THE PLENARY CONFERENCE OF THE
TRILATERAL COMMISSION, TOKYO 1985
The Trilateral Commission was formed in 1973 by private citizens of Western Europe, Japan, and North America to foster closer cooperation among these three regions on common problems. It seeks to improve public understanding of such problems, to support proposals for handling them jointly, and to nurture habits and practices of working together among these regions.

CHAIRMEN

North America: Europe: Japan:
David Rockefeller Georges Berthoin Isamu Yamashita

Subscriptions are available to Trilateral Commission publications. Subscription rates are $12 for one year and $22 for two years. A typical year includes this publication on the annual plenary plus two task force reports.

Mail all orders and payments to:
The Trilateral Commission (North America)
345 East 46th Street
New York, New York 10017

Copyright © 1985 The Trilateral Commission
Tokyo, April 1985

4 Chairman's Statement
   Takeshi Watanabe
   David Rockefeller
   Georges Berthoin

6 American Economic Policy and the World Economy
   Martin Feldstein

13 The Soviet Challenge
   Karl Kaiser
   Helmut Sonnenfeldt
   Hiroshi Kimura

21 Domestic Moods: A Trilateral Perspective
   W. Tom Johnson
   Edmund Wellenstein
   Masataka Kosaka

31 East Asia in Transition
   Han Sung-joo
   Sarasin Viraphol
   Gerardo Sicat
   William Henderson
   Koichi Kato
   Sun Shangqing

41 Task Force Reports
   Masashi Nishihara
   D. Gale Johnson
   Kenzo Hemmi
   Pierre Lardinois

Editor
   Michael M. Yoshitsu

Circulation
   Peter Witte

Graphic Design
   Paola Piglia
Ambassador Cohen points this out in a well-delivered speech. Nationalism is one of the greatest passions. It is an emotional force that unifies a country's people and culture. In its purest form, it is an essential element of the general harmony of mankind.

George Bastian
April 15, 1985

John Doe, Chairman
Chairman of the Committee
Commission,promo
October 10, 1985
Editor's Note

The Trilateral Commission held its 1985 plenary conference in Tokyo, April 21 to 23, under the chairmanship of Takeshi Watanabe. Set against rising concerns over trade friction between the United States and Japan, the uncertain impact of SDI on trilateral relations, and other economic and security issues, the conference probed the sources of discord as well as possible areas of policy progress. This publication, out of necessity, contains only a portion of the analyses that occurred during those three days of review.
Chairmen's Statement

Our 1985 plenary meeting in Tokyo, comes at a time of increasing uncertainty in the world economy; of the most bitter trade conflicts, especially between Japan and the United States, in the postwar era; of continuing very high unemployment in Western Europe and Canada; and of continuing emphasis in many of our countries on unilateral rather than international actions to improve economic welfare.

Throughout our discussions, the great urgency of further concrete actions to meet the present danger and to consolidate a more stable and broadly based recovery was repeatedly emphasized.

The forthcoming Economic Summit provides an opportunity to reaffirm the principle of trilateral harmony and to initiate an urgent action program.

The actions required of our governments are interlinked. All of our governments need to:

--Resist protectionist pressures, which jeopardize the recovery and can do great harm to our economies.

--Initiate a schedule, including the securing of negotiating mandates, leading to an early convening of a new GATT round of trade negotiations to cover both goods and services. A date certain for such a round should be fixed at the Summit.

--Engage in a more intensive discussion of international monetary imbalances, notably misalignments and excessive fluctuations of exchange rates. Meetings at the appropriate level can lead the way toward a thorough mutual...
reassessment of the principles underlying the international monetary system.

--Support improved well-being in developing countries, especially in sub-Saharan Africa where programs to meet the present food emergency, strengthen policy dialogue through international institutions such as the World Bank, and create effective programs to increase food security and longer-term agricultural production are of pressing humanitarian, economic and political importance.

In addition to these joint actions, we emphasize the following priorities for our respective regions:

For Japan, there is an urgent need to strengthen its contribution to the functioning of the world trade and monetary systems. We welcome the many positive steps Japan is taking, many of them unilaterally, including financial deregulation, the reduction of trade barriers, and the greater opening of its telecommunications market. The prompt implementation of these measures is needed to assure that the momentum of progress will not be lost. Also, with its very large trade surplus, Japan is in the best position to lead the way, through dramatic gestures of its own, toward a new GATT round.

For the United States, the need to address its deep budget deficit remains of paramount importance to its national interest and to the world economy. Only the United States itself can effectively initiate the measures needed to restore fiscal balance, which should help moderate the value of the dollar, and move its current and trade accounts toward equilibrium.

For Western Europe, vigorous action is needed to expand employment opportunities. U.S. action to reduce its budget deficit, and thus real interest rates, will give more room for expansionary policies on the part of these partners. They must also reduce structural rigidities which have inhibited the growth of their economies and contributed to high rates of unemployment. Like the United States, Canada must significantly reduce its budget deficit while at the same time addressing its serious unemployment problem.

World economic recovery is not an automatic process. Our publics and governments should not be lulled into a sense of false optimism—or succumb to unnecessary pessimism. A solid base for longer-term non-inflationary growth can and must be laid now.

Takeshi Watanabe

David Rockefeller

Georges Bertboin

Tokyo, April 23, 1985
During the past few years, the American economy has demonstrated impressive resiliency and America's economic performance has improved substantially. Inflation has dropped from 13 percent to four percent. The rise in unemployment that was an inevitable consequence of the accelerating inflation of the late 1970's has retreated to just a fraction over seven percent. And real GNP has increased more than 12 percent in the two years since the recovery began.

Much of this progress has been mirrored in other industrial countries. Inflation is down throughout Western Europe and real GNP is rising. Unfortunately, though, unemployment rates remain extremely high, a subject to which I shall return.

The experience of the past few years has underlined the interdependence of the world economy. Sharp changes in international trade, in capital flows and in exchange rates have had significant effects on all major economies. The rise in real interest rates everywhere reflects the close links among capital markets.

I believe that the U.S. budget deficit has been the dominant influence on the world economy during the past two years and that the coming resolution of America's fiscal imbalance will have profound effects during the years ahead. It is America's budget deficit that has been the primary cause of the high real interest rates and therefore of the rising dollar. By increasing American imports and depressing our exports, the overstrong dollar has proven to be a direct stimulus to the economies of Europe, Japan and Latin America.

But at the same time, the American budget deficit has raised real interest rates in the world capital market and induced European governments to pursue contradictory monetary and fiscal policies aimed at offsetting the inflationary pressure caused by the fall in their own currency values. The poor performance of European investment and employment is due in no small part to the budget deficits in the United States. In my remarks today, I will examine the nature of this impact and will discuss the legislation to reduce the budget deficit that I expect will be enacted in the coming months.

Our Trade Imbalance
I want to begin by talking about the U.S. trade imbalance that is now so much in the news and in the forefront of the policy debate in Washington. The U.S. merchandise trade deficit nearly quadrupled in the past three years, rising from $28 billion in 1982 to over $107 billion in 1984. This year it is likely to rise to about $140 billion or more than three and a half percent of our GNP.

Our vast trade deficit means that several important American industries that sell products in foreign markets or compete with imports from abroad are not sharing fully in our economic recovery. The businesses that are
suffering range widely from agriculture and timber to basic industries like steel and chemicals and to high technology firms.

Despite the very serious adverse consequences of the trade deficit and of the strong dollar that is its principal cause, they have also brought some temporary advantages to the American economy. The 1984 trade deficit was financed by a net inflow of nearly $100 billion of capital from abroad. That inflow of capital nearly doubled the funds available for net investment in the United States and kept real interest rates from moving substantially higher. In addition, the rising dollar lowered the prices of imports and of competing American products by enough to cut our overall inflation rate by at least one percentage point last year.

There is a real danger that the capital inflow and the rising dollar are giving Americans a false sense of well-being. The dollar must eventually decline by enough to offset most of the nearly 70 percent increase that has occurred since 1980. When it falls, there will be upward pressure on prices in the United States that could return us to the stagflation conditions of the 1970s. And with a smaller capital inflow from abroad, investment in the United States could be substantially lower and real interest rates significantly higher unless the reduced capital inflow is offset by a fall in government borrowing.

The trade deficit and the capital inflow have now made the United States a debtor nation. In the future, we as a nation will have to give up some of each year's production to service our public and private debts to the rest of the world. To pay for our current profligacy, our children will not be able to keep all that they produce.

But the greatest danger in our current trade deficit is that it may foster a return to protectionist policies. Although protectionist policies that close American markets to foreign competition or that subsidize U.S. exports can help the politically favored industries, they would do so at the expense of consumers and of all other industries.

The 20 percent tax on imports that has been proposed in Congress would immediately hurt American consumers and contribute to rising inflation. Moreover, a decreased demand for imports in the United States would also reduce Americans' demand for foreign currency and would therefore actually cause the dollar to rise further. As a result, American firms and American farmers would find that they have an even harder time selling their products abroad. While American firms that compete with foreign products at home would be able to raise their prices and profits, their gains would be more than offset by the losses experienced by American consumers and exporters.

Protectionism is never a one-sided affair. If the United States pursues protectionist policies, our trading partners will inevitably retaliate and will feel morally justified in protecting and subsidizing their own industries. American businesses and labor will suffer as we lose export markets and are denied the opportunity to do those things that we in the United States can do best.

Countries that are hurting each other in a trade war are also not likely to be effective political allies. Protectionist policies are therefore likely to have serious consequences for our foreign relations as well as for our economic well-being.

The Dollar
To remedy our trade deficit, the real value of the dollar must decline to reverse its nearly 70 percent rise in the past five years. Although our trade deficit also reflects the strength of the American recovery and the ability of the debtor nations to become less reliant on foreign loans, we would not want to reverse either of those developments. And although a stronger recovery in Europe and Japan would help to shrink our trade deficit, the potential magnitude of the gain from that source is rather small. So the dollar must be substantially reduced if we are to return to at least an approximate balance of trade.

The sharp increase in the dollar has occurred because dollar securities and dollar bank deposits have become much more attractive in comparison to investments in other currencies. The principal reason for this increased attractiveness has been the sharp rise in the real interest rate on medium-term and long-term dollar investments relative to the returns available elsewhere. For example, although Germany and the United States have experienced similar inflation over the past few years, interest rates on corporate bonds are nearly six percentage points lower in Germany than in the United States. Although everyone expects that the dollar will eventually decline, investors are willing to hold dollar bonds because the extra yield on American corporate bonds would be enough in just a half-dozen years to offset a one-third fall in the dollar's value relative to the German mark.

Some people have pointed to the rise in the dollar during the last half of 1984 while U.S. interest rates were declining as evidence that the interest rate has not been so important in determining the dollar's value. I think that misinterprets the evidence. It is the real expected interest rates on medium-term and long-term securities that matter and not the nominal market yields. Last summer the American economy had just completed six months of real growth at an 8.5 percent rate and the common worry was that the economy would soon be overheating. Moreover, many monetarists were predicting that past money growth would generate double-digit inflation by the end of 1984. In fact, the inflation stayed below four percent and the rate of economic growth dropped to less than three percent. In short, inflation expectations declined rapidly since last summer and may well have generated
higher expected real interest rates by January and less uncertainty about inflation than had prevailed six months earlier.

Some commentators have tried to explain the rise in the value of the dollar by pointing to the dynamism and profitability of the American economy. I believe that these factors have had relatively little direct effect on the value of the dollar. The vast bulk of foreign funds coming into the United States have come as bank deposits or as purchases of fixed income securities and have not been investments in corporate stock or direct investments in American business. Thus the profitability and dynamism of the American economy have attracted foreign funds primarily by contributing to the rise in U.S. real interest rates.

Although the rise in the real interest rate on dollar securities has been the key reason for their increased attractiveness, it has not been the only reason. The attractiveness of dollar securities has also been enhanced in the past several years by the pursuit of a monetary policy that has reduced the risk of inflation in the United States. In addition, the reduction in borrowing by the debtor nations has reduced the supply of dollars in world financial markets and thereby increased the dollar's value. Moreover, the political stability of the United States encourages individuals and institutions around the world to place their investments in dollar securities. Although it is important to reduce the dollar's value, it would obviously be wrong to do so by increasing the risk of inflation in the United States, by inducing the LDCs to go more deeply into debt, or by weakening the political stability of the United States.

The only appropriate policy for reducing the overstrong value of the dollar and achieving a trade balance is therefore to reduce the level of real interest rates in the United States. The sharp rise in real interest rates since the beginning of the decade is due primarily to the dramatic increase in the level of current and future structural budget deficits. Although the higher real interest rates also reflect an improved climate for business investment, the only desirable way to reduce real interest rates is by cutting the projected budget deficits. I believe that if Congress enacts legislation this summer that cuts the projected budget deficits to less than two percent of GNP by 1988 and that points to the likelihood of a balanced budget by early in the next decade, we will see a substantial decline in real interest rates and in the value of the dollar before the end of the year. By 1986 there would be a clear improvement in the U.S. trade balance.

Although a sharp reduction in real interest rates and projected budget deficits would bring an immediate decline of the dollar, the dollar must eventually fall even if budget deficits are not reduced. At some point, possibly as long as several years from now, foreign investors will become reluctant to continue putting a larger and larger share of their portfolios into dollar securities because the increasing risk of an unbalanced portfolio will outweigh the yield advantage of dollar securities. When that occurs, the dollar will fall.

The longer the delay before the fall of the dollar, the more damage the overstrong dollar will do to American industries that are engaged in international trade. But if the dollar falls substantially before there is a resolution of the budget deficit, the reduced capital inflow will mean sharply higher interest rates and a sharp contraction of investment in housing and in plant and equipment. The key therefore to preserving the health of the American economy is for the dollar to fall in parallel to the fall in the budget deficit. Before I turn to the prospects for that kind of fortuitous timing, I want to discuss the implications of the current situation for U.S.-Japan relations and for the economies of Western Europe.

JAPAN

The unprecedented trade deficit of the United States has been particularly severe source of friction with Japan. This growing conflict is important not only because Japan is America's largest overseas trading partner but even more so because Japan is the second largest industrial democracy in the world and the lynchpin of democracy in the Far East. It would be a disaster if the current trade conflict were permitted to undermine the friendly political and economic relations between the United States and Japan in the years ahead.

Although Japan has a $40 billion merchandise trade surplus with the United States and a $30 billion trade surplus with the world as a whole, sophisticated observers have come to realize that it is wrong to blame our overall trade deficit on Japan or to focus on any bilateral trade deficit in a multilateral trading world. Moreover, the Japanese yen has declined less since 1980 in relation to the dollar than other industrial currencies and our bilateral trade position has declined less with Japan since 1980 than with either the European Economic Community or Latin America.

The fundamental reason for Japan's trade surplus with the rest of the world is that Japan has an extremely high saving rate. Gross saving in Japan is over 30 percent of GNP, 50 percent higher than the average of the other OECD countries. Because the combination of Japanese investment and the budget deficit of the Japanese government is not enough to absorb all of that saving at home, the Japanese invest abroad as well. That overseas investment must, of course, be matched by a corresponding trade surplus.

Looked at in a slightly different way, the high Japanese saving rate results in extremely low interest rates on Japanese bonds. Long-term corporate bonds in Japan
now yield less than seven percent. It is not surprising that Japanese investors want to invest overseas. The process of selling yen and buying foreign currencies to finance that overseas investment depresses the yen and gives rise to Japan's trade surplus.

The Japanese could reduce their trade surplus if they pursued policies that increased investment in Japan. Improved tax incentives for investment would induce Japanese firms to invest more at home instead of seeking foreign investment opportunities. Investment in Japan could also be increased if the Japanese government would reduce the restrictions that currently block American and other non-Japanese firms that would like to invest in Japan.

Although the Japanese have recently acceded to U.S. pressures to allow increased borrowing in Japan by non-Japanese firms, this actually tends to depress the yen and strengthen the Japanese competitive position. Foreign governments should now press the Japanese to permit more direct investment in Japan by foreign firms on the same basis that Japanese firms enjoy in Japan.

It is frequently suggested that Japan's favorable trade balance would be reduced if Japan increased its extremely low level of defense spending. This would in fact be true only to the extent that the higher defense spending increased Japan's budget deficit and thereby absorbed more of the private savings that are now going abroad. An increase in defense spending that is financed by higher taxes or reductions in nondefense outlays would have no effect on the trade deficit. Indeed, even if Japan increased its defense outlays by purchasing more foreign-made defense equipment, that would only change the composition of Japan's trade surplus and not its total magnitude unless Japan increased its budget deficit in the process.

Because of Japan's current demographic situation, the national habits of thrift, and the institutional inducements to save, I believe that the Japanese will continue for many years to save more than they invest in Japan. The result will continue to be a capital outflow to the rest of the world and therefore a trade surplus. In a world where capital is scarce, we should learn to regard this as an advantage rather than a problem.

But there is a Japanese trade problem that has deep political implications for Japanese relations with the United States and with Europe and, more generally, for political relations in Asia. Virtually every American firm that does business or tries to do business in Japan complains that the combination of tariffs and nontariff barriers prevents the sale of foreign products and services in Japan even when they are clearly better in price and quality than their Japanese competition. American business is frustrated and furious about the way in which the Japanese government protects and nurtures Japanese industry. These same views are echoed by many leading European firms.

The current Congressional action calling for a tariff to block Japanese products from the American market is not really a reaction to the trade deficit per se or to the volume of Japanese sales in America. In proposing a tariff, Congress is reacting more out of anger and frustration than on a basis of economic logic. The Japanese should understand that the true basis of this frustration is the sense that Japan as a government and as a people are being unfair in their pursuit of policies that preclude foreign products from Japanese markets. If the international trading system is to continue to flourish and bring benefits to consumers throughout the world, the Japanese must make an opening of their markets to foreign products a matter of the highest national priority.

EUROPE:
The current economic policies of the United States also have profound implications for the economics of Europe that could have long-term effects on the NATO alliance. European leaders at the past two summit meetings and at other international conferences have complained loudly that the large U.S. budget deficits have caused high real interest rates and a massive capital flow to the United States. Although these same leaders are also prepared to admit that the U.S. trade deficit has increased demand for their exports, they are unanimous in their call for lower U.S. budget deficits.

I believe that these calls for lower U.S. deficits are more than the seizing of a convenient scapegoat for the relatively weak economic performance in Europe. Current European economic conditions make the rapidly rising dollar and the net capital flow to the United States substantial impediments to an improved economic performance in Europe.

Consider first the effect of the rising dollar and the consequent fall in the European currencies. Just as the stronger dollar is bringing reduced inflation to the United States, the falling value of the French franc, the German mark and the British pound is putting upward pressure on prices in those countries. To prevent that pressure from initiating a new round of domestic inflation, the government in each of those countries has been forced to pursue tighter monetary and fiscal policies than it would otherwise have chosen. These tighter monetary and fiscal policies have prevented a stronger recovery and have contributed to the continually rising rate of unemployment that now plagues all of the major European nations.

Let me be very clear about what I am saying. I am certainly not saying that all of Europe's current abnormally high unemployment can be attributed to the U.S. fiscal situation. There is no doubt that European real wages in the 1970s outstripped the natural increase in productivity and forced employers to reduce employ-
ment in order to raise productivity to the imposed real wage levels. The contrast between the U.S. and European experience in the 1970s is striking. Between 1970 and 1980, real earnings per hour actually declined in the United States while employment rose more than 25 percent. In Europe during the same decade real wages continued to rise at a substantial rate. The rigidity of the European labor markets exacerbated the problems caused by the excess real wages. As a result, there was no increase in total employment in the European Community and the rate of unemployment rose from less than three percent in 1970 to nearly 11 percent last year.

Although excessive real wages and basic labor market rigidities raised the European unemployment rate in the 1970s, the rising U.S. dollar since 1980 has led to higher European unemployment because it has induced European governments to pursue contradictory policies designed to offset the inflationary effects of their falling currencies. Because the rigidities in the European labor markets reduce the impact of unemployment on inflation, it takes a substantial rise in unemployment in Europe to offset the inflationary pressure that results from a rising dollar. It is not surprising that European political leaders are frustrated and annoyed by an American budget policy that they see has contributed to America's strong economic expansion while impeding their own.

The dramatic rise in the net capital flow to the United States has also made it more difficult to reduce European unemployment. The currently excessive real wage rates in Europe can only be corrected if the rate of increase of European real wages is reduced relative to rise in productivity. Although the high level of European unemployment has recently caused some decline in real wages, this is clearly a slow and painful process. The gap between productivity and wages could be closed more rapidly and with less pain if productivity were rising faster. One way to achieve that would be a higher rate of investment in plant and equipment. European leaders rightly see the net capital flow to the United States as denying Europe the capital that could raise productivity and lower unemployment. They are frustrated that the U.S. budget deficits are depressing European productivity and raising European unemployment through a change in net capital flows that at the same time mitigates the adverse effects of our budget deficits on U.S. investment and productivity.

It is difficult to judge the actual magnitude of these adverse effects. But there is no doubt that current European perceptions create a climate of ill will in which European governments can believe that the pursuit of protectionist policies aimed at increasing employment in Europe is a morally legitimate response to the harm being done by American budget deficits.

A substantial reduction in future U.S. budget deficits will certainly not eliminate all of the sources of economic friction between the United States and Europe or cause European governments to abandon all of their protectionist policies. But it would undoubtedly create a climate of greater cooperation within which the United States could hope to be more effective in persuading European governments to abandon their import barriers and production subsidies. In addition, the decline in the dollar that would follow a substantial decline in the American budget deficit would reverse the inflationary effect of deteriorating exchange rates and therefore encourage the European governments to pursue more expansionary monetary and fiscal policies.

European thinking about economic policy has changed significantly and is now at a very important crossroad. European governments are moving away from the belief, characteristic of so much of European thinking since World War II, that extensive government intervention in the economy is desirable. European leaders are now concluding that excessive government intervention has impeded economic change, reduced incentives, and created rigidities that diminish productivity and slow the rate of innovation and growth. There is a new faith in the role of the market and in the potential contribution of individual initiative and private industry. This is a positive development not only because it can contribute to the long-term well being of the people of Europe but also because it can strengthen the political ties between the United States and Europe. America's long-term political relations with the countries of Europe are likely to be better if our economic systems are more alike. Moreover, successful market economies require and encourage the same virtues of individualism and liberty in the economic sphere that we value as fundamental rights in the political sphere. A country that is committed to a free market economy must maintain a free and open society.

Prospects for Deficit Reduction

This brings me back to the subject with which I began my remarks: the prospects for reducing the U.S. budget deficit. I continue to talk frequently with my old colleagues in the Reagan administration and with leading members of Congress in both parties. On the basis of those conversations, I am actually quite optimistic that we will see legislative action this year that will substantially reduce future budget deficits.

More and more members of Congress see the urgency of reducing the projected deficits. Moreover, they have come to recognize that 1985 is the best time to do the politically difficult things that need to be done. Of course, there are no sure things in politics. And the magnitude of the deficit reductions that I expect to be enacted this year are less than I would like to see. But I
do believe that there is a better than even chance of really significant deficit reduction legislation during the next six months.

The thing that makes deficit reduction so hard to achieve and that makes the process so hard for foreigners to understand is the independence of the executive and legislative branches of the American government. The opposition party controls the lower House of Representatives and the President cannot control even his own party in either house of Congress. The result is not only a lack of discipline but also a great deal of posturing by all of the participants who are eager to avoid the adverse political consequences of the actions that they know should be taken.

The recent agreement between the President and the Senate Republicans is therefore very significant. They agreed to a package of spending cuts that would reduce the budget deficit by amounts rising from $50 billion in the next fiscal year to $100 billion in 1988, thereby reducing the projected 1988 deficit to $100 billion or just two percent of GNP and putting the economy on a path that could lead to a balanced budget by the early part of the next decade. Although I think that actual legislation will fall short of achieving this ideal pace of deficit reduction, I do believe that the final result will not be far off this target.

Let's look very briefly at what has been agreed to and at what is likely to come out of the legislative process. The President has agreed to cut his requested increases in defense spending to a three percent a year rate of increase from the more than seven percent rate that he had previously requested. This will cut the 1988 deficit by nearly $50 billion. It would not be surprising if the House of Representatives imposed even further defense cuts before the final legislation is enacted.

The President and the Senate Republican leadership have agreed to total cuts in nondefense spending that increase to $80 billion by 1988, including $11 billion of reduced outlays for old age retirement benefits that would be achieved by an ingenious plan for reducing the automatic inflation adjustment of benefits. Although I believe that all of these spending cuts will not survive the political process, I think that in the end non-defense spending in 1988 will be cut by about $50 billion. In addition to trimming the budget deficit, this will represent a remarkable achievement in reversing the growth of government spending in the American economy. By the end of the decade, non-defense spending on all programs other than the social insurance benefits for the aged will be back to the same share of GNP that they were at the beginning of the 1960s--just slightly over six percent of GNP. And total nondefense spending, including all of the programs for the aged, will be back to 12 percent of GNP, a level not seen since the early 1970s.

These reductions in spending on defense and non-defense programs and the resulting savings in interest on the national debt would cut the 1988 deficit by about $110 billion, a reduction equal to about 40 percent of the deficit that would be likely with no legislative action. Such a deficit reduction would be a major achievement with favorable effects on real interest rates and on the value of the dollar.

It would, however, still leave an unacceptably large 1988 deficit of about $175 billion or 3.5 percent of GNP. Further progress in shrinking the deficit will require increased tax revenue. Although President Reagan has made it exceedingly clear that he doesn't like the idea of raising taxes, I believe that in the end he will agree to a rise in tax revenue after he believes he has achieved as much spending reduction as Congress is willing to enact. Although the President would veto an increase in personal income tax rates, there are a number of other ways of raising tax revenue that I believe would be acceptable: a gasoline tax or other energy tax; a modification of tax bracket indexing in parallel to the change in the indexing of social security benefits; and a tax reform that modifies existing tax rules in a way that permits both a reduction in tax rates and an increase in tax revenue.

The next six months will be a crucial time for American economic policy and therefore for the future of the world economy. If the U.S. Congress and the Reagan administration can now agree on appropriate budget and tax policies, America's economic future can be very bright indeed. But if these things are not done, America can lose the progress of the past three years and fall into a future of economic stagnation, high inflation and rising unemployment.

I believe that America's political leaders now know what should be done and that they will try to take the needed steps in the months ahead. Their success will be important not only for the United States but for the rest of the world as well.

---

Martin Feldstein is Professor of Economics at Harvard University and President of the National Bureau of Economic Research, positions which he returned to in 1984 after two years of service as Chairman of the President's Council of Economic Advisers. A revised version of his Tokyo speech appears in the summer 1985 edition of Foreign Affairs.
Sir Michael Palliser
To me it has seemed frankly absurd to argue that we need the earliest possible negotiations on trade questions but at the same time to contend that exchange rates should be left to the sole control of the markets. The truth is that the sort of fluctuations we have seen over the past two or more years in the rates for the dollar, the DM, the Yen and Sterling are far more inhibiting to freedom of trade than any amount of non-tariff trade barriers or other obstacles to the movement of goods and services.

. . . Paul Volcker is calling for Europe and Japan to stimulate their economies because of his concern that the U.S. economy is beginning to fade. We in Europe have to reply that, if we are to do that without immediately reviving inflation in Europe, it is necessary for both U.S. interest rates and the value of the dollar to fall. But that in turn requires a lowering of the federal deficit. All these things bang together—as should we.

Sir Michael Palliser, Chairman, Samuel Montagu & Co., London

Kiichi Miyazawa
In the area of our domestic economy, I proposed early last year a new policy calling for doubling the national assets during the next decade. The primary purpose of this program is to redress the relative poverty of our housing and social infra-structure through channelling our economic potentialities to that end. Stimulating and increasing domestic demand on a large scale will help reduce internal pressure for exports and enhance import opportunities.

In the area of the international economy, Japan, given the strength and magnitude of its economy, should now express its readiness to offer the total elimination of industrial tariffs at the coming New Round of negotiations and actually reduce unilaterally, if necessary, the first 25 percent even before the Round begins, to give it a push and the incentive.

Kiichi Miyazawa, former Japanese Minister of Foreign Affairs

C. Fred Bergsten
I would suggest a package of three or four items that in combination might have a chance of heading off an enormous trade conflict between the United States and Japan. First, it is obvious that Prime Minister Nakasone's package of market liberalization measures increasing imports into Japan is an essential part of the program. Japan simply must follow through on that and show results—not just policy changes—in terms of higher imports in some key sectors. Secondly, our countries must agree promptly to launch a new multilateral trade negotiation at a date certain. And thirdly, both our countries must try to move the yen/dollar exchange rate—within a matter of a few months—to at least 200. How do we do it?

We clearly should try to put in place a macro-economic package of U.S. budget cuts and tax increases in Japanese fiscal stimulus to growth and investments particularly aimed to change the motivations for capital flows by reducing the interest differential between the two currencies. But even that, I think, will take some time, and so my final proposal would be to directly manipulate the capital flows themselves. Here are three possibilities. One would be for Japan to immediately offer new incentives for investment in yen assets. The second is for Japan to borrow abroad very aggressively and very sizeably through government flotation of bonds. The third possibility—and this is the final and most dramatic step—would be to simply stop the capital outflow for a few quarters. We know that administrative guidance continues. One could tighten the administrative guidance to zero, and simply require the large institutional investors—the insurance companies, the pension funds, the banks—to stop the capital outflow for a few months. That certainly could be done; it has been done in the past; it is the one step that could be implemented quickly; it would have an enormous effect in the exchange markets very rapidly; and it would not even have to be announced.

C. Fred Bergsten, former U.S. Assistant Secretary of the Treasury for International Affairs
The concurrence of three developments in East-West relations calls for a fresh look at the policies of the trilateral countries vis-a-vis the Soviet Union and Eastern Europe: first, the election of Gorbachev; second, a further loosening of the Soviet sphere of influence in Eastern Europe; and third, the Geneva negotiations, in particular SDI.

**The Meaning of Gorbachev’s Election**

What does the election of Gorbachev mean in the Soviet Union? It seems to me the conservatives in the Soviet Union have understood that the country’s second rank as a world power is only tenuously based on military power, and that consistent economic failure will eventually endanger the Soviet power position. Only very thorough reform at home in Soviet society can preserve the status of the Soviet Union as a world power—and that will be Gorbachev’s mission.

With regard to external affairs, it seems to me we can expect flexibility in the coming years. The West will soon discover that Gorbachev will fight for his country’s interests as toughly as his predecessors, but in all likelihood with greater astuteness. With peace offensives by him, with the Strategic Defense Initiative opening vulnerable flanks in the West because of the dissension it is likely to create, Gorbachev will represent a formidable challenge and a greater one than the ineffective and dying leaders of the immediate past, now mourned with some nostalgia by some in the West.

At the heart of all policy vis-a-vis the Soviet Union lie two questions: First, what changes can we expect in the Soviet Union; and second, can we influence it from outside? After almost seven decades of Soviet history, including one decade of detente, I think we can conclude that two things are likely to remain more or less constant: first, the Soviet Union’s one-dimensional character as a system based on military power and the rule of the party elite; and second, the yearning for over-insurance, with all the problems that it creates for the international environment. It is unrealistic to expect that during this century these elements will fundamentally change.

Now, within these confines, can Soviet behavior be influenced from outside? Libraries have been filled on both sides of the argument. I personally believe that there is some margin for impact, though a rather small one. A Soviet Union accepted as a world power and engaged in a constructive dialogue on a broad range of issues is more likely to follow minimum rules of international stability than under conditions of Western siege (implementing what the Reagan Administration used to call “management of decline”). In order to preserve and recreate the economic and social preconditions for her position as a world power, the Soviet Union has to implement change and reform for many years to come—reform more radical than at any time after World War II. Her one-dimensional military policy has stretched her resources to a very dangerous point. There is, therefore, in my opinion, after the election of Gorbachev, a chance for a reactivated and imaginative Western policy in economic areas; and hence, a chance for improving East-West relations, at least in one important area.

**Eastern Europe**

Second is Eastern Europe. The Soviet sphere of influence in Eastern Europe is characterized by a growing degree of internal liberalization and differences in foreign policy. To be sure, neither have Western democratic standards been reached nor does the growing autonomy in foreign policy go beyond certain limits, but the change can be noticed; it is very important; and it can be seen in a number of countries: Poland, Hungary, Rumania, and now even East Germany and Bulgaria.

Europe’s line of division created by the Yalta Agreement (or, depending on one’s perspective, by its non-implementation) is going to stay for a long time, in my opinion, even if the strengthening of human rights and the strengthening of the autonomy of these countries is the wish of the Western countries. An overt strategy calling for a Western repudiation of the Yalta agreements, as our fellow Commissioner and my friend Zbigniew Brzezinski recently proposed in Foreign Affairs, is likely to have the opposite effect by strengthening resistance to desirable change. I cannot think of a better prescription for bringing about resistance to even modest measures than to present them as the mosaic stones of a grand strategy to bring down the Soviet empire. There is a bitter lesson in many postwar attempts to increase autonomy within the Soviet bloc, thus acting against basic Soviet interests. They end in a bloodbath or in political repression. Therefore, evolution is only possible within certain limits. A policy that violates essential Soviet interests is likely to be blocked by Soviet resistance, if necessary by the Red Army. Change that takes place, however, within a framework with some Soviet participation or in a frame of reference that the Soviets cannot object to, has a small chance. It might induce evolution towards more autonomy or more human rights. The Conference on Security and Cooperation in Europe is an example of the first; economic cooperation an example of the second kind of approach. Only gradual evolution is possible—nothing sudden. Wherever steps toward enhanced human rights are possible (for example in Poland) or toward greater autonomy in foreign policy (for example, Rumania), they should be quietly, and I stress quietly, supported. A policy of differentiation is necessary vis-a-vis Eastern Europe, but public distinctions between good and bad Communist countries (as, for example, Vice President Bush used them during his
famous Vienna speech) are likely to be counter-productive and might even be an obstacle to evolution. If Europe's division is to be overcome—and that is every West European's and most East European's wish—then discretion and subtlety must be the prevailing priority of our policy.

Let me also, in concluding this point, deal with another proposal made by Zbig Brzezinski, namely that by reducing the American presence in Europe drastically and unifying Western Europe the Soviet Union could be induced to leave Eastern Europe. Now it might very well be that West European unification in combination with an American withdrawal might have that effect, but there is no guarantee. In fact the contrary might happen. Unification of Europe in the field of security might very well induce the Soviets to stay. We do not know. Moreover, there are no majorities in Western Europe that want a dramatic reduction in the American presence in order to induce the Soviet Union's withdrawal from Central Europe. In addition, the notion of a neutral reunited Germany—and that plays a certain role in this conception—appears unfeasible since the Soviet Union is unlikely to release East Germany and since the West Germans, except for a very small minority, do not want to expose themselves to the hair-raising risks of such a course.

**Strategic Defense Initiative**

Let me make some concluding remarks on SDI. The Strategic Defense Initiative of President Reagan, in my opinion, may offer the chance of a new mix between defensive and offensive weapons and therefore should be explored.

To the Soviet Union, it offers opportunities and challenges. As far as the opportunities are concerned, SDI and its public presentation in the West inevitably are now discrediting a strategy on which peace will depend probably until the rest of the century. I am referring here to the justification of SDI in terms of the immorality of nuclear deterrence or by trying to suggest that nuclear weapons could be gotten rid of through that initiative. In other words, SDI, while possibly solving problems in the more distant future, is likely to create very serious problems right now in our own societies, in particular in Western Europe. It opens new opportunities for Soviet propaganda aggravated by the inevitable ambivalence of the scheme for internal Alliance relations. Moreover, the forthcoming negotiations may recreate the same dilemmas as we have had during the negotiations on intermediate nuclear forces. The Soviets are likely to use the Western public process to gain the results which they fail to gain at the negotiating table. Simultaneously, however, SDI represents a tremendous challenge to the Soviets: the danger of United States superiority, of an extraordinary leap in arms competition of unprecedented and indeed critical proportions to the Soviet Union which, as I stressed earlier, is already stretching her resources to the limits. This is a dramatic innovative move in the West in a situation where the Soviet Union, according to the estimates of its own elites, has now reached a distance from the West comparable to the time when Stalin died. These elements may combine with possible disadvantages that the West may become aware of, or the result might be the mutual recognition of a negotiated shared approach in this area and creation of the basis for future agreement. In any case, the road to that result is going to be long and rugged.

In conclusion, I would like to say that the Strategic Defense Initiative inevitably creates conflict and discord, both between East and West and within the West; and it might be for that very reason that we must make efforts to focus on an area where an expansion of cooperation is possible. That seems to be the economic area, where the Soviet Union, in order to preserve her status as a world power, has to make an unprecedented effort toward internal reform.

- Karl Kaiser is Director of the Research Institute of the German Society for Foreign Affairs and Professor of International Relations at Cologne University. Educated at the Universities of Cologne, Grenoble, and Oxford, Mr. Kaiser was a Research Associate and Lecturer at Harvard University, in 1963-68. He taught at the John Hopkins Center in Bologna and the Universities of Bonn and Saarbrücken in 1968-73.
I will confine these remarks to some observations about where the Soviet Union may be headed, but my forbearance should not be taken as necessarily agreeing with everything that Karl has just said.

**THE RISE OF GORBACHEV**

The rise of Mikhail Gorbachev to the General Secretariat of the Communist Party—and I assume to the Presidency of the Soviet Union as well in due course—was extraordinarily fast, particularly in the Brezhnev era marked for its stability if not stagnation. The rapidity of the rise itself raises some questions about how deep his roots in the party apparatus, in fact are, and I think that may well prove to be one of his problems in the coming period. On the other hand, in terms of experience, he has had high-level experience beyond his original field of agriculture (he was virtually the acting chairman of the "regency council" over the last few years) and must be considered to have been in part responsible for the policies of the last few years, certainly for the tactical twists and turns in Soviet policy, some of which have not been trivial, like the return to arms control negotiations.

He also has another quality which one might describe as the "teflon General Secretary". To have had this rapid ascent after being the Secretary in charge of agriculture is no mean political feat. It points to one aspect of his career, which is that he was extremely lucky and diverse in his choice of patrons—ranging all the way from Suslov (who came from the same area in which Gorbachev grew up) through Kulakov (his immediate predecessor in the agriculture department of the Central Committee and as Secretary in the province in which Gorbachev operated) to Brezhnev and Andropov and Chernenko, all of whom he appears to have served quite loyally, particularly the dying Chernenko, all the while planning his ascent to the top job. What this says about his ideological orientation is very hard to determine at this point, but that he has been a skillful operator within the system is undeniable.

Gorbachev clearly is, from all the accounts, an intelligent and vigorous figure and there is a presumption that he will be around for a long time (although Khrushchev made it for only ten years and there is no guarantee that Soviet leaders last as long as Stalin or Brezhnev). He has a businesslike style by all accounts, but he is not widely known, particularly in the Soviet Union. Ironically enough, he is far better known in the West—because of repeated showings of the same set of television pictures from his visits in London and in Canada some time earlier, and some of the staged photographic opportunities in Moscow. In the Soviet Union, he is really not known even in the extended elite. Consequently, we are seeing (and will continue to see) a variety of moves to get attention in the Soviet Union and to create something of a presence and profile, such as with the factory visits over the last few days. There will be a Warsaw Pact meeting very shortly and, of course, the long-heralded V-E Day celebrations in which I assume he will be in some way at the center—symbolizing his own ascent to authority and power.

Gorbachev will be taking time to organize his regime, and we may hear about some more job appointments in the next couple of days when the Central Committee meets. It will be extremely interesting to observe how Politburo vacancies, of which there are several, will be filled—and whether one can identify the people that will assume these jobs as essentially Gorbachev people. There are older figures in the Politburo—some five of them—and it will be equally interesting to see how long it takes to pension them off. There is the Central Committee plenum now and everything points to a Party Congress later in the year or perhaps early next year—which will be a major occasion for replenishing the top party organs. It will also promulgate a new Party program (in which Andropov had taken a good deal of interest) and the next Five-Year Plan, both quite important for the future of the Soviet regime.

Perhaps Gorbachev will assume the qualities of an authoritative leader faster than his predecessors, but it will still take time and it’s not clear to me that the authority he will achieve as this process advances will necessarily resemble what Khrushchev had for perhaps three or four years and Brezhnev had for perhaps ten years. Moreover, he has the additional problem of filling jobs down the line in the party as well as in the government. He will have to be skillful not only at getting decisions made at the center, but also extremely skillful and hard-nosed at getting them implemented down through the system—a problem that has frequently defeated efforts even at modest reform, because the bureaucracy just won’t budge.

**A BREATHING SPELL IN EXTERNAL RELATIONS?**

The logic of the situation in which the Soviet Union finds itself as Gorbachev assumes power seems to me to call for a certain breathing spell in external relations in order to cope with domestic issues such as economic stagnation and the confusion in the Soviet empire. There were some signs before Gorbachev took office that a breathing spell was being sought, in fact this goes back to the Brezhnev period. One front on which this quite clearly will be sought is with China—although how far it goes remains very open. From the Soviet standpoint, some degree of modus vivendi with China would be of some considerable value for many reasons. (The Chinese seem to have shown somewhat greater moderation in terms of the three conditions that they had previously established for an improvement with the Soviet Union.) This, incidentally, may spillover into the Korean peninsula, where we may
already be seeing some signs of Soviet support for the kinds of contacts between North and South that have resumed lately, and we may see some softening on such matters as the 1988 Olympics in Seoul.

Western Europe is another front for seeking a breathing spell or some degree of quietness on the Soviet Union's borders. Despite the enormous agitation over the Euro-missile issue, the Soviets never lost interest in economic relations and improved political relations with several of the West European countries. Japan may, in fact, also be on the list, although as we know the territorial issue has always been in the way. I don't see an early Gorbachev regime changing anything on that score, but short of that I think the Soviets may try even to test the waters in Japan.

I think we will continue to see a certain caution in the Third World, already evident over the last few years. This has contributed to the peculiar phenomenon that the five years or so in which relations between the United States and the Soviet Union deteriorated in virtually all respects did not witness the recurrence of the kinds of crises that we used to have with the Soviet Union that involved direct confrontation—such as in the Middle East and over Cuba and Vietnam and earlier in Korea and Berlin and so on. I want to stress caution does not mean retraction and does not mean an absence of readiness to exploit opportunities. It just means caution.

Vis-a-vis the United States, I think policy and attitudes continue to be very ambivalent. On the one hand, this regime particularly wants to avoid any impression of bending to American power and American robustness. They're bound to continue to be quite suspicious of President Reagan. But at the same time, I think they're quite curious to see how eager he is or has become to get into the history books via improved relations with the Soviet Union. (I think, incidentally, this is a totally mistaken view of President Reagan.) Moreover, the Soviets are very carefully observing domestic American debates on the budget, on defense expenditures, in Nicaragua, on South Africa. They clearly are conscious of frictions between the United States and Western Europe on several issues, including SDI, and with Japan, especially with regard to the trade issues. The Soviets may, in fact, have exaggerated notions of some of these frictions and above all, they may have exaggerated notions of the economic problems of the United States, as suggested in Gorbachev's performance for the American Congressmen last week. He met some four hours with them and spoke, despite great authority and vigor, in terms that suggested a not very intimate knowledge of the American economy.

For the moment indications are that the Soviets intend to stand pat on the major arms control issues in Geneva, using essentially public agitation techniques to see how serious the American SDI program in fact is in the face of external pressure and Congressional resistance. I would say, though, that if SDI in fact shows the kind of promise that many Americans believe it might in technical terms and in terms of the cost exchange ratios between defense and offense, the Soviets will not be able to avoid or escape the effects of those conclusions in the American research effort, no matter what propaganda opportunities are opened to them. But that's still down the road. In the meantime, they seem to be quite prepared, even eager, to pursue bilateral matters with the United States and have a multiplicity of contacts, private and official. They have engaged again in contact with the Administration in regard to various crisis areas. The Middle East has been the first one and there are others scheduled over the next two months, although I find it difficult to see what can in fact be negotiated with respect to the various crisis areas. Afghanistan, for example—also because of its potential spillover to Pakistan—strikes me as riddled with dilemmas and not really susceptible to much progress through American-Soviet negotiations. I think that Gorbachev almost certainly wants a summit meeting with President Reagan. In fact, I believe he needs it more than President Reagan, because for him it has to do with building his own authority and his own image, whatever else it does. For Reagan, it may be for the history books, but they're not quite as important as consolidating power. Perhaps there'll be two stages, with an informal meeting in New York at the United Nations and then a real summit later on. Gorbachev in the meantime is also seeking plenty of summit activities with others, especially in Western Europe, and I would say in Tokyo you might even get him to visit here.

Even if the Soviets are relatively cautious, one should not expect any dismantling of the Soviet empire or any inclination to give up the status of a superpower. Certainly Gorbachev will not consider himself to have been elected to preside over the dissolution of the Soviet empire. A new generation may be impatient about domestic rigidity and eager to get its hands on the levers of domestic power—I have no doubt that it is—but they may also want to show that the Soviet Union is a robust great power and I think one can expect to see some muscle-flexing, not least in the Pacific region.

**An Ambiguous Challenge**

So, to conclude, the leadership change poses an ambiguous challenge for the West. We need, obviously, to hold open possibilities for some reasonable arrangements and for more contact. I think that virtually goes without saying and I think we're all doing it in various ways. But I think we also need to keep the risks high for Soviet power plays and Soviet expansionism. Nicaragua could in fact be a place where the Soviets misjudge the level of
American tolerance. Pakistan may also experience continued pressures. (That could get worse than it has been, but I think this is less likely now with the change of government in India and because it would cut across what the Soviets are attempting to do vis-a-vis China.)

All in all, therefore, I am agnostic about the opportunities presented by the Gorbachev ascent. He himself is an unwritten book in terms of his attitudes, and some of the pages that have in fact been written on don’t necessarily invite rampant optimism.

Helmut Sonnenfeldt is a Guest Scholar at the Brookings Institution in Washington, D.C. During the mid and late 1960s, Mr. Sonnenfeldt headed the Office of Research and Analysis for the USSR and Eastern Europe in the U.S. Department of State. He then moved to the National Security Council (1969-74) as Senior Staff Member dealing with U.S.-European and East-West Relations; and was Counselor of the State Department in 1974-77.

Since both gentlemen have pretty well covered the ascent of Gorbachev to power and possible policy towards the United States, Europe, China, etc., that makes me rather comfortable in concentrating on possible policy changes of the Soviet Union under Gorbachev towards one specific area, namely Japan.

It is my basic assessment that Soviet foreign policy in recent years with regard to Japan has been unsuccessful and even counter-productive. Taking for granted that you share this assessment with me, I’d like to proceed to the question of why has the Soviet Union failed in its Japan policy.

In my view, the major reason that Soviet policy towards Japan has been unsuccessful is its wrong, unrealistic and increasingly out-of-date premises. Soviet foreign policy is based, for example, upon the belief that military strength can be converted into political influence, and that the Japanese are easily intimidated. This is an out-of-date notion, because, to begin with, since the defeat of World War II, Japanese have, fortunately or unfortunately, been insensitive to the use and influence of military power, regardless of who wants to employ it. Furthermore, the Japanese, having achieved the status of No. 2 economic superpower, are now full of self-confidence and even tend to look down upon the Soviet Union’s poor economic performance.

A second premise, upon which Soviet foreign policy toward Japan is based, is the Soviet proclivity to regard the United States as a much too important concern in their global strategy, thus giving relations with other countries, including Japan, a secondary place and subordinating them to the primary Soviet objective of struggle with the United States, their arch-enemy. The Soviets appear to believe that their success or failure with the United States on a global level will more or less determine their interactions with other countries in other regions. Only within this framework of Soviet perceptions of world situations, and its concomitant global strategy can we explain why the USSR continues to take counter-productive actions toward Japan. Because Soviet leaders firmly believe in, or expect, final victory over their arch opponent, the United States, they do not care meanwhile about temporary losses or failures in their diplomacy toward Japan. However, their foreign policy based on such strategy has proved to be a failure. When Japan was a small nation, the Soviet Union did not care much whether its diplomacy toward Japan was successful or not; but given the recent increase in Japan’s international voice and influence and the possible continuation of that increase, Moscow’s diplomacy toward Japan cannot be regarded as wise and up-to-date.

If you accept these two premises that I have singled out as the fundamentals of Soviet foreign policy, then you can easily understand my long-held, somewhat original argument which regards as very superficial the standard,
popular view that the “Northern Territories” issue constitutes the greatest barrier between these two neighboring countries. That's not true, in my view. The Northern Territories issue is merely the visible tip of the iceberg. The more profound stumbling block lies in different world outlooks, strategies, and means of solving international conflicts between Japan and the Soviet Union since World War II.

At any rate, if the Soviets are to be successful in their conduct of foreign policy toward Japan, it will become necessary for them to undergo, above all, a kind of mental reprogramming—for instance, a transformation from obsession with military strength to a more non-military—economic, scientific, technological, or psychologically-oriented—mentality. Having undergone such a mental transformation, the Soviet leaders might realize the urgency of forming a distinct foreign policy toward Japan—a policy which is not simply an extension, function or appendix of their global or U.S. strategy, but one independent enough to be distinguishable from it, taking full account of the specific conditions of Japan-Soviet relations.

The question is whether one can expect such a transformation from the new Soviet leader, Mikhail Gorbachev. In reply to this question, I'd like to make the following three points: First, with regard to Japan, if Gorbachev and other Soviet leaders were to undergo the mental transformation just described above and subsequently change their policy as well as attitude toward Japan, it would be fine with us. Such a change would be simply welcome. We would not have any objection to it. It may be assumed that such a transformation or modification of traditional perceptions, values and images seems to be a sort of inevitable process or development, but in fact this change is proceeding at a frustratingly slow speed with much zig-zagging. Even prior to the advent of Mr. Gorbachev to power, some specialists attached to the Soviet Academy of Sciences and editors of some newspapers or periodicals of the Soviet Union, and even some members at the International Departments of the Communist Party Central Committee, have made remarks which can be interpreted by us as illustrating that this process of change has already started in the Soviet Union. On the other hand, however, we are also aware of the fact that these people still remain a small minority in the Soviet Union, and seem to have no influence at all over the practical policy decisions toward Japan of the top Soviet leadership. We have not so far detected any evidence whatsoever to indicate that the top Soviet decisionmakers, including Gorbachev, have made any changes in their policy toward Japan.

Second, the change that one can detect in the Gorbachev government is at best one of style, not of the basic Soviet policy stance or policy orientation. This point must be kept in mind, not simply because Japanese are so-called suckers for style, but also because in the past, Soviet behavior and manner in dealing with Japan was very bad—it has been unsophisticated, clumsy, heavy-handed, inflexible, and intimidating. Therefore, if the Soviet leadership under Gorbachev is to adopt a less heavy-handed, more affable manner and style in its attitude toward Japan, even if it were only superficial and tactical, the chances are good that the Japanese would be easily impressed and deceived. This is illustrated by the recent “Gorbachev fever” (with high expectations among some Japanese politicians about the new Soviet leadership under Gorbachev) which came about in the wake of Nakasone’s meeting with Gorbachev at the Chernenkov funeral. As long as the Soviets change neither their style nor the substance of their policy toward Japan, we can safely say that their policy remains unsuccessful, inept, unimaginative if not stupid, almost a total disaster. Though it may sound a bit like “sour grapes,” we can at least console ourselves, saying that, “Thanks to Soviet mistakes, we can sleep well.” At the same time, however, if the Kremlin under Gorbachev were to change only its style and approaches, without changing its basic goals and objectives toward Japan, it would be tougher and more formidable than before, and require us to be better prepared on our side. It would be quite a challenge to us. In a sense, however, we need a tough leader in the Soviet Union to negotiate with them. If they have weak leaders, we cannot negotiate with them.

Finally, in more concrete terms, what the Kremlin under Gorbachev is going to try to do with regard to Japan is as follows: First, to obtain credit and access to the high technology that the Soviet Union so badly and desperately needs and has increasing difficulty in getting from Europe. Secondly, to launch a peace offensive aimed at driving a wedge between Japan and the United States, Western Europe and even China. Thirdly, to obstruct Japan’s rearmament and movement for the return of the Northern Islands. The new Soviet leadership appears to want to achieve these objectives, which are obviously incompatible with each other, without making any substantial concessions to Japan. This is my current conclusion.

I’m afraid perhaps you feel that my observation is not spectacular, brilliant nor original, but please blame the Soviets, partly because they have not yet produced any spectacular, original, or innovative policy changes—making my speech rather dull.

Hiroshi Kimura is Professor and Director of the Slavic Research Center at Hokkaido University. Dr. Kimura was a Fulbright-Hays Visiting Professor at the Institute for Sino-Soviet Studies of George Washington University (1977-78) and at Stanford University (1982-83), having served as Special Research Fellow at the Japanese Embassy in Vienna (1972-73) and in Moscow (1973-75)
Domestic Moods: A Trilateral Perspective
The failure of American intervention in Southeast Asia still afflicts our stature in world affairs and still frustrates domestic consensus. Although there is wide spread agreement among policy analysts that the position of the United States in Asia is much stronger today, President Reagan was the inheritor of the Vietnam legacy. One of his most important accomplishments over the past four years has been to instill in Americans a greater sense of self-esteem and a stronger confidence that the country can regain the power and prestige it once held in world affairs and that it can resolve the vexing social issues that still plague it.

After four consecutive presidents who were unable either to fulfill their major commitments or to retain the confidence of even their own parties, Americans were understandably eager to have Ronald Reagan succeed. And what we have had over the past four years is an administration led by an extraordinarily bold and confident man—A President whose faith in his own beliefs has led him to accept huge political risks. Thus, during his first term, he was quite prepared to take the blame for the worst economic decline since the great depression because he thought it was the only way to conquer inflation. In the eyes of many, his instincts and his judgment were correct. A majority of Americans did regard double-digit inflation as the chief threat to their security. And, certainly, no one can begrudge Mr. Reagan the political strength he continues to draw from the resurgent economy:

—Inflation appears to be firmly under control.
—Unemployment is down.
—The gross national product is up.
—And most sectors of our economy—manufacturing, services, finance, communications and the growth of new capital and technology—all confirm our fundamental economic strength.

In international affairs, the popular perception is that America is much stronger today than it was four years ago. A majority of citizens perceive that Mr. Reagan has kept his 1980 promise to enhance American political leadership in the free world by dealing more forcefully with our antagonists and more generously with our friends. There is the further perception that America is stronger militarily vis-à-vis the Soviet Union than it had been, and that greater parity in arms creates a more positive atmosphere for negotiation of nuclear weapons reduction and other outstanding differences. Mr. Reagan’s own public attitude toward the Soviets reflects what most Americans now believe to be a more hopeful relationship between the superpowers. Four years ago, his rhetoric was harsh but today he declares himself ready for personal meeting with Mikhail Gorbachev. Add to this the resumption of arms negotiations in Geneva, and the consensus in my country would be that the President’s policies are succeeding internationally as they are on the home front.

There is not, of course, universal approval of Mr. Reagan’s performance. On the domestic front, there is increasing anxiety over his inability to control the massive deficit . . . and active opposition to his reduced commitment of resources to the environment, to the cities, to civil rights, to the poor and the elderly. Internationally, the dispatch of American combat forces to Lebanon and Grenada—together with our ever deeper involvement in hostilities in Central America—are highly divisive. There is a growing concern that the lessons of our long, costly and futile intervention in Southeast Asia may have been forgotten.

After weighing the assets and liabilities of this President, how is one to account for his continuing popularity, even among Americans who disagree with many of his actions? He is an optimist whose confidence engenders confidence in others, a persuasive communicator and, of course, a highly personable man. Americans like him. We have witnessed what some have described as a “Reagan Revolution”—the force of the President’s own popularity and the power of his own advocacy have wrought significant changes in our economic and political life. There also have been subtle, evolutionary changes under this administration. But the impetus has come not so much from government in general as from the President’s accurate reading of what Americans want and do not want from their political leadership.

The majority is no longer as certain as it was 20 or 30 years ago that government is the ideal instrument to effect social or economic reform or that it has the foresight or the competence to guide us down the hazardous path to the future. This attitude, I might add, is endemic to almost all of the world’s democracies. It is not at all difficult for President Reagan to respond to that concern. He was himself an aggressive critic of government long before he held office either as governor of California or as President. He has long-held core beliefs that government is too big. It can be said, uncritically, that the administration’s record over the past four years has been one of response to the public will and the President’s traditional values rather than significant innovation.

—On economic policy, most Americans still support pragmatic but selective use of government controls. Witness their acceptance of a recession to escape destructive inflation and price increases.
—On social policy, most Americans continue to be tolerant of diversity and strongly support individual rights, but still draw the line at too much, too soon. There is, for example, no great outcry against the diminution of affirmative action . . . nor is there great support for equalizing opportunities in public education.
—In foreign relations, most Americans believe in peace through strength, but remain wary of foreign entanglements.

The consensus is that military intervention is acceptable only when there is a clear and present threat to American interests. For the most part, the administration has been responsive to the majority opinion in all three policy areas. The question now is whether the past will be prelude to the next four years, and whether the President will continue to react to the public will. Clearly, the preeminent issue facing my own country—and, the world—is the achievement of an East-West detente that will reduce the possibility of nuclear war. A second, but crucial issue, is the reduction of the massive federal deficit that also has explosive implications not only for my own government but also for the world economy.

In the area of foreign affairs, including detente, I have sought the opinions of three former members of the Trilateral Commission who now serve as senior members of the Reagan Administration. They are Vice President George Bush, Secretary of State George Shultz and Secretary of Defense Caspar Weinberger. Vice President Bush said the primary goal of the second term is to secure “a sound agreement with the Soviets . . . one that will significantly reduce nuclear arms in a verifiable way.” But he also stresses that steps will be taken to strengthen “the steadfast unity between our friends in Japan, in Western Europe and in Canada” because those relationships are more important to us than ever.

Secretary Shultz strikes a similar note. He said our priorities in foreign affairs are:

—“First, maintaining our alliances and friendships.”

—“Second, seeking a more secure and constructive relationship with the Soviet Union, including an arms reduction agreement.”

—“Third, seeking the peaceful resolution of regional conflicts.”

—“And, fourth, strengthening the global economy by supporting free trade and encouraging open market policies that encourage growth.”

As with his colleagues in the Cabinet, Secretary of Defense Weinberger cites “the achievement of genuine nuclear arm reduction” as having the highest priority of the second term. But he also believes there will be major emphasis on the “modernization of strategic and conventional forces” and on “support for the Strategic Defense Initiative.”

That, then, is the view from inside the Administration. And, except for arms negotiations—which have had a lower priority over the past four years—a continuation of present policy appears to be the order of the day. And that, too, will be generally acceptable to most Americans. In a Gallup Poll earlier this year, 50 percent of Americans felt that the two superpowers are now equal in nuclear strength, while only two years ago the Russians were seen to be far ahead in nuclear capability. The polls in each passing year since 1980 reveal a gradually diminishing concern over the nation’s military security, and a corresponding decline in support for higher military budgets. But with greater military strength and security there is also developing a growing suspicion of international commitments and intervention. The one area in which Mr. Reagan’s policies conflict sharply with public opinion at home is his apparent determination to push the United States ever deeper into the internal affairs of Central America and the Caribbean. The dispatch of assault troops to Grenada in 1983 had majority support only because it was swift and successful and because it was thought necessary at the time to rescue the American medical students. And the crushing of an unpopular Marxist regime was a major plus for the President among his more conservative supporters. In El Salvador, Mr. Reagan is benefiting from a period of relative stability. Although the insurgents remain a formidable threat, the recent strengthening of the moderate Duarte government is being read in Washington as an encouraging sign.

But in Nicaragua, the outlook is far from hopeful. Mr. Reagan has spoken of the anti-Sandinista rebels—known as Contras—as “the moral equivalents of our Founding Fathers.” This, of course, is a gross distortion of American history. It also ignores the questionable moral standards of the rebel leadership, which includes former officers in the notorious and repressive National Guard of Anastasio Somoza. There is rising opposition to his Nicaraguan policy, faced with almost certain defeat in Congress, the President has agreed to postpone his fight for military aid to the rebels fighting the Nicaraguan government, according to press reports this morning. A compromise may be worked out so the proposed $14 million in aid would be used only for non-lethal purposes. Even so, many analysts believe the Presidents will employ other means to keep the pressure on Managua. Public reaction may influence the President and his advisors to reassess his policy. Certainly, he has only to recall—from the experience of his predecessors—that the result can be disastrous when a chief executive draws the country into an overseas conflict without popular support.

On the domestic front, one issue drives all others—the runaway budget deficit. After three years of stubborn disagreement, Congress and the White House are groping toward a de facto compromise. The defense budget will continue to rise significantly in constant dollars, as the President and many in Congress believe it should. It will not, however, rise to the level that the administration originally sought. In this instance, at least, Mr. Reagan is a victim of his own success. The surer Americans
become that their military strength is a deterrent to aggression, the more willing they are to trim the Pentagon budget.

There is, however, a point beyond which Americans will not go in tolerating further reductions in domestic spending. While demanding more efficient management of public funds, there is a growing consensus for entitlements in Social Security and Medicare... and the administration would tamper with them at its own risk. My assessment is that Congress may use tax reform or another vehicle to enhance government revenues marginally, but there will be no substantial net increase in federal taxes. The President would not accept it... the Congress, facing uncertain election prospects next year, would not accept it. And the public, of course, favors more tax reductions as adamantly as it opposes all proposals for increases.

What are the prospects, then, for even a slowing in the pace of the extraordinary deficit? Again, I have gone this week to one of the President's closest advisers for his opinion. Budget Director David Stockman informs me that the budget reduction package agreed to by the White House and the Senate Republican leadership in early April "would, if enacted, lead to a dramatic improvement in our fiscal situation... most of the program reforms and terminations contained in the package are of a permanent nature, not easily subject to reversal in future years." Measuring that assessment against the possibility of no significant agreement on budget cutting, Mr. Stockman's expectations may not be out of line. But even assuming approval of the Senate Republicans' recommendations, we are still left with the near certainty of extremely large deficits for the foreseeable future—and the prospect that the national debt may double by the end of Mr. Reagan's second term. That, of course, is a dismal prospect not only for the U.S. but for all nations whose economies are sensitive to the American economy, including all member nations of the Trilateral Commission.

There is one final aspect of domestic policy that will be highly significant in the second term—the battle over trade policy. Protectionism is fast becoming a genuinely popular cause in my country. More than ever in the past, American producers are complaining that they cannot compete in world markets... not because of poor management or inefficiency but because of the overvalued dollar and restrictions. Thus far, the Reagan Administration—like its predecessors—has fought against protectionist sentiment, as have most responsible business leaders. But as the perception grows that cheaper imports are throwing tens of thousands of Americans out of work in our largest industries, the demand for tariff barriers is also growing. The demand comes from Democrats in Congress whose constituents are out of work in the urban industrial centers. It comes from trade union leaders. And, more strongly than ever before, it also comes from Republicans in Washington in response to the complaints of the private sector.

Up to a point, the pull and tug between protectionists and free traders is a recurrent fact of life, and one that my country has been able to live with despite the imbalances in trade. But for how much longer? The current impetus for restrictions on imports comes from the widespread conviction that not all countries are playing by the same rules. I regret to say, particularly with reference to Japan, that ever larger numbers of Americans—workers and producers—believe they have become victims of free trade... that Japan has not given American products a fair chance to compete in its own markets.

Japan's recently announced new economic initiatives and Prime Minister Nakasone's recent plea to the Japanese to purchase more foreign products are encouraging steps in the view of American traders. The announcement yesterday of new, simplified technical standards for telecommunications equipment used in homes and offices could remove another important barrier to foreign companies' sales in Japan. Incidentally, Prime Minister Nakasone put his personal money where his new trade policies are yesterday. While shopping yesterday, he bought a French shirt, an Italian tie, an Italian sports coat, and a British dart board for his grandson. 284 dollars. He also tasted a California wine and nibbled on California nuts, but—sadly for us—passed up a purchase of items "made in the USA." Maybe next time.

The seriousness of what I believe to be a critical hazard to our trade relations with Japan is evident in the probability that the trade imbalance between our two countries probably will exceed 40 billion dollars this year alone. The cause of free trade, in which we all believe, is at grave risk if exporting nations continue to maintain direct or indirect impediments to foreign competition within their own markets. In my opinion, our Japanese friends must now deliver on their promises to permit U.S. sales here. Thus far, Mr. Reagan's commitment to free trade has been very strong. But, again, I would remind you that he is also a reactive President who is demonstrably capable of shifting his positions if it becomes untenable.

In summation, what can we anticipate for the balance of the Reagan presidency? There will not be a lame duck second term. The President expects to get much done.

—There will be intense and sincere efforts to reach effective agreement with the Soviets on nuclear arms. There is a genuine desire, I think, by the President to be a peace maker but through strength, not weakness.

We can also expect a parallel effort to reduce East-West tensions through greater economic, political and cultural relations with Communist nations. A full summit con-
ference or merely a direct personal exchange between
President Reagan and Premier Gorbachev obviously
could enhance those prospects.
— There will be a continued commitment to
strengthen our defenses, including research on star wars
or the strategic defense initiative.
— Also high on the agenda will be a new round of
trade negotiations to strengthen the U.S. economy and
to promote economic recovery in Western Europe. But
the current controversy over Japanese trading policies
will continue to pose a serious challenge to the President's
ability to resist retaliation.

The most optimistic note I could strike in closing my
remarks would be to refer to my earlier statement that
Mr. Reagan has set a tone of confidence and a sense of
pride in the psyches of many millions of Americans who
once felt that their country was on a downhill course.
The strong improvement in the economy is, of course,
one reason for this resurgent faith in the country and its
future. The President's own buoyant spirit is another.
President Reagan won a smashing victory in
November—49 states. He has a strong mandate for his
second term, and I expect him to use it fully—especially
between now and 1986. It is my hope, as I know it is
yours, that this new spirit of confidence will eventually
infuse all of our national undertakings and that it will
bring a greater measure of generosity and responsibility
in our relations with the world community.

W. Thomas Johnson has served as Special Assistant to
President Johnson and then as Executive Assistant to the
former President in Austin, Texas. In 1977 Mr. Johnson
joined the Los Angeles Times as President and Chief Operating
Officer, and in 1980 was named its Publisher and Chief
Executive Officer. Mr. Johnson is also Chairman of the Board
of the Lyndon B. Johnson Foundation, and a Trustee of the
Rockefeller Foundation.
Recently the image of Europe and the European Community has not been bright. The comparison of Europe to a "cultural museum" or some kind of geopolitical discotheque has been made by the Japanese. And doubts about European vitality can also be found in the American press. Headlines like "Europe's Good Old Ways Aren't the Way Forward" and "Strait-laced Europe Lags" reflect these sentiments. Then too in Europe itself "Europessimism" became a fashion of sorts with one Swiss paper coining the phrase "Euroscerosis."

After hearing such statements, you may wonder how I have the courage to make a presentation on the subject of Europe in a trilateral framework. My answer is that we have had the worst of Europessimism and its underlying "Eurostagnation," Where can we now detect positive developments? First, there is a European economy gradually on the mend. It follows a strategy with three principal components: 1) a historic reversal of the growth of public expenditures and the resulting burdens and rigidities, 2) a convergence of monetary policies on stability, and 3) a re-examination of labor market conventions and regulations with a view toward increasing employment. The short-run results of these policies may be undramatic, but the therapies being administered are of a fundamental character. We do not want to jeopardize these results by hasty policy shifts.

There are other positive developments. During the decade after the 1973 oil shock, labor productivity continued to grow faster in Europe than in the United States. And in terms of GNP per man-years worked, European productivity now exceeds that of the Japanese. Moreover, in some fields of advanced technology like bio-chemistry, Europe is a world leader. Finally, European space ventures have been remarkably successful. The European Space Agency has been a great asset and will allow cooperation on an equal footing with the United States.

Apart from these positive economic developments, there has been a major political success. Spain and Portugal will enter the Community as full members in 1986. Let nobody deride the seven years these negotiations required to complete. When one realizes how difficult it is and how long it takes to arrange some easing of import regulations for a few wood and food products into the Japanese market, one understands what it means to integrate important agricultural producers like Portugal and Spain into the European Community market system.

The size and shape of the Community will of course change. There will be 50 million more inhabitants, bringing the total to 320 million or about seven percent of the world population. And the land area will expand to 2.25 million square kilometers, a 33 percent increase. Naturally, there will be an increase in the Community's share of world trade. But far more important is the geopolitical significance of the Community's enlargement. The entry of Spain and Portugal will consecrate the end of their political isolation, will consolidate their membership in the circle of Western democracies, and will facilitate their full participation in the cooperative framework of the Western world. It was for these very reasons that we invited our Spanish and Portuguese colleagues several years ago to join us in the Trilateral Commission. As a citizen of Europe, I am proud that I can now address them as Community citizens as well.

CHALLENGES FOR THE ENLARGED COMMUNITY

In my view, the main policy challenges facing the enlarged Community fall under four headings:

1) Agriculture. For the European Community as well as for the United States and Japan, there is the realization that the policies of the past cannot continue without change and correction. Enlargement of the Community will make this problem even more acute. Since we have a Task Force Report on agricultural policy and trade, I will simply recall that the Community ministers have indeed had the courage to take unpopular measures limiting excess production, notably in the milk sector, by cutting price support. They are currently grappling with the annual price review, keenly aware of the importance of adjustments for the survival of their agricultural policy and for the Community's position as one of the main trading partners on the world scene. Their task is not enviable, but it is critically important.

2) The Common Market. As recently as a year ago, the Community appeared to have lost its sense of purpose. It quarrelled for five years at every heads of government meeting about who paid too much or too little. It ignored both the deteriorating state of the economy and its continuing lag behind the economies of the United States and Japan. And it failed to prevent Community expenses from overtaking Community resources. In reality, the picture of the Community's performance was less bleak than it appeared, but the highly publicized frustrated meetings overshadowed more positive aspects and contributed to a dangerous disenchantment of public opinion. To its credit, the summit meeting of Community leaders in Fontainebleau, chaired by President Mitterrand in June 1984, eliminated a few roadblocks and thus freed the way for tackling the problems of the unsatisfactory state of the Community and its common market.

There is much to do. Officially, the common market was established well before its target date of January 1, 1970. As a practical matter, however, a well-functioning common market requires much more than the removal of custom barriers on which the Community concentrated originally. Some provisions of the Treaty of Rome con-
continued to be neglected—for example, those on liberalization of trade in services. In addition, new barriers were erected, e.g., in the form of standards, health and safety regulations and the like. Finally, government procurement remained a national domain and national subsidies to ailing industries distorted competition. Now, the urgency of achieving a real, performing, dynamic single market is fully recognized. It is imbedded in the concept of a “Europe without frontiers” that will be implemented near the end of this decade.

3) **Macro-economics.** In the early days of the European Community macro-economic policies and monetary matters were considered to be the domain of Bretton Woods. Since the collapse of that particular monetary order, the Community has tried to substitute something of its own, which by now has taken the form of the “European Monetary System.” The existing machinery is no more than a half-way house, but it is the only known mechanism which has successfully insulated the mutual exchange relations of a regional group from the fluctuations of monetary instability at the world level. For the participating countries, the EMS has proven to be a great benefit. And the rise of the e.c.u. has been quite spectacular indeed. Moreover, the discipline of participating in the system has helped the authorities of the various countries impose macro-economic policies more in line with each other and with the requirements of the situation. As a result of converging macro-economic policies, inflation has been brought down, public sector deficits have been reduced, and conditions for moving towards economic and monetary union are better now than at any time in the past.

4) **European Union.** The directly elected European Parliament has completed a draft treaty which would absorb the present European treaties and would add new responsibilities (e.g., foreign policy) and new political powers to existing arrangements. The heads of government have asked a committee of knowledgeable Europeans to look into these matters. They have just reported back, although not all agree with the majority view on the need for institutional reform. Still, one thing seems clear. In a Community of Twelve even more than in a Community of Ten, decision-making grinds to a halt if we stick to the bad habit of seeking complete agreement on all details. In practice, this bad habit puts a premium on bureaucratic discord and national idiosyncrasies. Whether called “European Union” or something else, the enlarged Community will need streamlined decision-making. Otherwise, it will not serve its purpose, let alone survive in the long run.

**Broader Issues**

1) **Foreign Policy and Security Issues.** Community members currently use the framework of the European Political Cooperation to discuss foreign policy issues, including security aspects. But there are limits to this. Ireland is neutral. Denmark keeps a low profile. And Greece resists over-involvement. Other Community members have therefore sought alternative ways to consult more closely as European allies under the North Atlantic Treaty. As a result, they have turned to the West European Union, which was created even before NATO, but later became dormant. This is an important development. Foreign policy issues are becoming so complex that consensus can no longer be automatically assumed. We need a thorough process of discussion among ourselves as well as close consultations with the United States. Portugal has already asked to be admitted into this revived Western Union. And Spain and others are welcome to do the same if they so wish.

2) **SDI.** Paul Nitze, President Reagan's special adviser on arms negotiations, recently stated that basic Western strategic concepts would stay in force for a long time even if a U.S. space-based defense system were later built. He explained to an I.I.S.S. audience in London that the time-scale of the SDI program extends well into the next century. Meanwhile, the United States will go on trying to negotiate radical cuts in nuclear weapons in Geneva.

These are welcome views. It is of the utmost importance that enough time and effort are spent on the analysis and explanation of these matters, so that conclusions can be reached with conviction and full knowledge. Western European governments have succeeded, under sometimes very difficult circumstances, to stick to their commitments under the INF deployment decisions of 1979. They deserve credit for their perseverance. All questions relating to arms negotiations, strategic concepts and the like remain very sensitive in Europe because of our very special geographic situation and must be handled with great calm, patience and determination. It is absolutely imperative that we continue to keep the alliance together.

3) **The International Economic Order.** The trilateral countries are the providers of the world economic order—or what we have of it. This order may be a bit shaky in parts and incomplete in others, but there is no substitute for it and we must do everything to keep it and to improve it. Ten days ago, the Western industrialized nations in the OECD framework in Paris decided to start preparations for a new round of trade negotiations. It was also recognized that the international monetary system needed to be reviewed. Both these news items were reassuring. The first priority now is to avoid irreversible unilateral actions in the trade field. The second requirement is to protect the world economic recovery, which in the case of Europe and Japan has largely been export-led or export-induced. Both these regions must now push in the direction of growth through endogenous rather than exogenous means. They must do so with care. We in
Europe cannot tackle unemployment President Ronald Reagan's way of boosting the economy with the help of a huge budget deficit. As the British Chancellor of the Exchequer said, the American option, which rests on the unique position of the dollar as a reserve currency, is not open to others. Nevertheless, Western Europe as well as Japan must do its bit. We must also avoid the risk of trade conflict in the trilateral areas by joining in a meaningful and creative new drive for trade promotion, including trade in services. In parallel we must reduce the risk of erratic and violent fluctuations of exchange rates. Progress here will facilitate any new trade negotiations.

Finally, it is necessary to underscore the importance of the developing countries in the context of the world economic order. Some of these developing countries, especially in Asia, have been spectacularly successful these last years. Others, especially in Africa south of the Sahara, suffer grievously. Still others in Latin America are struggling uphill and desperately need expanding export opportunities in the industrialized countries to succeed. There has been great progress in dealing with the international debt crisis, but the problem remains critical for a second tier of developing countries. The international financial system remains vulnerable to third world debt and prudence suggests that positive steps must be taken to reduce the risk of relapse. We in Europe see with some preoccupation that the international financial institutions, which are so important in this context, do not always get the support we think they deserve. That is also part of an improved international economic order.

In summation, the trilateral countries have many challenges before them. At the same time, they have many opportunities to deal effectively with them—provided they listen carefully to each other and choose mutually reinforcing policies over scattered approaches.

Edmund Wellenstein was Director-General for External Affairs of the Commission of the European Communities in 1973-76. Presently, Dr. Wellenstein is Chairman of the Supervisory Board of the Netherlands Institute of International Relations and was nominated by the Heads of State and Governments of the European Community on the Ad Hoc Committee on a People's Europe.

Today Japan enjoys political stability. A recent opinion poll shows that Prime Minister Yasuhiro Nakasone is supported by more than 50 percent of the people, the highest rating of any prime minister in the past 25 years. Support for the Liberal-Democratic Party (LDP) is also strong. Indeed, it is the highest since the end of the 1950s. This situation may be partially explained by the political achievements and policy objectives of the Prime Minister. They fall into five categories:

a) administrative reform—where he has tried with some success to limit the growth of public expenditures and to de-regulate the economy

b) defense—where he has made a more serious effort than his predecessors, although the achievements themselves have not been so spectacular

c) educational reform where he has started broad ranging discussions whose eventual outcome is still uncertain

d) tax reform where he suggested a new tax system, introducing indirect taxes to change the balance between them and direct taxes.

e) moderate growth, trade surplus and capital outflow where a completely new situation has arisen and where all are at a loss for a response as Japan is severely criticized.

Of these, administrative and educational reform are clearly important sources of Nakasone's popularity. In contrast, his effort toward greater self-defense capabilities is unpopular and his suggestion of tax reform is even more so.

There are other, non-issue factors which contribute to Nakasone's strong standing. First, people support him from the feeling, correct or incorrect, that there are no other good candidates. Nakasone has been successful in conveying the image that he is a new, non-traditional type of leader. He is outspoken. He is active. And he also tries to appear to be active, for which he is occasionally criticized as showy. Moreover, people may support Nakasone as his position in any intra-factional struggle is weak and he must therefore appeal directly to the public. Most important, however, is a trait of present day Japanese society—namely, sobriety or the lack of boldness. This term defines the strong work ethic, low expectations and frugality of the Japanese people. Such a state of mind helps Nakasone and the LDP. The less people expect, the less dissatisfaction they entertain. Indeed, several surveys show that the level of Japanese expectation declined in the early 1970s. People are thus satisfied with or at least tolerate the status quo. The political result is greater popular support for the LDP. So Nakasone's suggestion of unpleasant tasks ahead does not repel people; they know they do not live in a dream world. To the contrary, Nakasone wins respect for facing such difficult problems as defense and taxes. In
short, he projects the image of a serious and honest man. Historically speaking, sobriety became the dominant tone of Japanese society after October 1973 when the first oil shock occurred and inflation was soon ignited. It was then that Japan was at the peak of its boom psychology. Naturally the shock was great and many suffered financially. As one example, there were housewives who bought 50 kilometers from the center of the city in the hope that it would become a good suburban area. That, however, did not happen. From this and other experiences, the Japanese learned it was unwise to entertain high expectations. At the same time, they had to adjust to a new era in which energy prices rose sharply overnight. Indeed, increasing productivity to offset dependence on raw materials became a national goal of sorts. The Japanese succeeded. They made their economy more productive with exports growing particularly in new, technologically sophisticated products and with imports of raw materials staying constant or in some cases declining (oil). The natural result was the trade surplus for which Japan is now criticized. This became the first test for the 1984 Nakasone government that started in the fall of 1984 and will continue for two years. As criticism from abroad mounted, the problem of trade imbalance became a major issue in domestic politics. Before dealing with it, I must first touch upon the second important feature of the past ten years—namely, Mr. Kakuei Tanaka.

In 1974, Tanaka had to quit both the prime ministership and the LDP as a result of the Lockheed Scandal. Yet he remains powerful as a “grey eminence” because of his strong personality, his fund-raising abilities, and the strength of the machine he created. The political situation in Japan has been strange indeed. Although not a member of the LDP, he controls its largest faction through which he exerts very strong and often decisive influence within the LDP. But this era may be coming to an end. One signal appeared to be the attempt last fall to replace Nakasone with Nikkaido, a powerful figure in the Tanaka faction. At that time, old-generation politicians led by Suzuki and Fukuda tried to remove Nakasone by appointing Nikkaido party chairman. The plan was clever. First, the Suzuki faction and the Fukuda faction are large. (There are five factions in the LDP.) In descending order of size, they are the Tanaka faction, the Suzuki faction, the Fukuda faction, the Nakasone faction, and the Miki or Komoto faction.) Second, within the Tanaka faction, there was dissatisfaction over its inability to use superior size and strength to secure the chairmanship of the LDP and thereby the prime ministership of Japan. The reason for this is linked to Tanaka himself. Fearing the loss of his ability to influence Japanese politics as a “grey eminence,” Tanaka refuses to relinquish control over his faction. He therefore refrains from appointing a formal leader for his faction. And without one, the Tanaka faction cannot win the chairmanship of the LDP.

This disenchantment within the Tanaka faction and their own combined strength notwithstanding, Suzuki and Fukuda failed on several counts. First, they lacked legitimacy. Nakasone has been a successful and a popular prime minister. To replace him for ambiguous, factional reasons was considered harmful to the LDP. The plan was thus opposed by quite a few. Another, more important reason was the so-called new leaders. Takeshita and Abe in particular did not support Suzuki’s plan; since, in their view, it would decrease their chances of being elected in 1986. Nakasone cannot continue as prime minister after the 1986 fall regardless of the strong popular support he may have. According to party rules, no one can become party chairman for more than two terms or four years. For the new leaders, their future lay in letting Nakasone continue until 1986, not in appointing Nikkaido as an interim leader. In other words, there was a considerable element of generational strife in which the new generation prevailed. In hindsight, this struggle revealed that 1) Tanaka’s control over his faction had been weakened and 2) the so-called new leaders had acquired a certain strength. Taken together, these two factors suggest that Tanaka’s days are numbered. This year he fell seriously ill, making this trend even more visible.

At this point, I wish to return to policy problems. The time for the new leaders seems to be approaching. But are they well prepared? It is not easy to answer “yes.” What the new leaders can present to the Japanese is still unclear. One exception may be Miyazawa who proposed an asset’s doubling plan. Perhaps the discussion over macro-economic policy, caused by the problem of trade imbalance and criticism from the United States, will force the new leaders to clarify their positions. Whether or not that occurs, policy discussions have already begun. Several politicians argue that the government should stimulate domestic demand and domestic consumption to curb the need to export goods. The result, they believe, will be a decrease in the large trade surplus and the large-scale export of capital.

For his part, however, Prime Minister Nakasone continues to give priority to the reduction of the budget deficit, adhering to a tight economic policy. In my view, the Japanese people support Nakasone’s policy more than the proposals of his opponents. The basic reason is again the sobriety of the Japanese people. The guiding principle of almost all Japanese companies is to seek greater efficiency by cutting waste. They believe that government should do the same. The belief in such a strategy is further strengthened by its apparent success and by the tendency throughout the free world toward
limited government.

It cannot be denied that Japan needs to streamline its government. The Japanese government issued a large amount of government bonds to deal with the recession and the inflation which followed the 1973 oil shock. Since then budget deficits have become routine. No wonder then that administrative reform to make government slimmer and more efficient should become a slogan after 1980. But here we must note the difference between the American and the Japanese effort for limited government. In my opinion, the chief driving force in the United States has been deregulation. The Americans have taken a position in favor of curtailing government intervention, whether that be in economic activities or for the welfare of the people.

In Japan, the view is strongly "étatist"—namely, that the state should direct the activities of society. The welfare state is thus considered to be good if it can be afforded. State regulations are also deemed necessary and are often demanded by the people. It is only because government cannot perform all these functions that government must be limited. An ordinary Japanese citizen would say "the more welfare-oriented the government the better." But, as politicians respond, exorbitant costs mean that we must settle for a scaled-down set of welfare policies. Therefore, the Japanese move toward limited government is motivated by the desire to cut the budget deficit, almost to the point of obsession. Bold measures to revitalize the economy cannot be taken in such an atmosphere.

Nakasone is true to his convictions. He firmly believes in the cause of the free world and has therefore tried to increase Japan's defense capabilities more than anyone else. In this, I do support Nakasone. But, similar to the clear majority of Japanese, he also firmly believes in the virtue of frugality. This has been and continues to be a traditional value of the Japanese. So while Nakasone has sincerely tried to eliminate Japan's non-tariff barriers and has advocated the purchase of foreign goods, he still opposes any bold moves to stimulate the economy. I cannot say whether he is right or wrong on this; for no Japanese statesman can act against the national trait and prevalent mood of the country—namely, sobriety. Moreover, the world cannot enjoy sustained prosperity unless the people in the free world regain the virtue of frugality. Nevertheless, Nakasone may be incorrect in a different respect. The Japanese are frugal and may be excessively so. Moreover, Japan may have to change from a tight economic policy to economic stimulation if it wishes to avoid seeing the free world sink into another recession. Finally, excessive frugality over the long term may yield economic stagnation. In my view, a proposal like Miyazawa's assets doubling plan may not be the answer.

To the ordinary Japanese, it sounds like a tired repetition of the good old song sung in the days when rapid growth was possible. Young people like my students, who are not frugal, do not show much interest in Miyazawa's idea either. Somehow the argument sounds a bit dated.

In conclusion, let me say that the debate over macro-economic policy in Japan is very important for Japan and for the free world. I hope that the debate will also decide the leadership issue in the years to come. If it does not, there is the possibility of it being settled by *nemawashi*, a complicated process of informal bargaining in which "old" people play important roles as go-between. If that happens, the LDP will lose its popularity.

Masataka Kosaka is Professor of International Relations at Kyoto University. Professor Kosaka has been a Director at the Research Institute for Peace and Security since 1978 and received the Yoshino Sakuzo Award for *Maturation and Disintegration of Classic Diplomacy* in 1978.
My assignment is to discuss the relevance of the Pacific region to Korea and particularly the trilateral nexus as it relates to Korea. We can think of the Korean interest in three broad issue areas: security, politics, and economics.

When we talk about security, we are mostly concerned with the North Korean security threat. Even the Soviet military buildup as well as other developments concern us insofar as they relate to North Korean capabilities and policies.

South Koreans tend to think largely of two countries in connection with this security concern. They are primarily the United States and secondarily Japan. The U.S. security commitment to Korea seems to be firm. The troop withdrawal issue seems to be over at least for the time being. And barring any unforeseen international crisis or domestic upheaval, it seems that the U.S. security commitment will stay intact. South Korea does not seek any regional defense arrangement or formal alliance with Japan. It is neither sought nor considered possible. But the U.S.-Japan relationship with some of the other major countries is of course vitally important. In fact, during the past decade or so, the evolving U.S.-China friendship with China has been a positive factor in Korean security, in large part by restraining North Korea. Moreover, the deteriorating relationship between Washington and Moscow has also been a plus a short run by heightening U.S. recognition of South Korea's military importance. In the longer run, however, it will prove to be a minus factor for Korean security.

As for the U.S.-Japan relationship, South Korea looks at the U.S. encouragement of greater Japanese military spending with mixed feelings. On the one hand, South Korea considers it a positive step in strengthening both the security situation in the area and U.S.-Japan security cooperation in general. On the other hand, there are certain concerns over a variety of items. They include a possible adverse reaction from the Soviet Union, the possible negative impact of a militarily stronger Japan on U.S.-Japan relations, the possible military threat that such a Japan would pose to Korea and her other neighbors, and the possible negative consequences that a greater emphasis on military power would have for domestic politics in Japan. To prevent these from occurring, South Korea wishes to see four conditions in any Japanese military buildup. First, it should be gradual. Second, it should be defensive in nature. Third, it should occur within the context of the U.S.-Japan Security Treaty. And fourth, it should occur in close consultation with Japan's neighbors. The first three conditions seem to be met, while the consultation part still seems to be somewhat desired.

Of greater importance is another issue--security on the seas. The Koreans seek the safety of the Korean merchant marines as well as the ability to deal with such unforeseen incidents and accidents as the recent intrusion into Korean waters of a Chinese torpedo boat and most recently the collision between a Chinese ship and a South Korean ship. All of these have been handled well. Nevertheless we cannot rule out the possibility of future incidents involving Soviet vessels. Indeed, events after the shooting down of the Korean airliner in 1983 indicate a greater need for cooperation between Japan and Korea, and among Japan, Korea and the United States particularly in the naval area.

The second set of issues deals with politics. Here I am referring primarily to North-South Korean relations. As of now, things look very, very flexible. There will be a North-South dialogue on economic cooperation in the middle of May (1985) and what we call a "Red Cross Talk" at the end of May. In addition, there is a North Korean proposal for an inter-parliamentary talk. Finally, there has been a fundamental change in the attitude, style and approach of the North Koreans. For example, in the proposal for an inter-parliamentary talk, they used rather moderate language including the official name of South Korea--the Republic of Korea. This is unprecedented and seems to indicate that the North Koreans have changed their tactics if not their goals. We can speculate why the North Koreans would do this. In my view, there will ultimately be some token accommodation if for no other reason than to enable North Korea to establish economic and political ties with countries close to South Korea. We think that China has had a hand in this, both directly and indirectly, by encouraging North Korea to be accommodating and by setting the example for North Korea with more pragmatic, development-oriented policies.

Finally, I want to briefly review this issue of regional economic cooperation. There will be the fourth PECC (Pacific Economic Cooperation Conference) meeting in Korea at the end of April (1985). It does not intend to promote a regional free market or a forum for trade negotiations to replace the GATT process. Basically, it intends to promote consultation among the countries in the region.

One other point. On the recent trade friction between the United States and Japan, South Korean interests coincide with those of the other NICs. Initially, when the friction came out into the open, there was the temptation on the part of Korea to join the United States in criticizing or pressuring Japan. But I think it dawned on most Koreans that more friction was not good because greater protectionism in the United States would adversely affect Korea and the other NICs. Moreover, a greater opening of the market in Japan will not necessarily benefit countries like Korea. And if the friction intensifies, there will be a worsening of the international trade situation in general. Under the circumstances, I
think Koreans would be eager to have some kind of representation in the consultation process. They feel very helpless that their own interest is directly involved and yet Japan and the United States are dealing with each other in a bilateral way, not as part of a multilateral process.

As for multilateral negotiations, my reading is that the Korean government would participate. But it will be an uphill fight for many Korean officials and Korean scholars. Domestic resistance comes from three major sources. One, predictably, is certain economic forces. The other is parts of the bureaucracy. And the third, curiously enough, is the dissident groups. Recently there have been student disturbances and demonstrations in Korea. These dissident groups have taken a major stand opposing any opening of the Korean market. It is futile to tell them that they are actually saying the same thing as some of the capitalists they hate so much. In their view, the government is selling out the country by opening the market in return for political support from other countries, particularly from the United States. The government thus finds itself in a very difficult situation. And it takes a politically strong government with a rational mind to follow what seems to be reasonable internationalist policy.

Han Sung-joo is Director of the Asiatic Research Center and Professor of International Relations at Korea University. His publications include The Failure of Democracy in Korea and "Power and Development in South Korea." He is also a contributing columnist for Newsweek.
Sarasin Viraphol

I am speaking from the perspective of the non-Communist developing countries of which ASEAN constitutes a part. I think the overriding concern for most of us is not to emulate Japan or the industrial West but to catch up with the so-called "Four Tigers" of East Asia—namely the NICs of Taiwan, Hong Kong, Singapore, and South Korea. This is the economic goal we have set for ourselves. Whether or not we succeed will depend on a number of factors, some within our control and others entirely outside our control. Still, we are reasonably optimistic that it can be attained by the 21st century.

In the political realm, we can already speak of one achievement—that is, our ability to put our own house in order. This, I think, is the primary reason for the successes we have so far achieved in our political development. Of course, the record is not completely satisfactory. But there is reason to be satisfied with much of the progress—particularly in meeting the serious internal challenges of armed insurgency that most of the states in our region have faced.

With regard to ASEAN itself, it has occasionally been mentioned that the ASEAN region has achieved phenomenal economic growth over the past decade. It should also be mentioned that this growth has benefited the peoples of our region. Although there is still a debate over the desirability of the development model we chose, there is no doubt that this model has been tied to the development of the industrial democracies which have provided markets for our goods and have also been the sources of our economic interaction as a whole.

On the political side, the individual countries of ASEAN have managed to find resilience in forming a collective body and using it to eliminate or minimize friction and conflict among themselves. Moreover, they have used it to meet the challenges imposed on the region by countries outside the region, particularly by the major Communist powers.

What needs to be addressed, of course, is this question of how to deal with the friction that arises from increasing interdependence with countries outside and inside the region. It is perhaps easier to deal with this problem through collective consultation rather than through some process of avoidance. So we expect to continue to fine tune our relations with our like-minded friends in Japan, the United States and the European Community, and also to deal with newfound friends, so to speak, who may not share the same ideology and political or economic systems. Here I am of course talking about China, the Soviet Union and Indochina. Despite the growing threat of the Soviet military presence in Southeast Asia, and despite the different aspirations, and political orientation of the countries of Indochina, we must deal with them to insure our own survival, security and prosperity.

Finally, what can we expect from our friends in the trilateral partnership? I think there is the expectation that the EC, Japan and the United States can do a great deal to insure our economic development by keeping their markets open for our goods and services and by giving us the appropriate forms of economic cooperation and technical assistance. This is the key expectation of the developing states of ASEAN. Politically speaking, we also feel that this is an opportune moment for the trilateral countries to help strengthen the individual countries of the region and to make the region itself more secure and more prosperous so that the hoped for benefits may be shared by all.

Sarasin Viraphol is the Deputy Chief of Mission at the Thai Embassy in Japan. Dr. Sarasin previously served at the Ministry of Foreign Affairs in Bangkok; first as Counselor for the Office of the Permanent Secretary (1982-83), and then as Director for Policy and Planning and Private Secretary to the Minister of Foreign Affairs (1983-84).
I will discuss certain points that may be useful in explaining cooperation within ASEAN and how it relates to the larger dimensions of cooperation in the Pacific. ASEAN has evolved as a body that has largely tried to improve economic cooperation among its members. It was founded in 1967, but only after 1975 did it pursue greater economic cooperation. In my view, the discussions over security since 1975 provided the impetus. For leaders at the summit meetings in Bali in 1975 and in Kuala Lumpur in 1978, the question of strengthening the cooperative foundations of the region was foremost on their minds. Evidently for them, economic cooperation would lead to greater stability and security.

Following these efforts were dialogues with other regional groups. There were bilateral forums on economic issues first between ASEAN on the one hand and Japan, the United States and then the EEC on the other. These meetings fostered a greater interchange of views and possibly a greater understanding on the need for cooperation on various economic issues. They also led to further discussions with other countries in the Pacific region. Australia and New Zealand as well as Canada have had bilateral talks with ASEAN. These developments were proceeding while the concept of broader economic cooperation in the Pacific was being cultivated from various quarters. The leadership for much of this emanated from several sectors in the region. Most important, however, were informal suggestions from Japan and the United States that strengthened the various mechanisms as well as the various meetings on this concept of Pacific cooperation.

One important question arises as this concept further evolves. It relates to a system of preferential arrangements. For officials in the United States, Japan and so on, the general framework of thinking is global on economic issues. Nevertheless one of the issues raised in ASEAN talks with the United States and Japan is how far some preferential system or at least a greater access to the markets of those countries can be achieved. And when the United States made some references to a Caribbean initiative and to an initiative on agricultural trade with Israel, some of the ASEAN countries became a little more excited about Pacific cooperation. For them, the mere possibility of preferential arrangements would serve their interests and help speed regional movement.

Now how does this relate to interested parties in Europe who are listening and assessing how any movement toward greater cooperation in the Pacific might affect them. Within the Pacific region, there is still very little that can be called a regional grouping. In fact, with the exception of ASEAN, cooperation within the Pacific region is fairly rudimentary. So any attempt to strengthen Pacific cooperation, whether it is in the form of investment, technology, or aid, would probably deepen inter-dependence among the countries there. In my view, greater inter-dependence and its possible spinoff, greater regional development, would not adversely affect the countries in Europe. Perhaps greater inter-dependence with Europe would ensue. And the history of international trade shows that as countries become more developed the issues become more complex. Moreover, the countries themselves may share in a division of greater benefits.
I think it’s very clear that Australians generally see themselves as part of the Pacific region, if not of Asia itself. There is an historic claim arising from the interest that we have had in the region and the role that we’ve played in numerous conflicts, including the Second World War, Korea, Malaya, and Vietnam. There is also a demonstrable shift in trade. In the pre-1960 era when Britain joined the Community, approximately 60 percent of Australian trade was with Europe and 20 percent was with the Pacific. Now these figures are almost the reverse with the gap widening in favor of the Pacific. Finally, there is also a cultural link and an awareness which is developing in Australia. Far more young people are now learning such languages as Bahasa, Mandarin, and Japanese; and the emphasis is gone from German, French and the other traditional languages of Australia’s heritage. So in that sense, there is a basic cultural conflict between the origins of the majority of the population and the direction in which our economic well-being and destiny lie.

Speaking as a businessman, I think what is needed in the future is something that brings together in a consultative way the private sector, members of academic and research institutes, and people from government. This should not be anything that is formal, tight and exclusive like the Pacific Area Free Trade Arrangement proposed by Professor Kojima around 1965. A partial step in this direction was the establishment of the Pacific Economic Cooperation Conference (PECC), whose next meeting will be held in Seoul at the end of April 1985. This will bring together these various tiers of interest. That conference will report on initiatives that came out of the previous conference in Bali. So perhaps the pragmatic businessman will see some developments which may be of practical benefit to him. There is likely to be established a Minerals and Energy Forum as well as study groups on agriculture and forestry among other things. The reports of these groups will be put to the conference in Seoul for endorsement, adoption, or rejection. It’s an important conference from the private sector’s point of view. This is because of a growing sense of impatience. Despite our involvement with and support for the Pacific Basin concept, businessmen believe there has to be something tangible and practical to grasp.

With regard to another forum, Australia has been enthusiastic about entering or certainly supporting a new round of multilateral trade negotiations. We have been very unhappy with the outcome of the previous round, feeling that the work program has been tardy and that in some areas it has been nonexistent. We also believe that pressures in a new round should be very much applied to agricultural products and non-tariff barriers. Certainly trade in services and other matters of interest to the United States in particular need to be right up front. And I understand Japan is also very interested in trade in services. So it is in that environment that a) the impatience and b) the issues which are of great importance to Australia, New Zealand, and other agricultural producers in the region should be addressed. From our point of view, a collective discussion of views and interests will yield a better result.

On the question of what might occur in the absence of a round, the answer is “I don’t know.” I’m a little concerned about the possibility of the United States moving off into regional or subregional negotiations. Those fears are personal ones and may be totally unfounded. But again, if it were to be a possibility, it’s all the more important to have regional representation as comprehensive and as cohesive as possible.

William Henderson is Director-General of the Confederation of Australian Industry and a member of the Pacific Economic Cooperation Conference.
Japan's defense policy consists of two main elements. One is to rely on our Self-Defense Forces to deter and to deal with limited and small-scale aggression. The other is to rely on our Security Treaty with the United States for major contingencies and for nuclear deterrence. To some foreign friends, Japan's policy appears to be an anomaly because Japan is the first country in world history to become a global economic power, accounting now for ten percent of world gross national product, but to strictly limit its military power. In my remarks today, I want to explain this apparent anomaly, and also to provide you with some sense of shifting Japanese sentiments on the Security Treaty and on the Self-Defense Forces.

The Japan-U.S. Security Treaty
The year 1984 represented a kind of milestone in the evolution of Japan's defense policy. First of all, it marked the 30th anniversary of the establishment of our postwar Self-Defense Forces. The need for these forces can now be said to be fully, if somewhat reluctantly, established in Japan, a subject I will return to later. Secondly, 1984 witnessed my appointment as the forty-second Director General of the Japan Defense Agency. My appointment received special attention in Japan for two reasons. I am the first director to have been reared and educated entirely under Japan's postwar peace constitution. Secondly, I am a member of what we call in Japan "the Ampo generation," that is the generation which, as students, led the massive demonstrations against the 1960 revision of the Japan-U.S. Security Treaty. The Security Treaty is abbreviated "Ampo" in Japanese.

The demonstrations are a useful reference point for understanding changes and continuities in Japan's postwar defense policy. The struggle over Ampo was a social movement in Japan somewhat comparable to the anti-Vietnam War movement in the United States or the May crisis of 1968 in de Gaulle's France. The youthful idealism of my generation found its expression in the demonstrations against the Security Treaty. Like so many other students, I did not have clear convictions regarding the Security Treaty nor had I carefully thought out Japan's security needs. But I was swept up in the tide of the movement and joined the ranks of the demonstrators.

Now a quarter of a century later, I am a firm supporter of the Security Treaty. My own personal history mirrors that of my generation. In 1960, the Security Treaty was so unpopular that Prime Minister Kishi had to resort to very questionable parliamentary tactics, including the use of police forces to remove opposition party members physically blocking the speaker from leaving his room, which in effect, prevented the voting on the Treaty. The proposed trip of President Eisenhower about the same time had to be cancelled. Mr. Kishi was soon forced to resign. According to the surveys of the time, only a third of the population regarded the Treaty as beneficial to Japan. Today, in contrast, about 70 percent of the Japanese population supports the Security Treaty.

How is it that the same "Ampo" generation which so violently opposed the Security Treaty in 1960 now overwhelmingly supports it? It is not simply a matter of us getting older. Over the past 25 years very important changes occurred in the international environment surrounding Japan. Undoubtedly the most important of these has been the rapprochement between China and the United States. China is geographically and culturally very close to Japan. Particularly among the Ampo generation, China was associated with a socialist utopian paradise, where there were no flies and the streets were always clean. For an older generation, there were guilt feelings toward China. At a time of hostile Sino-American relations, the Japanese people feared that Japan might become involved, through the Security Treaty, in war with another Asian country, especially China. The change in Sino-American relations and China's indications for support for the Japan-U.S. Security Treaty helped dispel these fears and swept away the most potent argument of the opposition parties against the Security Treaty. Moreover, the withdrawal of U.S. forces from Vietnam further reassured us that Japan would not be drawn into an Asian war in which its own national interests were not directly at stake.

To this must be added a growing sense of concern about our national security as the Soviet military buildup in the Asia and Pacific region continued. Japan's basic policy is that we seek friendship with all countries and "have no enemy." We do not regard the Soviet Union as an enemy. But, in view of the Soviet military buildup, we realistically recognize the need for countervailing power to maintain the peace of this region. The Security Treaty helps maintain countervailing power, but Japan also has to make a greater contribution to its own defense. That brings me to the second element of Japan's defense posture—its Self-Defense Forces.

Self-Defense Forces
The anti-Ampo struggle was also associated with opposition to Japan's own Self-Defense Forces. It may seem hard for foreigners to imagine the degree of antipathy that existed toward even self-defense in the early postwar years. The explanation, of course, lies in the wartime experience, including the use of nuclear weapons only on Japanese soil, and in the efforts by the postwar occupation authorities to fundamentally root out militarism not only by dismantling the armed forces and arms industries, but also by changing Japanese thinking. The present Constitution, drafted during the Occupation, renounced war as a means of settling international dis-
putes and the maintenance of ground, sea or air forces for military purposes.

The conviction that “war and militarism are bad” was easily confused with the notion that the existence of a military itself might be bad. In contrast to many other democratic countries where civilian primacy had been long established and where military forces are associated with the protection of democratic institutions and values, in the minds of much of the Japanese public, the existence of the military and preservation of democracy appeared as contradictory notions.

At the time of the establishment of the SDF, uniformed officers suffered public abuse and were overtly called names such as “tax thieves.” According to one well-known intellectual, Self-Defense Academy students were “the shame of Japan.” In order to change its image, the SDF regularly has given an annual full-scale concert by the SDF Band. These concerts used to be one of the few channels between the SDF and the general public.

Today, even though the SDF has many other channels available to the general public, these concerts continue on a regular basis. The high regard for their performance is the result of the determined efforts to gain public support of the SDF.

In the mid 1950s, only a slight majority of the population supported the existence of the SDF, while almost a fifth were opposed. By the mid-1960s, support had climbed to over 80 percent where it remains today. An estimated seven percent of the population is still opposed to the SDF. An important reason for this change in attitude is growing public confidence in the Self-Defense Forces and in the strength of Japan’s constitutional system.

**Japan’s Security Policy Today**

The period since the anti-Ampo struggle has witnessed a remarkable strengthening of support for the twin pillars of Japan’s security policy—the SDF and the Security Treaty. A recent survey showed that about 70 percent of the public favors these two pillars. The development of this consensus, as stated before, reflects growing understanding of our international environment. It also reflects the efforts of the government to win support for its position on security issues. What future changes might be expected?

First of all, it must be understood that increased support for the present security posture of the Japanese government does not imply that there is broad public support for a vastly increased defense effort. The pacifist aspirations of the Japanese people remain very strong. This is reflected in the fact that the Japan Socialist Party, which continues to adhere to a policy of unarmed neutrality, remains the largest opposition party. It is also reflected in our recent Diet deliberations on the defense budget, where the key political issue was whether defense spending should or should not go beyond one percent of gross national product.

Increased public support for Japan’s defense effort has been predicated on the understanding that these efforts will continue within the limits set by the Constitution and by a series of legally non-binding principles that have become firmly established over the years. One limit is that Japan’s posture will be “exclusively defensive” in character. This means that Japan will never engage in defense operations until actually under attack, and that Japan will never send the SDF overseas to engage in actual combat. Japan can never have weapons such as strategic bombers, aircraft carriers, or intercontinental missiles. Another limitation is that we cannot practice conscription. Among the established principles are the three “non-nuclear principles,” banning the production, possession or introduction into Japan of nuclear weapons. Japan’s defense efforts will be conducted within this framework.

Secondly, however, it should be understood that the Japanese government clearly recognizes the need to strengthen its own own self-defense capabilities as a contribution to maintaining peace in this part of the world and sharing defense burdens with its ally and friends. Japan has been expanding its capabilities to meet the goals established by the 1976 National Defense Program Outline. The goals of the program are, in fact, forces of approximately 100,000 men organized into 13 divisions, maritime forces of some 60 surface ships and approximately 220 combat aircraft, and an air force of approximately 450 combat aircraft.

These forces, although not large, will be of the highest quality and be armed with defensive weapons employing sophisticated military technology. Within the present defense spending constraints, Japan has built Self-Defense Forces with high morale and excellent training. To cite some examples where we exceed international standards: the scramble time of our F-4 aircraft is less than four minutes; the target accuracy of our forces at the annual Nike Hawk drills held in the United States is more than 90 percent; and the quality of maintenance of aircraft and vehicles, as demonstrated in joint Japan-U.S. drills, are rated very highly.

As a part of its efforts to strengthen its contribution to free world defense, Japan has engaged in much more intensive defense consultations with its ally, the United States. This includes discussions of roles and missions, joint scenario studies, and an increased number of exercises. In our military procurement we have placed emphasis on interoperability of our forces with those of our ally; we are seeking to increase interoperability in parts, aircraft, guns, missile systems and so forth. This disappoints some European arms manufacturers, but it
serves an important free world purpose.

In the Japan-U.S. discussions on defense issues, I have met many Americans who are interested in the defense of sea-lines of communication; therefore, let me touch briefly on this topic. The subject of defense of the seas is not new in Japanese postwar defense thinking. For a long time, we have defined our policies of preparedness in terms of two possible threats: a threat of invasion of Japanese territory and a threat to Japanese sea transportation. For this reason, Japan already has one of the largest fleets of destroyers in the world. Also, Japan has taken the policy of defense of sea-lines of communication extending about 1,000 nautical miles from Japan to the southwest and southeast. The appropriate capability for effectively carrying out this policy is being considered in the defense buildup plan.

In case of a major obstruction of these sea lines, Japan and the United States will fight together. Japanese Self-Defense Forces will take the lead in defensive operations. Japan, however, can take action to defend its sea-lines of communication only when attacked and it must keep its operations within the scope necessary for defending its country. The Constitution prohibits us from exercising collective self-defense, and therefore, we cannot participate in a NATO-type defense system in which each country takes charge of a certain sea area in which it guarantees the safety of all ships.

Japan, however, is anxious to extend its political consultations with its partners in the free world on security and arms control issues. A few years ago, there was virtually no attention given in Japan to the interdependence of European and East Asian security questions. At the time of the Soviet invasion of Afghanistan, however, the Japanese became suddenly conscious of the need for strong unity among all free countries. The purpose of our political solidarity on such issues is to minimize the possibility of any future miscalculations of this kind by the Soviet Union. Our awareness of the importance of trilateral consultations on issues of war and peace has been reinforced by the discussions of theater nuclear weapons. The free world partners have made it clear that the reduction or limitation of theater nuclear weapons in Europe could not result in their removal to Soviet Asia. All three trilateral regions have a common stake in arms discussions.

CONCLUSION

Japan does not intend to become a global or even a regional military power. We are, however, a country with global interests, and we need to make a greater contribution to the strengthening of the global order. These responsibilities will be exercised primarily in the economic and political spheres. The Japanese people themselves have begun to demand that Japan make a greater contribution to international society. Thus, despite the decrease in general expenditures in the national budget during the past three years, expenditures for national defense and foreign assistance have been increasing at higher rates. In the fiscal year 1985 budget, for example, the share of expenditure for defense increased 6.9 percent, while overseas development assistance (ODA) increased by 10 percent. Obviously, while defense and ODA cannot be substitutes for each other, the relatively larger increase in the ODA budget and the lack of opposition to this increase, in contrast to opposition complaints about a "drastic" increase in the defense budget, show that Japan's international contributions will take place primarily in the economic arena.

To some of our friends, it may seem that Japan is unduly tardy in recognizing its defense interests. In contrast to the Japan of a quarter of a century ago, however, today's Japan has a defense posture that has gained broad public acceptance. Before the Afghanistan invasion, it was considered evil to discuss military cooperation, even with our ally. Joint contingency planning or interoperability of weapons systems were taboo subjects in the Diet. Because today Japan is not polarized on security issues, Japan can be a much stronger ally and partner in the free world. Of course, we have a continuing job in increasing our public awareness on issues relating to defense, deterrents, and peace. But a basis of trust between the Japanese people and its Self-Defense Forces is being slowly and successfully built. A parallel task is to strengthen consultations and understanding with free world partners. Successful achievement of these two tasks is indispensable if Japan is to continue in the future to develop a security posture responding to international needs and to the dictates of its peace Constitution.

Koichi Kato was appointed Minister of State for Defense by Prime Minister Nakasone in December 1984. He has also served as Deputy Chief Cabinet Secretary in 1978-80; as Chairman of the Liberal-Democratic Party Policy Affairs Research Council's Agriculture and Forestry Committee in 1981-83; and as Director-General of the LDP's General Affairs Bureau in 1983-84.
For China, economic interaction and technical exchanges with Japan, the United States, and the European Community countries will continue to be very important. Indeed, the majority of these activities will occur with these three regions of the world. However, the extent to which they participate in the economic operation of the country will hinge on the degree to which they are willing to compete. In 1984, the total volume of China's imports and exports was $30 billion, a 22.7 percent increase over 1983. Of that 1984 total, Japan accounted for 26 percent, Western Europe accounted for 13 percent, and the United States accounted for 12 percent. Future percentages and the overall shape of China-trilateral economic relations, again, will depend on this element of competition.

At the same time, we believe that foreign trade as well as economic growth should stay on a stable path. It is thus our wish that Japanese, North American and European involvement in our economic efforts be for the long-run and as part of a larger framework with a long-term perspective. This is vitally important; for China is now in a transition period, moving from her old economic system to a newly reformed one. Her technical and competitive skills will have to be strengthened over the next several years. During that time, we will not see any significant increase in our exports. In contrast, domestic demand for such items as technology, equipment and raw materials will rapidly increase. With imports thus growing at a faster rate than exports, we will need credit from abroad and foreign currency from non-trade activities. With regard to the latter, China is trying to obtain foreign currency in a variety of ways. From the perspective of legislation, control and management, and our management system, we have come to favor the so-called joint venture contract. It differs from equity joint ventures. The joint venture contract is flexible and benefits both parties. But it has its limits and is not appropriate for long-term, large-scale business activities.

Finally, as our economic reforms and opening measures proceed, economic and technical exchanges between China and the trilateral countries will become more complex, assuming many different shapes in the future. We will naturally encounter new difficulties including problems related to personnel and the like. Nevertheless I remain very optimistic about the promise of economic interchange between China and the trilateral regions of the world.

SURPLUS AGRICULTURAL POPULATION
In the year 2000, China's population is expected to exceed 1.2 billion. By then, the agricultural population of China should decrease by 30 percent and should shift to other areas. As a matter of policy, we would like to construct small- and medium-size cities where we will gradually channel the remaining surplus. In the coastal areas and in other regions, we have already started construction of such smaller cities.

Another element of this policy relates to the tertiary sector of our economy. It is very weak and has the great potential to absorb our surplus population. Although these people will leave the agricultural sector, they will remain in the same geographic area engaged in the tertiary industry of that locale.

The population will also shift for another reason. As our industries develop, the population will follow. The movement is now from east to west, with the former being our coastal areas and the latter being our inland areas. Industries are moving in this direction. So the west is gaining the population previously concentrated along the coast.

INFRASTRUCTURE
Development of land transportation is most urgent. We have a vast land area but our railway system is smaller than India's and our river transportation is not very well developed either. To attain our economic objectives by the end of the century, China will give highest priority to domestic transportation. In the seventh five-year program (1986-1990), investment emphasis is placed most strongly on both the railway and road systems. Thus, progress here will occur more quickly than in any other area targeted for development.

FOREIGN INVESTMENT
For quite some time, China had a closed policy on external economic relations. So we lack experience in joint venture operations with foreign companies. In the past five years, we have tried to overcome this. Using foreign capital, we have tried to step up our business activities. At the same time, we adopted more legislation to protect foreign investment than Hong Kong and Singapore. Nevertheless, I must admit that in certain areas the legislation is still insufficient. So we are successively announcing various rules on double taxation, patent rights and the like. Our basic principle is to recognize the legal rights of foreign companies working with us and our objective is to protect such rights. We are starting to see many problems before us and will be using our new experiences to try to gradually perfect the system we have. Still, in my view, our system compares favorably with those of Hong Kong and Singapore.

Sun Shangqing is Deputy Secretary-General of the Chinese Academy of Social Sciences, and Standing Secretary of the Technical-Economic Research Center under the State Council of China. Mr. Sun is also the author of several books including one published in Japan, A New Road for China's Economics.
Task Force Reports
The growing significance of the East Asian region requires a fresh examination of the questions that the Trilateral Commission countries face today: How does the security of East Asia affect trilateral interests, individually and collectively, and how should the trilateral countries respond to such threats, individually and collectively? What factors are promoting or damaging trilateral security interests? What differences among trilateral policies toward the region are adversely affecting their interests and thus need to be resolved through closer consultation and coordination? There exists a large literature on the interests and roles of the United States and Japan in East Asia, but there are few references to Canadian and Western European interests and involvements, and even fewer discussions of the link between East Asia's security and the common interests of the trilateral countries. Hence this report...

A. STRATEGIC AND INTERMEDIATE-RANGE NUCLEAR FORCES
Among the trilateral countries, the United States should bear primary responsibility, after consultation with the other key trilateral partners, in maintaining the global strategic and INF balance and in negotiating nuclear arms control terms with the Soviet Union. Since the deployment of nuclear forces by both the United States and the Soviet Union in East Asia is coupled with the security of the European countries and Canada, Europeans and Canadians should also regard this regional balance as important to their security. Japan, being in the region, naturally has to take a greater interest in the nuclear balance, particularly the Soviet SS-20 missiles, in East Asia. The important function of Europe, Canada, and Japan, then is to show united support of the U.S. position vis-a-vis the Soviet Union, once consultation has taken place, lest the Soviet Union plays off its two fronts against each other. Moscow has a record of trying to divide the United States and its allies, thereby undermining Washington's negotiating positions.

B. CONVENTIONAL BALANCE
The United States should continue to play a vital role in maintaining the conventional arms balance with the Soviet Union by maintaining its bases in Japan, South Korea, the Philippines, and Australia, and by modernizing its forces to match those of the USSR. Canada and Western Europe are not expected to play a direct military role in East Asia, but Britain's participation in the Manila Pact and the Five-Power Defense Arrangement as well as its military presence in Hong Kong (until 1997) should be noted and continued. West European training of East Asian officers has been valuable and ought to be continued. Japan, for its part, should accelerate its arms modernization program and strengthen its self-defense capability, thus giving additional substance to Japan-U.S. security cooperation, which is the core for Asia-Pacific security. Canada's traditional international peace-keeping role should continue to be encouraged.

An appropriate level of Sino-American military cooperation will be beneficial for East Asian and trilateral security. But Washington should be cautious in promoting military cooperation with Beijing for this has already made the ASEAN nations and Japan apprehensive. Japan and some European nations feel uneasy because too close military cooperation between the United States and China could provoke the Soviet Union.

C. CHINA
China needs special attention from the trilateral governments. The trilateral nations agree on its strategic importance to global security and trade, but disagree as to how strong a China should be. Perhaps even more essentially, they should first agree on whether or not they should treat China as a member of their extended partnership. China itself is ambivalent on this. While pessimistic, skeptical, and optimistic views coexist regarding China's future ability to govern itself, the trilateral countries and other countries as well should assist China's stable political and economic development.

At the same time the trilateral nations should find some way to avoid unnecessary mutual competition in providing for China certain critical technologies such as computers and nuclear energy development. Japan should avoid giving its European and North American partners the impression that "a Japanese-Chinese coprosperity sphere" may be on the rise.

D. KOREA
The Korean issue is likewise very much connected with the strategic environment of the region and with trilateral security. The past division of trilateral roles appears sound: namely, the military role is played primarily by Washington, and the political roles are played primarily by Washington and Tokyo, while other trilateral countries play an economic role. However, as North Korea appears to be seeking foreign investment, the trilateral nations, particularly the European nations, must not neglect the political and security implications of new economic relationships they may develop with the North. They should refrain from increasing political and economic contacts with Pyongyang to the extent that Seoul feels threatened. The United States should consult with other trilateral governments, Japan in particular, on any future significant changes in its
military and political policies toward the peninsula. Japan's role in retaining low-level non-political contacts with North Korea should be continued, for its possible moderating influence on the external behavior of the latter, which seeks Japanese goods and capital. The trilateral countries should encourage the North-South dialogue to become more meaningful and should work to create an international climate favorable for holding the Seoul Olympics in 1988, by ensuring the Soviet participation, for instance.

F. INDOCHINA

Indochina seems to require even closer trilateral attention, for there are no common policies except on refugees. On the Kampuchean issue the postures of the trilateral countries are in near disarray. Trilateral governments have given support to the ASEAN position calling for a phased Vietnamese troop withdrawal and a neutralist government in Phnom Penh. But they have different policies on the recognition of Democratic Kampuchea and different political stances toward Hanoi.

The trilateral countries should handle their political and economic contacts with Vietnam with care, so as not to undermine ASEAN's, especially Thailand's position vis-a-vis Hanoi. Because of historical ties, France may be able to play a useful political role here. Although Indochina is a strategically important region and is seen clearly as an area of East-West competition, the United States is reluctant to play a direct military and political role there. The Kampuchean problem and the growing Soviet presence in the peninsula and the South China Sea require a more active U.S. diplomatic role in defending the ASEAN's position on Kampuchea, supporting Kampuchean resistance, and restraining Vietnamese and Soviet military moves in Southeast Asia. Excessive American involvement in Vietnam, as in the 1960s, worked against Washington's interests and invited criticisms from U.S. allies, whereas too little involvement, as at present, simply gives freedom of action to the Vietnamese military in Indochina and the Soviet military in the region.

G. REGIONAL ARMS CONTROL

East Asia, being different from Europe in terms of geography and power alignments, calls for a different set of arms control measures. As a dominant military power in the region, the United States should play a decisive role in this field, too. Japan has hitherto neglected its role, but it should make efforts to study and propose those arms control measures workable in East Asia. If Japan, together with other trilateral countries, could also persuade China to accede to the Nuclear Non-Proliferation Treaty, it would certainly contribute to alleviating apprehensions about the future transfer of nuclear energy capabilities.

H. "THE PACIFIC BASIN COMMUNITY"

The trilateral countries should share the view that prosperous Pacific economic growth can be beneficial to all of them if properly managed. The United States, Japan, and Canada should make greater efforts to keep the emerging new community open in terms of membership. They should avoid building a formal institutional framework for the Pacific. Fifteen to twenty potential member nations of widely different characters would make only an ineffective institution.
The membership question also inevitably involves complicated issues of Taiwan, North and South Korea, and so forth. The United States, Japan, and Canada should encourage their European partners to be more actively involved in the Pacific economy.

In the meantime, a major issue today is the upsurge of trade problems between Japan and its trilateral partners, especially the United States, and between Japan and many East Asian countries such as South Korea, the Philippines, and Thailand. Japan and the United States bear the primary responsibility for reducing their mutual trade imbalance, by readjusting dollar-yen exchange rates and industrial structures and by reducing trade barriers. The Pacific powers, particularly Japan, should make strenuous efforts in adjusting industrial structures to buy goods from the NICs and ASEAN nations. European roles continue to be important in promoting their exports.

I. MECHANISMS FOR TRILATERAL COORDINATION

No trilateral consultation or coordination is possible without appropriate machinery. Nor will communication necessarily flow smoothly unless channels of communication are established in advance, for critical events may require quick responses. Issues of East Asian security are too complex and multidimensional to be handled by any single mechanism. Given the fact that there exist already quite a few mechanisms for communication and that any consultation involves more time from already pressed high-ranking leaders, attempts should be made to make use of and improve the existing arrangements rather than to create new ones.

Some of the more useful mechanisms may be cited here. The annual Seven-Nation Summit could discuss the issues of strategic force balance as they relate to East Asia as well as China and the future of the Pacific basin. The ASEAN annual foreign ministers conference, to which are invited counterparts from the United States, Canada, Japan, and the EC (President of the Council of Ministers) as well as Australia and New Zealand, has discussed refugees, Kampuchea, the Soviet presence in Southeast Asia, and Pacific basin cooperation, although the last without European participation. This meeting does not always have a sufficiently strong European input. But there are ASEAN-EC ministerial meetings as well, which might be strengthened.

Many trilateral nations participate in economic aid and debt payment programs through the OFCD, the World Bank and the International Monetary Fund (IMF), the Asian Development Bank, and the U.N. specialized agencies such as the Economic and Social Commission for Asia and the Pacific. Their interests are also expressed through bilateral contacts with the governments of East Asia and international consortia such as those for the Philippines and Indonesia. These economic aid organizations and mechanisms are presumably sufficient to meet the needs of the region. Perhaps some of them should even be dissolved to eliminate interorganizational redundancy, rivalry, and resultant inefficiency.

Where China is concerned, the Coordinating Committee for Export Control (COCOM), which is composed of Japan and all NATO nations except Iceland and Spain, could improve the process for giving permits for selling "strategic export items" to China. U.S. and Japanese specialists on China periodically meet to compare notes; this might be extended to include other countries as well. With regard to Korea, the ambassadors of trilateral governments in Seoul could informally consult occasionally on developments in the peninsula so that they have better understanding of them.

For the foreseeable future, East Asia will be a vital region of the world, which no major nation can ignore. Both optimistic and pessimistic pictures of the future of the region are possible. What will be the future course of China, the most populous nation on the earth? How will the Soviet Union under Gorbachev behave toward this economically attractive region? What kind of economic and technological impact will Japan have on the region? Will Japan continue to remain a militarily small power? Will the United States be able to balance its concerns for the Atlantic and Pacific? How much will Canada be involved there, and will West Europe succeed in restoring an appropriate involvement and influence in the region? The region presents a challenge for all those desiring democratic values.
Agricultural Policy and Trade
D. Gale Johnson
Kenzo Hemmi
Pierre Lardinois

This report is concerned with adjusting the agricultural policies of the trilateral countries. From an international perspective, these policies leave much to be desired. While our countries have substantially liberalized trade in industrial products over the past four decades, little progress has been made in reducing the barriers to trade in farm products. In all too many cases, particular farm programs—in the European Community, the United States, Canada and Japan—have been devised with little or no concern about their effects upon producers in other countries. Even though GATT rules provide significant exceptions for such products within general prohibitions against quantitative restrictions and export subsidies, most countries have made little or no effort to modify their domestic farm programs to make them consistent with GATT. Agricultural trade issues have been important sources of tension in recent years among trilateral countries—and with other OECD countries (notably Australia and New Zealand) and developing countries as well.

Part of the impetus for our report is provided by the prospect of a new round of multilateral negotiations about agriculture under GATT auspices. The new GATT Round provides an opportunity for progress—and in our final chapter we shall sketch a constructive course for the negotiations. The very essence of new GATT negotiations is to be found in defining the extent to which the pursuit of domestic agricultural policies should be permitted to affect trade by restricting or displacing imports or increasing exports.

It is politically naïve to imagine—as earlier GATT Rounds indicate, for instance—that international undesirability in itself could bring about major agricultural policy changes. These policies have deep internal roots. A more reasonable hope is that as domestic policy regimes are adjusted, these adjustments will move in a direction that makes more international sense. What makes the current moment a relatively propitious one for our report—and provides impetus for our work—is that internal pressures are forcing more serious consideration of agricultural policy adjustments, adjustments which may move in a more market-oriented direction that makes more international sense as well. The most obvious and immediate source of pressure—in all three of our regions—is high government costs of existing arrangements in a tight budget climate.

The policies which concern us here—and are of most concern internationally—are those directly affecting the prices and output of farm products. Chapter I of the report sketches such policies in the United States, Canada, the European Community and Japan. Some of the important differences in the structure of farming in different trilateral regions will be noted, especially since these differences appear to have affected the nature of farm price and income support policies.

The aims of agricultural policies in the three regions are similar. They aim at stabilization of markets, income support, orientation of production and the modernization of farming. Differences among agricultural policies in the three regions are differences of degree rather than of kind. Moreover, domestic agricultural and food policies have always been dominated by national interests and views about the world market. As such they are not very susceptible to negotiation or coordination on a medium term basis. Consequently a more market-oriented stance on international trade has regularly yielded to these imperatives. By their very nature and complexity, agricultural policies with neutral effects on international trade today are non-existent; and there seems to be no accepted standard in the international community to balance the difference in (political) appreciation between “acceptable stabilization of markets” and “unacceptable (income) support.” Myths and realities on this issue result in the recurring “diplomacy of the megaphone” or shouting matches across the Atlantic and the Pacific, because the stakes for government and the farming community are high. The minimum requirement to orient domestic agricultural policies is therefore a trilateral view on the development of a domestic production and international markets.

Price supports and liberal trade are not in conflict when support levels are set below the trend of international market prices and are adjustable as markets change. Such supports provide a measure of stability—protecting producers against extraordinary temporary price drops—while minimizing market distortion. But price supports are of course often set above international market levels, which then leads to interventions at the border to insulate the internal market—whether through the variable levy typical of the European Community, import quotas used by the United States and Canada, a state-trading agency like that used by Japan for a number of commodities, or some other technique. High price supports have also led governments into the additional problem of dealing with excess supplies. This has happened in all trilateral countries. In the European Community and Japan—traditional large importers among trilateral countries—production of some major commodities, encouraged by high price supports, has grown over time beyond internal consumption. The United States has likewise had high price supports that have generated surpluses of grains and dairy products. One alternative, used at times by all, has been to dispose of excess supplies internationally at subsidized prices. Another alternative is to directly limit internal production—whether through incentives to farmers to take land out of production or, more typically, some form of production
quotas, which can lead to remarkable economic distortions. Another alternative, of course, is to induce supply reductions with lower price supports.

Lower budgetary costs do not necessarily mean greater market orientation. Deficiency payment systems, for instance, are probably more market-oriented than price supports in the marketplace at the same target price level; but deficiency payments require much larger budgetary outlays. Price supports shift the costs from taxpayers to consumers.

Chapter II of the report examines the relevant provisions of GATT. It draws together available work on the trade effects of the programs laid out in Chapter I, including effects on developing countries. The OECD is now engaged in a remarkably comprehensive assessment along these lines, but that work was not available in time for use in this report—we hope it will be available for the new GATT Round. Chapter II (and Section E of the Appendix) includes an examination of effects of agricultural policies on the level and stability of international prices—which we do by presenting some of the existing research on what would happen to the level and stability of international prices if there were reduction in protection. Current policies tend to increase the instability of international prices. Greater international price variations are a necessary corollary of policies which eliminate internal price variations through varying imports in line with fluctuations in domestic production. As for the level of prices, some international markets are so distorted—such as sugar and dairy products—that it is virtually impossible to gauge the price effects of market-oriented domestic policies; but in both of these cases international price levels would probably rise considerably. In other major markets where analysis is more feasible, market-oriented policies would not have marked effects. Except for rice, the general effect would be to increase prices somewhat.

Part of the analytical argument of our report is that if the trilateral countries acted in unison to reduce their market interventions, the presumed adverse effects of liberalization would be significantly reduced. International prices would become more stable, at roughly the same or higher levels for most major commodities.

There would of course be costs in moving to more market-oriented agricultural policies. Chapter III notes three kinds of transition costs: short run losses in farm income, the loss in value of assets and the costs of adjustment to alternative employment for those farmers who must leave agriculture as protection is removed or substantially reduced. These costs are real and if there is to be any realistic chance of liberalization, these costs must be recognized and compensatory measures taken. While there would be short run income losses in the move to more market-oriented policies, we believe that the long run effect of the removal of trade interventions and other protective measures upon the return to labor and capital employed in agriculture would be negligible provided that there are opportunities for farm workers to find attractive non-farm employment. This is true because the protective measures are ineffective in increasing over time the returns to any resource engaged in agriculture, other than farm land. There is ample evidence that income transfers in the United States quickly become capitalized into the value of assets in inelastic supply (e.g., land), enriching their first generation recipients but leaving their successors with higher entry barriers and a dangerously burdensome cost structure—and increasing the cost of adjustment to more market-oriented policies.

As we shall emphasize with both vigor and conviction, the prospects for changing the current domestic agricultural programs to market-oriented policies will be greatly enhanced if the macroeconomic policies in the United States quickly become capitalized into the value of assets in inelastic supply (e.g., land), enriching their first generation recipients but leaving their successors with higher entry barriers and a dangerously burdensome cost structure—and increasing the cost of adjustment to more market-oriented policies unless there are non-farm job opportunities of an attractive nature available.

It must also be recognized that there are substantial differences among geographic regions in the ease with which adjustments can be made. For example, in the farm communities in northern Europe the differences between the country and the city have diminished. In the past when conditions of reasonably full employment prevailed, farm people could more easily adjust to changing economic conditions affecting agriculture, including policy changes. But in southern Europe the differences between country and city remain quite large and farm people find it more costly and difficult to adjust to changing conditions. It is necessary to recognize that such differences do exist and that it is desirable to undertake special measures to promote adjustments.

The average income of farm families in each of our regions has risen significantly during the postwar era as a percentage of average family income in the overall economy. The improvement in income, however, has come in part from the increase in income from non-farm sources—such income now constitutes more than half of the income of farm families in our countries. This is an indication of the integration of farm people over time into the general economy as a consequence of improved education, transportation, and communication. One result of increased integration and non-farm employment possibilities has been the increase in part-time farms as a percentage of all farms, and for these farms
the effects of farm price policies on their incomes is much less than for full-time farms. The basic analytical point here is a simple one, but not generally understood: The average incomes of all farm families are determined more by the levels of income in the economy generally than by the level of farm prices or by changes in farm prices over an extended period of time.

The level of farm prices does determine to some degree how many people will be engaged in agriculture, which leads us to another basic analytical point reflected in the postwar economic history of all of our countries: The process of economic growth everywhere requires that the absolute level of employment in agriculture decline over time. Farm employment must decline given the combination of low income elasticity of demand for farm products (i.e., demand increases more slowly than income in our countries) with productivity change at least as rapid as in the rest of the economy. In fact, increases in labor productivity in agriculture have generally been greater than in industrial employment. No country has been able to avoid the decline in farm employment, and attempts to do so become quite costly to taxpayers or consumers. We recognize the presence in each of our societies of disadvantaged, often older rural persons with a claim on society for assistance, but this assistance is better provided—at less cost to the overall community—through targeted programs rather than through high agricultural price supports that generally benefit other producers more.

Whatever its analytical merits, we recognize that general liberalization is not politically feasible in the near future. But progress can and should be made toward more market-oriented policies, toward lower levels of protection. In our final chapter—Chapter IV—we set out high priority adjustments for the United States, Canada, the European Community and Japan. While we are aware of the immediate policy debates in each of our regions, we have not let ourselves be completely bound by immediate political constraints. It is our purpose to look a little further down the road at those high priority adjustments which can and should be made over the medium term.

It is quite clear what is required if domestic farm policy regimes are to contribute to an improved international situation for all producers and consumers. We recommend that domestic programs should be made more market-oriented; that the trilateral countries should move together in achieving more market-oriented policies for agriculture; that it should be recognized that it is not possible to move to more market-oriented policies all at once; and that during the transition period there should be no additional trade barriers introduced nor should existing barriers be unilaterally broadened.

New GATT Round negotiations on agriculture provide an important framework for multilateral progress over the next several years, and in Chapter IV we also try to set out a constructive path for these negotiations. We have not approached this effort in the spirit of negotiators for our individual countries or regions. The spirit here, as throughout this report, has been that of a joint effort to help us all move forward. We all stand to gain from more market-oriented agricultural policies that make more international sense.

Masashi Nishihara is Professor of International Relations at the National Defense Academy. Professor Nishihara has served for Kyoto University's Center for Southeast Asian Studies in Jakarta and was a Visiting Research Fellow at the Rockefeller Foundation from 1981 to 1982. His publications include "Promoting Partnership: Japan and Europe" and "Expanding Japan's Credible Defense Role."

D. Gale Johnson is Eliakim Hastings Distinguished Service Professor of Economics at the University of Chicago. He has served as consultant to the U.S. Agency for International Development and as agricultural advisor to the Office of the President’s Special Representative for Trade Negotiations. Professor Johnson’s publications include World Agriculture in Disarray, World Food Problems and Prospects, and Progress of Economic Reform in the People’s Republic of China.

Pierre Lardinois is Chairman of the Executive Board of Rabobank Nederland in Utrecht. Educated at the University of Agriculture at Wageningen, Mr. Lardinois has spent most of his career in public service. Prior positions include Minister for Agriculture and Fisheries of the Netherlands, Member of the Commission of the European Communities with special responsibility for agriculture, and member of the European Parliament.

Kenzo Hemmi is Professor at the Asia University and former Dean of the Faculty of Agriculture at Tokyo University. Professor Hemmi has served on the research staff at the National Research Institute of Agricultural Economics and as consultant to the United Nations. His publications include Primary Commodity Problems and Agriculture in Contemporary Economy.

The full-length editions of both task force reports are available from the Trilateral Commission offices in Paris, New York and Tokyo.
On April 23, at the conclusion of the Tokyo plenary meeting, Takeshi Watanabe announced his plans to relinquish the Japanese Chairmanship of the Trilateral Commission, which he had held since the beginning of the Commission in 1973. Mr. Watanabe has become President of the Japan Credit-Rating Agency, an agency recently created in the context of Japan's financial liberalization. Mr. Watanabe spent many years in Japan's Finance Ministry before becoming the first President of the Asian Development Bank and then the first Japanese Chairman of the Trilateral Commission. Noting Mr. Watanabe's 12 years of leadership, David Rockefeller said: "We look back with nothing but gratitude for the truly remarkable job he has done."

On July 5, Isamu Yamashita was named new Japanese Chairman by Japanese Executive Committee members. A former senior official at the Ministry of International Trade and Industry, and until mid-1985 Chairman of the Mitsui Engineering and Shipbuilding Company, Mr. Yamashita brings to his new leadership role a unique blend of public service expertise and private sector experience. Mr. Yamashita was one of the fifteen members of the United States-Japan Advisory Commission which reported to Prime Minister Nakasone and President Reagan last fall. He is Vice Chairman of the Japan Federation of Economic Organizations (Keidanren) and Chairman of the Expert Committee on Science and Technology.