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Beyond Trade Frictions—A New Horizon For U.S.-Japan Economic Relations

I.

Trade friction, to some, has become the symbol of the U.S.-Japan relationship. Japan's economy, devastated by World War II, made a phoenix-like comeback which no one could have predicted at the end of World War II. Whether or not American power has declined, the *relative* rise of Japanese economic power *vis-à-vis* the United States has been instrumental in giving rise to periodic economic frictions. Materially, the relative shift necessitated adjustments, which may be economically beneficial but humanly painful; psychologically, the two nations were unprepared for such changes in their relative standings.

The postwar U.S.-Japan economic relationship has shifted from that between a protector and a protege to that between powerful rivals. However, since World War II, the United States has been accustomed to assuming responsibility as the only predominant world power, and Japan satisfied itself with a subordinate status. Neither country is accustomed to sharing joint responsibility in the world with each other. At the risk of oversimplification, Americans do not want to be awakened from a great dream that America is in every sense the absolute "Number One" in the world, and the Japanese from a cozy one of happily accepting the role of an inconspicuous second-fiddle. Both nations are simply ill-prepared for a new stage in their bilateral relations.

This is not a particularly helpful situation. As former Ambassador to Japan, Mike Mansfield, who retired very recently with great achievements, has repeatedly said, the U.S.-Japan relationship is the "most important bilateral relationship in the world, bar none." Indeed, given

* Economic Counselor, Embassy of Japan. The author is deeply indebted to Mr. Shinichi Nishimiya, First Secretary, Embassy of Japan at Washington, D.C., for his valuable comments and assistance in writing this paper. The views expressed in this paper, however, are the author's own and do not necessarily represent those of the organization to which he belongs.

the combined economic prowess of the two countries, the handling of the bilateral relations will no doubt have enormous impact not only on the respective countries but also on the world as a whole. The most important political task for the leaders of both nations, therefore, is to manage and promote bilateral relations with a clear sense of global direction. This task is truly difficult, but they must assume responsibility for tackling it to the best of their ability.

This paper is intended to review some characteristics of trade and economic frictions between the United States and Japan in a historical and global perspective, and to discuss desirable directions in which the two countries should move from this juncture in history.

II.

During the period from 1945 to 1964, Japan's trade balance with the United States had always been in the latter's favor. In fact, a large part of Japan's global trade deficit was occupied by the United States, and the solution of trade imbalance with the U.S. had been considered crucial for the improvement of Japan's global trade balance. In 1965, Japan started showing surplus in trade relations with the United States for the first time after World War II. Since then, except for the years 1967 and 1975, the trade imbalance between the two countries has expanded rapidly in Japan's favor, particularly in the 1980s, reaching the record level of \$59.8 billion in 1987. (At this writing, the figure is expected to contract around 10% for 1988.)

During the past two decades, there have been three peaks in trade frictions between the United States and Japan. The first peak was witnessed from 1968 through 1972. In the 1968 presidential campaign, Republican candidate Richard Nixon committed himself to protecting the American textile industry through controlling imports from Japan in order to get more votes from textile producers and workers in the South. When elected President, he strongly urged Japan to restrain its exports of wool and synthetic fiber products to the United States in addition to the already-restricted cotton products. His proposal met fierce resistance from Japan, whose share of the total American consumption of textiles amounted to only one percent. This conflict, called the "textile war," was political rather than economic in nature, eventually resulting in the conclusion of the U.S.-Japan textile agreement in 1972.

The second peak was from 1977 through 1979. The controversial products were steel and color televisions. In the case of steel, there existed the Voluntary Restraint Agreement ("VRA") between the two countries from 1969 to 1971 and from 1972 to 1974. In 1977, however, the United States introduced the trigger price system. In the same year, what the United States government called the Orderly Marketing Agreement ("OMA") was concluded to voluntarily restrain Japanese exports of color televisions. In a broader context, Japan, for the first time in

postwar history was asked to cooperate within the Economic Summit framework to stimulate its economy ("locomotive theory") and restrain oil imports ("oil shock").

The third peak, from the early 1980s to this day, has seen a striking broadening and perpetuation of frictions—indeed, one may hesitate to call the period a "peak" since frictions seem like a permanent feature. Frictions are no longer limited to issues of Japanese exports to the U.S. market, although controversy over automobiles, steel, machine tools, conductors, textiles and many other products remains. The various tariff and non-tariff issues concerning access to the Japanese market have come to account for a large portion of negotiations between the two countries. Further, this new period is characterized by the diversity of the areas at issue: not just a few manufactured goods, but also services (*e.g.* capital market, telecommunications, construction) and investment. In the goods area, the two countries have dealt with agriculture (*e.g.* beef and citrus) and high technology (*e.g.* satellites and computers) simultaneously. Also, as this period corresponds to a period of major macroeconomic policy misalignments, economic policy coordination has been a matter of major debate. Finally, since Japan's economy is perceived as having caught up with the U.S. economy in scale and sophistication, criticism is being focused on the question of security—ranging from the free-ride and burden-sharing issues, to export controls and foreign aid, to the issue of how to preserve the U.S. defense industrial base. What, then, are the characteristics of today's situation?

First, earlier conflicts involving surges in the export of labor-intensive products to the United States are behind us, due to Japan's industrial sophistication, higher wage levels, and loss of competitiveness *vis-a-vis* the developing nations. Today, both American and Japanese textile industries face dynamic challenges posed by such Asian newly industrialized economies ("NIEs") as Hong Kong, South Korea, Singapore and Taiwan. Although the U.S.-Japan textile agreement still exists (with several revisions after 1972), its economic significance is marginal, reflecting the changed situation concerning textiles. Japan is now a net importer of textiles.

Second, Japan's challenges to American basic industries such as steel and automobiles generated serious repercussions from the United States. But Japan's voluntary export restraints, direct investment into the United States, joint production, and other measures have produced friction. In these fields, however, the problem is not solved. For one thing, the situation is contained only because there remain export restraints—at the expense of consumers. While free trade in these areas will benefit the U.S. economy as a whole, many Americans continue to support protection of these industries precisely because they are "basic". They are perceived as the backbone of manufacturing and even of the defense industrial base, and they carry considerable symbolic weight as the fundamental pillars of flourishing American capitalism. The situation is further exacerbated because of global overcapacity of

these industries, real or potential, owing to the rapid catch-up by the NIEs.

Third, frictions have developed in high technology industries such as computers, semiconductors, communication equipment, high definition television ("HDTV"), optical fibers, bio-technology, industrial robots, machine tools, pharmaceuticals, and other areas. As the two countries move away from labor-intensive, and to a certain extent from capital-intensive industries, into technology-intensive industries, friction in this area is unavoidable. At the same time, as the two world leaders in high technology, there is hope that we should be able to manage frictions in this area since we face a positive-sum game in an ever-growing world market. In fact, the growth rate of high-technology industries is twice as fast as that of all industries taken as a whole. The development of high-technology industry will be very conducive to the technological progress of other industries. Nevertheless, high technology is closely related to national security, so management of issues in this field will face complications both bilaterally and globally (*e.g.* COCOM issues).

Fourth, as our two economies have become deeply integrated, we are beginning to witness frictions in new, more generic areas such as services (financial markets, telecommunications), investment, and intellectual property rights. We also face potential frictions in areas which, under "arms' length" or "waters' edge" diplomacy, would normally be left to the discretion of sovereign decisions: issues such as distribution systems, tax systems, land policy, buying habits and corporate behavior. Such penetrating issues may also be seen as a result of the high integration and deep interdependence of our economies. None of these potential disputes lend themselves to easy reconciliation, primarily because they exist in uncharted waters in terms of international disputes.

Fifth, as we have seen, issues have diversified out of the bilateral realm to include more global ones, such as macroeconomics, foreign aid and debt, national security, and so on. No single country can truly dictate a certain course at the expense or acquiescence of others, yet what one country does affects others. This is especially true of the world's two largest economies—Japan and the United States.

Finally, despite all these complications, the United States has not been able to bid farewell to what economists would call the "large country assumption," *i.e.*, a large country can set the parameters to its liking, and Japan still clings to the "small country assumption," *i.e.*, parameters are simply given and all you can do is maximize within the constraints. This has become a potential threat when the United States has begun to not only threaten, but actually impose sanctions, a final act of setting the parameters in an unfriendly manner short of war. How Japan might respond, beyond criticizing "American big power arrogance of imposing their views while not keeping their own house in order," remains to be seen. A solution, however, must emphasize the sharing of costs, responsibilities, and power. Counter-retaliation will only exacerbate tensions.

III.

It may be advisable at this point to look at trade frictions in relation to trade imbalances. The aggravation of America's global trade balance and the widening of the U.S.-Japan trade imbalance has irritated the American people, leading to over-heating of trade frictions. Some observers say that trade friction became really serious when Japan's trade surplus *vis-a-vis* the United States went beyond 20% of the total amount of trade between the two countries. In fact, using Japanese statistics, this surplus/total trade ratio became 20.2% in 1977 when the trigger price system was introduced for steel and the color television war took place. Since 1981, this surplus/total trade ratio worsened dramatically, reaching 45.3% in 1987. Setting aside the analytical soundness of this school of thought, it has a certain validity in the political and psychological sense.

It would be almost impossible to expect that the U.S.-Japan surplus/total trade ratio will be narrowed down to the order of less than 20% overnight, since the problems are deeply rooted in our economic structures and behaviors. Setting aside causes and blames, a rough look at a few factors should be a sufficient illustration. First, the composition of Japanese imports from the United States has remained fairly stable, with food, energy, raw materials and capital goods accounting for the bulk of imports. As a long-term trend, U.S. capital goods have been losing competitiveness while the remaining primary products do not enjoy high income elasticity of import. In contrast, the structure of U.S. imports from Japan has shifted steadily up-scale and, for some time, has concentrated on consumer goods (including automobiles), where income elasticity of import is high, and on capital goods, where Japanese competitiveness has been increasing. Second, in a more general sense, Japanese income elasticity of import has been low (1.18 in the long-run),¹ whereas the U.S. figure is high (1.81) (the sixth year).² Consequently, the United States buys approximately twice the increase rate of income as Japan at the same growth rate. Third, the investment/savings ratios of the two countries are a mirror-image of each other—Japan underinvests while America undersaves. In a more contemporary context, as someone put it nicely, "Japan is a creditor that behaves like a debtor. America is a debtor that behaves like a creditor!" Couple these factors with the high dollar/high growth situation in the United States during the first half of the 1980s, and it is no wonder that we have mammoth trade imbalances.

There is no reason, however, for pessimism. Basically, we have been tackling these structural problems throughout the latter half of the 1980s. Exchange rate realignment has created the opportunity for potentially important structural changes in the trade relationship of the

1. Economic Research Institute, Economic Planning Agency, External Balance Effects of Exchange Rate Changes and Macroeconomic Policies 6 (Tokyo) (Mar. 1988).

2. *Id.*

two countries, and its importance goes beyond any immediate changes in price competitiveness. The Japanese trading structure is changing steadily, and when translated into behavioral patterns, elasticities will also change; policies at both ends are designed to change the investment/savings balance. Domestic growth-oriented policies in Japan have already redirected GNP growth away from exports and vastly increased imports. As these policies take root, the Japanese economic scene is rapidly changing. In FY 1986, domestic and external demand contributions to Japan's GNP growth were 4.1% and negative 1.4% respectively, thus making real GNP growth 2.7%. In FY 1987, they grew by 6.2% and negative 1.0%, respectively, with real GNP growth of 5.2%. FY 1988 is expected to see 6.6% domestic growth and negative 1.6% external growth, with real GNP growth at 4.9%.

Incidentally, the most radical tax reform since the recommendations of the Shoup Tax Mission of 1949 and 1950, effective on April 1, 1989, will positively affect domestic demand, by reducing individual income tax and corporate tax and by eliminating or phasing out outdated and high excise taxes levied on the "luxury goods" of yesteryear—cars, electrical appliances, sporting goods, etc. This rise in domestic demand will only be partially offset by the price rise due to the introduction of a low (3%) but broadly based consumption tax. Overall, the tax reform is estimated to promote real GNP growth by an annual rate of approximately 0.2%.

Coming back to trade, then, Japan's imports of manufactured goods—the low level of which has long been a favorite target of criticism—are rapidly increasing. From January to September 1988, manufactured imports from the U.S. (excluding gold, which was a unique erratic factor) grew by 35.2%, as compared with the corresponding period of the previous year, and accounted for 55.3% of the total imports from the United States. Incidentally, the share of manufactured goods in the global imports was 46.3% in the same period of January-September, 1988. Manufactured imports from NIEs and ASEAN countries increased even more: by 50.6% in 1987 and by 60.2% in the first half of 1988 as compared with the same period of the previous year.

Increases in imports thus have contributed to scaling down Japan's surplus for nearly two years. Although exports may be on the rise again on a monthly basis, dampening the surplus reduction trend, this factor in and of itself should not be a source of concern. The increase is a response to growing demand abroad and adds to productive capacity in the importing countries, which will eventually export even more to Japan. This is precisely the case in Asian NIEs and the ASEAN countries. It is also true with respect to the United States to a certain degree, although the failure so far to redress the structural problems in the U.S., including the shorter-term problem of lack of extra capacity to satisfy growing demand at home and abroad, is still contributing to a high level of imports from Japan and elsewhere.

IV.

We have seen the diversity of today's U.S.-Japan economic relations, together with the diversity of problems we face generally. The question remains, are we addressing them satisfactorily? My answer is a qualified "yes". This may surprise some, given the enormity and complexity of our bilateral frictions. Yet, if we look carefully at the sets of issues, many of them are being dealt with properly.

On macroeconomic policy coordination, the problems have been correctly identified (exchange rate, growth rate, investment/savings balance), mechanisms have been set in place (the G-7 and other forums), and the work is being done with considerable success. The process is an ongoing one, with the U.S. budget deficit one of the largest remaining issues to be squarely addressed. Yet there seems to be recognition that there is no radically different alternative to what we are already doing.

On bilateral trade and economic issues, the two countries have come a long way indeed. Both in terms of Japanese exports to the U.S. market and U.S. access to the Japanese market, we have settled a myriad of issues, or at least have learned how to contain certain disputes. Problems will continue to arise, as we have already witnessed in such areas as investment and intellectual property rights. Such disputes should be expected, given the broad, interdependent nature of the U.S.-Japan relationship, but we have proven over the years our mutual ability to solve them.

On the global issues, cooperation between Japan and the United States enjoys a relatively short history. Yet we have embarked upon a course of collaboration in assistance to developing nations, coping with the debt problem and promoting an open, multilateral trade system. Results may not be there yet, and, to be sure, there are extremely difficult issues ahead, but both sides seem committed to move forward.

I am most concerned about three areas of particular difficulty: what I might tentatively call the "intractables" in the economic field, "burden sharing," and mindsets. These controversies are not insurmountable, but shall require maximum attention and extraordinary management efforts by the leaders of our two countries. Without such efforts, we cannot safely say that we are really addressing the problems.

1. Intractables

This area is as yet ill-defined. Roughly put, "intractables" are those issues that belong more to the socio-cultural domain than the domain of trade and economic policies and institutions. Trade and economic policies and institutions are amenable to legislative change, albeit at considerable cost and pain. But when, for example, the Japanese are told that their distribution system is somehow a barrier to U.S. exports, they don't really know what can be done. Admittedly, there are policy issues (like the "Large Store Law" in this case) that can be defined and addressed. But when "the distribution system" in its socio-cultural totality is the target, we enter the world of the intractables. Difficulties

in corporate or consumer behavior might be another example. Here again, there are certain behaviors (like "cartels") which are policy matters, but when the Japanese are told "somehow, Japanese consumers don't buy foreign" (which is factually inaccurate), we are at a loss.

The danger in dealing with intractables is that there is a natural tendency to interpret them by one's own criteria and to impose one's own judgment, and ultimately reactions (i.e. sanctions) on the other party. The other party views such actions as bullying and an attempt to dictate. Ill-measured counter-reactions will likely lead to a vicious circle.

All this may sound very hypothetical, yet the reality of our bilateral economic relationship is rapidly reaching this point. Japan is rapidly addressing all conceivable problems, such as exchange rates, domestic expansion and market access, and yet when its surplus with the United States is perceived as not shrinking commensurately, people are inclined to begin the witch-hunt. It is conceivable that further policy or institutional problems will be detected, which eventually can be addressed and resolved. But if the conclusion is reached that "the Japanese are not closed, they are not unfair: they are simply different. Therefore, we, too, should apply different rules and retaliate," then intractables have been dealt with in the wrong way. Bear in mind that, in this case, the Japanese themselves believe that everything that can be done has been done. Any further criticism is viewed as both an unwarranted intrusion into the Japanese way of life and, simultaneously, as an excuse about America's own inaction. Critics of Japan would immediately respond, "Ah, the Japanese are making their usual excuses again." But similar reactions, albeit subconscious, can be found in the American psyche when the Japanese criticize them for "not working hard enough, not making a sufficient sales effort."

I cannot really think of a quick fix to these intractable issues, and, indeed, we may end up with the much overworked phrase "deeper mutual understanding" as the only way out. Nevertheless, there are a few useful points to bear in mind when we are faced with intractables:

- a) Narrower definition: What may look like an intractable can often be defined better by narrowing down the issue to matters of policies and institutions. For example, the U.S. might avoid criticising the "distribution system" in its vague entirety and instead focus on the "Large Store Law."
- b) Longer time-frame: Intractables are not unchangeables. They merely take much, much longer to change. Changes can take place as a result of modification in parameters, including policy parameters, if they do so at a sufficiently slow pace to allow changes in socio-cultural behavior. The fact that the Japanese wore *kimonos* in the 19th century may well have been a barrier for exporters of western-style clothing, and at the time such a barrier was a clear intractable. Today, besides exceptional ceremonial cases, *kimonos* are no longer worn. Nineteenth century Japan may have been able to deal with issues concerning *kimono* tariffs or subsidies for the *kimono* industry, but not with foreign demand to stop wearing *kimonos*. What induced the change in the habit over time was wearing western-style uniforms

at school and in the military (which, incidentally, happened to be policy parameter changes).

- c) Cultural magnanimity: Intractables surface because the two countries have very different cultural, historical, and traditional backgrounds. Interpreting the other's behavioral patterns through one's own cultural system can lead to mistranslation of an "intractable" into a "tractable" guarded by intransigence, which leaves the only remedy being the application of pressure by retaliation. I do not advocate making culture an excuse for avoiding action on tractables, but a fine line has to be drawn somewhere to avoid a cultural war.

In this connection, let me touch upon the so-called "comprehensive approach" toward Japan, such as the U.S.-Japan Free Trade Area ("FTA") concept, that is becoming somewhat popular in this country. To be sure, the "comprehensive approach" has many rationales, such as an alternative to the sector-by-sector approach and a counter-weight against the European Community single market in 1992. But it seems to me that somewhere along the line, advocates will be tempted to negotiate the "intractables." (Already, "distribution system" is mentioned as an area for possible negotiation.) That would spell disaster, for it would heighten the American expectation of "finally attacking the Japanese at the root cause of the problem," an expectation only to be dashed sooner or later.

I happen to believe that the desirability of an FTA fundamentally depends upon how we envision its impact on the world economy. Careful study is required because it will be a pact between the first and second strongest economies in the world, with possible perception by others of a resurgence of block economy. It is still premature, therefore, to determine whether it is advisable for the two countries to enter into negotiations. The most important goal is to make an FTA concept an ideal, a frame of reference, to guide us in our long-term efforts to eliminate trade barriers on both sides in the shorter run. In any event, we need to make sure that "intractables" do not become part of the exercise.³

3. Is the rice issue an "intractable"? Not in the sense used here. Rice eating may be so, but the rice issue itself, i.e. the issue of the legitimacy of importing almost no rice, is not. It is, to be sure, a very difficult issue because rice culture itself is deeply related to socio-cultural matters embedded in two millenia of Japanese history. But the Japanese government has already expressed its readiness to discuss rice in the agricultural negotiations of the Uruguay Round when other governments agree to discuss their own difficult agricultural problems such as export subsidies, variable levies on imports by the European Community, and the GATT-waivered import restrictions by the United States. The question of access to the Japanese market will not be excluded in such negotiations. It should be noted at the same time that as the world's largest and most stable net importer of agricultural products, Japan has a crucial interest in food security, which should be fully discussed in the Uruguay Round.

2. *Burden Sharing*

There are loud calls in the United States for more "burden sharing" by Japan, particularly in the U.S. Congress. The attitude that the Bush Administration will take on this issue is of critical importance. The undercurrent running through these calls is a feeling shared by a number of Americans that Japan is unfair because she makes too little contribution to the world in defense. In other words, she is taking a "free ride" on the U.S. defense efforts, while at the same time enjoying the benefits of the free trade system with the United States as her ultimate military guarantor.

To this, Japan would respond that Japan's defense budget, which has been increasing at an annual rate of more than five percent in the 1980s, higher than any major NATO country, is now comparable in absolute terms to that of the U.K. or France. Actually, it is also comparable to the portion of the U.S. defense budget allocated for the Asia-Pacific region. Japan also provides the U.S. with 135 military bases which play crucial roles for the U.S. Far East strategy, and is the most tolerant host nation for U.S. forces stationed abroad. We would argue that Japan becoming a military power would reduce security and stability in the region, rather than enhance it, and that as a matter of principle, she will continue her non-military economic assistance to developing nations to enhance their economic strength and hence political resilience. We would argue further that Japan, as the largest economic aid donor in the world, will reach beyond this region to the same end.

Why does the issue of "burden sharing" bother us in the context of our bilateral economic relations? Because the debate, as summarized above, is not really soluble in the short-run. It is ill-defined and emotionally charged. It could spoil the atmosphere which will otherwise enable our two countries to move ahead on important economic matters of global significance.

This is not to say that we should ignore burden sharing, but rather that we should keep it in proper perspective. A few things will help in this respect. First, we can better define the issue. Japan wholeheartedly shares with the United States the objective of maintaining and further strengthening global security and the security of the East Asia-Pacific region. There are many ways to achieve this goal. Maintaining adequate defense spending is an important, but not an exclusive, solution. The problem with the current "burden-sharing" debate is that the means of achieving the goal, and its numerical expression, has become the end in itself. Boiling everything down to GNP ratios of defense and foreign aid spending levels is not only simplistic; it diverts attention away from the real issue because it assumes that higher levels of spending in these areas are unequivocally the right thing to do. Yet, in the area of defense, substantially higher spending just for the sake of balancing numbers would scare Japan's neighbors. Even in the area of foreign aid, where more is generally better than less, we should not simply pump out money for the sake of having better figures. We have to make

sure that allocated funds are spent productively and do not distort economic development. Moreover, for economic development, expanding trade is generally a more powerful and non-distorting avenue.

Second, in a similar vein, Japan would want to make sure philosophically that it is not the "burden" *per se* that we want to share. Indeed, "burden sharing" has an overtone of passing an unwanted buck around—something the United States no longer wants and Japan is unwilling to bear. The real issue is "objective sharing" or "ideal sharing," where the two countries, together with other like-minded countries, would discuss how best we might be able to achieve our common goals. In this context, we should also note that without some kind of "power sharing" our road will be a bumpy one. To "put up, and shut up" is something one should not expect to happen in relations among sovereign nations.

Third, however, Japan should be sensitive to the aspect of fairness. In fact, the current "burden sharing" debate is not much a security debate but rather a fairness issue in disguise. It is a fact that the U.S. budget situation is tight and that Japan earns enormous trade surpluses from the United States. It is also a fact that the United States is the ultimate guarantor of Japan's security, and will remain so for a long time to be. It is the lack of sensitivity by the Japanese to these facts that provides ammunition to misguided "burden sharing" arguments. Counter-arguments that do not incorporate this sensitivity only make the situation worse.

I do not mean that burden sharing is unnecessary. Quite to the contrary; what is important is that we address the problem in a well-defined, positive fashion, and in a broader perspective. Lively discussion should be encouraged, and other major partners (like the European Community countries) should be invited. Through such discussions, a desirable direction looking towards the 21st century should emerge, and, in due course, phrases like "creative partnership" or "joint responsibility" that better capture our objectives will be discovered. Incidentally, new Secretary of State James Baker III referred to it as "creative responsibility sharing or division of labor" at his confirmation hearing at the Senate Foreign Relations Committee.

3. *Mindset*

I have hinted in this paper that the United States may no longer be able to take for granted the so-called "large-country assumption," and that Japan may not and should not behave on the "small-country assumption." Whether this is actually so is a matter of discourse, but, it seems to me that it is high time the two countries assess their respective and relative positions in the international setting. We should ask ourselves whether our mindsets are not captive to these kinds of assumptions, and start trying to change them. I am not suggesting a Paul Kennedy-style

analysis⁴ of our relative prowess, but I do think that so long as our mindsets do not change, there is little we can do together for better bilateral or international relations.

Indeed, the relationship calls for fundamental reorientation if we are ever to progress beyond the usual domain of frictions and trouble-shooting. The U.S. and Japan would probably be able to muddle through with the conventional sources of bilateral frictions (trade, investment, macroeconomic policies and so on), but managing our differences with respect to the "intractables" and "burden sharing," for instance, and reaching beyond for our common ideals of a free, peaceful, and prosperous world, require Japan and the United States to challenge their own mindsets. Without such a transfiguration, the United States would continue to set the parameters and Japan would simply accept them and maximize within their given constraints. The United States does not, however, have the ability to totally fix the parameters, and frustration on its part would thus accumulate. At the same time, no revolutionary initiative would emerge from Japan, yet she would feel "bashed," "bullied" and "pressured." Moreover, how she reacts would considerably influence the parameters.

To some, this kind of dilemma might suggest a fundamental incompatibility of the two countries, which ultimately would suggest heavy conflict. To others, this dilemma means we both have to change and channel our energies of conflict into a dynamism for cooperation. History may not as yet have witnessed a situation of two (or more, but not too many) countries behaving on "large country assumptions" except, of course, in times of war. As most economic theories of oligopoly would suggest, there is inherent instability in such a situation. But, in today's world, where Japan and the United States together share such a large place, and yet neither being preponderant, we need to be courageous enough to open the Pandora's box and to muster our wisdom to control the energy, if we are to move ahead to achieve our cherished common goals.

V.

Under today's circumstances, the responsibility of providing international public goods such as international security and stability, free trade, a credible international currency system, economic cooperation, debt relief, and other similar activities has grown far too great to be borne by a single country. Industrialized democracies besides the United States, like Japan and the Western European countries, are now in a position to harmonize national actions with global interests and to share a greater role in providing such public goods to the international society. Today's situation between the United States and these countries, however, is at a crossroads in terms of whether they will really be

4. P. KENNEDY, *THE RISE AND FALL OF THE GREAT POWERS* (1987).

able to cross the rubicon, or remain where they are and engage in a conflict of mutual attrition.

Militarily, the international system in the coming decades will continue to be basically dominated by the current bipolar structure. The international economic system, on the other hand, will be an extremely interdependent multi-polar system. Yet given the basic stability that the bipolar deterrence has given us, and the increasing importance of the economic factor in setting the tone for peace or conflict, western nations will need to establish a collective management system of advanced democracies, where the goals will be common and means are shared, that will transcend the conventional dichotomy between the politico-military and the economic. Here, the United States will remain the leader, but not as a preponderant power dictating all the parameters. The U.S. must lead in the capacity of a *primus inter pares*. Japan would be a principal contributor to this collective management system, not a bystander. So would our Western European friends.

It is becoming apparent that a great majority of the Japanese people are of the opinion, consciously or unconsciously, that Japan should make immense efforts in order to occupy the "honored place in the international society" mentioned in the Constitution of Japan. This feeling is being enhanced even more today as a result of restored economic success. Prime Minister Noboru Takeshita correctly understands this situation and seems determined to give a positive sense of direction to the Japanese people in order to translate this new mood into genuine contribution to the world. Shortly after he assumed office, he declared in his first policy speech to the National Diet, on December 7, 1987, that it is essential "that we clearly establish Japan as a country that contributes to the international community, and that we draw upon Japan's wealth and vigor for the world." As it has subsequently been elaborated in London, New York and Toronto, Mr. Takeshita's concept of "a nation contributing more to the world" is meant to be an alternative to the neo-mercantilist view which has influenced a good part of post-World War II Japan. Mr. Takeshita continued: "Japan's existence and development are premised on world peace and prosperity, and now that Japan has become a mainstay of the international order, we must be more active in contributing to world peace and promoting international cooperation and prosperity." An attempt to shift to a *positive* "large country assumption" can be detected in these statements.

It seems to me that Japan is on the brink of active and positive participation in the collective management system. Japan has successfully transformed its economy into a domestic demand-led system as a result of international macroeconomic policy coordination. She has embarked upon a most ambitious plan of economic cooperation to developing countries, and she intends to make a substantial contribution to ameliorating the international debt problem. Her trade policies have come a long way. Whether she could take that extra step of transfiguration,

however, still depends very much on healthy relations with the United States—a partnership that would go far beyond trade frictions.