

of the new round of GATT negotiations and special considerations for the economic growth of developing countries. Specifically, the package included reform of 88 regulations criticized abroad, elimination of import tariffs on 1,853 items, 20% reduction of import tariffs on other products, simplification of standards and licensing procedures and improvement in government procurement activities. Besides, it formalized Japan's commitment to liberalize financial and capital markets by containing a major provision of relaxation and ultimate removal of interest rate ceilings on large denomination deposits by the spring of 1987. The package was to prove meaningful, as the US-Japan-Trade Study Group admitted in its report on the progress of the Action program in September 1986. Considering domestic opposition to these steps, summitry seemed to facilitate the government's efforts to open the Japanese market.

#### D. The 1986 Tokyo Summit

By the time Tokyo hosted its second summit, the Japanese economy had undergone noticeable changes.<sup>248</sup> The Action program appeared to have only a minor impact on soothing frustration over perceived Japanese trade practices, especially in the US Congress. The Reagan regime also informed Japanese trade negotiators of the imperative of a visible decrease of Japan's external surplus with the US by taking immediate steps to make major import purchases. Pressures for retaliatory actions remained extremely high despite Nakasone initiatives. Protectionist bills were tabled in Congress one after another. A number of protectionist moves were taken by the US against Japan. The widening Japanese trade surplus was the major cause for these. In fact, the Japanese trade imbalance was not easily corrected. The trade data for JFY 1985, ending on March 31, registered a 3.3% increase in total Japanese exports and a 5.1% decrease in imports. The only good news about the customs statistics was the increase of manufactured imports which represented 31% of total imports, up from the preceding year's 20%. In the meantime, American attention had shifted to the monetary cause of the Japanese trade imbalance.

The Reagan Administration abandoned its long-cherished "benign neglect" stance on the strong dollar at the Plaza Hotel in September 1985.<sup>249</sup> As the first serious effort to attain macroeconomic policy coordination and to secure the monetary cooperation of its economic partners, the US launched the exchange rate initiative with the other G-5 finance ministers and followed up with Reagan's trade policy speech of September 23. Underscoring the serious "external imbalances", the G-5 Plaza accord acknowledged that "exchange rates should better reflect fundamental economic conditions" than before and pledged coordinated efforts to achieve "some further orderly appreciation of the main non-dollar currencies against the dollar." It was the first public recognition by the US and its allies that the overvalued dollar was a major source of the trade misalignment and exhibited their joint resolution to deal with it. It was also a form of international burden-sharing particularly aimed at the growing economic strength of Japan. To stem the protectionist trend in Congress, the President subsequently delivered a "fair trade" speech outlining administrative steps to combat foreign export subsidies and other forms of allegedly unfair competition. Actions soon ensued. The G-5 jointly intervened in money markets to bring about the needed correction. The BOJ spent over one billion dollars in one week and soon raised its discount rate in order to strengthen the yen against the dollar. The yen-dollar rate appreciated from 239 Yen on September 20 to 217 Yen on September 27, a gain of almost 10% in one week. In retrospect, the joint

policy coordination was remarkably successful in lowering the dollar probably because the market participants interpreted the statement and actions of the G-5 as a signal for forthcoming changes in macroeconomic policy stances of the countries concerned. The result was a 26.8% depreciation of the dollar vis-à-vis the yen from the G-5 meeting to mid-April 1986. But the problem with the accord was that it did not address the point of how far the dollar should fall and the way to limit the extent of the dollar's depreciation. Consequently, the rapid appreciation of the yen would become the major concern of Japan at Tokyo.

The agreement by the G-5 under US leadership made possible what the seven heads of government and state could not do at Bonn - depreciate the American dollar. The incident seemed to show the fundamental effectiveness of policy realignment if the international circumstances were conducive. After the G-5 currency realignment, coordinated macroeconomic policies became more of a norm for the major economies.<sup>250</sup> With the initiative of Finance Minister Takeshita, concerted interest rate reductions were successfully conducted by Germany, France, Japan, and the US in March. The US and Japan further lowered their official discount rate to 8% and 5% respectively in April. The UK and France followed suit. The importance of monitoring economic policy coordination was noted at the G-10 conference in Washington in April. The conference reaffirmed the strengthening of multilateral surveillance initiated at the 1982 Versailles summit, thereby paving the way for Secretary Baker's international policy coordination system at the Tokyo summit. Before Tokyo, harmonization of policy measures had been accepted as a substitute for unilateral action.

Another significant development for Japan was the publication of the so-called Maekawa report in April 1986.<sup>251</sup> In early November 1985, Nakasone set up the 17-member private advisory group to dissipate the raging trade conflict and prepare for the Tokyo summit. The Maekawa report, released just before Nakasone's visit to Washington, boldly advocated the need for profound long-term changes to substantially reduce Japan's dependency on exports and to expand domestic demand so as to "transform the Japanese economic structure into one oriented towards international coordination." The report set forth a comprehensive set of policies to achieve six broad recommendations including basic reform in Japan's trade and industrial structure, stabilization of the exchange rate at a proper level, further liberalization and internationalization of its financial markets and review of the preferential tax treatment of savings. Following through on its recommendations, the government unveiled in April and approved in May its own guidelines containing a list of measures designed to transform Japan's economy from one dependent on external demand to one driven by domestic demand. But the guidelines refrained from encouraging new issues of deficit-financing government bonds, reflecting still prevalent prudence in fiscal policy. In addition to these policy recommendations, soon after the release of the Maekawa report, Tokyo also made public a set of measures aimed at stimulating domestic demand in the short run. Public-works projects included the promotion of housing construction by individuals, reduction of electricity and gas prices and financial relief to small - and medium - sized companies hurt by the strong yen. All these steps were intended to detract from mounting criticism against Japan at the upcoming meeting in Tokyo.

Equipped with the Maekawa report and the package of economic stimuli, Nakasone met Reagan to prepare himself for chairing the Tokyo summit.<sup>252</sup> With a view to moderating fierce US accusations, he tried to convince the Administration and Congress that Japan would shift its economy from an export-driven to a domestic demand-led one in the future, substantially raise imported products, and rectify the \$ 50 billion bilateral

trade surplus. He also consented to the establishment of a joint Japanese-American advisory board which would monitor the entire process of implementing the recommendations of the Maekawa report. However, the exchange-rate issue was far from resolved. The dollar was now trading at around 180 yen, depriving Japan's export-oriented corporations of a sizable amount of their earnings. While the Prime Minister expressed his desire to stabilize the yen-dollar rate at the current level, Reagan wanted it to be determined by natural market forces, alluding to a refusal of joint monetary intervention. The monetary issue was now becoming a political objective for the Nakasone regime, but the prospect for a solution at the summit was not promising as far as the bilateral meeting with the US President was concerned.

Nakasone did not have a firm grip on the domestic situation.<sup>253</sup> In fact, the Maekawa report was not overwhelmingly endorsed by everyone. The LDP leadership was dissatisfied with Nakasone's manner of placing private advisory groups ahead of the party policy formulation apparatus. Most of the mass media agreed with the long-term objectives of the proposed changes but doubted its abstract principles without clear-cut blueprints to attain these objectives. The concept of reorienting the economy away from exports met much resistance from some business sectors. These mixed reactions prompted Nakasone to equivocate on the Maekawa report; he started to take a wishy-washy stand on it by calling it his private declaration of political determination after his visit to Washington. Still, it was apparent that with Japan's gigantic \$ 49 billion current account surplus, domestic demand expansion was a necessity for Tokyo. The thorny problem of how to improve domestic demand had reignited the traditional debate between fiscal conservatives and Keynesian expansionists prior to the summit. The debate was further spurred by a series of economic conferences from a G-10 meeting in Washington to the OECD ministerial council in Paris that called on Japan to play the role of a kind of "locomotive engine" to pull up the world economy. As the Japanese economy was setting into a slight recessionary phase due to the rapid yen appreciation, voices calling for stimulating domestic demand by introducing a supplementary budget were much more widespread and powerful than before Bonn. With the augmented influence of expansionists in Japan, Nakasone's macroeconomic policy adjustment between the Maekawa report and fiscal consolidation plan increasingly depended on the summit result.

Another domestic issue was assuming its urgency as the dollar plunged below the 170 yen-level, as the summit approached.<sup>254</sup> All the opposition parties exerted enormous pressure on the government to obtain an international consensus at the summit to stabilize the yen's value. They also demanded promotion of US-Soviet dialogue, disapproval of such military sanctions as the US raid on Libya, and a fiscal stimulus to revitalize depressed industries. The same voices were raised among LDP members. For instance, Chairman of the Executive Council Miyazawa, Nakasone's chief political rival and an expansionist, publicly outlined his view that calling for joint monetary intervention from other countries was natural and proposed a large-scale supplementary budget based on public-works project as a prescription to revive the economy. Nakasone himself admitted that the present level of the yen-dollar exchange rate was too low and he wished to use the summit as an occasion to bring about a consensus on stabilization of the yen, hopefully by introducing a coordinated intervention. Stabilization of the energy market was another matter Tokyo hoped to discuss because stable oil prices were deemed essential to contribute to peace and security in the Middle East as well as a boon for oil-consumers like Japan. Neither the UK nor the US, however, had changed their opposition to artificial market intervention and the prospect for inserting a sentence calling for stable oil prices looked dim. Nakasone's other

themes listed "peace and disarmament." The delicate issue of Libyan terrorism was looming larger and Japan, as a host, hoped to play it down because of its imperative to maintain intimate relations with the Arab world. As usual, the implicit goal of Japan was to persuade other countries to understand the Japanese economic situation so that they would not resort to castigating Japan's trade policies. At the same time, solidifying the free trade system by engineering September 1986 for the start of the GATT's new round of MTNs was high on the agenda of Tokyo.

Like the previous summits, Nakasone and other Japanese participants finished their last-minute efforts to make the Tokyo summit fruitful by bilateral talks with other summiteers.<sup>255</sup> The Japanese pleaded with other summiteers to consider ways to stabilize the yen-dollar exchange rate by expounding on how hard the domestic industries had been hit by the 40% rise in the yen over the past six months. Kohl agreed with Nakasone on the importance of currency stability and Mitterrand supported the inclusion of currency problems in the formal session. Three summit participants, Reagan, EC Commissioner Delors, and British Exchequer Lawson, however, did not give even lip service to coordinated monetary intervention to help prevent the future rise of the yen. Other bilateral economic topics like the pending US-Japan semiconductor talks, and Japanese market-opening policies were taken up at the lower levels of bilateral meetings. One benefit of these meetings was an Italian decision to double its import quotas on 34 Japanese imports. Also Nakasone responded positively to the request of Brian Mulroney to create the Group of 7 by including Canada and Italy and concurred with him on the importance of initiating the new trade round from September.

Political and other issues were also on the agenda. Both Reagan and Nakasone shared the opinion that concrete statements should be published on steps against international terrorism and the Soviet Chernobyl nuclear accident. Deviating from his neutral stance right after the US bombing on Libya, Nakasone drew one step closer to the US position by stating that American countermeasures could not be avoided. As seen in this case, the "Ron-Yasu" relationship was seen to be given top priority over other relationships. But the balance of the relationship was increasingly tilting toward "Ron's" favour. "Yasu's" status as a host of the summit was compelling him to create a convergence of interests by accommodation rather than confrontation. Still, the government was optimistic that it could play Japan's traditional diplomatic game premised on a separation between politics and economics at the summit; it estimated, rather naively, that Libya would not be singled out as a terrorist country in the declaration. Though not encouraging, the bilateral meetings largely absorbed all criticism and requests on Japan's commercial policies from other summit members, thereby getting the Japanese trade surplus issue off the formal summit agenda.

Like Mitterrand, Nakasone wanted his summit discussions centred more on economic than political issues, but events overtook both the talks and Japanese media attention. Thus, the second Tokyo summit assumed the shape of a "terrorism summit" for Japan.<sup>256</sup> As in the first Tokyo meeting, host status restricted Japanese options on crucial issues. The Japanese proclivity for consensus-building, and Nakasone's personal wish to make the summit visibly conclusive and a stepping stone for victory in the upcoming July Upper House elections, made Japan even less outspoken on critical problems. A case in point was the strenuous issue of terrorism and the Libyan-American conflict. Japan was against international terrorism and, as seen, Prime Minister Fukuda took the initiative in engineering the production of an anti-terrorism statement at the 1978 Bonn summit. It was over the means of countering terrorism that Japan somewhat differed from the rest of the world. Japan disliked a hard line stance, and the US attack on Libya was

not endorsed in Japan; the American claim of its evidence was not fully accepted as reasonable and the opposition parties disapproved the use of force against an alleged terrorist country. For fear of causing a backlash from the Middle East and severe repercussions domestically, Tokyo wanted the declaration to exclude Libya's name and to propose less specifically defined anti-terrorist measures. It also thought that France and Italy, having close relations with the Arab world, would not consent to naming Libya as a terrorist state. Japan's calculations, however, turned out to be too naive. Thatcher demanded an outright rewriting of the draft on terrorism and, with US and Canadian support, strongly suggested that Libya be singled out as a terrorist country. France and Italy did not disagree and Japan was isolated from the rest of the summit countries on the issue. The necessity to pursue a consensus for the sake of having a successful summit took precedence over national insistence. A statement on international terrorism identified Libya as a "state which is clearly involved in sponsoring or supporting international terrorism" and made public a decision to apply six detailed "measures in our jurisdiction" to the terrorist states.

Apparently, Japan's position as a host turned against its national interest on the issue.<sup>257</sup> The media and opposition criticized the government's decision. Unease was expressed by some LDP members on whether the statement would obstruct Japan's delicate Middle East policy. An MFA official reportedly confided that Japan would have taken issue with the others on the matter if it had been on the agenda of another international conference unrestrained by the burden of hosting. The government lost no time in patching up the scar left by naming Libya. Foreign Minister Abe explicitly declared that the statement would not be incompatible with the traditional Japanese stance on the Middle East and decided no specific measure in the statement required Japan to take action, in light of Japan's minimum diplomatic involvement with Libya. Further pressed by the opposition in the Diet, Abe later revealed Japan's noncommittal stance on American bombing of Libya. He publicly acknowledged that support for the summit statement would not mean Japan's endorsement of the US action. The fact that no economic sanctions against a terrorist nation was added to the statement barely saved Japan's fragile position. Despite a temporary rupture with some of the Arabian countries, the summit outcome did not result in a diplomatic upheaval for Japan. Taking the chair at the summit also meant acting as a mediator.<sup>258</sup> Both Canada and Italy reportedly threatened to walk out unless they would become members of the exclusive club of finance ministers and central bankers. The EC also insisted on its inclusion in the surveillance group. Nakasone successfully intervened and helped establish the Group of 7 (G-7), but refused the admission of the EC by merely "taking note" of the EC position. The declaration created the G-7 to manage and improve the international monetary system and to discuss and to deal with the related economic policy measures. Likewise, on the statement on the implications of the Chernobyl nuclear accident, the Japanese Prime Minister blocked Thatcher's wish to make Soviet responsibility crystal-clear and did not insert strong terms denouncing the Soviet mishandling of its accident. His emphasis on the US-Soviet dialogue was not dashed by this statement. Also, reflecting the Japanese wish, "the need for continuity of policies for achieving long-term energy market stability and security of supply" was "recognized" in the declaration. Japan reconciled its interest in increasing the oil stock level with other summiteers' unwilling views by not including the idea in the document.

These successful reconciliatory roles notwithstanding, the Japanese leader lost a number of vital points at the conference.<sup>259</sup> His hope of setting September as the date for the beginning of the new round of MTNs was aborted by the fierce EC-North American dispute over agriculture. The US, Canada, and West Germany proposed introduction of

the agricultural sector in the new trade round, attempting to undermine the European agricultural subsidy system. The French-Italian coalition was diametrically opposed to their scheme. Though Nakasone was not recorded in the press as mentioning anything about the issue, the deadline meant abandonment of his hoped-for plan to give the new round a boost at the summit. The declaration again only noted the importance of "the early launching of the new round of multilateral trade negotiations" without specifying the date.

Compared with the trade matter, macroeconomic policy coordination was further facilitated by the creation of a discreet device.<sup>260</sup> In response to the Japanese wish to stabilize the yen, the US presented Baker's international economic policy coordination scheme that would "review" the Seven's "individual economic policy objectives and forecasts collectively at least once a year, using the indicators specified below, with a particular view to examining their mutual compatibility." Tokyo regarded this "multilateral surveillance ... to reach an understanding on appropriate medial measures whenever there are significant deviations from an intended course; and recommend that remedial efforts focus ... on underlying policy fundamentals" as effective for the stabilization of the yen because the sentence "reaffirming" coordinated intervention "in exchange markets when to do so would be helpful" was added in the declaration. But other Japanese voices interpreted this plan differently. Some thought that the plan would intrude into Japanese economic sovereignty and erode the autonomy of Japanese economic management. Others feared a much stronger Japanese yen and other economic policies imposed on Japan to reduce its trade surplus by the adoption of multilateral surveillance using "objective" indicators and "peer group pressure". The utility of Baker's method was also doubted by some segments in Japan. Zaikai's response to the plan was divided. Apprehension over domestic intervention as well as optimism about sustaining noninflationary economic growth and the stability of exchange markets were indicated. The JSP officially took the line that external pressures would increase as a consequence of the acceptance of the strengthened multilateral surveillance system. But all seemed to admit the effects of the agreement remained to be seen.

More devastating for Nakasone was the absence of consensus on the way to halt the fall of the dollar.<sup>261</sup> In spite of the assiduous pre-summit lobbying for stabilization of the yen-dollar exchange rate with a view to employing joint intervention in money markets, no tangible agreement was reached in the way desired by the Japanese authorities. Reacting sharply to the lack of concrete measures to break the dollar's fall, market forces appreciated the yen from the pre-summit 169 yen to the post-war low of 164 yen during the summit. Not only did all opposition parties bitterly blast Nakasone's failure but displeasure was also uttered openly by some LDP members and powerful Zaikai leaders. Some media started to label the Tokyo summit as an example of a failed summit. It was obvious that the summit, by causing pre-summit overexpectation, greatly discouraged some influential groups in Japan and undermined Nakasone's political position within the Japanese political community. Gerald Curtis described the post-summit atmosphere in Japan as follows:

The reaction [to the Tokyo summit] was more than disappointment that the U.S. did not do anything to try to stop the rise of the yen; it came close to a feeling of betrayal. "We gave Reagan what he wanted on referring to Libya by name in the terrorist statement," many Japanese were saying, "and he gave us nothing back in trying to control the appreciation of the yen." The feeling that Reagan somehow owed it to Japan to do something about the yen, that yen appreciation was yet another example of Japan being victimized by stronger powers, and that

the U.S. would respond to the Japanese expectation that it would help protect was very strong. Also very much a part of the Japanese mood was the conviction that yen appreciation was being used to punish Japanese for working hard, for being productive, and for making high-quality products that Americans wanted to buy.<sup>262</sup>

As seen in this situation, strong yen-induced deflationary effects suffered by some sectors in Japanese society led to vocal dissatisfaction with the summit result. This, coupled with the shared perception of greater international responsibility, refueled the "locomotive" theory premised on fiscal expansion in Japan. As a result, tight-fisted Nakasone was propelled to shift his attitude to indicate his consideration of enacting a supplementary budget to boost Japan's economic growth.

The "failure" of the Tokyo conference, however, did not have a long-term impact on Japanese economic management and international relations.<sup>263</sup> True, the opposition was semi-unanimous in condemning the summit outcome. Only Komeito gave some good marks to the emphasis on Asian issues in the declaration. The traditional support of Zaikai turned unusually sour about this summit result. But some of the Japanese positions were securely incorporated into the declaration. The crucial Japanese free trade principle was underscored in stronger terms as the summiters' "commitment to halting and reversing protectionism, and to reducing and dismantling trade restrictions" was "reaffirmed." Nakasone's pet theory of "structural adjustment policies" along the line of the Maekawa report in parallel with the maintenance of "a firm control of public spending within an appropriate medium-term framework of fiscal and monetary policies" was mentioned. Moreover, reduction of "excessive fiscal deficits" in some of the summit countries was suggested, whereas no urge for Japan to raise its public spending was demanded. The summit declaration per se could be construed to approve Nakasone's fiscal consolidation approach. More significantly, almost all summit leaders returned home satisfied by largely obtaining what they had wanted. Thatcher and Delors called Tokyo the best summit they had attended and Mitterrand did not grumble about participating in the next summit. And the ever-vital imperative for all Japanese governments' summit diplomacy - escape from collective recrimination - was maintained. Domestic pressures against Nakasone did temporarily rise, but international pressures were somewhat eased by the Tokyo summit.

Also to the relief of the Prime Minister, the overall tone of the four newspapers' editorials on the Tokyo summit were pedagogical, but not negative.<sup>264</sup> The press unanimously recognized the perception gap between Japan and other summit partners over the yen appreciation issue, and exhorted the government to take some specific steps to share a bigger role in the world economy. The Baker proposals of international economic policy cooperation were largely welcomed by three papers whereas the Nihon Keizai took notice of their significance for the crucial change in the US external economic policy stance, as well as their problems. The Asahi and Mainichi criticized the Libya condemnation. Their criticism was directed at the utility of the anti-Libyan statement and the subsequent unease about isolating Libya further from the rest of the world. Other issues were touched lightly. The Asahi hailed the statement on Chernobyl, though it was pessimistic about the exchange of information. The Yomiuri called an accord on the new round "a step forward." Like the previous summits, it gave the Tokyo summits the best grade of the four dailies by judging the general outcome as largely successful. The Mainichi followed next, rating highly the unity among participants while cautioning against greater Japanese responsibility. The Asahi delineated the "miscalculation" of the Japanese Tokyo summit diplomatic endeavors while