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JAPANESE FOREIGN ECONOMIC POLICY FORMATION:
Explaining the Reactive State

By KENT E. CALDER*

Takashi Inoguchi, *Kokusai Kankei no Seiji Keizai Gaku: Nihon no Yakuwari to Sentaku* [The political economy of international relations: Japan's role and choice]. Tokyo: Tokyo Daigaku Shuppan Kai, 1985, 253 pp.
Yōichi Funabashi, *Nichibei Keizai Masatsu* [Japan-U.S. economic conflict]. Tokyo: Iwanami Shinsho, 1987, 232 pp.
Atsushi Kusano, *Nichibei Orange Kōshō* [Japan-U.S. orange negotiations]. Tokyo: Nihon Keizai Shimbun Sha, 1983, 237 pp.
Thomas McCraw, ed., *America versus Japan*. Boston: Harvard Business School Press, 1986, 463 pp.
Kenneth B. Pyle, ed., *The Trade Crisis: How Will Japan Respond?* Seattle: Society for Japanese Studies, 1987, 251 pp.
Michèle Schmiegelow, ed., *Japan's Response to Crisis and Change in the World Economy*. New York: M. E. Sharpe, 1986, 309 pp.

AS trade frictions between Japan and its Western economic partners have escalated, both Western and Japanese analysts, particularly at the popular level, have developed increasingly divergent and strongly held conceptions of what Japanese foreign economic policies currently are, and how they got to be that way. Some see Japanese policies as remarkably liberal in view of Japan's pervasive resource vulnerabilities; others regard these same policies as rapaciously mercantilist. Yet despite this broad divergence of views—as well as the rising importance of Japan's behavior—for the international system, for comparative political analysis, and for international relations theory, there has been remarkably little serious international dialogue about the character of the Japanese state in its complex relationship with the global economic system. Scholarly Western-language publications in the international relations field in particular have all too frequently given short shrift to or ignored Japanese

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interpretations of Japan's own policy processes, institutions, and objectives.

For an understanding of the complex mixture of strategy, hesitancy, and pragmatism that characterizes Japanese foreign economic policy behavior, particularly in the late 1980s, this essay employs the concept of the "reactive state." This concept denies neither the strategic intent of much Japanese policy making nor its successful implementation in many instances. It is also broadly consistent with arguments stressing the importance of international considerations, particularly the U.S.-Japan alliance, in influencing Japanese foreign economic behavior. The reactive state interpretation merely maintains that the impetus to policy change is typically supplied by outside pressure, and that reaction prevails over strategy in the relatively narrow range of cases where the two come into conflict. Thus, ambiguous foreign demands may serve, through deft strategic redefinition within Japan itself, as a stimulus for enhancing Japanese competitive capabilities; this occurred during the capital and import liberalization controversies of the late 1960s after Japan joined the OECD. But institutional difficulties in initiating pro-active policies handicap Japan in pursuing strategic interests in multilateral settings, a reality becoming more important to both Japan and the international economic system with the decline of American pre-eminence.

The essay begins by exploring the concept of the reactive state within the broader context of analysis in international political economy. It proceeds to an empirical investigation of postwar Japanese foreign economic policy behavior, with particular emphasis on the post-1971 period, and explains Japanese passivity in international affairs when activism would have been both possible and beneficial for Japan. This tension between reactive behavior and strategic imperatives became particularly pronounced during 1971-1973, after the stable trade, financial, and energy regimes within which Japan prospered during the 1950s and 1960s began to dissolve abruptly with the Nixon Shocks, flexible exchange rates, and the first oil shock.

Although the concept of the reactive state as presented here is a general notion, broadly applicable to nonhegemonic powers in highly interdependent international systems, it has particular relevance to contemporary Japan. The reactive aspects of Japanese foreign economic behavior are remarkably pronounced, considering the country's economic strength, the strategic inclinations of its technocracy, and the turbulence of the international economic system; the economic basis for a more proactive Japanese global role is gradually being established, however. The article concludes with an assessment of implications of Japan's character as a reactive state for the broader global political economy and for future research.

Japan as a Reactive State

The essential characteristics of the "reactive state" in this analysis are two-fold: (1) the state fails to undertake major independent foreign economic policy initiatives when it has the power and national incentives to do so; and (2) it responds to outside pressures for change, albeit erratically, unsystematically, and often incompletely. In a four-fold typology of nation-states in terms of these two characteristics, the reactive state can thus be distinguished from pro-active hegemonic and middle-range powers such as the United States, France, and many of the other large European powers during the 1950s and 1960s. It can also be distinguished from inflexible, autistic states incapable of responding to outside stimuli even under pressure. Contemporary Japan is sometimes accused of being such a state. Small, advanced European nations such as Austria and Norway, with foreign economic strategies that are highly responsive to developments in a broader global political economy whose parameters they do not attempt to shape, could be considered reactive states under the definition adopted here;[1] so could the newly industrializing nations of East Asia, such as South Korea, Taiwan, and Singapore, although their internal social and state structures are obviously very different from those of the small European democratic corporatist states.[2] Ample natural resource endowments, large internal markets, relatively centralized domestic policy-making structures, defense incentives for autarkic development, and a tradition of North-South confrontation have made the larger Latin American NICs (as well as India) somewhat more pro-active but less pragmatically flexible than their East Asian counterparts; Brazilian and Indian informatics policies during the late 1970s and the early 1980s are cases in point.[3]

From the perspective of international relations theory, Japan is an es-

[1] On the industrial adjustment and foreign economic strategies of the smaller European industrial states, see Peter J. Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell University Press, 1985).

[2] On the foreign economic policies of the East Asian NICs, see Roy Hofheinz, Jr., and Kent E. Calder, *The Eastasia Edge* (New York: Basic Books, 1982), 171-91; David Yoffie, *Power and Protectionism: Strategies of the Newly Industrializing Countries* (New York: Columbia University Press, 1983); and Frederic C. Deyo, ed., *The Political Economy of the New Asian Industrialism* (Ithaca, NY: Cornell University Press, 1987).

[3] On Brazilian informatics policies and the constraints they placed on U.S. multinationals, see Peter B. Evans, "State, Capital and the Transformation of Dependence: The Brazilian Computer Case," *World Development* 14 (July 1986), 791-808.

On the Indian case, see Joseph Grieco, "Between Dependency and Autonomy: India's Expecially interesting reactive state because of its enormous economic size, its substantial population (more than France and West Germany combined),[4] and its pre-1945 history of pro-activism in the international system. In all these respects, it is more similar to the pro-active middle-range European economic powers (such as West Germany, Britain, and France) than to other reactive states (such as Austria and Norway), which are typically smaller in size and influence. Japan has, in addition, a far larger domestic market, and is less dependent on international trade than any of these states, including the major European powers. It has carefully controlled Western multinational corporations and banks in order to prevent them from compromising state authority; few other governments have done this successfully. Moreover, since 1985 Japan has been the largest creditor in the world; its capital outflows in 1986 were more than twice those of all OPEC nations combined at the height of their wealth.[5]

Despite its manifest economic and geostrategic resources and its demonstrated ability to operate strategically within its national boundaries, the Japanese state has been consistently more cautious in taking international initiatives than most major European governments. It has also typically been more deferential to pressure from the United States—and at times even from the European Community—than these middle-range powers. These differences raise fundamental issues regarding the relationship of national economic capabilities to foreign economic policy. The Japanese case also raises basic issues regarding the relationship of domestic structure to international economic behavior, particularly concerning domestic political constraints on pro-active foreign economic policy.

Considering the importance of the subject to the functioning of the global economic system and to theoretical analyses in international political economy, competent book-length empirical studies of Japanese foreign economic policy behavior are still remarkably scarce. Those that are available, such as the 1986 Harvard Business School's comparative study of business-government relations, *America versus Japan*, edited by Thomas K. McCraw (reviewed here), and the various collaborative projects of I. M. Destler, Hideo Sato, and Haruhiro Fukui,[6] focus predominantly on U.S.-Japan relations.

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perience with the International Computer Industry," *International Organization* 36 (Summer 1982), 609-32.

[4] In 1986, Japan's population was an estimated 121.5 million, compared with 61.1 million for West Germany, 57.2 million for Italy, 56.6 million for the United Kingdom, and 55.4 million for France. See Keizai Kōhō Center, *Japan 1988: An International Comparison* (Tokyo: Keizai Kōhō Center, 1987), 6.

[5] Japanese long-term capital outflows in 1986 totaled $132 billion; OPEC annual capital outflows in the mid-1970s averaged under $65 billion. See *Nomura Investment Review*, July 1987, p. 11; *New York Times*, August 31, 1986.

[6] I. M. Destler, Hideo Sato, and Haruhiro Fukui, *Managing an Alliance* (Washington, DC:

Because of the explosive recent intensification of U.S.-Japan economic interdependence[7] and the far-reaching implications of that interdependence for the global political economy as a whole,[8] U.S.-Japan comparisons are of crucial importance for policy purposes. But in securing a deepened theoretical understanding of the reactive postwar Japanese state, U.S.-Japan analysis must be supplemented with comparisons between Japan and European states, comparisons between Japan before 1970 and the current newly industrializing countries (NICs), comparisons between recent Japanese behavior and that of earlier emergent economic superpowers, and comparisons between pre-World War II and post-World War II Japan itself. The important question is why Japanese foreign economic policy has been so much more reactive than that of other middle-range economic powers, even as Japan moves toward economic superpower status. In this respect, comparisons with the United States are especially useful when they are lagged to compare recent Japanese realities with American economic policy making between World Wars I and II, before the American global hegemonic role had been clearly established.[9]

During the 1950s and 1960s, both Japan and Western Europe were subordinate elements of the U.S.-dominated Western hegemonic system. Evidence from one of the few studies that has yet undertaken a systematic comparative analysis of Japan and Europe—Michèle Schmiegelow's edited volume under review here—affirms that the early post-World War II foreign economic policies of the middle-range European powers were significantly more pro-active, and on important occasions significantly *less* deferential to the United States, than those of Japan. In a fascinating comparative essay, Henrik Schmiegelow points out, for example, that several of the European nations, particularly France, pursued openly neomercantilist exchange-rate policies during the 1950s and the 1960s, involving pragmatic competitive devaluations broadly counter to the Bretton Woods structure of fixed exchange rates (p. 31). In sharp contrast to this practice, and to Japan's own mercantilist strategy of competitive devaluation during the 1930s, postwar Japan adhered rigidly to a fixed exchange rate of ¥360 to the dollar, consistently avoiding devaluations despite recurrent balance-of-payments deficits and a strong sense of

Brookings Institution, 1976); I. M. Destler and Hideo Sato, *The Textile Wrangle* (Ithaca, NY: Cornell University Press, 1979); I. M. Destler and Hideo Sato, eds., *Coping with U.S.-Japan Economic Relations* (Lexington, MA: Lexington Books, 1982).

[7] See Kent E. Calder, "The Emerging Politics of the Trans-Pacific Economy," *World Policy Journal* 2 (Fall 1985), 593-623.

[8] See Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987), 328-40.

[9] On such prehegemonic American foreign economic policy making, see, for example, David A. Lake, "International Economic Structures and American Foreign Economic Policy, 1887-1934," *World Politics* 35 (July 1983), 517-43.

external vulnerability. Only in 1969-1971, as Japan reached full employment and a structural balance-of-payments surplus was emerging, did Japanese exchange-rate policies benefit Japanese exports at clear cost to others because Japan persistently refused to consider realignment of a demonstrably undervalued yen. Throughout the period of formal dollar-gold convertibility up to August 1971, Japan refrained from active accumulation of gold reserves, which might have antagonized the United States. With regard to exchange-rate policy, Japan was significantly more deferential to the U.S. in its slowness to accumulate gold than the major middle-range European powers, particularly France.

Inoguchi's *Kokusai Kankei no Seiji Keizai Gaku* (The Political Economy of International Relations), is one of the few Japanese scholarly works that consider both Japan's role in the international economic system and its domestic politics bearing on foreign economic policy. Evidence from the volumes by Schmiegelow, Pyle, and McCraw, as well as from Inoguchi's work, suggests that the foreign economic policies of the reactive Japanese state remain less pro-active and confrontational than those of the major middle-range European powers, although the direct comparative data continue to be highly fragmentary. In the postwar period, Western Europe's economic ties to the United States were much closer than those of Japan. Europe has consistently had private-sector institutional structures that were relatively conducive to expanded imports and foreign investment; this pattern does not prevail in Japan, as Okimoto points out in his useful analysis of private-institutional barriers to rapid foreign economic penetration (Okimoto in Pyle, 85-116). But when confronted with explicit foreign political pressure—often the crucial catalyst for policy decisions by the reactive state—Japan has been more forthcoming with specific, formal policy changes than is generally realized. David Yoffie points out, for example, that in 1960 one-quarter of the Japanese government's special taxation measures for enterprises were devoted to promoting exports; by 1975, in the wake of widespread criticism of Japanese trade policies, all incentives had been shifted to favor domestic projects (Yoffie in McCraw, 47). Michèle Schmiegelow notes that Japan's average tariff levels for manufactures in the mid-1980s were lower than those of the United States and the European Community; indeed, Japan had reached West Germany's level of actual import liberalization as early as April 1971, even though West Germany had started from a substantially more liberal early postwar base (Schmiegelow, 5).

As Chalmers Johnson points out, Japan has eliminated virtually all the formal tariff and nontariff barriers to trade that were specifically criticized by its trading partners as being contrary to GATT rules (Johnson in Pyle, 75). To Schmiegelow, Japan's 1980 Foreign Exchange and Foreign Trade Control Law appears to be no less liberal than that of West Germany (Schmiegelow, 2); one might add that, since the Yen-Dollar Agreement of May 1984, Japanese foreign-exchange control policies have been significantly more liberal than those of West Germany. Schmiegelow also points out that since the mid-1960s, Japan has been unusually liberal, for a nation at its stage of development, in its treatment of capital outflows (p. 13). These measures did not emerge unilaterally; Yoffie maintains with only modest overstatement that Japan has been willing to alter its prevailing policies only under external pressures, such as those epitomized in the Nixon Shocks of 1971 (Yoffie in McCraw, 67).

Despite some self-interested nuances, Japanese foreign-aid policies also appear reactive to foreign pressure as well as broadly supportive of U.S. strategic purposes in the global political economy (Inoguchi, 201-4). Beginning with reparations policies in the 1950s (undertaken at the behest of the United States), Japan has played a key role in supporting Southeast Asian economies, thereby neutralizing the appeal of China in that region.[10] Since the 1970s, Japan has also provided increasing assistance to South Asian, Middle Eastern, and Latin American nations of strategic interest to the United States, complementing America's own security assistance (Inoguchi, 201-2).

Japanese behavior at major multilateral financial conferences of the past two decades has also been that of a reactive state. It has been passive, yet unusually cooperative with U.S. hegemonic demands, despite divergent Japanese interests and, particularly since 1985, despite Japan's substantial presence in the international monetary system. At the Smithsonian Conference of December 1971, for example, Japan accepted under pressure a nominal change of 16.88 percent in the parity value of the yen—the largest realignment imposed on any state, and the first revaluation of the yen since 1949. West Germany, by contrast, had unilaterally revalued in 1962, 1969, and in May 1971; consequently, its revaluation of the Deutschmark at the Smithsonian Conference was much smaller than Japan's. Similarly, Japan agreed at the Plaza Conference of September 1985, also under pressure, to cooperate actively in the effort of the Group of Five (G-5) major industrialized nations to drive down the dollar. The Nakasone administration only began its active intervention to stabilize exchange rates some months later, as the yen's surging strength started to threaten the domestic Japanese economy with a deep recession.

Japan's approach to macroeconomic coordination with other major in-

[10] On the details, see Akio Watanabe, "Sengo Shoki no Nichibei Kankei to Tōnan Azia" [Early postwar Japan-U.S. relations and Southeast Asia], in Chihiro Hosoda and Sadamu Ariga, eds., *Kokusai Kankyō no Henyō to Nichibei Kankei* [Change in the international environment and Japan-U.S. relations] (Tokyo: Tokyo Daigaku Shuppan Kai, 1987), 27-54.

dustrialized nations is also that of the passive (but often pragmatically flexible) reactive state, far less disposed to either pro-activism or dogmatic rigidity than either West Germany or France. Although initially hesitant, Japan fell into harmony with the Carter administration's "locomotive strategy" following the Bonn Summit of 1978, in sharp contrast to the recalcitrant West Germans. Similarly, in response to U.S. pressures during 1986-1987, Japan began to reflate, beginning with off-budget credit programs;[11] West Germany refused to do so until after the global stock market crash of October 1987. Japan's reflation, however, occurred only after six years (1980-1986) during which conservative Japanese fiscal policies seriously exacerbated international trade frictions by intensifying Japanese current account surpluses and capital flows (Edward Lincoln in Schmiegelow, 154). Reflation came about not through autonomous Japanese decisions, but as a result of strong foreign pressure for fiscal expansion.

The Japanese state is clearly more systematic than most states in defining national industrial policy objectives, in redefining ambiguous foreign demands to suit domestic purposes, and in handling its relations with domestic and foreign firms within Japan. It can also be highly calculating in specific bilateral trade transactions (Yoffie in McCraw, 36-37). On the other hand, Japan is more hesitant in pursuing strategic trade and industrial interests in cases that require pro-active multilateral initiatives, especially in the face of clear foreign opposition.

Japanese policies toward telecommunications and data processing, for example, bear the hallmark of the diffident reactive state, in contrast to more rigid and statist continental European approaches. This has been true despite the long-term industrial significance of telematics to the Japanese economy. There were, to be sure, active mercantilist overtones to nascent Japanese software policies of the early 1980s, when draft legislation prepared by MITI in 1984 raised the possibility of compulsory licensing and relatively loose patent-law protection of software, as well as other provisions to which Japan's trading partners objected strongly. Following strong multilateral foreign pressure against Japan during 1985, however, these MITI proposals were retracted. In the case of value-added networks and other telecommunications activities made possible under the Telecommunications Business Law of 1985, initial Japanese proposals to restrict foreign involvement were also sharply modified under foreign

[11] The Fiscal Investment and Loans Program, for example, expanded by 6.2% in 1986, and by 22.2% in 1987. See Junichi Yonezawa, Takuo Noguchi, and Katsuhiro Kubota, *Zusetsu: Zaisei Tōyūshi* [The fiscal investment and loans program: A graphic description], 1987 ed. (Tokyo: Tōyō Keizai Shinpōsha, 1987), 254-55.

pressure; the result was a considerably more liberal telecommunications and data-processing environment for foreign firms by the mid-1980s than prevailed in either France or West Germany.[12] In both of the latter countries, the telecommunications industry remained in public hands during the late 1980s, with only a gradual and grudging recognition of the role of market forces in stimulating innovation, and with much stronger and more rigid rejection of U.S. proposals for reform than was the case in Japan.

Reactive Japanese foreign policies have persisted throughout the 1980s, not only in the face of massive and rising Japanese economic capabilities, but also—as Kenneth Pyle notes in his edited volume under review—despite determined efforts by Prime Minister Yasuhiro Nakasone (1982-1987) to fashion a more decisive, pro-active international role for Japan (pp. 5-32). Pyle points out that, on the eve of assuming office in November 1982, Nakasone wrote that "the first necessity is a change in our thinking. Having 'caught up,' we must now expect others to try to catch up with us. We must seek out a new path for ourselves and open it up ourselves."[13] Throughout his long term as Prime Minister, Nakasone continued to stress the importance of an active international role for Japan; some tentative steps toward an expanded diplomatic role included his abortive efforts in 1983-1984 to mediate the Iran-Iraq war. In the economic arena, however, Nakasone's expressed intentions did not produce much actual change in policy. He did press strongly and successfully for Japanese concessions in the case of the Yen-Dollar Agreement of 1984. In this instance, intervention had few domestic political complications, since Nakasone's personal ties with the Ministry of Finance bureaucrats whom he was forced to override were relatively weak, and market forces had in any case created strong support for financial liberalization within Japan. But in several other cases, such as the U.S.-Japan telecommunications negotiations of 1984-85, domestic political vulnerability—particularly Nakasone's lack of a strong factional power base within the Liberal Democratic Party (LDP)—prevented him from intervening decisively to generate a clear, activist policy stance. Instead, he temporized and waited for foreign pressure to determine the outline of an appropriate Japanese response.[14]

Even the so-called Maekawa Report on structural transformation of

[12] See Kent E. Calder, *Dealing with Emerging Japanese Information Industries in the 1980s: The Cases of VAN and Software* (Center of International Studies, Princeton University, forthcoming 1988).

[13] Yasuhiro Nakasone, "Takumashii Bunka to Fukushi no Kuni o" [Toward a nation of welfare and vigorous culture], *Seiron*, January 1983, 26-37; quoted in Pyle, 16.

[14] Calder (fn. 12).

the Japanese economy toward a more import-oriented profile, inspired by Nakasone, was brought forward in reactive fashion, appearing just prior to the 1986 Tokyo summit, when foreign pressures for decisive Japanese initiatives in trade policy were growing intense.[15] The report stresses quite clearly and boldly the importance of a fundamental change in national direction, away from the strong export orientation that had been traditional in Japan since the mid-19th century. It outlines a number of broad alternative national goals, such as expanding domestic demand, changes in fiscal and monetary policy, and increased imports of manufactured goods. But it provides few specifics on how such a transformation away from exports might be realized. There is only one statistic in the entire eleven-page report—the 3.6 percent figure representing Japan's trade surplus as a share of GNP in 1986. At an early stage, the advisory group that prepared the report apparently considered various prospective policy initiatives, such as setting a target date for Japan to bring its trade surplus to zero, or boosting government spending to stimulate the economy. But the final document included no quantified targets at all, reportedly due to various bureaucratic counterpressures.[16]

Why Japanese Foreign Economic Policy Tends to Be Reactive

In order to understand why states have reactive foreign economic policies, we must answer two parallel questions: why those policies are not pro-active, and why they are not simply rigid. Possible answers to both questions lie in one of three areas: considerations of state strategy, the character of the international system, and the internal structure of individual states that jointly make up the system. None of these possibilities are mutually exclusive as explanations for reactive state behavior; in the Japanese case, all were concurrent between the end of World War II and roughly the end of the 1960s. Japanese national strategy dictated avoiding broad international commitments or a pro-active global role, so as to devote maximum attention to economic growth; the pre-eminence of the United States—with whom Japan shared an interest in multilateral free trade and stable exchange-rate regimes—obviated the need for independent Japanese initiatives. Conversely, heavy dependence on the United States for capital, markets, and diplomatic support—rendered es-

[15] The report was informally named after the former governor of the Bank of Japan, Haruo Maekawa, the chairman of the advisory group. The formal name is Advisory Group on Economic Structural Adjustment for International Harmony; the committee was charged with recommending ways of "more fully internationalizing the Japanese economy."

[16] *Japan Times*, April 8, 1986.

pecially acute by Japan's resource vulnerabilities, diplomatic isolation, and highly geared corporate strategies that mandated stable, steady cash flows—also made Japan unusually deferential to strongly expressed U.S. demands. Like some smaller U.S. allies, Japan could try to deflect or redirect those demands, but it could not totally forestall them.[17]

When the United States indicated a strong interest in concessions by Japan (as on the mutual security treaty, the Treaty of Commerce and Navigation, the Airline Treaty, and the Fisheries Treaty of the 1950s; and on adoption of I.M.F. Article 9 status and trade with the Soviet Union and China during the 1960s), Tokyo grudgingly but pragmatically accommodated U.S. concerns—indeed, more so than Americans usually recognize in hindsight. During the first two postwar decades, the United States simply did not press Japan very hard, due to the marginal attractiveness of the Japanese market, Washington's failure to foresee Japan's resurgent competitive potential, and the U.S. preoccupation with security considerations. The United States was obsessed with the need to retain Japanese diplomatic support against the Soviet Union and China; it also feared that severe pressure regarding economic issues would exacerbate Japan's seemingly fragile economic circumstances and lead either to political instability or to a counterproductive surge of anti-American sentiment within Japan.

While international systems explanations focusing on the U.S.-Japan relationship provide important insights into both Japanese passivity and Japanese responsiveness vis-à-vis the United States during the 1950s and 1960s, it is harder to explain the reactivity of Japanese foreign economic policy making since the Nixon Shocks of 1971—particularly since 1985. Japan has grown much larger in economic, technological, and even military terms than most of the other reactive states.

Unlike South Korea and most other reactive states, Japan has no net external debt; indeed, it is by far the world's largest creditor, with well over $200 billion in net external assets at the end of 1987. Compared to most reactive states or other middle-range powers, foreign investment in Japan is minimal relative to the overall scale of the national economy and has little domestic political influence; moreover, Japan has a much larger domestic market than the others. Supplying close to $100 billion annually in capital exports to cover the U.S. fiscal deficit, Japan has developed considerable leverage over the United States in their bilateral trans-Pacific relationship. Yet Japan has declined to use this international leverage

[17] See Robert O. Keohane, "The Big Influence of Small Allies," *Foreign Policy* No. 2 (Spring 1971), 161-82, on the methods smaller states use to influence the foreign policies of larger powers upon whom they are dependent.

overtly in support of its interests, even to the extent of taking strong initiatives to secure exchange-rate stabilization that might limit multi-billion dollar portfolio losses for Japanese overseas investors.[18]

DOMESTIC CONSTRAINTS ON INTERNATIONAL INITIATIVES

Despite the importance of the international environment and considerations of state strategy, particularly during the early postwar period, Japan's reactive behavior in the international political economy of the late 1980s cannot be explained without reference to Japanese domestic social and political structure. In contrast to the situation of the 1950s and 1960s, the international economic order of the 1980s clearly allows for and encourages Japanese activism, especially in view of the declining hegemonic capabilities of the United States, economic stagnation in Western Europe, and Japan's own broad-based economic, technological, and, increasingly, geostrategic leverage on the global scene.[19] Considerations of national strategy not only permit but mandate Japanese activism, particularly in international monetary affairs; with external financial assets upward of $200 billion, most of them dollar-denominated, Japan is sharply and adversely affected by the depreciation of the dollar and other major currencies against the yen, such as occurred steadily during the two years after the Plaza Accord of September 1985. With the international system allowing Japanese activism beyond the continuing strategic assistance to domestic firms within Japan, and conditions of national strategy seeming to dictate such activism, the reactive character of Japanese foreign economic policy in the late 1980s would clearly appear to have important roots in the Japanese domestic structure.

Japanese domestic political structure discourages pro-active foreign policy behavior in several respects. Perhaps most importantly, the fragmented character of state authority in Japan makes decisive action more difficult than in countries with strong chief executives, such as the United States or Fifth-Republic France. The problem of domestic coordination is compounded in Japan by the lack of both a functionally oriented ad-

[18] In fiscal 1986, for example, Japan's 24 insurance companies incurred a ¥2.2 trillion (over $15 billion) foreign exchange loss on their ¥10 trillion in foreign securities holdings, 50% of which were in U.S. Treasury offerings. Results for 1987 were reportedly comparable. See *Japan Times*, January 5, 1988.

[19] By 1988, Japan had, at prevailing exchange rates, by various definitions either the third-largest or the seventh-largest defense budget in the world, with rising defense technology capabilities and a central role in funding both U.S. defense budgets and economic assistance programs supportive of U.S. basing rights in states such as the Philippines. The Japanese defense budget for fiscal 1988 by Japanese definition was ¥3.67 trillion (around $30.4 billion at December 1987 exchange rates). By the NATO definition, including military pensions that Japan treats as welfare spending, Japan's defense budget was around $45 billion—significantly larger than the 1987 totals for France ($34.5 billion), West Germany ($34.2 billion), and Britain ($31.8 billion). See *The Economist*, January 23, 1988, pp. 27-28.

ministrative corps and authoritative codification of ministerial responsibilities to dampen bureaucratic disputes over jurisdiction. Japan has, as Karel van Wolferen puts it, "a hierarchy, or complex of overlapping hierarchies, without a top,"[20] the intermittent attempts of figures such as former Prime Minister Nakasone to play transcendent leadership roles notwithstanding.

To be sure, Japan has powerful national ministries such as MITI and the Ministry of Finance, which lend an aspect of decisiveness to policy on narrow technical issues within their clear individual areas of technical expertise and established professional concern (*nawabari*), such as technical standards for the consumer electronics industry or the establishment of research cartels in integrated circuits.[21] But on broad, complex questions of global economic management, or on issues created by emerging technology or economic transformation where bureaucratic responsibilities have yet to be defined, ministerial jurisdiction is often unclear, and internal conflict over how to proceed is often strong. In such cases, of which multilateral financial and telecommunications issues in the 1980s are typical, Japanese policies can hardly avoid being reactive.

Fragmentation of decision-making authority, leading to reactive policy making, is not a new characteristic of Japanese diplomacy. Bureaucratic divisions and lack of a strong central executive led to indecisive and reactive policy making at the Washington and London Naval Conferences of the interwar period,[22] although decisive military actions were also typical of that era. Cleavages within the machinery of state also seriously undermined Japanese diplomacy and military effectiveness during World War II.[23] Similar dynamics appear to have been at work in drafting the Maekawa Report of 1986. In that case, a range of relatively bold proposals for policy change, such as setting a target date for Japan to bring its trade surplus to zero, was apparently defeated by complex bureaucratic counterpressures flowing from the lack of decisive central authority.

Domestic interest-group pressures and the Japanese state's unusual

[20] Van Wolferen, "The Japan Problem," *Foreign Affairs* 65 (Winter 1986-87), 289.

[21] On the details of Japanese semiconductor industry development, including the relatively coherent and strategic role of public policy, see Daniel I. Okimoto, ed., *The Competitive Edge* (Stanford, CA: Stanford University Press, 1983).

[22] See the studies by Sadao Asada of the 1922 Washington and the 1930 London Naval Conferences, in Chihiro Hosoya and Jōji Watanuki, eds., *Taigai Seisaku Kettei no Nichibei Hikaku* [A comparison of U.S. and Japanese foreign policy processes] (Tokyo: University of Tokyo Press, 1977); and Chihiro Hosoya and Makoto Saitō, eds., *Washington Taisei to Nichibei Kankei* [The Washington system and U.S.-Japan relations] (Tokyo: University of Tokyo Press, 1978).

[23] See Ryōichi Tobe, Yoshiya Teramoto, Shinichi Kamata, Yoshio Suginō, and Ikujirō Murai, *Shippai no Honshitsu: Nihongun no Soshikiteki Kenkyū* [The essence of failure: Organizational research on the Japanese military] (Tokyo: Diamondo Sha, 1984).

sensitivity to them also intensify the reactive character of current Japanese foreign economic policy making, particularly in the area of trade policy. In contrast to the United States, France, Britain, and even West Germany, Japan has a relatively weak defense lobby, few emigrés with irredentist concerns, and relatively few powerful indigenous multinational enterprises with far-flung, global geostrategic interests. The most powerful interest groups (aside from large umbrella business federations such as Keidanren, which has 600 corporate members and is too unwieldy to direct an activist foreign policy), are agricultural federations and small-business dominated regional chambers of commerce. These parochial groups have virtually no international interests other than to resist foreign encroachments into Japanese domestic markets. During the 1970s and 1980s, domestic interest groups have been entering into increasingly intimate "iron triangle"-style clientelistic relationships with bureaucrats and politicians, forming "policy tribes" (*zoku*) that impede decisive policy initiatives even further.[24]

Although the evidence is mixed, many knowledgeable analysts suggest that the role of individual conservative politicians and of the Liberal Democratic Party itself in policy making has increased during the 1980s.[25] Improved expertise, information, and staff support, together with the growing ability to control bureaucratic promotions (the result of over thirty years of continuous power) have enhanced the LDP's policy-making influence. So have internal divisions within the bureaucracy, particularly in sectors such as telecommunications and postal finance, where technology and the contours of markets are changing rapidly and spheres of bureaucratic responsibility are poorly defined. Within the LDP itself, career party politicians appear to be gaining influence in policy making at the expense of ex-bureaucrats; since 1968, no former bureaucrat has become chairman of the Policy Affairs Research Council, the LDP's increasingly important policy-making arm (Inoguchi, 56).

Within a Liberal Democratic Party increasingly important in foreign policy formation, there are few incentives to propose clear, independent foreign policy initiatives. Japan's system of medium-size electoral districts forces as many as five members of the largest political parties (especially the ruling LDP) to run against one another in the same electoral district; thus, extremely small shifts in the total vote become crucial to a

[24] On the phenomenon of "policy tribes," see Takashi Inoguchi and Tomoaki Iwai, *Zoku Giin no Kenkyū* [Research on tribal dietmen] (Tokyo: Nihon Keizai Shimbun Sha, 1987).

[25] See, for example, Seizaburō Satō and Tetsuhisa Matsuzaki, *Jimintō Seiken* [The LDP administration] (Tokyo: Kōdansha, 1986), and Nihon Keizai Shimbun Seiji Bu, ed., *Jimintō Seichō Kai* [The LDP policy affairs research council] (Tokyo: Nihon Keizai Shimbun Sha, 1983).

candidate's election prospects. As a result, LDP legislators tend to be highly sensitive to constituency pressure, especially from relatively well-organized grassroots pressure groups such as agriculture and small business. Most of them have no clear ideology or maxims for conducting international relations other than a pragmatic response to foreign pressure (Funabashi, 33). Empirical analysis shows that politicians specializing in foreign affairs and defense matters tend to do rather poorly at the polls in Japan; the most secure Dietmen—those most likely to advance to the higher ranks of a seniority-oriented conservative political world—devote themselves to service to their constituents, especially in the agricultural and construction areas (Inoguchi, 43). Because these Dietmen often have broad expertise but little personal vision, they are disposed to reactive policy making, in which the impetus to change necessarily comes from outside (Funabashi, 41).

Candidates for prime minister, of course, must have views on the key foreign policy questions of the day; some demonstrated foreign policy expertise is an asset—especially during turbulent periods in the international economy, such as the late 1980s. There have been a few documented cases of LDP initiatives in the process of trade liberalization, mainly by aspirants to the office of prime minister or by foreign affairs specialists.[26] But Japan's numerous "action programs," as well as the LDP's Special Committee for Economic Counter-Measures (Esaki Committee), have achieved little success at dismantling domestic trade barriers in the absence of strong, directed foreign pressure, as the history of Japanese agricultural trade policy in the 1980s demonstrates (Funabashi, 61-62). The common pattern has been for the LDP's complex factional structure, grassroots constituency-sensitive orientation, and strong domestic interest-group ties to inhibit the party from undertaking decisive, independent foreign policy initiatives. The party's welfare-oriented biases also tend to erode the mercantilist cast of Japanese policy making. The LDP thus gains influence at the expense of a more strategically oriented bureaucracy; trade policy is biased in favor of inefficient domestic agriculture and labor-intensive manufacturing.

The prospects for future LDP influence with the bureaucracy are uneven. In areas where the responsible ministries have little international expertise and where the interests of the constituency are strong, such as air transport agreements, the LDP already appears dominant. The ruling party also often plays a decisive mediating role in sectors such as telematics, where bureaucratic jurisdictions are ambiguous and interministerial

[26] Some see the LDP's mediation of the import liberalization controversy of metal baseball bats in the early 1980s as one such case. See *ibid.*, 40-43.

conflicts correspondingly severe. This role is frequently indirect, however, and not easily visible to outsiders. The area of finance provides a mixed picture. The LDP is deeply involved in mediating the future of the massive postal savings system and in brokering tax reform, but it avoids many controversial issues, such as banking and securities-industry liberalization, that lie within the clear jurisdiction of the Ministry of Finance.

Bureaucracy and big business are still powerful in the policy process—perhaps more than Inoguchi's analysis implies—where their responsibilities are clear and their interests deeply engaged. But the net effect of the party's rising influence in Japanese policy making has generally been to intensify the reactive bias of the Japanese state. This has been especially true on delicate trade-policy questions, where pro-active initiatives directed toward liberalization of existing barriers are often politically controversial within Japan.

Reactive states, as has been mentioned, have their flexible dimensions. Despite the existence of clientelistic "policy tribes" in such areas as agriculture, Japan has totally liberalized imports of lemons (to the point where an industry that was significant until 1962 has almost disappeared) as well as most non-citrus fruits; it currently takes over three-quarters of U.S. global beef and veal exports.[27] During the 1980s, Japan has also made important concessions to its foreign trading partners on telecommunications equipment procurements, copyright protection for software, technical standards for consumer appliances, underwriting opportunities in yen-denominated securities for foreign financial institutions, and access to government credit for foreign subsidiaries operating in Japan. But these concessions, it must be stressed, have always been in response to foreign pressure—usually focused and rendered relevant to business and political realities in Japan by local subsidiaries of Western multinationals, which typically maintain ties to both Japanese and foreign governments. As Daniel Okimoto points out, a strong physical presence in Japan will be crucial for foreign firms as they become more seriously involved in the Japanese market (Okimoto in Pyle, 116). Apart from the business reasons he cites (pp. 101-3), one of the most important reasons for this is the significant role of local subsidiaries of foreign companies, especially well-established entities like IBM-Japan, in helping to mediate relations with the reactive Japanese state while benefiting from its pragmatic, if often subtle and obscure, concessions to outside pressure.

[27] In 1986, 77.7% of global U.S. beef and veal exports went to Japan. So did 86.5%, 73.2%, 55.2%, and 29.2% of U.S. lemon/lime, pork, grapefruit, and orange/tangerine exports, respectively. See Keizai Kōhō Center (fn. 4), 18.

The Sources of Intermittent Japanese Flexibility

Why is the Japanese state reactive but nevertheless intermittently flexible in the face of foreign pressure? Keenly sensed international vulnerabilities, including a dearth of raw materials, frequent lack of state-of-the-art technology, and a pervasive sense of diplomatic isolation are obvious factors. Dependence on the United States for security and markets is also relevant. But, taken together, these considerations are still underpredictive; an understanding of domestic structure is also important to a full explanation.

Funabashi's *Nichibei Keizai Masatsu* [Japan-U.S. Economic Conflict] and Kusano's *Nichibei Orange Kōshō* [Japan-U.S. Orange Negotiations] illustrate the political dynamics of, as well as the limits to, the Japanese reactive state's flexibility in international economic affairs. They depict the Japanese political system as one that, like its trading partner across the Pacific, is divided internally. That system is in the throes of perpetual domestic conflict, driven by political cycles, interest-group pressures, and bureaucratic machinations in complex interrelationships with one another (Funabashi, 10-11). In the case of the orange negotiations, Japanese consumers, the Japanese Foreign Ministry, and longtime orange-cartel boss Kazuo Fujii all had differing interests with respect to expanded U.S. orange imports into Japan. At the same time, many of these interested Japanese parties to the orange-import controversy had implicit allies in the United States, either because of parallel economic interests or direct political connections. The transnational "managed trade" coalition of Sunkist in California and orange-cartel boss Fujii in Japan were arrayed against Japanese consumers and the Florida citrus interests championed by Florida senator Richard Stone. Similar transnational dynamics were at work in the automobile, rice, and financial negotiations examined by Funabashi (pp. 120-230).

Because of the widening U.S.-Japan trade deficit, the American government was under pressure to take action in the orange case, which is broadly typical of the trade cases presented in the volumes under review. Washington was well-equipped to act, due to the centralization of political power on the American side in the hands of the executive branch and its trade negotiator, Robert Strauss. The Japanese government, faced with conflicting pressures from various ministries and interest groups, and without a centralized forum for resolution, had more trouble in coming to a coherent position. But one point on which both rival interest-group coalitions and the U.S. government agreed was the need for some marginal increase in U.S. orange exports to Japan. Under pressure from

Strauss, the Japanese negotiators became more flexible regarding an increase in the import quota for oranges; they used this concession effectively to sidestep the issue of full-scale import liberalization, which, due to internal divisions, the U.S. side could not press very strongly (Kusano, 11).

The orange negotiations thus are a case in which the flexibility of the reactive Japanese state—like the demands of the pro-active American state—were both real and limited. While the Japanese political system was not prepared to fully liberalize, it was prepared to *compensate*. Virtually all relevant actors in the orange negotiations, in both the United States and Japan, were given a lucrative piece of what they wanted (Kusano, 205). Although quotas were not dismantled, they were expanded so gradually that both the American exporters and the import cartel increased total revenues. Only the Japanese consumer, unrepresented in the negotiations, failed to reap major benefits—a particularly ironic outcome given basic Ricardian precepts of comparative advantage in international trade.

One major reason for flexibility (albeit often limited flexibility) in Japan's reactive policies is rooted in domestic political structure: the existence of crosscutting communities of interest between Japanese and foreign interest groups. Both U.S. exporters and the Japanese import cartel benefited from a marginal increase in Japanese orange import quotas, for example, as long as that increase was quite limited. As the Japanese economy becomes more and more deeply integrated with those of foreign trading partners—particularly that of the United States—crossnational interest-group coalitions that have the leverage within Japan to induce some flexibility in the Japanese government will grow in number and political influence. The strong yen of the late 1980s, for example, is promoting further coalitions between large Japanese distributors and foreign exporters on behalf of Japanese import expansion. T. J. Pempel points out that Japanese policy making is becoming very much a transnational process on many issues of foreign economic policy as well as on security matters (Pempel in Pyle, 149-50).

Among the strongest forces for reactive foreign economic policy making in Japan is the unusual structure of the Japanese mass media and their relationship to broader policy processes: they encourage some policy flexibility while also inhibiting pro-active Japanese initiatives. Japan has the most powerful mass media in the non-Communist world, with each of the three major national newspapers listing circulations of more than four times that of *The New York Times*. All these national dailies also have powerful television and other mass-media affiliates with whom they cooperate closely. The major media organizations operate through a common press-club system that standardizes both access to and timing of release of information from major political and bureaucratic sources. By Western (especially Anglo-American) standards, these are highly unusual characteristics; the integration and power of the media since the advent of television in the late 1950s is unprecedented in Japanese history as well.[28] The size and coordination capabilities of the Japanese media, operating within a homogeneous and relatively conformist society, give them an extraordinary ability to sway grassroots opinion, and to create a plausible pretext for action by the political authorities—probably the strongest such capacity in the world. Politicians and bureaucrats who watch cautiously to see how foreign overtures or domestic trial balloons are received by the media and the grassroots can use the power of the media to advantage; more assertive tactics would probably not be effective. Thus, in the absence of outside pressures for action, the media structure in Japan creates strong incentives toward hesitant initial behavior. However, the media also facilitate policy change once a consensus on the need for it has been reached.

Reactive Japanese Foreign Economic Policy: Implications for Japan and the World

Even in the 1980s, Japan's approach to the international economy, like that of the United States and most other major industrial nations, is in many respects still deeply rooted in the economic crises of the early post-World War II period.[29] During the era of economic and political uncertainty, whose perils were compounded by resource shortages and the effects of wartime destruction, the framework was forged for Japanese participation in the broader global economy. Japan succeeded brilliantly in achieving its objectives as long as the parameters of the global trade system remained stable. The very success of Japanese trade strategies, however, together with that of other newly industrializing nations, had begun to undermine the viability of the prevailing global trade and mon-

[28] On the influence of the Japanese mass media since the late 1950s, see, for example, Mataichi Kido, ed., *Gendai Jyanarisumu: Shimbun* [Modern journalism: Newspapers] (Tokyo: Jiji Tsushin Sha, 1973); Mataichi Kido, ed., *Gendai Jyanarisumu: Hōsō* [Modern journalism: Broadcasting] (Tokyo: Jiji Tsushin Sha, 1973); Ichirō Miyake, Jōji Watanuki, and Ikuo Kabashima, *Byōdō o meguru Elito to Taikō Elito* [Elites and counter-elites who bring about equality] (Tokyo: Sōbun Sha, 1985); and Ikuo Kabashima and Jeffrey Broadbent, "Referent Pluralism: Mass Media and Politics in Japan," *Journal of Japanese Studies* 12 (Summer 1986), 329-61.

[29] Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford, CA: Stanford University Press, 1982); also see McCraw, ed., *America versus Japan*, esp. p. 37.

etary regimes by the mid-1980s, despite periodic *ad hoc* adjustments since the Nixon Shocks and the Smithsonian Accord of 1971.

As Thomas McCraw and his colleagues point out in the study under review, the growing international economic crisis of the late 1980s, centering on the U.S.-Japan relationship, has deep structural origins and cannot readily be solved by macroeconomic nostrums (McCraw, throughout). Exchange-rate adjustments, such as the greater than 50 percent revaluation of the yen against the dollar during 1985-1987, can exert pressure for change, but cannot themselves produce it. Fundamental structural adjustments within the major trading nations (analogous to those that gradually gave birth to the current status quo of a relatively open America and a more closed and strategically oriented Japan) or thorough changes in international trade and financial arrangements are ultimately required.

The urgency of change is clear from even a cursory examination of emerging global balance-of-payments disequilibria. In 1986, the trade deficit of the United States reached $144 billion. Japan's trade surplus per year, by contrast, was running almost $100 billion.[30] Foreign capital inflows were financing the U.S. current account deficit at an annual rate of around $140 billion, turning the United States into the largest debtor in the world.[31] The bulk of these capital inflows came from Japan.

By mid-1987, the substantial exchange-rate shifts of the previous two years were beginning to have a marginal impact on Japan's trade balance in yen-denominated terms. But Japanese investment earnings—a major share of which represented the converse American debt-service burden—were growing even more rapidly. By the early 1990s, Japan is likely to be a net creditor of at least $500 billion, with annual investment earnings between $25 and $50 billion.[32] The United States, on the other hand, stands to become a massive debtor; I.M.F. estimates suggest a magnitude of around $800 billion by 1990 alone, with debt service payments of approximately $60 billion,[33] or roughly the size of the 1987 U.S.-Japan trade deficit.

Japan will be facing strong economic and political pressures to alter its export-oriented behavior and to assume a major role in reordering the international monetary and trade systems. Japanese self-interest—not to mention the viability of the international economic order—will require

[30] According to Ministry of Finance statistics, Japan's 1986 trade surplus was $92.8 billion. See *Nomura Investment Review*, January 1988, p. 10.

[31] Martin Feldstein, "Correcting the Trade Deficit," *Foreign Affairs* (Spring 1987), 795-96.

[32] C. Fred Bergsten, "Economic Imbalances and World Politics," *Foreign Affairs* 65 (Spring 1987), 770-71.

[33] Feldstein (fn. 31), 801.

much greater activism on the international economic scene than Japan has manifested at any time over the four postwar decades. What implication does the reactive-state interpretation of Japanese foreign economic policy have for Japan's ability to assume these new roles?

It is essential to recall the dual character of Japan's reactive 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. Even in agriculture, long-run structural changes in the Japanese domestic political economy are laying the basis for growing import dependence in case strategically focused—and strategically limited—foreign pressures should demand it.

Several times during the late 1970s and the early 1980s, foreign pressure induced policy changes in Japan on such matters as restraints on automobile exports to the United States (1981), access to the Japanese market for beef and oranges (1978), macroeconomic stimulation (1978), and market access for American telecommunications equipment (1980). The G-5 Plaza Accord of September 1985 may also have generated pressures for policy change in Japan, together with subsequent but related short-term interest rate increases by the Bank of Japan.[34] The massive imbalances of the international trade and monetary system in the late 1980s, combined with Japan's character as a reactive state, suggest that the importance of *gaiatsu* (foreign pressure) in Japanese foreign economic policy formation will further intensify.

In the short run, the reactive character of the Japanese state in foreign economic policy, particularly in dealings with the United States, helps to prolong a period of U.S. global hegemony in which American commitments have come to exceed American economic power.[35] For example, with the Foreign Exchange and Foreign Trade Control Law of 1980, the Yen-Dollar Agreement of 1984, and other related measures, Japan has responded positively to U.S. pressures for liberalization of outward capital flows;[36] the resulting unprecedented trans-Pacific capital flows played a central role in the ability of the United States to sustain the defense buildup of the 1981-1986 period. Consistent Japanese support for the U.S.

[34] *Ibid.*, 799-800.

[35] See Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987), 328-36.

[36] For further details on the process of Japanese financial liberalization and its implications for long-term U.S.-Japan capital flows, see Kent E. Calder, "Japanese Capital Outflows: Origins and Implications for the Global Political Economy," testimony before the Joint Economic Committee, U.S. Congress, December 11, 1986.

at summit conferences of the advanced industrial nations, G-5 financial negotiations, the I.M.F., and the preliminary Uruguay Round of trade negotiations has also allowed Washington's positions to prevail more frequently than American economic power alone would justify.

Yet reactive Japanese economic diplomacy, and the intensifying foreign pressures that motivate it, have potentially fateful long-run consequences within Japan. Most importantly, they are stimulating Japanese nationalism, as the Japanese people become increasingly aware of their country's relatively high economic efficiency and global prominence just as the barrage of global criticism against Japan intensifies.[37] Many see foreign criticism as unjustified. Although the Japanese government continues to respond, at least formally, to most demands from the major Western nations, popular support for such action is growing thinner.

Nationalist forces within Japan have also been stimulated by the sharp exchange-rate realignments of 1985-1987. These pushed weaker export sectors of the Japanese domestic economy, such as shipbuilding and textiles, into deep recession even as they intensified market pressures for enhanced import dependence. If severe exchange-rate induced deflationary pressures persist throughout an extended period of structural transition to a less export-dependent economy, and if they generate serious unemployment in the process, they may ultimately undermine the one-party dominance that has persisted in Japan for well over thirty years.

Perhaps the sharpest potential stimulus to anti-internationalist sentiment in Japan would be determined foreign efforts to force liberalization of labor-intensive import sectors such as wood products, food processing, and metal fabrication, in combination with forced rationalization of the Japanese distribution system. Together, these four sectors employ roughly one-third of Japan's entire work force. Relatively inefficient labor-intensive manufacturing, which had totally lost international competitiveness by the 1980s, employs as many workers as the major export sectors. For example, over twice as many workers are employed in predominantly small-scale metal fabrication as in the entire steel and nonferrous metal production sectors combined.[38] Under the impact of the

[37] Among the growing literature combatively justifying Japanese economic management and blaming others for global imbalances, see Osamu Shimomura, "Ijōna Amerika Keizai, Rifujin na Amerika" [A distorted American economy, and an unfair America], *Next* (July 1985), 90-95; Kenichi Ohmae, "Nichibei ni 'Fukinkō' wa nai" [Between Japan and the U.S. there is no imbalance], *Bungei Shunjū* (April 1986), 94-109; and Osamu Shimomura, "Nihon Mondai kara 'Amerikan Puroburemu' e" [From the Japan problem to the American problem] *Seiron* (July 1987), 40-49.

[38] In 1985 the metal fabrication industry employed 1,278,000 workers, compared to 427,000 for the steel industry, and 202,000 for the nonferrous metals production sector. See Management and Coordination Agency Statistics Bureau, *Japan Statistical Yearbook*, 1987 ed. (Tokyo: Management and Coordination Agency Statistics Bureau, 1987), 74.

sharp yen revaluation that began in late 1985, unemployment is already rising steadily. Foreign efforts to force rationalization of distribution and labor-intensive manufacturing would exacerbate this problem, and could possibly trigger a sharp antiforeign reaction, particularly within the LDP.

Indefinite continuation of the recent cyclical pattern of unfocused, often insensitive foreign pressure and reactive Japanese policy making could have dangerous consequences in the long run. At an extreme, it could place an unstable, uncertain, but nationalistic Japan in a central position within the global monetary system, inviting disastrous worldwide repercussions. It is therefore necessary to think more systematically about how foreign demands on Japan can be more focused and qualified so as to avoid inflaming Japanese nationalism still further. It is also important to consider means of encouraging Japan to engage in moderate, proactive diplomacy in the interest of the world system as a whole. Japan's economic partners should give particular thought to coordinating trade and monetary policy claims on Japan, so that the two types of policy do not work at cross-purposes.

Economic changes of the past two decades, spawned in the interaction between Japan's reactive foreign economic policy and the international system, are providing some groundwork for a more decisive Japanese global role. Direct foreign investment outward from Japan, like portfolio investment, has been massive, driven by relative costs of production as well as by Japanese fears of Western protectionism. Both these motivations for direct overseas investment are a function of the sharp shifts in exchange rates and the intermittent protectionist measures that followed the demise of the Bretton Woods system in the early 1970s. In 1986, Japanese direct foreign investment surged to $22.3 billion, nearly twice the level of the previous year; it was less than $1 billion in 1971, when Bretton Woods broke down.[39] Although in 1980 only 2 percent of the production of Japanese corporations took place offshore, compared to 10 percent for U.S. firms, this ratio between U.S. and Japanese offshore production was moving rapidly toward equality by the late 1980s.

Japan has also been developing major new stakes in the profile of the international monetary system, as a result of foreign-currency denominated securities holdings that totaled almost $102 billion at the end of 1986.[40] International pressures appear to have given Japanese manufacturing firms, particularly those investing massively in new plants and equipment abroad, a growing interest in a more active Japanese economic diplomacy, including a diplomacy more occupied with national security

[39] Keizai Kōhō Center (fn. 4), 56.
[40] *Nomura Investment Review*, April 1987, p. 11.

concerns. The growing role of Japan in the international financial system, as the world's largest exporter of capital, has brought about sharply increased prosperity and influence for Japanese financiers domestically; it has also given these financiers an expanded stake in a stable international monetary regime.[41] If the exchange-rate turbulence of the mid-1980s persists as Japanese financial surpluses continue to rise, Japan will have powerful incentives to become more active in global regime formation—through insisting on stronger multilateral foreign investment guarantees or on yen-dominated U.S. Treasury debt, for instance. By the spring of 1986, calls for measures of this sort were already beginning to surface within Japan,[42] although the Japanese government, in classically reactive fashion, was slow to assert its clear national interests in the absence of external pressure to do so.

The economic basis for a gradual revision of Japan's reactive-state approach to economic diplomacy and for the emergence of a more positive Japanese leadership role in the international political economy is now beginning to emerge, just as its analogue did during the 1840s in Britain and during the 1890s in the United States. Do we have, in the rising financial houses, automobile producers, and electronics firms of Japan—newly wealthy as a consequence of Japan's changing role in the world economy—the functional equivalent of the merchants of Bristol and Wall Street who gave the stimulus to the assertive hegemonic roles played in the past by Britain and the United States? The issue is complex, but our analysis provides the basis for some guarded generalizations.

First of all, it seems unlikely that Japan could or would become an overarching hegemon in the international system comparable to the Anglo-Saxon powers in their heyday, even if strong economic reasons for activism gradually transformed the reactive Japanese state. Because of its relatively weak armed forces and the strong domestic constraints on their expansion, Japan could not easily play a hegemonic role in strategic and military affairs. Aside from imports to correct resource shortages, trade is much less fundamental to Japanese economic growth or to the maintenance of domestic employment than is often supposed; less than 20 percent of Japan's work force is employed in sectors generating over 80 per-

[41] After the sweeping reforms of the foreign exchange law in 1980, operating profits of the top four securities houses rose between 29% and 51% in one year. By the end of 1985, they stood at roughly triple the levels of 1979-1980, while those of the major banks quadrupled during the same period. By 1986, all four of the largest banks in the world, and six of the ten largest, were Japanese. See The Oriental Economist, *Japan Company Handbook*, First Half 1986 (Tokyo: Tōyō Keizai Shinpō Sha, 1986), 1010-1113; and Nihon Shimbun Sha, ed., *Nikkei Sōgō Charts* [Nikkei composite charts] (Tokyo: Nihon Keizai Shimbun Sha, 1985), 425-30.

[42] See, for example, Yoshihide Ishiyama, "Utage no ato no Kokusai Tsuka Kaikaku" [International currency reform after the banquet], *Chūō Kōron*, April 1986, pp. 176-87.

cent of total exports, while total exports comprise only around 15 percent of GNP.[43]

Domestic structural constraints—particularly the lack of a strong central executive, coupled with the presence of strong elite ministries with specialized and at times divergent concerns—will probably combine with national interest to produce a Japanese leadership role that will be technical and sector-specific rather than broadly political. The strongest prospects for Japanese activism will most likely appear in energy and finance, where sharp global price fluctuations and Japan's dependence on world markets create an overwhelming interest in shaping future international regimes. In the short run, Japan may be expected to exert influence in these areas either through multilateral mechanisms or through informal G-2 arrangements with the United States, such as those pioneered in the Baker-Miyazawa Agreement of October 1986.[44] Only an extended period of turbulence in the global economy with discernible, threatening contours would elicit strong movement away from the continuing tradition of the reactive Japanese state.

[43] Bank of Japan Research and Statistics Department, *Keizai Tōkei Nenpō* [Economic statistics annual], 1985 ed. (Tokyo: Nihon Ginkō, 1986), 249-52.

[44] On the G-2 concept, see Funabashi, 194-230 and Bergsten (fn. 32), 789-93.