

summit in West Germany.

The role played by the London summit in these developments was important. As Putnam and Bayne indicate,<sup>99</sup> summit pressures and domestic politics created by an internal division were intertwined in such a way that the Japanese expansionists could "draw authority from the summit", and thereby overcome the resistance of the powerful MOF. Though Japan could only attain 5.3% GNP growth in 1977 -- a clear violation of London's tacit pledge -- the pressures to implement the commitment encouraged fiscal expansion by Fukuda, and thus prepared the path for another pledge at Bonn. Unlike Miki and the MFA, who failed to override the MOF on the North-South assistance problem at Rambouillet, Fukuda used the legitimacy of the summit as a building block in obtaining the desired objective of the expansionists.

### B. The 1978 Bonn Summit

US-Japanese economic tensions abated to some extent after the announcement of the Strauss-Ushidi statement. The US switched its primary target to West Germany. However, the Japanese current account surplus continued to expand steadily, despite the Japanese commitment in the agreement.<sup>100</sup> Thus the pressures on Japan to correct its surpluses with the US and EC did not subside. In response to these pressures the Fukuda regime imposed export restraints on designated commodities. It also implemented a 124-item tariff reduction effective in March 1974, removed NTBs and residual import restrictions, and expanded import financing credit. In March 1978, the BOJ reduced its discount rate to 3.5% so as to boost the economy. The yen's value, meanwhile, appreciated to the 200-yen level by the time of the Bonn summit.

The 1978 Bonn summit was characterized by very detailed pre-summit preparations for policy coordination. For instance, the OECD meeting in February 1978 installed the "Coordination Reflation Action Program" to include the United Kingdom, France, Italy and the Benelux states in a "convoy" package, as distinct from the "locomotive" approach of London.<sup>101</sup> The first preparations for Japan took place at the second Carter-Fukuda summit, held in May 1978.<sup>102</sup> Compared with the inadequate economic growth of Japan, the US economy was booming, with increased domestic demand satisfied by foreign exports. The result was a \$26.7 billion overall trade deficit, one third of which was with Japan. The US-Japan trade imbalance further increased at a pace of about \$ 1 billion surplus per month for Japan. While the Japanese were concerned with yen appreciation, the Americans started to treat inflation as the number one problem. With these developments as a backdrop, Fukuda and Carter reached a consensus that Japan and the US would renew their efforts to manage the destabilizing factors in the world economy. Japan would do its share in achieving the 7% GNP target and cutting current account surpluses. The US would try to control its inflation and inhibit the fall of the dollar. In order to facilitate the ongoing Tokyo Round negotiations, the US-Japan adjustments were to be made in May. Japan also announced its plan to double ODA over 3 years instead of 5 years. In a meeting with a group of American politicians, Fukuda expounded his views on Japanese economic conditions. He listed the steep appreciation of the yen as one of the major restraints on achieving a 6.7% growth rate in 1977. He asked for stabilization of the American dollar as a step toward a 7% growth rate in 1978, and for an improvement of America's energy policy. In fact, criticism against US energy and exchange rate policies was mounting not only

from Japan but also from the European countries. The former issue would culminate in a pre-summit trade-off between Carter and Schmidt, and the latter would take the form of the European Monetary System (EMS) scheme. Fukuda was somewhat successful in curtailing American discontent about Japan's economic and trade policies. One obstacle to a smooth summit was now removed.

Just in time for the summit, Fukuda took a number of steps to deflect foreign and domestic criticism of his administration.<sup>103</sup> Domestically, he maintained that the inflation of other countries, particularly that of the US, was mainly to blame for the huge Japanese trade surplus. He made it clear that he would urge the US to further curb its inflation and decrease its oil imports. But he did not forget to lay the groundwork for a possible introduction of a supplementary budget in case of an economic downturn. This was a reflection of the prevalent domestic view that Japan might be "ganged up on" by other summiteers unless it shouldered its responsibility as a strong surplus economy. Actually, the Japanese economic figures were generally more favorable than those of other nations. Since October 1977, economic growth had turned around and the last quarter (January-March) of JFY 1977 recorded 2.4% real GNP growth. The inflation rate in April was 3.9%, just behind the lowest rate of 2.9% (of West Germany) among the summit seven. This was mainly a result of cheap imports created by the yen's appreciation. Japan accumulated \$11 billion in international payments surplus in 1977, and its trade surplus grew at a yearly rate of \$22 billion in the first quarter of 1978.

Taking the critical mood of the US and Europe against Japan into account, Fukuda established his positions in the summit with a view to avoid becoming a "scapegoat".<sup>104</sup> Fukuda renewed his pledges to attain a domestic demand-led 7% GNP growth target by increasing public works spending if necessary, and to double the Japanese ODA within the next 3 years. He then announced that Japan would try to hold the volume of its exports to the level of 1977 and introduced an emergency import program of concentrated uranium, and aircraft. Reduction of the trade surplus would be the main objective of Japanese foreign economic policies, but this would necessitate the stabilization of the yen-dollar exchange rate as well as a curtailment of inflation in other countries, notably the US. However, Fukuda stopped short of designating a concrete figure for Japan's surplus cut. On energy, the establishment of nuclear fuel recycling was identified as desirable. He would again embrace the idea of a "Common Fund", long advocated by the LDCs to secure their commodity export earnings. His strategy for Bonn was to ally Japan with other like-minded summiteers to push ahead with their common objectives. A meeting with the French Prime Minister produced an agreement on the need to stabilize the currency system and to promote the multilateral trade talks with a view to preventing protectionism. Japanese-German talks led to an agreement to resist unreasonable demands, and to urge the US to slash its oil imports and to strengthen its measures for a stable dollar on international money markets.

Well-organized preparations and carefully-chosen policies before and during the summit saved Fukuda from embarrassment. Significant progress had already been made by the time of the opening of the summit due to bilateral negotiations and talks among the sherpas.<sup>105</sup> Thus, Fukuda only had to follow his original plan.<sup>106</sup> He reiterated a 7% growth plan led by domestic demand expansion, reduction of the current account surplus by export restraint and temporary export measures, and a doubling of ODA. He also included efforts to liberalize foreign exchange markets, to enact a supplementary budget if necessary, and to solidify Japanese direct overseas investment and yen-denominated bonds as surplus-cutting tactics. Fukuda acknowledged that the results since their last

meeting had been rather unsatisfactory for each economy in the fields of economic growth, inflation or balance of payments. However, he argued for a solution of these difficulties under the spirit of "cooperation and solidarity", and proceeded to advocate the maintenance of free trade principles and collaboration in energy research and development (R & D). His call for stabilizing the dollar's value was taken up by others, as was his concern about US overconsumption of petroleum. Japan, on the other hand, would take responsibility for reflating its economy and paring down its large payments surplus with other summit nations, especially the US.

Fukuda's fear of receiving a heavy rhetorical attack did not materialize. Indeed, a number of Fukuda's remarks and proposals were supported by other summiteers and put into the summit statement.<sup>107</sup> Prompted by Schmidt, he brought up the idea of denouncing international terrorist activities in the joint declaration. His proposal was endorsed by Trudeau and Schmidt, and approved by other participants if the issuance of the declaration was technically feasible. The result was a Statement on Air-Hijacking. Fukuda's request for a joint research development project on new energy sources such as nuclear fusion was intended to include other countries in the US-Japan joint program agreed to at the May meeting. A majority of the summiteers, including the French and Germans, favored the offer. The clause that "joint or coordinated energy research and development should be carried out to hasten the development of new, including renewable, energy sources and the more efficient use of existing sources" was thus put into the declaration. Fukuda also wanted to complete the Tokyo Round by the end of 1978. In the wake of a major coup in the negotiations just prior to the meeting, this seemed possible. The summit members decided to "charge [their negotiators], in cooperation with other participants, to resolve the outstanding issues and to conclude successfully the detailed negotiations by December 15, 1978". Contrary to the retreat on the maintenance of an open trade position in the last summit, this provided a great incentive to the negotiations at Geneva. The MTNs were to end in April 1979 with noticeable Japanese concessions to US demands.<sup>108</sup> In addition, Fukuda's support for the "Common Fund" system was inserted into the section on North-South problems.

Less satisfactory for Japan was the outcome of the discussions on the stabilization of the yen-dollar exchange rate. A MITI survey in February demonstrated that the high yen had hurt such industries as textiles and chemicals, through depressed export earnings.<sup>109</sup> Some sectors of the business community were complaining about the fall of the dollar. Japan expressed its apprehension about the rapid rise of the yen and asked for technical measures to intervene jointly in money markets.<sup>110</sup> The US however, did not agree. The communiqué placed more emphasis on the solution of international payments imbalances as a major factor in rectifying exchange rate instability. No outright pledge was obtained from the US on the matter. As long as Japan was running a sizable surplus with the US, Washington's monetary authorities seemed to be unprepared for joint action. It was not until the November announcement by Carter that the US would achieve exchange rate stability by coordinated currency market intervention through issuing "Carter bonds" and other actions that the yen's value started depreciating.<sup>111</sup> The November action became a model of multilateral policy coordination.

The Bonn summit also provided a suitable occasion for the settlement of some outstanding bilateral issues.<sup>112</sup> US-Japanese bargaining on tariff cuts for industrial goods like colour film and computers was resumed in parallel with the summit at Bonn. On the last day of the summit, Japan acquiesced in accepting 4.9% and 4% tariff reductions respectively for imports of American computers and colour film. The result

was quite a tactical manoeuvre; the US negotiators were having trouble containing domestic protectionist pressures and thus were keen on utilizing the summit to obviate anti-Japanese criticism in Congress, while the Japanese wished to be rid of the American impression of a "closed" Japanese market. Another bilateral achievement was the follow-through of the May Carter-Fukuda agreement to jointly develop nuclear fusion and solar energy projects. Fukuda made it clear that the Japanese were prepared to give \$1 billion to the project while Carter said the US would take the Japanese government's position on peaceful utilization of nuclear energy into account. Unlike the London meeting, nuclear energy was not a centre of controversy between the US and Japan at Bonn.

For most Japanese, the Bonn summit turned out to be better than expected. It was a summit success that Fukuda badly needed. Expecting an LDP presidential race in December, he needed to turn his political fortunes around, particularly because of his low popularity (a 24% approval rating against 43% disapproval) before the summit.<sup>113</sup> Fortunately for him, the summit did not bring about concerted direct attacks on Japan's trade surplus. Nor was Japan singled out from the other participants, as had been feared. However, there were a few demands made of Japan: Trudeau urged the surplus countries to step up foreign economic assistance and the British Exchequer Healey called on Japan to make its ODA increase in strong yen instead of weak dollars.<sup>114</sup> As a result of various Japanese international promises inserted in the declaration, and Fukuda's rather un-Japanese outspoken assertion of Japan's positions, the grievances of the summiteers were not aggravated.

All participants made some concessions to coordinate their economic and energy policies. The American pledge to restrain its oil consumption and the German promise to introduce supplementary measures to boost its economy could be cited to skeptical domestic audiences as major proof of multilateral efforts at world economic growth. Although the majority of LDP members felt that Fukuda's summit diplomacy had been satisfactory, rival faction members did not hesitate to de-emphasize the Prime Minister's success, as was often the case in this multi-faction party.<sup>115</sup> Fukuda privately gained confidence from the summit.<sup>116</sup> He judged that he had articulated Japan's concerns and insisted that his positions had attracted no criticisms from others, and were largely well received. On his way back home, he renewed his determination to take initiatives to secure a 7% GNP rise and to decrease the Japanese surplus. He also disclosed his intention to run for the LDP presidential race, stressing the international responsibility given to him as a chairman of the Tokyo summit next year.

Zaikai was relieved to find no overt "Japan-bashing" at the summit.<sup>117</sup> The heads of the Keidanren and Nissho liked the consensus on collective responsibility delineated in the specific pledges. Still, many felt that there was nothing novel contained in the declaration, a sentiment shared by many business leaders. All leaders exhorted the government to do its best to translate the international pledges into practice. More criticisms came from the opposition camp. Except for the DSP and NLC, the other four parties did not disguise their distrust of Fukuda's promises. All parties appeared to take the 7% growth target and surplus-reduction measures seriously. The Komeito and DSP proposed such measures as a large-scale supplementary budget and tax cuts to stimulate domestic demand. Blaming Fukuda for being overly eager to fall in line with US positions, the JSP advocated an international forum including the developing countries and socialist states instead of a "political show" like the summit meeting. The newly-funded Shaminren (Social Democratic Federation), a small rightist splinter group from the JSP, bitterly accused Fukuda of making numerous empty promises and trying to

exploit the summit to extend his political life. Later the Opposition asked how the currency issue had been addressed by the Bonn summit. The government had to admit that conditions had not been right for discussing the matter in Bonn.

The four major dailies' editorials unanimously endorsed the Bonn approach of stating in concrete terms in the final declaration the shared responsibilities of summit countries.<sup>118</sup> They preferred to see actual results at the summit rather than an idealistic, formality-conscious summit designed to confirm an abstract cooperative spirit. Although they agreed that the realization of the pledges would determine their final evaluation of Bonn, three of the newspapers (Mainichi excepted) rated the overall summit performance high. The settlement of the US-Japan tariff cut negotiations was hailed by the Asahi and Nihon Keizai. In contrast to the Mainichi's pessimistic view, both Yomiuri and Asahi welcomed Schmidt's promise to spur German growth, while the Nihon Keizai implicitly favored the promotion of the "Common Fund" project. It was in the field of energy that all papers showed their discontent at a lack of concrete prescriptions. They cast doubt on US plans to slash its oil imports and to conserve energy. On the trade issue opinions differed between the Asahi and Nihon Keizai on one hand, and the Mainichi, on the other. The former generally accepted the language of the trade section while the latter was concerned about absence of the phrase "free trade" in the declaration and pessimistic about constraining protectionism even if the present GATT round would end in 1978. Stabilization of the dollar was interpreted by the Nihon Keizai, Yomiuri and Asahi as still outstanding. As for Fukuda's international commitments, the press, implicitly at least, agreed on the necessity to cut back on Japan's current account surplus. The 7% growth goal was, however, not praised by the Asahi, which placed more stress on curtailing inflation, and the Mainichi, which hoped to "qualitatively" transform the Japanese economy.

The most tangible outcome of the Bonn summit was the agreement on international responsibility-sharing in pursuit of macroeconomic policy coordination. What differentiated Bonn from previous summits was its acknowledgement beforehand that the summit countries' national interests did not automatically converge.<sup>119</sup> A well-prepared summit made divergent national interests more harmonious than before by confirming prior to the summit what could be conceded and what could not. Japan had adjusted its policies before the summit for domestic and external reasons. Thus, Japan was ready to take on shared multilateral responsibility as a surplus country at the meeting. In sum, external pressure, especially from the US, had prompted policy adjustment, which the summit reinforced. However, the ensuing second oil crisis complicated Japan's macroeconomic performance and the fulfillment of its summit pledges. One objective was, however, clearly met. The target figure set by Fukuda for a Japanese ODA increase was attained: The value of economic assistance was more than doubled in three years (1977 - 1980).<sup>120</sup>

In macroeconomic policies, there emerged some domestic moves toward fulfilling the Bonn agreements. Fukuda maintained his serious attitude toward the pledges at Bonn.<sup>121</sup> Soon after the summit MITI employed its "administrative guidance" to elicit a promise from nine major electric power companies to take steps to decrease current account surpluses. The presidents of the companies were called on to add their temporary imports to the already-set \$1.5 billion total and to invest more than 5 trillion yen on plant and equipment in the next year. The Bonn summit also helped strengthen the position of the expansionists in the LDP. The Chairman of the Executive Council insisted on providing a drastic increase in economic assistance and a 1 trillion yen tax cut while MITI Minister Komoto advocated a large-scale supplementary budget and \$10

billion in temporary import measures. Not only words but deeds followed. The international legitimacy provided by the Bonn summit helped persuade the tight-fisted MOF bureaucrats to produce fiscal stimulus. In view of a clear shortfall in economic growth, Tokyo adopted in early September, an additional budgetary stimulus consisting of increased public-works expenditures and increased foreign aid and imports to balance the current account. As a consequence, domestic demand expanded by 8.1% level and Japan's export volume fell 5.6% in 1978, driven by a 10% increase in imports. Indeed, as Henry Owen later testified, Japan "made a good-faith effort to achieve its Bonn target", though the growth for 1978 at 5.5% was one and a half points lower than the pledged 7%. Most of the analysts shared Owen's view that Japan did try to deliver on the growth-rate commitment.

The trade and current account surpluses, however, continued, with the latter marking a record \$165 billion for calendar year 1978. This was mainly brought about by the yen's rapid and substantial revaluation.<sup>122</sup> Between early 1977 and late 1978 (when a coordinated intervention helped block the fall of the dollar), the yen's value soared about 35% vis-à-vis the dollar. The result was an increase in Japan's current account surplus in dollar terms but a sharp shrinkage in yen terms. One failure of Fukuda's summit diplomacy -- to obtain a pledge to neutralize fluctuations of the dollar from the US -- undermined Japan's efforts to implement current account surplus reduction.

The 7% growth pledge had another side-effect.<sup>123</sup> Fukuda's commitment to the growth rate gave his rival for the prime ministership -- Masayoshi Ohira -- a good target to attack. Ohira put Fukuda on the defensive by denouncing his single-minded pursuit of the GNP rate even after many Japanese had begun to treat it as unachievable. Fukuda's surprising defeat by Ohira in the party's primary election was not directly attributable to the 7% target pledge. But it would indirectly bind the Ohira regime's relations with the US. It was widely believed that the fiscal stimulus package adopted to attain the 7% growth target partly contributed to the exacerbation of the government's budget deficit and the subsequent inflation. The second oil shock, the subsequent reaction of the monetary authorities, and other fiscal mismanagement blurred the whole picture of the precise causes of Japan's economic illness. More plausibly, the Bonn agreement might have worsened the Japanese economy's ability to cushion the adverse impact of the oil crisis. In the longer run, the Bonn experience that made Japan the "engine of growth without inflation" resulted in the mid-1980s' argument of some economists that Japan should not play the role of "engine". They feared the expansion of government deficits caused by an increase in domestic demand as happened after the 1978 Bonn summit.