security responsibilities as long as the US remained at the apex of global leadership. Its rapid rise from a state concentrated on economic development to a country that was seeking a new position at the forefront of industrialised countries demanded greater responsibility.

Desiring national economic development to spur job creation and give their states viability in the face of the Cold War, East Asian states desired a role for Japan that allowed it to fund and assist regional economic development. Through trade and aid initially, then through FDI in the 1980s through *endaka* and the search for cost competitiveness, Japan boosted its role as a catalyst for further regional economic development. It was this role that regional states, either bilaterally or through ASEAN, that they encouraged Japan to fulfil. It could lead economically, but with limitations on how far such leadership could progress into political and strategic fields. While specific regional state and Japanese national interests coincided with concepts such as the 'flying geese' model, even within this model there lay doubts as to Japan's ability to be trusted with the responsibility of leading. Japan's legitimacy deficit in regional relations continued to undermine potential leadership role in cooperating in areas such as regional security.

For Japan, this period ended in a different way to which the previous era, covered in Chapter 3, ended. The need to fulfil greater responsibilities coincided with increasing domestic problems, both political and economic. Japan's postwar political system that had held given Japan the political stability to maintain growth during this period began to fracture, partially due to the increasing amount of corruption. There had always been corrupt dealings in and around 'modern' Japanese politics. However, the severity of these crises worsened as the political system was rocked by a number of escalating scandals. Starting with the 'Lockheed scandal' in 1976, which forced the then Prime Minister Kakuei Tanaka to resign from the post, it was followed by the 'Recruit scandal' of 1988. This latter scandal seriously damaged public faith in the LDP government, including a number of senior LDP politicians, such as Prime Minister Takeshita, who like Tanaka, resigned in ignominy.[125] These scandals had an important effect on the public's trust of the politicians that were expected to undertake the next phase of Japan's economic transformation.

The impending economic problems brought about by the changes in the international political economy were to add to Japan's post-Yoshida Doctrine dilemma. Within the Japanese economy, the Plaza Accord and the easing of fiscal constraints such as interest rates created a huge speculative bubble (with a dual boom in the Nikkei share index and in domestic real estate prices). In May 1986, nine months after the Plaza Accord, the G-5 met in Tokyo to discuss how to prevent the US dollar falling further; the devaluation of the yen had continued so that it was now ¥170 to the dollar (from ¥240 before the Accord). As high interest rates at home and reduced competitiveness in overseas markets squashed profitability, Prime Minister Nakasone faced an increasing wave of criticism from export-orientated small medium enterprises (SMEs).[126] After continued appreciation in the early months of 1987, the Louvre Accord was signed,

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125 D. B. Smith, *Japan since 1945: The Rise of an Economic Superpower*, p. 123.
126 Y. Funabashi, *Managing the Dollar*, pp. 129-130.

stabilising the yen at 137 to US$1, the highest the yen had been against the dollar in 40 years.[127] This was a 43 percent appreciation in little over two years and the effects of this, as we have seen, changed the regional political economy, including an increase in regional FDI and an increasingly strained relationship between the US and Japan as the appreciation did little to cut the trade deficit. The role that Japan followed in international affairs, that of Nichibei partner and supporter of US economic leadership, had substantially weakened its domestic economy to the point of its own crisis.

During the latter stages of 1989, the BOJ (and MOF, albeit reluctantly) rapidly raised interest rates in an effort to regain control of the bubble. The strategy worked, but left a lasting impression on the domestic banking system; the legacy of unrecoverable or bad loans would be a continuing issue for Japanese governments to handle throughout the 1990s. The issue of increased manufacturing costs and limited availability of credit drove many companies to manufacture overseas, in North America, Europe and East and Southeast Asia. The increasing amounts of FDI to East and Southeast Asia led to the belief that Japan could fulfil a regional role. It could not only help kick-start the economic development of ASEAN but also re-develop its domestic economy, in effect creating a new chapter in the 'textbook' of East Asian development. The period between 1990 and 1995 would see both roles, of hegemonic supporter and regional catalyst of development, come into conflict, especially with the end of the Cold War and the birth of a liberal-inspired 'New World Order'.

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[127] Y. Funabashi, *Managing the Dollar*, p. 177 and 190.