

revived; the predominant economic mood was anti-expansionist.

C. The 1985 Bonn Summit

Unaffected by the London summit, the Japanese economy steadily grew throughout 1984 led by expanding external demand, especially from the US.²³¹ As a consequence, Japanese GNP occupied 12% of the world total, up from 7% in 1965 while the US share dropped from 40% to 34%. The role of the Japanese yen was strengthened as well. The dollar's share in official currency reserves of the world was predominant at 76% and the yen's share was negligible in 1973. Eleven years later the dollar's share decreased to 65% while that of the yen edged up to 5% because of the liberalization of capital flows. However, the fundamentally export-oriented structure of Japanese economic expansion until mid-1985 meant the swelling of Japanese trade and current account surpluses between the time of the London and Bonn summits. The current account surplus in 1984 amounted to a record-breaking \$37 billion. The US-Japan trade imbalance mushroomed from \$18 billion in 1983 to \$33 billion in 1984. EC-Japan trade was still in favour of Japan with \$190 billion in Japanese earnings in 1984. Naturally, trade disputes, which had calmed down prior to the London summit, soon gained strength and protectionist pressures had tremendous impact on the formulation of Japanese trade and macroeconomic policies.

The robust US economic growth was running out of steam before the summit. Also the US ran a budget deficit of \$175 billion and a current account deficit of \$116 billion in 1984.²³² The twin deficits consequently fueled rising protectionism in the US Congress after London. The protectionist forces in the US secured enactment of an omnibus trade bill in October 1984 that made it possible for the executive branch to take such countermeasures as import restrictions unless a trading partner opened its markets to the level of the US. Japan was soon pressed in December to sign a VER accord with the US on Japanese steel exports. Also in line with the spirit of the London summit, Japan introduced in December means to raise industrial imports under the Generalized System of Preference (GSP) from developing countries. However, the international reception of a series of Japanese packages was not very sympathetic, and the "Ron-Yasu" summit in January 1985 ignored the personal affinity of the leaders to ask for more Japanese market liberalization measures. There was a need for Reagan to take drastic steps in pressing Japan to give the US better market access in Japan as Congressional protectionism and the American popular perception of the worsened US-Japan trade problems remained. As a result, the meeting initiated a new negotiating format - the "Market-Oriented, Sector-Specific" (MOSS) approach - that would address specific barriers in specific sectors. The approach represented the American grievance that the sequence of packages offered so far were too general and slow to put into effect. The Americans argued that focusing on specific issues and sectors would create more prompt, and most of all, politically more tangible results in the shape of increased US market access in Japan, and especially, better trade balances. The MOSS negotiations would centre on such areas as telecommunications, medical equipment and pharmaceutical, electronics, and forest products. Particularly in the area of telecommunications, the US had a wish to boost its sales following the privatization of Nippon Telegraph and Telephone (NTT) in the spring of 1985. The Americans believed that the Japanese were "dragging their feet" about fewer regulations, less strict technical standards and the right to sell equipment without any regulations to protect

their domestic market. The Japanese disliked the American negotiators' high-handed manner during the negotiations.

In a bid to fend off trade wrangles, Nakasone appointed State Minister Komoto in March 1985 to draft a set of concrete trade measures based on the recommendations of the Committee on External Economic Relations (the so-called Okita Committee).²³³ Meanwhile, anti-Japanese sentiment was raging on Capital Hill. A number of protectionist bills were introduced with the clear intent of "sending a message to Japan" that the US patience with the exorbitant trade imbalance had "worn thin". For instance, in March a resolution demanding trade retaliation against Japan scored a 92-0 Senate victory. Nakasone had to push for further market-opening measures. As a result, talks concerning US access to the Japanese telecommunications market were completed in early April. On April 9, Nakasone held an extraordinary press conference in which he outlined the medium-term comprehensive market-opening policies that factored in most of the US requests. This outline which was later to become the ACTION program, was based on the Okita Committee's report that found that the Japanese market should be "open, in principle, and restrictive as exceptions." The Prime Minister also went over the bureaucrats' heads to appeal directly to Japanese consumers to purchase \$100 per capita of foreign products, so that imports would grow by \$12 billion.

The White House reacted to the announcement in a friendly but guarded way. Congressional and business doubts about the effectiveness of the intended measures were not completely erased. Western Europeans, by and large, received the speech in the same manner as the Americans did. Though by the time of the German summit, three specific sectors of the MOSS trade negotiations were largely completed, the perception that Tokyo still had a long way to go to satisfy the Westerners was revealed at the OECD ministerial meeting in mid-April. The US Secretary of Commerce singled out Japan and urged further market opening. An EC representative also asked Tokyo to come up with structural reform measures. Japan persisted and succeeded in dropping the phrase in the communiqué that identified Japan's current account surpluses as a cause of international trade tensions. In the published communiqué, however, Japan was given a mission, along with the US and other OPEC countries, to push for the continued deregulation of its financial markets, expansion of domestic and overseas investment and further encouragement of imports by providing better market access for foreigners in order to redress its trade abnormality. At the meeting, Japan made a pledge to add an additional seven billion yen to its bilateral financial aid to Africa and to set a new mid-term aid target for 1986 and beyond. But, the Japanese call for the beginning of preparations for a new round of MTNs in mid-1985 with negotiations in the spring of 1986 was not approved by some EC members. Acknowledgement that the new round should be launched as soon as possible was the only solace for Japan.

Domestically, external pressures and heightened trade tensions revived a sort of "locomotive theory" advocated by expansionist-oriented politicians and businessmen.²³⁴ To help restrain the spiraling trade surpluses, the Okita Committee suggested a reconsideration of the Japanese tradition of high savings rates and subdued consumption and suggested the stimulation of domestic demand to beef up imports. Domestic demand expansion was welcomed by almost everyone. However, the means to attain this end differed considerably among influential Japanese. Supported by Finance Minister Takeshita and Foreign Minister Abe, Nakasone held firm on his objection to demand stimulation through higher public spending; his conviction of the desirability of fiscal austerity was undaunted. In fact, by 1985 Japan's ratio of outstanding long-term debt

to GNP was 48.8%, exceptionally high even compared with the US figure of 33.8%. Thus, his commitment to fiscal consolidation without raising taxes propelled him to propose, as an alternative, a new comprehensive set of market access measures and deregulation to activate increased domestic demand in the private sector. The Keynesian expansionists, led by LDP Vice President Nikaido and the Chairman of the LDP Miyazawa, demanded fiscal stimuli. They contended that boosted public borrowing would not "crowd out" private investment and not trigger inflation in view of a large surplus of domestic savings over investments. A reflationary budgeting measure would spur investment, accelerate economic growth and raise import demand, thus leading to the alleviation of trade frictions. Zaikai was also divided between the fiscally conservative group headed by the president of Keidanren and the liberal group led by the head of Keizai Doyukai and the president of Toyota. The expansionists were encouraged by Shultz's Princeton University speech that stressed the necessity of domestic demand stimulation by converting Japanese high savings to investment and consumption. The "locomotive" debate was fully rekindled, and was complicated by the political ambitions of Nikaido and Miyazawa to engineer an early removal of Nakasone from office. Entangled with this debate was the slowdown of economic growth in the world. More than in the pre-London summit situation, Japan's responsibility as a surplus country to reflâte its economy was increasingly suggested by foreigners. The controversy over domestic demand expansion was not yet over when Nakasone left for Europe.

In the increasingly protectionist atmosphere of the world and with the American attitudinal shift towards collaboration, there emerged a need and opportunity for policy coordination among the summiteers. In the months prior to Bonn, there occurred an attempt to implement the pledge agreed to at previous summits.²³⁵ The Group of 5 (G-5)/IMF multilateral surveillance group made an announcement in January that they "reaffirmed their commitment made at Williamsburg to undertake coordinated intervention in the [foreign exchange] markets as necessary." To calm down the speculative fever over dollar appreciation, they jointly intervened in markets and helped bring about a drop in the dollar's value over succeeding weeks. In light of the new Treasury Secretary's accommodative attitude toward Mitterrand's request for a "new Bretton Woods", the omen for producing more appropriate macro-economic and monetary policy co-ordination was better than before.

The need for better economic policy collaboration was reflected in the relatively bleak economic situation before Bonn. Economic performance was not particularly bright and was worse in some respects than that of the previous summit.²³⁶ The economy of the US, achieving a remarkable 7% growth in 1984, was slowing down in early 1985 to 1.3% growth in GNP. The overall economic growth of the Seven was not bad in 1984; only the economy of the UK declined over the previous year. But unemployment rates went up for five of the summit countries (all except Canada and the US) and six countries' rates were higher than the 7% level in 1984. Therefore, the Japanese lop-sided trade surplus, the twin deficits of the US and the consequent relatively high interest rates and strong dollar, the correction of "structural rigidities" in the European economies and high unemployment rates were considered by the Japanese to be subjects for discussions at Bonn.

Just as before London, Nakasone met with opposition politicians to build a consensus on Japan's summit diplomacy.²³⁷ Nakasone's positions toward the summit were quite similar to those he had held one year earlier. Responding to the opposition's call for East-West dialogue and disarmament, he reiterated his hope to make the summit a forum for peace and disarmament and to push for an early meeting between the two superpowers.

But he did not reply fully to the opposition's demands to stimulate domestic demand through fiscal incentives, and instead proclaimed his commitment to economic growth without inflation and to rolling back international protectionist moves by strengthening free trade principles. All the opposition parties prodded the Prime Minister either to reject Japanese participation in the contentious Strategic Defense Initiative (SDI) project or to prudently deal with it. Nakasone had shown his "understanding" of the plan when he had met Reagan in January, but had not decided on it. Noting the importance of SDI research as a politico-strategic bargaining chip, he basically remained noncommittal. However, the necessity of unity among the summiteers on this issue was to be stressed by him later. His enthusiasm for fixing the date for a new round of trade talks remained. He was also planning to seek an understanding from fellow members on Japanese market-opening efforts, and unlike the previous summit, to ask the US more explicitly to remedy its economic malaise. The Cambodian problem, settlement of the Iran-Iraq War and the dialogue between North and South Korea were listed on his political agenda.

This time, the pre-summit rehearsal for Nakasone included two meetings with Kohl and an encounter with Reagan²³⁸. The former resulted in a statement stressing bilateral ties and cooperation in development aid to the Third World, with a warning against the protectionist trend. The Japanese Prime Minister, however, was asked by his German counterpart to further liberalize Japanese markets, and failed to obtain clear-cut support from Kohl for his idea of starting the GATT trade round in 1986. The two leaders decided on four conditions that would justify American SDI research; SDI should not pursue a dominant position of strength, it should maintain the nuclear deterrent, it should be restricted to the limits of the ABM Treaty, and full consultation with Moscow and the American allies should precede production and deployment of the weapons. Solidarity among the Seven on the matter was also stressed at the bilateral meeting. The "Ron-Yasu" meeting was an opportunity for Reagan to formally request Japanese participation in SDI research. Nakasone kept his noncommittal attitude. He presented Reagan with the four conditions plus another request to reduce offensive weapons; this was seen as an important prerequisite to SDI development. Both agreed not to seek a conclusion to the MTN problem but to push for the start of the new round in 1986 at Bonn. Both leaders were more open than at the pre-summit bilateral meeting before London; Reagan nudged Nakasone to do more to import forest products and implied the need to contribute to greater defence efforts while Nakasone asked Reagan to further rectify the budget deficits and high interest rates. By then it was reported that all of the summiteers, except the French, managed to concur on the issue of initiating a new round of MTNs. The French wanted to link trade with monetary reform. The isolation of the French in the pre-summit preparations was emphasized by the media.

Divergent French positions were underlined throughout the Summit and, in the end, frustrated a number of possible agreements. As the French isolation attracted the attention of other summiteers, the "Japan problem" was not as focused upon as had been expected. The two major accusers - the French and Americans - were too busy insisting on their accusations against each other. SDI was the largest political issue that the participants spent time discussing.²³⁹ For Reagan, support of other countries would mean a great victory that he could exploit to ask for more funding from a resistant Congress. Although Reagan could obtain participation in SDI research from the UK, West Germany and Italy, Canada was not keen on it and France objected to the bitter end. Inclusion of a reference to the SDI in the Chairman's summary was supported by Nakasone, but that was the furthest he could go. The political declaration noted the summiteers' "appreciation" (not "support" as originally wished by the US), of

"the positive proposals of the United States of America" with regard to the arms talks at Geneva. The sentence was deliberately ambivalent so that it could be interpreted by Reagan to indicate the summit's implicit acceptance of the SDI scheme while others could argue that the SDI was not part of "the positive proposals." Japan and West Germany denied that the "positive proposals" contained the SDI project. Kohl's summary at the end of the session did not refer to any consensus on the SDI among the summit members.

As at London, French intransigence precluded issuing a unanimous position on the new GATT trade negotiations round.²⁴⁰ Domestic concern over agriculture was the main stumbling block to French movement on the issue. The US along with Canada wanted to take up agriculture while Japan was sympathetic to France on its agricultural stance. The US and Japan were for listing high technology and services as objects of tariff reductions. Mitterrand counterargued that trade in services should be treated outside of the GATT and both the new round and the concept of monetary reform should be simultaneously promoted. Reagan's proposal for setting 1986 as a starting year failed to persuade the French President to change his mind. Unanimity was achieved in the declaration that reaffirmed the OECD Ministerial communiqué which stated that "a new GATT round should begin as soon as possible", but unanimity was denied by the phrase "most" of the summiteers thought that "this should be in 1986." The paramount Japanese interest was given better support, but again no date was fixed at the summit.

Despite a somewhat softened attitude expressed by the Americans prior to the meeting, a fundamental French-American rapprochement over the currency system could not be struck.²⁴¹ The split between the French, who had hoped for a "target zone," and the Americans and others, who opposed it, was not narrowed. The summiteers acknowledged that it was "essential to improve the functioning of the international monetary system" and confirmed the work that would be completed by the Finance Ministers of the Group of Ten (G-10) on "ways to improve the functioning of the monetary system" and that the proposals put forward by the G-10 would be "discussed at the next meeting of the Interim Committee of the International Monetary Fund in Seoul in October, with a view to making the international monetary system more stable and more effective". Thus, the result on monetary discussions was inconclusive. The severe French-American rift probably prevented the trade-off between the monetary issue and the trade issue. Both agreed to disagree on vital issues.

Compared with these two controversies, the agreement on macroeconomic work-sharing was smooth and produced a country-specific formula, reminiscent of the 1978 Bonn summit pledges.²⁴² The difference between the first Bonn summit and the second was the absence of Keynesian demand management economics. Also, though Japan's \$94.3 billion trade surplus did not attract collective all-out criticism from the participants, recrimination was not entirely absent. The British encouraged the Japanese to liberalize further its capital and financial markets with a view to accelerating the internationalization of the yen, since Japanese domestic demand growth was a desirable direction for Japan's trade partners. Nakasone explicitly refuted the employment of fiscal policy measures to stimulate internal demand, by citing the fact that Japan was suffering a 4.6% budget deficit as a ratio of its GNP. Instead, he put forward expansion of domestic demand through deregulation and tax reform. Applying "freedom, in principle, and restriction as exceptions" to the market-opening measures, he pledged to put his April 9 decision into a comprehensive import-increasing package. Consequently, the declaration, which specified international economic policy coordination in the format of country-by-country responsibility-sharing, gave Japan the task of achieving "further

progress in deregulating financial markets, promoting the international role of the yen, facilitating access to markets and encouraging growth in imports." In it, it was noted that the "essential" consideration for Tokyo was "to persevere with its policy of budgetary discipline and strengthening market functions, particularly with a view to fostering investment." The line adopted at the summit was not only fully compatible with Nakasone's fiscal conservatism but also unleashed a great impetus to move towards further deregulation and market liberalization. Nakasone exploited the summit to give his domestic reform plans strong international endorsement so that he could overcome stubborn domestic resistance.

An augmented Japanese voice and role were noticeable at Bonn.²⁴³ For example, the sentence that the countries of "the dynamic Pacific region" were "drawing even closer together" was inserted into the declaration on the 40th anniversary of the end of the Second World War. Urged by Japan, the summit expressed its earnest hope of the creation of a political environment that "permits the parties to overcome the division of the Korean peninsula in freedom." The Japanese desire for "genuine non-alignment" shown at London was reaffirmed in stronger terms as the summit countries indicated their "respect" for non-alignment's "important contribution to international security and peace". In addition, the declaration called on all countries to "refrain from the threat and the use of force" in accordance with the aim of the UN Charter, reflecting the Japanese penchant for non-aggression and non-violence. Also, during important discussions, Nakasone was more outspoken against US positions and attempted to play more of an intermediary role than in the previous summits, though his overall strategy based on alliance with the US was unchanged. On the trade issue, he tried to reconcile the divergence between the French and the Americans by empathizing with the French. At one time when Mitterrand threatened not to take part in the next summit because of his displeasure with the political decision-making function of the summit, the Japanese leader reportedly attempted to sway his decision by emphasizing the value of summitry for Asian nations such as Japan. Similarly, Nakasone was educated by the summit discussions. Echoing Mitterrand's concern about the new MTN round, he stressed the need to consult closely with developing countries and to make the content of the negotiations well-balanced. In sum, the Bonn summit showed growing Japanese input and output at an international forum.

The country-specific, role-dividing macroeconomic formula agreed to at Bonn diverted Japanese domestic attention to the subject of the future management of Japanese macroeconomic policy harmonization with other summit nations.²⁴⁴ Finance Minister Takeshita, after returning from Bonn, renewed Nakasone's pledge to implement economic measures outlined on April 9 and specifically suggested the relaxation of regulations on land and housing investment as a way to fulfill the summit pledge. However, he added Nakasone's wish that the draconian tax reform was not meant to include tax reduction to expand internal demand. Zaikai responded to the outcome of the summit with relief and approval, but there emerged a difference of evaluation on Nakasone's public remark on tax reform at Bonn. More importantly, the summit brought home to all major business leaders the need to cope with the trade issue by taking drastic steps to open markets. Also they rated the political declaration highly, but the absence of specific dates attached to the initiation of the new trade round was regretted. The proposal for tax reform drew the line between those who were cautious about tax reduction for fear of deterioration of budgetary restraints and those who favored reduction of corporate taxes to energize entrepreneurial activities.

Other domestic reactions did not differ substantially from those of the previous

meetings. The ruling parties hailed the agreements at the summit while the opposition retained their negative views.²⁴⁵ Nakasone's LDP praised the accord on macroeconomic work-sharing and said it was pleased that Japan had not come under heavy attack for its trade surplus. It concluded that the Japanese efforts to cut the surplus by liberating its market was recognized by other countries. The NLC, now ruling with the LDP, also welcomed the burden-sharing procedure for non-inflationary growth and Japan's constructive role in promoting the new GATT round. Both the JSP and Komeito deplored the lack of concrete solutions for such urgent economic ills as trade frictions and budget deficits, and along with the JCP, criticized Nakasone's accommodative posture toward SDI research. Unlike the previous summits, however, the two centrist parties added a favorable reference to the summit; the Komeito gave credit to a consensus on the new round of MTNs while the DSP appreciated the maintenance of the free trade principle.

The leading dailies' editorial evaluations were well-inclined on the whole.²⁴⁶ All papers agreed that Japan should take effective steps to further liberalize its market and to cut its lop-sided trade surplus. They called on Nakasone not to take refuge from the "Japan-bashing" at Bonn. The division of work agreed to at the summit was unanimously well received. Promotion of the new MTN round was endorsed by the Yomiuri and Asahi. The former, in particular, lamented the French rejection of the US-Japan proposal and urged France to step forward on the matter. The second Bonn summit was characterized by a conflict of interests, according to the Mainichi, Yomiuri and Asahi, but all three accepted such a style of summitry. The Asahi especially approved the way Bonn was run and judged that the summit process was energized by not stifling the disputes. The political document was rather popular among the Japanese press as well. Four newspapers unanimously supported the major principles incorporated in the political declaration on the Second World War. Both Asahi and Mainichi asked the Prime Minister to learn the lessons of history from the declarations. SDI was another primary editorial concern and demonstrated the ideological line of the dailies. The Yomiuri and Nihon Keizai did not take sides on the issue while the Asahi and Mainichi strongly advised Tokyo not to accept the American invitation. As far as the leading media reactions were concerned, the unanimous push for further market-opening policies was a great benefit for the Nakasone regime.

As Nakasone himself noted, Japan could attain its major imperative at the Bonn summit - avoidance of being harshly attacked by all other summiteers - by introducing a comprehensive market-opening package.²⁴⁷ However, its overriding wish to obtain a consensus on the date for the commencement of the new GATT round was disrupted by the lone obstinate resistance of France. In retrospect, Japan's effort was not fruitless. The annual meeting of the GATT Contracting Parties, in the fall, decided to set up a committee to prepare the new round. The preparations were scheduled to be completed by September 1986. The summit declaration clearly fueled the power of fiscal conservatives and undermined the position of fiscal expansionists. Though the domestic demand controversy did not fizzle out after the meeting, Nakasone's fiscal consolidation policy without increasing taxes was sustained by the fiscally tight JFY 1986 budget. The budget would cut public works projects by 2.3%.

Significantly, Nakasone did table a series of measures to dissipate trade frictions. Following through his April 9 announcement, he presented the Three-Year Action Program for Improved Market Access on July 30. Stating its underlying premise as a willingness to achieve market access "greatly exceeding that of the international level", the plan set out the principles of minimum government intervention, positive promotion