

THE EDWIN O. REISCHAUER CENTER  
FOR EAST ASIAN STUDIES



# THE UNITED STATES AND JAPAN IN GLOBAL CONTEXT: 2013

THE PAUL H. NITZE SCHOOL OF ADVANCED INTERNATIONAL STUDIES  
THE JOHNS HOPKINS UNIVERSITY  
Washington, D.C.

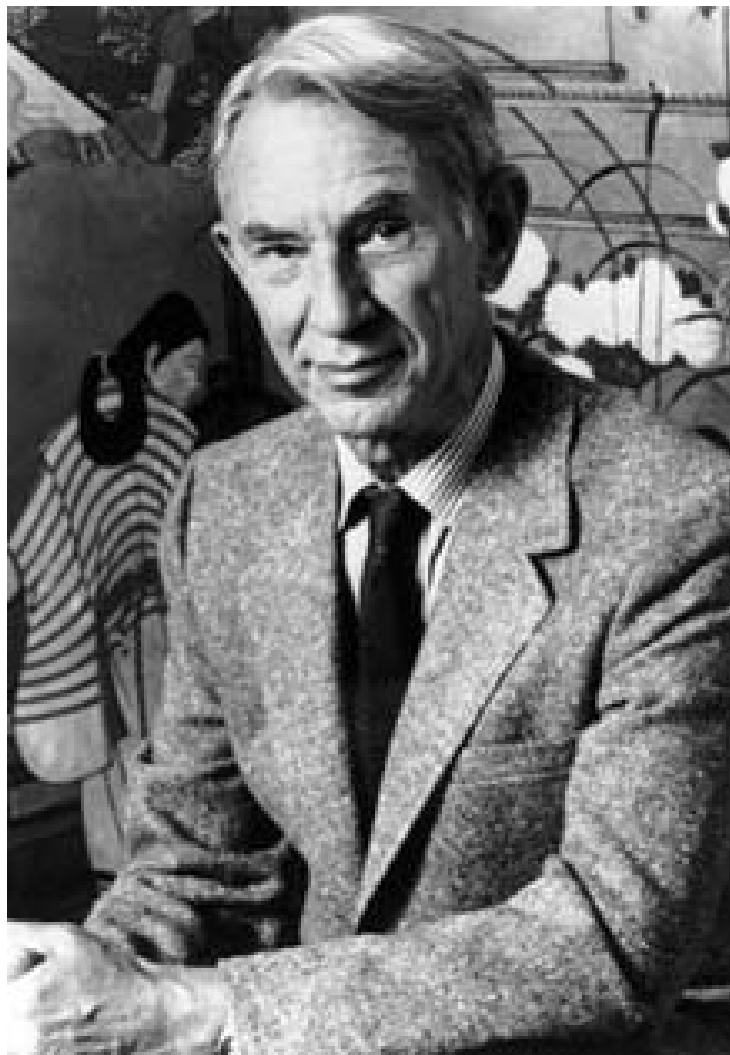


THE EDWIN O. REISCHAUER CENTER  
FOR EAST ASIAN STUDIES

THE UNITED STATES AND JAPAN  
IN GLOBAL CONTEXT: 2013

THE PAUL H. NITZE SCHOOL OF ADVANCED INTERNATIONAL STUDIES  
THE JOHNS HOPKINS UNIVERSITY  
Washington, D.C.





**Edwin O. Reischauer**

(Oct. 15, 1910 – Sept. 1, 1990)





**Yearbook Class of 2013**

**Sean Cate, Yuki Onogi, Curtis Yibing Che, David Wells, James Bisbee, Tina Zhe Liu, Professor William Brooks, Yaowaluk Suthimanus, Haitham Jendoubi, and Yun Han**

## TABLE OF CONTENTS

Introduction.....	2
<i>William L. Brooks</i>	
Brash Idealism and the Futenma Issue: Democratic Participation and New Security Perspectives in Japan .....	26
<i>James Bisbee</i>	
The Impact of Japan's Territorial Dispute with China on the U.S.' Rebalancing toward Asia.....	55
<i>Yun Han</i>	
Japan's Economic Partner of Choice: The United States or China?.....	74
<i>Sean Cate</i>	
Implications of Abenomics for the U.S.-Japan Relationship.....	98
<i>Haitham Jendoubi</i>	
Abe's Risky Decision to Join U.S.-led TPP Negotiations .....	116
<i>Yaowaluk Suthimanus</i>	
U.S.-Japan Nuclear Cooperation in the Wake of the Fukushima Accident .....	132
<i>David Wells</i>	
Japan's Post-Fukushima Quest for Stable LNG Supply: America or Russia?.....	153
<i>Yuki Onogi</i>	
Crisis in U.S.-Japan Educational Exchanges .....	173
<i>Zhe Liu</i>	
Waning Cultural Influence of Japan on the U.S.: Case Study of Video Games .....	193
<i>Curtis Yibing Che</i>	
Class Research Trip to Tokyo, March 2013: Photo Album .....	213
The Reischauer Center in 2012-2013: Expanding Global Horizons.....	216
<i>Kent E. Calder</i>	
Reischauer Center 2012-2013 Events .....	220



## Introduction

By William L. Brooks

If 2011 was a national crisis for Japan due the devastating triple disaster of an earthquake, tsunami, and nuclear accident in northern Honshu, 2012 was a major political game-changer, with the crushing defeat of the Democratic Party of Japan (DPJ) after only three years in power by the Liberal Democratic Party (LDP), the former ruling party that once had been seen as permanently relegated to the Diet sidelines. What happened during that fateful year? And what has happened so far in 2013 since the LDP returned under Prime Minister Shinzo Abe?

This issue of the yearbook, *U.S.-Japan Relations in Global Context*, in answering those questions, probes into some of the basic issues that have shaped Japan's domestic and international policy agenda during 2012 and 2013, as displayed in the nine expertly-researched and professionally-written papers by the SAIS students in the course with the same name.

For over a quarter of a century, SAIS has published a yearbook on U.S.-Japan relations as they play out in an international setting or, conversely, how domestic issues in Japan impact on its relationship with the United States, as well as other countries and regions. This year's themes have a strong bilateral flavor and cover such fascinating subjects as how the seemingly insolvable Okinawa basing issue is affecting Japanese perceptions of the Alliance and the presence of foreign troops on Japanese soil, and how Japan's escalating territorial row with China may be complicating America's rebalancing of its foreign and security policy toward Asia.

Other papers evaluate Japan's economic relationships with China and the U.S., Prime Minister Abe's economic policies and his decision to join the U.S.-led Trans-Pacific Partnership (TPP), as they affect U.S. interests. Energy is twice on the agenda: first, in a paper on Japan's nuclear energy cooperation with the U.S. after the nuclear accident in 2011; and second, in another paper on energy-pinched Japan's scramble to line up long-term LNG supplies from Russia and the U.S.

The last two papers in the yearbook delve deeply into a perplexing trend of dwindling interest in each other's culture by young Japanese and Americans, as seen in the alarming decline in educational exchanges between Japan and the U.S., and the waning of Japanese pop-cultural influence in the U.S.

### **Decline and Fall of the Democratic Party of Japan (DPJ)**

Prime Minister Yoshihiko Noda, who replaced Naoto Kan in September 2011, inherited a party that was already starting to collapse internally from two years of squabbling and ineffective leadership. By January 2012, due to defectors, the number of DPJ Lower House members had dropped to 291, twenty less than when the party took over in September 2009. Even with coalition partners, it was no longer possible to assemble a two-third majority vote in the Lower House to override bills turned back in the opposition-controlled Upper House. Passing legislation required cooperation from the opposition parties. But the former ruling party, the LDP, had become more interested in toppling the DPJ from power by forcing a snap election than in

agreeing to compromises on key bills. In the end, Noda made a deal with the LDP but in it was a poison pill that ultimately destroyed his administration and his party.

In March 2012, only six months after Prime Minister Noda took office, his administration was in serious trouble. Although Noda was able to make progress with some issues left over from his two predecessors, Yukio Hatoyama and Naoto Kan, his cabinet's support rate began to plummet. The chief reason was his unbending commitment to raise the consumption tax rate, for which the government was readying a package of relevant legislative measures for presentation to the Diet that month.

Noda, after taking over from Kan in September 2011, found himself on the defensive in steering his government. He inherited a negative legacy from his two DPJ predecessors: Hatoyama, who resigned under a cloud after renegeing on a commitment to Okinawa to relocate a U.S. Marine base, Futenma, to another part of Japan, and Kan, who was blamed for inadequate crisis-management responses to the Great East Japan Earthquake disaster and the accompanying Fukushima nuclear accident.

Prime Minister Noda was so obsessed with passing the consumption tax hike that he neglected some important policy areas and stumbled badly in others. His impetuosity frustrated his party, ultimately splitting it, delighted the opposition camp in the Diet, and decimated his popularity with the electorate. The anti-consumption tax hike force in DPJ also tended to be against Japan joining the TPP -- making the internal divide virtually irresolvable.

Noda's prioritization of domestic issues over his external policy agenda hurt Japan's interests. For example, he bypassed a golden diplomatic opportunity in March 2012 by missing the main discussions at the Nuclear Security Summit. Noda arrived in Seoul on the night of March 26 to attend the Summit. Although Noda planned to urge all participating countries to cooperate for blocking the launching of a long-range missile by North Korea, he was not scheduled to hold talks with the leaders of any major countries, such as the United States, China, and South Korea.

In contrast, President Barack Obama actively conducted "summit diplomacy" to promote nuclear nonproliferation after arriving in Seoul on March 26. Noda only released a statement mainly on the North Korean nuclear issue at a March 27 plenary meeting. But even though he should have planned consultations on the North Korean issue, he never set up talks with the leaders of the U.S., Russia, China, and South Korea. This was but one example of Noda's approach of prioritizing domestic affairs over foreign affairs.

In order to make his presence felt, the prime minister should have arrived in Seoul by noon of March 26, but he even cancelled the dinner party planned for that evening because of intensive deliberations in the House of Councillors Budget Committee. He should have coordinated the Diet schedule to allow him to attend the full Summit. Instead, he let the opposition parties take the lead in order to get their early support for the fiscal 2012 budget and consumption tax hike-related bills. He even moved up by three hours his return to Japan in order to persuade the DPJ in person and obtain its approval in the run-up to the cabinet approval of the consumption tax-hike legislation.

Japan experienced a similar situation when the first Nuclear Security Summit was held in Washington in April 2010. President Obama declined talks with the Japanese leader because of Tokyo's flip-flopping over the relocation of the U.S. Marine Corps' Futenma Air Station. Prime Minister Yukio Hatoyama explained the situation for 10 minutes at the dinner table, but his explanation was largely ignored. Japan was described by a U.S. paper as the "biggest loser among the participating countries." The Summit in 2012 saw a similar diplomatic failure: Noda appearing briefly and largely being ignored by the other leaders.

The Noda cabinet's public support rate, which scored an impressive 65% in a Yomiuri Shimbun poll conducted shortly after its launch, was by March down to 30%. Other polls placed the rate even lower. In part, inept cabinet appointments hurt his administration's image. The consumer affairs minister, Kenji Yamaoka, was allegedly involved in a pyramid financing scheme, and his defense minister, Yasuo Ichikawa, who called himself "an amateur on security," were both censured in the House of Councillors. Ichikawa's successor, Defense Minister Tanaka, who also knew nothing about defense and security affairs, immediately came under heavy fire from the opposition camp for a string of gaffes.

Still, despite his plummeting popularity, Noda early on managed to pass two supplementary budgets with enormous funds earmarked for post-earthquake recovery and reconstruction measures. On the Futenma relocation problem, as well, the Noda administration increased the government's budget related to a package of economic stimulus measures for Okinawa and worked out with the U.S. a new scheme for realigning the U.S. forces in Okinawa to reduce the Marine presence. The Noda government also began to lay the groundwork for obtaining local consent for Futenma relocation, although that effort never bore any fruit. Eventually, in his third cabinet reshuffle, he started to appoint better qualified ministers, especially Satoshi Morimoto, an academic with a solid reputation as a security expert. But by then, his party was in shambles internally.

Noda's initial mistake that led ultimately to his political downfall was to form an alliance with the Liberal Democratic Party (LDP) and the New Komeito Party in order to pass a bill to increase the consumption tax. Some supporters lauded his decisiveness and leadership for seeking a bipartisan solution as the only way that such legislation could pass the opposition-controlled Upper House. But Noda's critics, including many in his own party, saw the DPJ as having abandoned its election pledge to break with LDP-style politics and returning to the LDP's close ties to bureaucrats and vested interests. Ultimately, a group in the DPJ opposed to Noda's apostasy left the party to found their own party under Noda's chief critic, former DPJ Secretary General Ichiro Ozawa.

The poison pill that came with the political deal with LDP was a commitment by Noda to dissolve the Lower House for a snap election once the consumption tax bill was passed. The LDP intended to hold him to that promise and pursued him relentlessly in the Diet.

### **Noda Goes Down in Flames**

Noda finally apparently lost his temper on November 14 during party leaders' debate with LDP President Shinzo Abe. Called a liar for not making good his promise to dissolve the House of Representatives, Noda, visibly angry, shocked his own party by suddenly announcing that he

would indeed do so on November 16 and hold a snap election on December 16. This may have been the first time for a prime minister to mention the date for dissolution during a Diet session broadcast on TV. Noda seemingly was grabbing the initiative away from the LDP, which had been demanding an election based on a deal worked out earlier in the year for the party's support for passage of the consumption tax hike. But his impetuous decision to make the election a referendum on his policies resulted in the breakup of the DPJ, which was crushed by the LDP in the December election. Defections from the party continued, and prior to the dissolution of the Diet, the DPJ already had less than a majority in the Lower House.

That Noda had been moving steadily toward dissolving the Diet before yearend was no surprise. His foiled attempts to include participation in the TPP talks in the DPJ's election campaign platform set off wide speculation that he would dissolve the Diet over that issue alone. Nonetheless, the expectation in his party – and the advice he was receiving – was to avoid holding an early election given the party's declining public support.

Noda seems to have miscalculated. The earlier signals he had sent on Diet dissolution prompted frenzied moves in the DPJ to topple him. Fierce opposition from the DPJ leadership erupted at the meeting of the party's decision-making body, the Standing Officers Council, on November 13. Some party members even openly talked about Noda's resignation. The Council meeting reached a "consensus" on opposing dissolution before yearend.

Noda had judged that the longer dissolution was put off, the more the DPJ's support rating would decline and that it would be better to hold the election before rising third-force political parties complete their preparations. But his party was unprepared for such an early election, too.

### **LDP's Landslide Victory on December 16**

The LDP enormous victory in the Lower House election on December 16, 2012, was more of repudiation by the electorate of the governing DPJ and its failed policies than it was a mandate for the LDP to return to power. The LDP rose from 118 seats before the election to 294, a solid majority. Together with its coalition partner New Komeito's 31 seats, the ruling camp commanded 325 seats out the 480 in the Lower House. The number of votes cast for the DPJ fell by more than half, from 45 per cent of the total vote in 2009 to 20 per cent in the election. The DPJ in 2009 won 308 seats, but before the 2012 election it had dwindled due to mass defections to 230 seats, below a majority. In the election, the DPJ lost heavily, picking up only 57 seats. Its future as a major second party in the Diet suddenly looked bleak indeed.

### **U.S.-Japan Relations at Year's End**

The irony is that Noda's ill-fated decision to dissolve the Lower House on November 14 came just after President Barack Obama's reelection. The Noda administration had intended to use that occasion to affirm the strengthening of the Alliance at an early date. The Prime Minister had sent a congratulatory telegram to Obama shortly after returning from the Asia-Europe Meeting (ASEM) in Laos on November 7. He stressed to reporters that he would like to "continue to cooperate" with the President.

At the same time, Noda wanted to deepen security cooperation on dealing with China, following rapidly deteriorating relations over the Senkaku territorial dispute. The Japanese and U.S.

governments were then planning to start consultations in December toward revising the U.S.-Japan-U.S. Defense Cooperation Guidelines. Last revised in 1997, these guidelines were premised on a contingency on the Korean Peninsula. The revision would review the division of labor between U.S. forces in Japan and the Self-Defense Forces (SDF) to boost the defense of Japan's southwestern region, in light of China's military buildup. The worsening conflict between Japan and China over the Senkakus had made the planned guidelines review timely and important.

The only cloud to "restarting the Japan-U.S. relationship" (as the Noda government called it) was the Okinawa basing problem, specifically, a notable lack of progress in the plan to relocate the Futenma Air Station, strong local opposition to the deployment of the new transport aircraft Osprey, and a series of crimes committed by U.S. soldiers that received high media attention. The Noda government also was unable to finally make a decision on whether Japan would participate in the TPP talks, due to unyielding opposition within the DPJ.

Quick to take advantage of the weakness of the Noda administration, Liberal Democratic Party President Shinzo Abe told reporters on November 7: "The alliance relationship has been in crisis since the Democratic Party of Japan (DPJ) took over the administration. It will be difficult for this administration to build a new relationship with the Obama administration. We would like to take back the reins of government and restore strong ties with the U.S."

### **Noda Gets a Pass on Managing the Alliance**

It would be a mistake, however, to assume that the Noda administration's mismanaged the Alliance. Just the opposite: with the exception of the Okinawa basing issue, the defense and security relationship improved remarkably under Noda's watch.

For example, a joint statement released after the summit talks between Prime Minister Noda and President Obama on April 30, 2012, mentioned "dynamic Japan-U.S. defense cooperation" to strengthen collaboration through warning and surveillance activities and joint training exercises. The purpose of such intensified cooperation was to keep in check China, which was stepping up its maritime activities. The Nansei Islands (also known as the Ryukyu Islands) especially was envisaged for warning and surveillance activities for the protection of maritime interests. The joint statement also mentioned the promotion of joint use of SDF and U.S. military facilities and strengthening collaboration between the U.S. military and the SDF through joint training exercises on the U.S. territory of Tinian.

The dynamic defense capability concept was mentioned for the first time in the National Defense Program Guidelines drawn up in 2010 when Naoto Kan was Prime Minister. Replacing the Basic Defense Force Concept to increase deterrence by evenly deploying SDF troops and facilities throughout the country, the dynamic defense capability concept is mainly designed to boost deterrence by mobilizing troops flexibly for warning and surveillance even in peacetime.

During his term in office, Prime Minister Noda, starting with his summit meetings with President Obama, was able to reaffirm the basic diplomatic and security framework of the U.S.-Japan relationship that during the government of Prime Minister Hatoyama was placed in jeopardy by

such notions as the creation of an East Asian Community without the U.S. or an “equilateral triangular relationship among Japan, the U.S., and China.”

Noda also reengaged Japan in a strategic dialogue with the U.S. over the shifting environment in Asia and the Pacific, notably the maritime interests of a more assertive China and the increasingly hostile stances of a nuclear-ambitious North Korea.

Noda’s appointment of Satoshi Morimoto, an academic with a solid reputation as a foreign and security affairs expert, as defense minister was a signal that the management of Japan’s national interests had returned to the policy agenda established under the LDP. Morimoto served as adviser to both the DPJ and LDP before that. But even Morimoto, with all his expertise, was hit with the escalating crisis over the Senkakus in late 2012, and he could not resolve the knotty issue of the relocation of Futenma Air Station in Okinawa. It remained a pending issue when the DPJ lost the election in December 2012 to the LDP.

### **LDP and Abe Back in Power**

The return to power of the Liberal Democratic Party (LDP) in the December 16 Lower House election after three years of Democratic Party of Japan (DPJ) rule was more a voter repudiation of the DPJ’s failed policies than an endorsement of the LDP’s policy agenda. Prime Minister Shinzo Abe, back for a second time in office, knew that he must regain the still skeptical public’s trust by quick and effective displays of policy energy if his party were to win the next election for the Upper House in July. To do so, he set an ambitious domestic and foreign policy agenda that included repairing relations with China and South Korea, and reclaiming a robust alliance with the U.S.

Repairing ties with China is still a work in progress. Already there has been a clash with China over cabinet visits to Yasukuni Shrine, where Class-A war criminals are enshrined, and with South Korea over the comfort-women (WWII sex slaves servicing the Japanese military) issue.

### **Okinawa Basing Issue**

With the LDP back in power in 2013 and Shinzo Abe back for the second time as Prime Minister – he served initially during 2006-2007 -- the security agenda that the DPJ either could not or would not tackle is being actively promoted. It includes the creation of a Japan-style National Security Council, removing the ban on collective self-defense in order to strengthen alliance cooperation, updating the National Defense Cooperation Guidelines with the U.S. -- a process started under the DPJ – and improving Japan’s intelligence collection and analysis capabilities.

Moreover, Abe is intent on resolving the Okinawa basing issue during his term in office. But as James Bisbee carefully argues in his paper, the plan to relocate Futenma Air Station is just as irresolvable as ever, and the Okinawa basing issue, since Prime Minister Hatoyama’s serious mishandling of it, now may have much broader political ramifications than either Tokyo or Washington may think. First, the long-delayed plan to close Futenma Air Station and relocate its functions elsewhere in the prefecture has already demonstrated a potential to damage U.S.-Japan relations, as it certainly did during the Hatoyama administration. But the inability to resolve this long-festering issue may also be leading to the erosion of the Japanese people’s tolerance for the presence of foreign troops in Japan.

Let us add to Bisbee's argument the Pentagon's decision to deploy Osprey aircraft in 2012 to replace superannuated helicopters at Futenma. The aircraft was deployed over the strong objections of Okinawa and, since Ospreys were sent first to other bases elsewhere, a hostile public reception spread across Japan. The many Japanese who believe the aircraft is unsafe because of accidents in the past and reject U.S. assurances to the contrary are angry that Japan has had to accept a deployment that they say no one wants. The technological prowess of the aircraft means nothing, since for protesters, forced deployments of the Osprey go against Japan's democratic principles.

In an editorial on September 6, 2012, the Okinawan daily *Ryukyu Shimpo* expressed the views of Okinawa against the MV-22 Osprey, but they are applicable to the nation as a whole:

“Okinawa Gov. Hirokazu Nakaima met with Defense Minister Satoshi Morimoto on Sept. 24 and with Chief Cabinet Secretary Osamu Fujimura on Sept. 25. In these meetings Nakaima strongly called for the cancellation of the plan to deploy the U.S. Marine Corps' MV-22 Osprey vertical takeoff and landing aircraft to the Futenma base. However, the government had no intention to change its deployment plan. Reportedly, the transfer of Ospreys to the Futenma base will start as early as this month.

“We wonder if the government expects the residents of Okinawa Prefecture to accept such a heartless measure without objection. If the possibility of an Osprey crash cannot be ruled out, the aircraft must not be deployed in defiance of the popular will. If deployment is forced upon the Okinawan people, the base will become the target of their hatred. That will lead to ‘moves to call for the closure of all military bases’ in the prefecture, which the governor has spoken of. So an unexpected situation could occur. The government should take Okinawa's view seriously and cancel the deployment plan.

“The prefectural assembly and all municipalities have adopted resolutions opposing the deployment of the Osprey. About 100,000 Okinawan residents staged a rally on Sept. 9 to protest the deployment. In accord with the will of the prefecture's people, the governor has strongly stressed that “he absolutely cannot accept [the deployment].” For a democratic country, it is rational to arrive at the judgment that it is impossible to deploy the Osprey to Futenma.

“Following the announcement declaring the Osprey to be safe, about which we harbor many doubts, test flights were defiantly conducted at the Iwakuni base. Being under the control of the U.S., the government is now paving the way for deploying the Osprey. Japan no longer appears to be a democratic nation. Defense Minister Satoshi Morimoto, who lacks consideration for the people of Okinawa, advances an irrational argument. The government will make a serious mistake if it assumes that Okinawan residents will tolerate a stance that can be interpreted as discrimination against the prefecture and accept the deployment in the end.”

While most opinion polls on Japanese views toward the U.S., such as the annual government's diplomatic survey, show warm feelings toward America and a majority view that the security

treaty with the U.S. has been useful for regional peace and stability, other surveys show that feelings toward the alliance in the future may be changing. According to a survey conducted in December 2010 by NHK, in response to the question, “What kind of country should Japan aim for to maintain security?” only 19% answered “make the Japan-U.S. alliance the cornerstone,” while 55% opted for “building an international security framework with Asian countries.”

Adding to this those favoring “unarmed neutrality,” 74% did not choose the Japan-U.S. alliance. (Source: “50 Years of the Japan-U.S. Security Treaty” series that aired on December 11, 2010) Since the survey was carried out during the height of Hatoyama’s efforts to review the basic security arrangements with the U.S., as well as to move the Marines at the Futenma base either out of Okinawa or Japan, there would seem to have been a broader resonance as seen in its startling results.

In other words, the public thinks that the U.S.-Japan security alliance “has been useful” until now, but it “will not be the cornerstone” in the future. If we start not from the people’s view of the security alliance “so far,” but from the perspective of how to realize Japan’s peace and security “from now on,” Hatoyama’s attempt to move forward into uncharted territory has significance.

As Bisbee argues, the Futenma relocation project, on the books since 1996 with still no progress in sight – despite several agreements and timetables -- has proven to be a persistent source of frustration for negotiators in Washington, Tokyo, and Okinawa. The manipulation of the issue by politicians and special interest groups is largely responsible for delays in implementation and renegotiated agreements for almost 17 years. Bisbee stresses that, ironically, the relocation project also provides a window into the evolving nature of Japanese democracy thanks in large part to the ability of local actors to hijack the issue for personal gain. His analysis uniquely examines the evolution of Japanese strategic thought and democracy through the lens of the Futenma relocation project. He sees a nascent third alternative to the traditional binary security perspective of balance of fears – entrapment or abandonment -- is visible in the Futenma project’s many delays.

Far from dismissing local politics and activism hampering the relocation project, Washington and Tokyo should begin to consider alternatives or augmentations to the Alliance that can accommodate an increasingly popular Japanese security perspective that challenges the traditional justifications for US bases on Japanese soil. In short, Bisbee concludes that even though the DPJ’s failed efforts under Hatoyama – Kan and Noda later reverted to an LDP-style security policy -- many Japanese do not think that the U.S.-Japan military alliance will continue to be the mainstay of Japan’s security in the future.

It would be a mistake to assume that Tokyo’s relations with Okinawa will improve now that the LDP is back in power. Despite the formal agreements that LDP governments inked in the past with the U.S. regarding the relocation of the Futenma Air Station and other base realignments, and carrot-stick efforts to obtain local acquiescence to them, the implementation process was never successful, as Bisbee’s paper points out.



The Abe administration's relations with Okinawa, too, have been rocky to the extent that the government cancelled a plan for May 15 ceremony to commemorate Okinawa's reversion to Japan in 1972. One reason has been of course the continued refusal of the prefecture to accept a Futenma relocation site inside the prefecture. Another has been Okinawa's strong feelings against the deployment of the MV-22 Ospreys to replace helicopters at Futenma—the new aircraft deemed dangerous there because of a history of accidents. But additional ire has welled up over perceived slights to Okinawa by the LDP.

Okinawans were infuriated by the central government's hosting a national ceremony on April 28 to commemorate Japan's recovering its sovereignty in 1952. For Okinawans, April 28 is a day of humiliation for being placed under U.S. military occupation until 1972. Another perceived slight was the central government's signing a fisheries agreement recently with Taiwan that covered waters near the Senkaku Islands, which are under Okinawa's jurisdiction. Okinawan fishermen were upset that a favorite fishing ground would be shared with Taiwanese fishing boats.

### **Japan Engages in Nation Building in South Sudan**

There is a global aspect to U.S.-Japan relations that comes out in Japan's contributions to international peace and security, often in a United Nations context, but also reflecting a strong convergence of bilateral interests. In such cases, the policies of the Noda and Abe administrations are not that different. One example is the large amount of foreign assistance that Japan provides to Afghanistan, some of it with a public security component. Peacekeeping activities make up another important component.

Prime Minister Noda's decision in 2011 to send peace-keeping troops to South Sudan for engineering duties was a success story for Japan that the Abe administration continues in mid-2013. Since January 2012, about 330 personnel of a Ground Self-Defense Force (GSDF) unit have been improving major trunk roads and an airstrip in the capital Juba, which is in Central Equatoria State. After a Bangladeshi units pull out of Eastern and Western Equatoria later in 2013, the GSDF unit will also operate in these two states. Extending the unit's area of engagement is quite appropriate for enhancing Japan's presence in and reinforcing ties with Africa, which is expected to grow markedly in the future.

GSDF engineers until recently operated also in the Golan Heights in the Middle East and Haiti but have been withdrawn. Now, South Sudan is the only country where Japan is engaged in peacekeeping operations. China, South Korea and India also have dispatched engineering units to South Sudan. In northern South Sudan, where the units of these three Asian nations conduct their peacekeeping activities, rebel forces still operate actively. In April 2013, rebels attacked a U.N. convoy and killed 12 people, including five Indian peacekeepers escorting the convoy. The public security situation has been relatively stable in the three southern states where the GSDF unit will operate.

South Sudan became independent from Sudan in July 2011, but little progress has been made in its nation-building efforts. From May to October, heavy rainfall makes roads impassable in many areas. Therefore, it is highly significant that the GSDF unit is helping to improve a road network that will serve as a foundation for that country's economic development. The GSDF engineers

have had a good track record in repairing and improving roads--its specialty area--in such countries as Cambodia and East Timor. GSDF reconstruction activities also were carried out in postwar Iraq.

### **Senkaku Row Boils Over and Over Again**

The summer of 2012 saw maritime disputes with China flare up across the South and East China seas. The Senkakus row erupted again in September when Japan's central government announced it had purchased three of the isles from their private owner, and even involved extensive riots and destruction of Japanese property in China. Chinese surveillance ships operating near the Senkaku Islands continue to square off against Japanese Coast Guard vessels, keeping tensions high and setting off fears that the standoff could escalate into a more serious conflict.

The incident set off a propaganda war aimed at the international community, with both governments appealing to world opinion regarding the legitimacy of their territorial claim. Beijing also made known its intention to officially revise and extend its continental shelf claim submission in the East China Sea to include the waters around the Senkakus, thus further irritating Tokyo. Although China has recently—and belatedly—tried to play down the island row, serious damage has been done to bilateral relations, taking its toll on tourism, business and other economic activities. Even events to commemorate the 40th anniversary of normalization of diplomatic relations in 1972 were canceled.

Although then-Secretary Hillary Clinton assured Japan in 2010 that the Senkakus, being under Japan's effective control, was covered by Article 5 of the U.S.-Japan Security Treaty, Washington's worst fear is being drawn into a war between China and Japan over those disputed isles. Washington has called for cooler heads to prevail, with a State Department spokesman saying that the United States does "not take a position on the sovereignty of the Senkakus" but expects "the two mature countries are fully capable of resolving" their territorial dispute. The U.S. military alliance with Japan is designed to guarantee peace and stability in the region through its deterrence capabilities. It is not intended to act as a lightning rod for conflict.

China's efforts to intimidate Japan by its excessive reaction to the territorial issue in 2010 and the well-orchestrated row in 2012, however, have produced just the opposite effect. Although Japan has remained relatively calm diplomatically, China's actions have riled up the normally complacent public and spurred saber-rattling by politicians on the right. Japan is not backing down. According to Japan's Foreign Ministry, China aims by its intrusions into Japanese waters to chip away at Japan's effective control, make Tokyo eventually admit that a territorial dispute exists, and ultimately achieve joint administration of the isles by the two countries.

Ironically, China, instead of driving a wedge between the U.S. and Japan by testing how far the U.S. will go in backing its ally, seems to be serving as a catalyst for reinvigorating the bilateral military relationship. It used to be provocations by North Korea that drove Japan closer to its ally the United States, but now it is China.

### **Abe Handled China Well during First Time as Premier**

Japan's relations with China under the Noda administration in 2012 and now under the Abe administration in 2013 continue to be contentious and confrontational, mainly due to China's

unrelenting aggressive activities near the disputed Senkaku Islands. It was not always like that, however.

When Abe first became prime minister in 2006, the territorial dispute never flared up because of adept management of the issue by both governments. Abe came into office determined to repair relations with China damaged during the administration of Prime Minister Junichiro Koizumi, who repeatedly visited Yasukuni Shrine to the chagrin of Asian neighbors.

On November 16, 2006, Abe held his first summit meeting with Chinese President Hu Jintao. The topic of Yasukuni never came up, since Abe had previously indicated that he had no intention of visiting the shrine during his term in office. In addition, a joint study group on the history issue was scheduled to meet in December. The two leaders' meeting was productive, with even a proposal for joint development of gas fields in the East China Sea on the agenda. Abe called for the creation of a bilateral "mutually beneficial strategic relationship."

On the Senkakus, as well, the dispute was shelved during Abe's first time in office. In October 2006, Hong Kong activists were planning to sail boats to the islands and then land there to stage a protest. Beijing pressured the activists not to go the isles and land, reportedly telling them that priority should be on the overall bilateral relationship.

#### **"Nationalization" of the Senkakus: Bombshell for Japan-China Relations**

During the DPJ's three years in office, however, relations with China deteriorated rapidly, not because of the history issue, but due to the island dispute flaring up again and again. In 2010, Prime Minister Kan encountered a fierce response from Beijing after a Chinese trawler captain was arrested for ramming two Japanese coast guard vessels with his boat. The captain was released, but this only made Kan the target of domestic criticism of his "weak-kneed" response.

Then, in 2012, Prime Minister Noda set off perhaps the worst postwar row with China when he decided to "nationalize" or purchase three of the privately-owned Senkaku isles. Noda wanted to prevent an even worse situation: nationalists led by Tokyo Governor Shintaro Ishihara purchasing and then occupying the islands.

In a speech on April 16 in Washington, Governor Ishihara had announced Tokyo's plan to purchase the Senkaku islands. The Noda administration was forced to decide how to effectively deal with this, particularly when private donations for the purchase kept pouring into the Tokyo government to the tune of almost 1 billion yen. Noda apparently calculated that it would be far better for the central government to beat Ishihara to the punch by buying them first. He expected the Chinese government to understand that ploy, but he miscalculated China's reaction. Noda decided on nationalization on May 18 and procedures started with the landowner, making an offer several hundred million yen higher than the donations collected by Tokyo. China was surprised and reacted strongly at Noda's announcement on July 7 that nationalization was being considered, resulting in its taking a tough stance. July 7 marked the anniversary of the Marco Polo Bridge Incident [in 1937] that triggered all-out war between Japan and China. Four days later, three Chinese fishery surveillance ships intruded into Japan's territorial waters. On Aug. 15, Hong Kong activists landed on one of the Senkaku islands, and in late August, anti-Japan demonstrations spread throughout China.

The cabinet decision on the nationalization of the Senkakus was made on Sept. 11. Only two days earlier, on Sept. 9, Noda and Hu talked informally on the sidelines of the Asia-Pacific Economic Cooperation (APEC) summit in Vladivostok, Russia. Noda conveyed his sympathy for the earthquake in Yunnan that had just occurred, but Hu snapped that “nationalization is illegal.” Even though Noda said “we will deal with this from a broad perspective,” Hu stated in very strong terms: “Japan should fully understand the seriousness of the situation and must not make a wrong decision.”

When the cabinet made its decision Sept. 11, Beijing was furious, one Foreign Ministry official saying: “The Noda administration did not even understand the significance of our president’s words. It should have at least shown consideration and delayed the decision.” Anti-Japan demonstrations intensified in China. Many Japanese businesses were attacked. The escalation of the Senkaku row had only just begun.

### **War of Nerves**

Intrusions into Japan’s territorial waters near the Senkakus began on September 24, 2012, when three Chinese surveillance ships entered. By October, such actions became a regular occurrence. Taiwan ships, too, began intruding into the disputed waters. The Japan Coast Guard (JCG) is keeping watch over this area by sending its patrol boats to sail alongside the Chinese surveillance ships. However, a collision between public ships (government ships) could develop into a conflict between the two countries, so the war of nerves, often at a distance of about 500 meters, had raged on.

Of greatest concern is the possibility of a collision between ships. Under international law, no country is allowed to restrict navigational routes, conduct on-board inspections, or take other coercive measures against public ships even inside the territorial sea. In the event of a collision, Japan could be accused of “obstructing navigation.” The JCG has been stretched to its limit in assembling around 30 patrol boats in the Senkaku area.

In a Nikkei opinion poll in late September 2012, respondents were asked if they approved of the government’s purchase of three of the Senkaku Islands. A total of 66% said they favored the move, while those opposed only accounted for 21%. The survey came against the background of growing tension between Japan and China, with a number of Chinese government surveillance vessels repeatedly intruding into Japan’s territorial waters and anti-Japan demonstrations expanding in China. Asked how the government should respond to the worsening situation, those calling for the government to “take a strong stance toward China” significantly outnumbered those calling for it to “consider better relations between Japan and China,” 56% to 37%.

Interestingly, a poll by the *Sankei Shimbun* conducted online also in late September captured the public mood. It found an overwhelming percentage of Japanese ready to defend their country, even if that meant changing the Constitution to do so. Respondents were asked if they thought the Constitution should incorporate the Japanese people’s obligation to defend their country when amending it. In response, 75% answered “yes.” A majority of respondents, 56%, also thought that the Constitution should provide for conscription. And a total of 97% said that they wanted to do something for the defense of Japan.

Not surprisingly, the Senkaku Island row and whether Japan should take a tough stance toward China became a campaign issue in the national election that Noda had called for December 16. The Noda administration was adamant on somehow improving relations with China, with Chief Cabinet Secretary Osamu Fujimura stressing: “We will deal with the Japan-China relationship calmly, without losing sight of the big picture.”

The LDP leadership, however, took a tougher stance, with Secretary General Shigeru Ishiba arguing that “the Coast Guard’s capability is inadequate and Japan also does not have marines for island defense.” LDP President Abe also advocated the stationing of public servants on the Senkakus and the building of port facilities. He asked this question during the party leaders’ debate on Nov. 14: “Which party can better protect Japan’s territory, territorial sea, and people?” The December election resolved that issue when the electorate chose the LDP.

### **Almost on the Brink of War**

In January, however, Abe’s resolve was almost put to the test. On January 30, 2013, China’s reaction to the Abe administration’s tougher stance toward the Senkakus erupted into an incident that could have led to physical conflict. A Chinese military frigate locked its radar on a Japanese destroyer near the disputed islands. The frigate and the Japanese destroyer reportedly were only three kilometers apart in international waters some 110 to 130 kilometers north of the rocky isles. The commander of the frigate directed his vessel’s weapons-targeting radar, based on the Chinese military’s rules of engagement, without seeking instructions from the fleet command or navy headquarters. This was one of the most serious incidents in an escalating row over ownership of the islands in the East China Sea.

Beijing has consistently denied the allegation and accused Tokyo of hyping the “China threat” in a bid to manipulate world public opinion against it. But Kyodo News, in a March report, cited unnamed “senior Chinese military officials” saying the weapons targeting indeed had taken place. The officials, including “flag officers” – those at the rank of admiral – told Kyodo it was an “emergency decision”, not a planned action, and was taken by the commander of the frigate, the report said. It was not known if the commander had been reprimanded, Kyodo noted.

In her insightful paper examining the Senkaku issue against the backdrop of U.S.-China and U.S.-Japan relations, Yun Han objectively looks at the forces and strategic thinking that have shaped the way the dispute has been handled. As the two largest economic and military forces in the region, China and Japan are playing pivotal roles in the United States rebalancing toward the Asia-Pacific. In this context, the rising tensions between the two countries resulting from the escalating territorial dispute has become an almost game-changing factor influencing power relations in the region. Her paper examines how China and Japan have played roles in Obama administration foreign-policy making, and how the impact of the territorial dispute has complicated U.S. rebalancing efforts toward the Asia-Pacific.

The paper concludes that the escalation of the territorial dispute between Japan and China in 2012 and 2013 was the result of failed attempts by both countries to adapt to a new set of domestic and international realities that have been developing over past decades. Second, the current escalation has become both an opportunity for the U.S. to deepen its alliance with Japan, thereby strengthening its presence in the Asia-Pacific, and a challenge for the U.S. to manage its

relations with rising China. Third, given the increasingly volatile situation on the Korean Peninsula, both Tokyo and Beijing should make immediate efforts to relocate their public resources from counterproductive territorial disputes to the maintenance of peace and stability in the Asia-Pacific. Instead of the encirclement of China, Han argues for the promotion of the engagement of China in the region. The United States as a major stakeholder would certainly agree.

### **Encircling China**

Yet, Abe's broad diplomacy in the region has been designed to "encircle" China, ranging from stepped up security ties with the U.S. to strategic talks with India. A major effort to rebuild diplomatic and economic ties with Myanmar (Burma) is also under way, with an eye on replacing China as that country's major supplier of aid and technology. Just a few days after Prime Minister Abe visited Myanmar, the Prime Minister of India, Manmohan Singh, came to Japan May 27-30, 2013, with an agenda that included maritime security cooperation with Japan, such as joint drills in the Indian Ocean. Singh's visit prompted a state-run Chinese daily to accuse Tokyo of attempting to 'encircle' China by building strategic alliances in the neighborhood.

### **Abe's National Agenda**

By May 2013, Prime Minister Abe had launched a part of his ambitious agenda to build a strong national security system. For example, since his first time in office six years before, Abe has wanted to realize the establishment of a Japanese version of the U.S.' National Security Council (NSC). With that in mind, related bills were drafted and approved by the Cabinet in early June for submission to the Diet. The Japan-style NSC will establish a venue for regular discussions on diplomacy and national security in order to formulate mid to long term strategies. It will also allow the Prime Minister and his aides to respond to and manage a crisis effectively. The killing of ten Japanese taken hostage by terrorists in Algeria in early 2013 had a profound effect on the Japanese government and gave extra impetus for setting up the NSC as quickly as possible.

Prime Minister Abe also has been eager to complete a process that he had begun during his first time in office: authorizing Japan the right to use collective self-defense. It is now banned under an interpretation of the Constitution by the Cabinet Legislation Bureau. Abe wants to reverse the CLB's decision. Abe in 2007 appointed a panel to discuss the following four scenarios in connection with allowing Japan to use collective self-defense: (1) how Japan during a regional contingency should respond as an ally to an attack on U.S. vessels in international waters; (2) whether Japan can legally intercept overhead ballistic missiles targeting the U.S.; (3) whether Japanese Self-Defense Forces could rush to the rescue of foreign troops engaged with them in international peacekeeping activities; and (4) whether Japan could provide rear support for foreign forces engaged in international peacekeeping activities. The panel compiled a report in 2008 recommending allowing the exercise of the right of collective defense under scenarios (1) and (2). But Abe has pointed out that since "the security environment has changed drastically (from five years before)," the process should be revisited during his current term in office.

### **Constitutional Reform Fever Subsiding**

Abe's desire for drastically amending the Constitution is well-known, and debate over how to approach that challenge has intensified since he came into office. At first, the public seemed supportive, but with political discussions pro and con filling the media, it is now not so sure. The

accelerated timetable that Abe originally envisaged for changing the Constitution seems to be slowing down, perhaps seriously.

The public's mood for one thing has been changing since 2012. This can be seen in the results of opinion polls about the Constitution over the years. For example, the business daily Nikkei and TV Tokyo jointly conducted a public opinion survey before Constitution Day on May 3, 2012. In it, respondents were asked if they thought the Constitution should be amended. In response, affirmative answers outnumbered negative ones, with "yes" accounting for 53% and "no" for 33%. The proportion of those in favor of constitutional revision topped 50% for the first time in five years since the 2007 survey. In the last similar survey conducted in April 2010, those who said "yes" to constitutional revision accounted for 47% and those who said "no" for 40%. The gap expanded substantially. Again, in a September 2012 Mainichi poll, 65% of the public were in favor of amending the Constitution, and 56% agreed that parts of Article 9 should be changed. With the Abe administration's drive to expedite constitutional reform, including Article 9, the Japanese electorate has once again begun to shift gears. Faced with the possibility of real changes, the public seems to be backing away. Moreover, the LDP's coalition partner, New Komeito, has not been enthusiastic about some of the changes Abe envisions, such as a clause in Article 9 about creating a "national defense army," as well as reinterpreting the Constitution to allow the use of collective self-defense.

In a Tokyo Shimbun opinion poll, carried out in May 2013 with the summer election for the Upper House in mind, the Japanese public was split over the Abe administration's advocacy of amending the Constitution of Japan. Past polls had shown majority support. More poignantly, when asked whether Article 9, which declares Japan's renunciation of war, and Article 96, which prescribes rules for amending the Constitution, should be revised – Abe wants to change it from two-thirds of the Diet to a simple majority -- negative answers substantially outnumbered affirmative ones. Faced with the real possibility that the Constitution may actually be changed during the term of the current administration, the Japanese electorate is having second thoughts.

### **History Lesson**

In addition to the territorial disputes, no other issue has the potential for souring Japan's relations with Asian neighbors, particularly China and South Korea, than the history issue. This was not a factor for the Noda administration, which avoided public statements and actions on potentially loaded historical issues, but the Abe administration has not been so circumspect, and issues like cabinet-level visits to Yasukuni Shrine, where Class-A war criminals are enshrined, and recognition of coercion of women by the military in World War II to provide sexual services to soldiers as "comfort women" have surfaced already on Prime Minister Abe's watch.

South Korea has been particularly caustic on both historical issues, and the atmosphere of the Noda period for encouraging bilateral security cooperation in dealing with a belligerent North Korea has eroded during the Abe term. Japan was shocked on May 7 when Republic of Korea President Park Geun-Hye, meeting President Obama in Washington, diverted from the usual script on North Korea issues to say, "Japan needs to have a correct perception of history for peace in Northeast Asia." The trigger for such a startling remark at a summit meeting was reportedly Deputy Prime Minister Taro Aso's controversial official visit to Yasukuni Shrine on April 21 during the Spring Festival. Another catalyst was Abe's remark in Diet debate blurring

the meaning of Japan's World War II's "aggression." This was taken by Seoul as Japan's "denying the colonial rule and its war of aggression."

Genron NPO, a Japanese non-profit research organization, conducted a joint opinion survey early this May with South Korea's East Asia Institute on mutual perceptions between the two countries. An overwhelming 76.6% of South Koreans said they had an "unfavorable" impression of Japan, while those with a "favorable" view only reached 12.2%. The Japanese public, on the other hand, was split, with those with "unfavorable" impressions of South Korea also exceeding those with "favorable" views, 37.3% and 31.1%, respectively.

In the breakdown for the unfavorable impressions of each other, a total of 50.1% of Japanese and an alarming 84.5% of South Koreans cited the issue of the territorial dispute over Takeshima (Dokdo in Korean), an uninhabited island in the East China Sea claimed by each country.

If anything will help Japan and South Korea find common ground in order to overcome their side disputes it will be the North Korea threat. In late May, the defense ministers of Japan, the U.S. and South Korea for the first time in years held a trilateral meeting on the sidelines of the annual Asia Security Summit in Singapore. They confirmed to continue to cooperate to deter provocations by North Korea, which continues to develop nuclear and missile capabilities, and to make that country abandon its nuclear programs. Afterward, Defense Minister Itsunori Onodera said that a "relationship of trust has been established among the three countries," emphasizing the main result achieved by the meeting. Such trilateral cooperation is essential in order to block North Korea's nuclear development programs.

South Korea reportedly was initially hesitant about the idea of holding a meeting of the three defense chiefs but it was finally realized through the mediation of the U.S. A bilateral defense ministerial between Japan and South Korea, however, is not yet in the cards, due to the still smoldering territorial and historical issues.

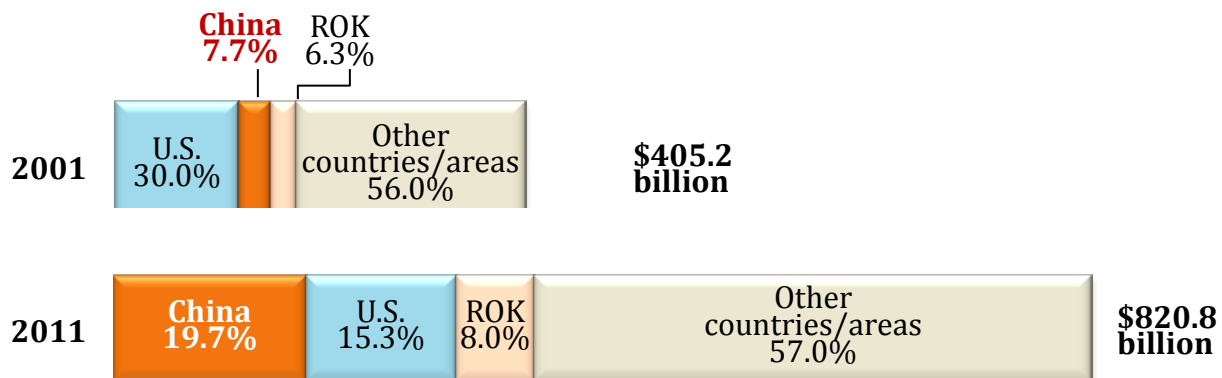
### **Japan-China Economic Relations: Trumped by U.S.?**

Sean Cate in his carefully argued paper of the ramifications of economic interdependence between Japan and China and between Japan and the U.S. tries to look beyond the usual rhetoric of cold politics, hot economics to describe the former relationship and dwindling importance of the U.S. economy for Japan in the latter case. He has focused instead on comparing the economic appeal of China to that of the United States. He concludes that the strengths of the appeal of the U.S. market outweigh the weaknesses and that the gains Japan receives from deepening economic ties with China are being outweighed by the costs that go along with them, compared to investment in the U.S. or other countries.

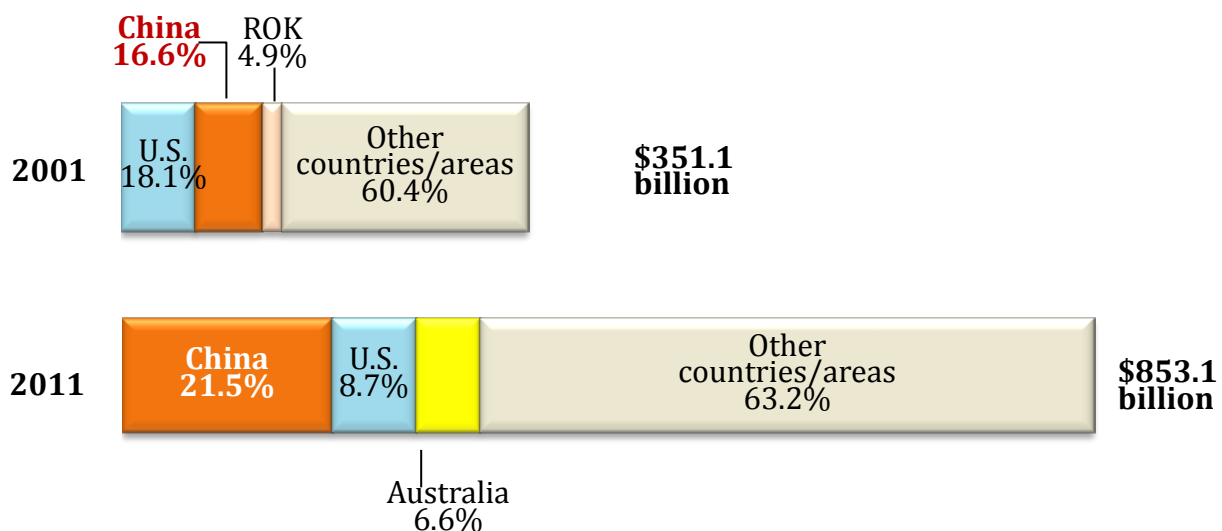


## China is Japan's Largest Trade Partner for Both Exports and Imports

### Exports from Japan



### Imports to Japan



(Source: JETRO)

Cates' argument aside, the merits and demerits of growing economic interdependence between Japan and China in view of the strategic challenge posed by rising China are being debated at length by experts in Japan. In a symposium on the Japan's dilemma held by the Keizai Koho Center in Tokyo on April 22, was held against the backdrop of strained bilateral ties with China over the Senkakus and the violent demonstrations that hit Japanese businesses in Chinese cities after the Noda administration purchased three of the disputed islands.

Former ambassador to China, Yuji Miyamoto stressed that the current impasse reflects a paradigm shift in Japan-China relations. In the past, as long as economic relations between Japan and China were sound, the two governments were able to manage such other potential areas of

friction as wartime history, the territorial dispute, or ties with Taiwan in a conciliatory way, said the former diplomat. But now, he emphasized, the Senkaku row, in which Beijing has taken military and other actions to clearly demonstrate its territorial claim, has placed security issues at the forefront of bilateral relations. No longer are security issues between the two countries mainly concerned with the risk of Japan becoming involved in a possible U.S.-China military confrontation over Taiwan. Now, the Senkaku row has put Japan and China in direct confrontation. These developments came after China overtook Japan as the world's second-largest economy in 2010, forcing Japan to find its new place in the East Asian order with its relative fall and China's rise, Miyamoto said.

The former ambassador went on to argue that the "mutually beneficial strategic relationship" that Japan and China vowed to pursue since 2006, when Abe was premier for the first time, is mainly about economic ties. What that means is for Japan and China in a globalized world where economic interdependence is common, to cooperate to seek common economic benefits. While security issues may be at the forefront of bilateral relations today, common economic interests are much more important for both countries to pursue, he said.

The Senkaku row has harmed economic ties as Japanese exports to and investments in China have declined. Miyamoto stressed that anti-Japan sentiments in China will continue to be a major risk factor for Japanese firms doing business there, along with the risk of greater social instability in China. Yet, he added, with many of the world's largest companies relying on the Chinese market and advancing into China to compete, if Japanese firms hesitate to do business in China because of the risks, they could lose out in the global competition game.

### **DPJ's Indecisiveness on TPP**

Competition is the name of the game in Japan's drive since 2010 to enter talks to join the U.S.-led Trans-Pacific Partnership (TPP), a free trade agreement of comprehensive nature that could ultimately become the largest economic bloc in the world, once Japan finalizes its entry.

In her paper on the TPP and the U.S.-Japan connection, Yaowaluk Suthimanus has analyzed the hot debate within Japan in recent months and the controversy over the impact of TPP on the Japanese economy. She has also aptly shown the pros and cons of the issue of Japan's membership from the U.S. perspective. While the media have tended to present the negative side of TPP entry for Japan, a surprising number of economists and trade specialists have weighed in to show in concrete terms that joining the expansive free trade agreement would be in Japan's best economic interests. Her paper argues that it is also in the interests of the United States to welcome Japan into the TPP.

The DPJ's indecisiveness on joining the TPP almost derailed Japan's opportunity to join the free-trade agreement talks that economists concur are in Japan's best long-range economic interests. When his predecessor Naoto Kan was unable to overcome domestic vested interests and announce Japan's intentions to join TPP, Prime Minister Noda took up the cudgel himself as a priority policy goal. But he also encountered strong resistance, especially in the DPJ. Noda announced in November 2011 in a summit meeting with President Obama Japan would start preliminary talks with concerned countries on joining the TPP talks. He deferred a formal announcement on joining the talks due to strong opposition from DPJ members worried about

the adverse effect on agriculture. Consultations between Japan and the U.S. did not make much progress and stalled in March 2012.

Noda was basically in favor of Japan joining the TPP. He had planned to finally convey to President Obama Japan's intention to join the talks at the East Asia Summit in mid-November. But that announcement never came. He was unable to overcome strong opposition to participation from the rural areas, as well as from the many DPJ members with rural constituencies. The party by November had dwindled to a situation where the ruling bloc was only six seats short of losing the majority in the House of Representatives and a vote of no confidence against the cabinet was becoming a real possibility. The way the Noda administration handled the TPP issue was symptomatic of the DPJ's political indecisiveness during its three years as the ruling party. The party simply could not build a consensus when it faced tough issues like TPP.

Insisting on reaching a decision after sufficient national debate, the government set up an economic partnership project team within the ruling party. However, since those opposed to participation in the TPP accounted for a majority of the participants in the panel, there was not substantial progress in coordinating views within the panel. With the members prioritizing discussion on a package reform of the tax, fiscal, and social security systems and motivated by the desire to keep the number of members bolting the party to a minimum, debate by the panel on TPP became hopelessly bogged down.

It took the decisiveness of Prime Minister Shinzo Abe to finally commit Japan to joining the TPP, first telling President Obama of his intention during their summit meeting in Washington on February 22, 2013, and then formally announcing on March 15 that Japan would participate. Japan will formally enter negotiations in July.

The Japanese public, too, has come to look favorably on the TPP as being in Japan's national interests. In a late May, a Sankei opinion poll found 57.6% of the public favoring Japan's joining the TPP talks, up two points from a month before. Other polls have similar results. Information evaluating the agreement as helping Japan's ailing economy seems to have over time influenced the public's thinking which a year or so before was either split or negative about TPP.

### **Is “Abenomics” the Answer to Japan’s Two Lost Decades?**

Prime Minister Abe's top priority has been to revive the ailing Japanese economy by overcoming the country's long-standing deflation. In the election campaign, he promised a bold monetary policy that included setting an inflation target, qualitative fiscal stimulation measures in the public sector, and a growth strategy that encourages private investment. He also promised to accelerate the reconstruction of earthquake and tsunami-devastated northern Japan, much of which remains a vast wasteland.

He has been faithful to his promises. Abe's extraordinary popularity in the polls, now slightly tapering off in mid-2013, can be mainly attributed to his attractive set of economic policy proposals, dubbed “Abenomics”, which aim at rebooting Japan's sluggish economy after years of deflation and stagnant growth. The public seems to agree, and a recent poll by the business daily

Nikkei (June 2, 2013) found that the Japanese public seems to be recovering some of its confidence, lost in recent years.

Nikkei asked its online readers if they thought Japan would be able to recover its influence in the international community. A majority, 51%, answered in the affirmative, expecting Japan to “successfully turn its economy around and boost its influence.” Some answered that Japan “still ranks at the top in economic power and technology.” Consistent in recent opinion polls has been the public’s overall satisfaction with the way the Abe administration is handling the economy, which bodes well for the LDP in the Upper House election in July.

In his well-argued paper, Haitham Jendoubi tracks one of the three “arrows” of Abenomics, monetary policy, which was announced first soon after Abe came into office. The three “arrows” of Abenomics—monetary stimulus, fiscal stimulus, and structural reforms—have now left their quivers, although economists differ regarding their relative importance and capacity to lead Japan’s economy towards sustainable growth. Jendoubi notes that the U.S. has approached Abenomics cautiously, with most attention initially focused on: (1) the dollar-yen exchange rate, (2) exchange rate movements’ influence on sensitive trade issues such as the U.S. automobile trade deficit, and (3) the sustainability of Japan’s debt burden amid continued fiscal stimulus and attempts by the Bank of Japan to achieve moderate inflation. Even though the United States has given its tacit approval to that arrow of Abenomics so far, it has joined the international community in upholding certain monetary-policy red lines, which Japan has been careful to respect.

As Jendoubi has found, U.S. business interests and policymakers have been anticipating the third arrow to be released from its quiver – long-term growth strategy – which has started to come out of this writing, such as the development of new industries, including medical services, and targeting women for career entry into the growing job market. Once Japan prioritizes structural reforms in its growth strategy, which most observers see as the greatest potential for sustainable Japanese growth, the U.S. would welcome the return of a revived Japan into the global economy and the arrival of a more powerful ally in the Asia-Pacific region – with an eye on Japan’s membership in the Trans-Pacific Partnership, as well. Lacking details, U.S. reaction to Abe’s growth strategy has been muted, but this could change to praise once the arrows start to strike their targets.

*The Washington Post*, showing early skepticism, said in an editorial on June 7 that the last “arrow” of Abe’s three-arrow economic policy “fell short.” The Post argued that the third arrow “justifiably disappointed” markets when Abe outlined the package of strategic growth measures June 5 because it offered an “underwhelming approach” to tackle a major source of Japan’s chronic stagnation. It described this source as “a vast web of regulations, subsidies and trade barriers whose net effect has been to support inefficient sectors, and the voters who live off them, at the expense of growth and innovation.” The daily’s editorial added that Abe had “failed to tackle agriculture, offer a convincing approach to burdensome labor-market rules or provide enough details to show whether his ideas are new or just a repackaging of proposals tried before, such as ‘special zones’ where companies can operate under looser regulations.” The editorial assumed that Abe’s party would win the Upper House election in July but then, to keep

momentum with the electorate, would have to add details about his proposed reforms, as well as assuage concerns of those voters with vested interests in the old system.

The daily's assessment may have some validity, but it frankly is too early to tell whether Abe's policies when fully fleshed out have tremendous potential or not. Incidentally, the editorial is wrong about there being no agricultural reform on Abe's economic agenda. Since Feb. 18, the Industrial Competitiveness Council has been holding meetings at the Prime Minister's Official Residence that included regulatory reform of the Agricultural Land Law, the basis for the nation's agricultural policy during the postwar period. Council members want the government to enable companies to enter the agricultural sector without restriction and engage in modernizing Japan's agriculture into a competitive export industry. In addition, Abe's growth strategy calls for doubling the incomes of farmers and their communities over 10 years. Moreover, the Agriculture Ministry has a plan for prefectural governments to lease and consolidate unused farmland, renting out such land to large-scale farmers. With Japan joining the TPP, such reforms in Japan's agricultural sector are now deemed essential to the survival of Japanese farming.

### **Nuclear Power Outage**

Japan's energy crisis brought on by the DPJ's shutting down its nuclear power lifeline after the Fukushima accident may be ultimately resolved by the LDP's restarting most of them.

David Wells' insightful paper on Japan's nuclear power allergy and its impact on U.S.-Japan civil nuclear cooperation documents well the policy gap that grew between the two countries in the aftermath of the Fukushima nuclear accident. The U.S. government was reportedly concerned, for example, about the efficacy of the Noda administration's policy to reduce the number of operating nuclear reactors to zero by 2030. Washington reportedly asked Tokyo to abandon its policy of reprocessing spent nuclear fuel if it decides to eliminate all nuclear reactors in the near future. The U.S. had nonproliferation concerns, for if Japan maintained its policy of extracting plutonium from spent nuclear fuel as the number of plants to handle such dwindled, plutonium convertible into nuclear weapons will continue to accumulate in the country. In such a case, Japan's policy would be incompatible with U.S. policy of pressing Iran and North Korea to accept nuclear nonproliferation. The Noda government reportedly began to comply by making a zero-target for nuclear energy a reference point only.

The public's nuclear energy allergy has not gone away, however. In a national survey in early June by Tokyo Shimbun, a majority of Japanese, 60%, opposed the Abe administration's policy of restarting nuclear power plants, even if deemed safe. This response came at a time when the support rate for the Abe Cabinet was an impressive 69%.

Armed with strong public support and the backing of his party to make bold decisions, Prime Minister Abe has decided to overcome the nation's nuclear allergy by daring to ignore it. As reported in the Asahi (May 31, 2013), the Abe administration is including "utilization of nuclear power plants" in the economic growth strategy it is compiling and will promise that "the government will work together to make utmost efforts" to reactivate nuclear plants. The Abe administration's "Abenomics" policies regard nuclear plants as indispensable for economic growth.

The draft strategy was presented to the Industrial Competitiveness Council on June 5, formally adopted on June 12, and then submitted to the Cabinet for final approval. The use of nuclear plants included in the growth strategy means that the Japanese economy and society will continue to rely on nuclear power for the foreseeable future.

### **Japan Joining Shale-Gas Revolution**

With the energy crisis bearing down on Japan, the Noda administration and now the Abe government have been courting Russia and the U.S. to supply much needed LNG, which the power industry in particular needs now and well into the future. A nuclear-power deficient Japan must rely in increased fossil-fuel supplies for its energy needs, and the cleanest form of such fuel is natural gas.

Yuki Onogi in his paper on Japan's post-Fukushima scramble to line up short to long-term supplies of LNG to fill the nuclear power gap pits the U.S. versus Russia as the provider of choice. But there are problems relying on one over the other, as Onogi points out, so it seems like Japan will keep a diversified portfolio that maximizes the potential that each country can provide and includes other new suppliers such as Canada and Australia. But hurdles are dropping, with the U.S. (Department of Energy) having approved exports of LNG to Japan under a waiver, since Japan still does not have a free trade agreement with the U.S., and Russia is eager to sign long-term contracts with Japan, as well as lure investment in the infrastructure to bring LNG to Japan.

The Abe administration's decision to restart as many nuclear power plants as possible – not an easy task given the public's new nuclear allergy and problems with the plants themselves -- will eventually take some of the pressure off power companies to rely so heavily on fossil fuels. A growing domestic supply of such renewable energy as solar and wind power will help, too. But in the meantime, Japan is paying a premium for its LNG imports, so lining up cheaper long-term suppliers is in the countries best economic interests. Of course, what is being sacrificed is the once viable goal to drastically cut greenhouse gas emissions that depended on increased use of clean nuclear energy

### **Educational Exchange Crisis**

For a number of reasons, as Tina Zhe Liu's paper analyzes, Japanese students are no longer interested in studying in the U.S., and the number of Americans studying in Japan – never high – is dwindling as well (though the impact of the earthquake in 2011 on student travel to Japan may have skewed the statistics). Liu's research examines why a crisis in U.S.-Japan educational exchanges has been worsening in recent years, probing into the complex reasons why Japanese students in the U.S. has fallen to below 20,000 in the academic year 2011-2012.

In contrast, Chinese students at American institutions of higher learning totaled about 190,000, nearly 10-fold the number from Japan, according to a report released in November 2012 by the U.S. Institute of International Education (IIE). The same report noted that the number of Japanese students enrolled in U.S. universities (including graduate schools) for that academic year decreased by 6% from the previous year to approximately 19,900. The number of Japanese students studying in America has decreased by more than 50% since the peak of nearly 50,000 in the latter half of the 1990s.

While students from Japan are declining sharply, those from other Asian countries are growing markedly, with China sending the most. According to 2012 statistics, the top three countries sending students to the U.S. were: (1) China, (2) India, and (3) South Korea, followed by Saudi Arabia, from which the number of students significantly increased primarily on account of its large government scholarship program. Japan placed 7th. The IIE report attributes the decrease to Japan's economic trend, the corporate employment cycle, and the rapid graying of the population, among other factors. Liu's paper examines this argument carefully and finds it to be more nuanced than originally thought.

Meanwhile, the number of American students enrolled in Chinese universities has also been on a sharp upward trajectory. In the 2010-2011 academic year about 15,000 American students studied at universities in China, 10 times as many as 15 years ago. On the other hand, American students in Japan, whose number had been on the upswing, totaled only about 4,100 (a 33% drop from the previous academic year) in the 2010-2011 academic year, marking the first yearly drop in 10 years. Since the Great East Japan Earthquake is believed to be the main reason for the drop, it will be interesting to see what the IIEE's 2013 report states. But the numbers of Americans studying in Japan is miniscule, and the Japanese government is painfully aware of the problem. Tokyo's answer is not U.S. specific, however, but global, with the Education Ministry announcing in late May 2013 a new program to increase foreign students to 300,000 by 2020.

The Ministry of Education, Culture, Sports, Science and Technology has designated 20 countries in the world, including India and Vietnam, as key regions, for recruiting capable international students. The ministry also aims to link up international students studying at Japanese universities with potential employers in Japan. It intends to promote the "globalization of Japanese universities and companies" in cooperation with industry, government, and academia. Funding will be incorporated into its budget request for the 2014 fiscal year.

The government put forward a "Plan for 300,000 Exchange Students" in 2008, setting the goal to increase the number of excellent international students studying in Japan to 300,000 by 2020. It has made an effort to set up joint offices abroad in cooperation with major Japanese universities. However, Japanese universities have been unpopular with foreign students on account of the impression they offer few degree programs in English and the high prices of commodities in Japan. As of May 2012, the number of international students studying in Japan remained at 138,000.

The University of Tokyo, Kyoto University, Tohoku University, the University of Tsukuba, Nagoya University, Kyushu University, Waseda University, and Ritsumeikan University, which participate in the government's "Global 30" Project, will inject funds in their overseas offices in India, Vietnam, Egypt and elsewhere and in Japanese government-affiliated facilities. This will help other universities use the facilities and play up the enhancement of Japanese universities' offering of classes in English.

The government will introduce a system in which international students studying in Japan at their own expenses can apply for a student loan to cover half of the cost while in their home countries before they enter Japan on the condition that they pass entrance exams. The system will be funded with a budget of 6.4 billion yen in fiscal 2013, enough for about 10,000 students.

### **Cultural Influence of Japan Waning?**

The educational exchange crisis in U.S.-Japan relations in recent years has a corollary in the cultural area, as well, though this is harder to quantify. The two alarming trends can be ascribed to an increasing lack of interest by each society in the other's politics, culture, systems, and even goods and services, like tourism. The American media play a role, having tended to ignore things Japanese in their international coverage in recent years, and while Japan's media still tend to keep a sharp eye on the American scene, the society in general seems to be looking increasingly inward.

One can approach the cultural gap issue from a marketing perspective, as Curtis Yibing Che's fascinating look at Japan's video gaming industry shows. That industry, which used to dominate the U.S. market, has now almost disappeared, showing that cultural tastes in each country have diverged. The contents of the choices for personal entertainment are quite dissimilar now. It is not just games: American blockbuster movies, for example, reportedly do not line up people at theaters in Japan, and who can remember the last time when a Japanese movie was a box-office attraction in the U.S.?

One can counter-argue that some aspects of Japanese culture still resonate in the U.S., such as the popularity of sushi and certain types of anime, but these areas were Americanized years ago and have now become iconic parts of "American" culture. The kind of problem of cultural divergence outlined in Che's paper seems symptomatic of a larger issue that in a way links to the phenomenon of dwindling Japanese students that Liu's paper examined.



## **Brash Idealism and the Futenma Issue: Democratic Participation and New Security Perspectives in Japan**

By James Bisbee

### **Part I: Introduction**

For the majority of the postwar period, the Japanese perspective on the U.S.-Japan Alliance can be understood using a binary calculus of security fears. The fear of abandonment has been balanced against the fear of entrapment. Abandonment refers to the fear that the United States for some reason might reduce its military commitments to Japan to an extent that would require the bolstering of Japan's Self Defense Forces (SDF) to politically unpalatable levels. Entrapment refers to the fear that U.S. military action in East Asia or elsewhere in the world might pull its ally Japan into an unwanted conflict. This balancing framework is necessary to understand any specific military facet of the Alliance, be it existing basing issues, the possibility of Japan's use of the right of collective self-defense, or the relatively ill-defined responsibilities of each partner in the case of specific contingencies in the areas near Japan.

Such a balancing of fears often occupied Japanese leaders during the decades of rule by the conservative Liberal Democratic Party (LDP), but the catholic efficacy of this framework was ill-suited to the Democratic Party of Japan (DPJ), a liberal party that was in power from 2009 to 2012. In particular, the DPJ's first prime minister, Yukio Hatoyama, tried to break from the traditional mold of LDP administrations by setting a new policy course for bilateral relations with the U.S. In broad terms, the traditional tension between abandonment and entrapment as a feature of the Alliance relationship was replaced, at least for a while, with what some experts refer to as 'brash idealism' – a revisionist foreign and security policy venture, if you will. Under it, the Hatoyama administration initially tried to tap into a perceived popular sentiment which questioned the received wisdom that Japan needed to overly depend on the U.S. military might for security. The DPJ came into power with a predilection that Japan under the LDP had overly tilted toward the United States, at the expense of Asia. The party, led by Hatoyama, came into power with bold plans and ideas to rectify that situation – destined to create an equilateral triangular relationship among Japan, the U.S., and China.

Although the new ruling party's shift toward idealism permeated all aspects of the U.S.-Japan Alliance, which was to be boldly and drastically reviewed, nowhere was it more visible than with the Hatoyama administration's approach to existing problems regarding the presence of U.S. military bases, particularly those on Okinawa. That prefecture hosted 74% of the U.S. bases and facilities in Japan.

In its most dramatic expression, Hatoyama's new vision of a Japanese security was the creation of a "close and equal alliance." But this did not mean that Japan would accept more roles and missions under the U.S.-Japan security arrangements. It meant that Japan would pare down the U.S. presence, starting with Okinawa. Based on a campaign promise, Hatoyama brought the Futenma Relocation Plan, under which the functions of that Marine base would be transferred to

a new runway to be built in a remote part of Okinawa, to an abrupt halt, after what had already been a decade of hard-fought negotiations. Hatoyama promised to move Futenma either out of Okinawa or out of Japan.

The problem was that the Prime Minister had no idea how to implement his campaign commitment, and after almost a year of futile efforts, he reneged on the promise and agreed to return to a version of the original relocation plan in Nago City in northern Okinawa. The majority of the blame for this debacle must be rightly placed on Hatoyama's political incompetence and not on a new ideological paradigm. But it would be foolish for U.S. policymakers to write off the DPJ's disruptive period in power as an outlying data point.

Indeed, it is surprising that a challenge to Japan's conventional postwar strategic thinking had not manifested itself sooner. While the end of the Cold War brought concerns in the 1990s on both sides of the Pacific about the relevance of the Alliance, the discussion in Japan cleaved to the traditional entrapment versus abandonment paradigm. Even major shocks to U.S.-Japan relations like the 1995 schoolgirl rape incident in Okinawa, which set off national outrage, brought high-level criticism of the administration of the Alliance – centered mainly on the Status of Forces Agreement (SOFA) – but not of the relevance of the Alliance itself.

While the absence of broader questioning of the Alliance is partially the product of exogenous security concerns – post-Cold War Asia was still a dangerous region – it also reflects the nature of Japanese democracy. There is a tendency, even in academic circles, to reductively characterize Japanese democracy in static terms: the legislative dominance of a single party for decades and that ruling party's cozy ties with the bureaucracy and narrow interest groups. Certainly the preponderant power held by a single party, during a period when, at least on paper, a multiparty system existed, suggests that the democratic mechanisms of expression are somehow flawed. Bluntly, for many if not most Japanese, the LDP during its heyday did not represent their broad interests – hence the growing percentage of unaffiliated voters until half of the electorate was in that category.

Still, the static nature of Japanese democratic institutions ignores important political reforms of the 1990s. For example, 1994's electoral reform, introduced when the LDP was out of power and a multi-party coalition ruled, reduced the importance of candidate-centered politics by replacing the traditional single non-transferrable voting system (SNTV) -- essentially multi-seat districts -- with a fusion of single-member district plurality and proportional representation. And 1998's non-profit organization (NPO) law empowered civil society by reducing the barriers to formal organization -- though it can be argued that NPOs in Japan have yet to reach the apogee of their political influence.

This analysis contends that the sentiments expressed by the Hatoyama administration are neither 'brash' (in the sense that they are anomalous) nor 'idealistic'. Rather, they represent attitudinal changes in the Japanese society toward the Alliance that question its traditional contours. That it has taken this long for a strategic challenge to the Alliance to find meaningful political expression is reflective of both the time required for institutional change to occur in a consensus-centered society, as well as the exogenous changes in the regional security environment –

namely, the Soviet threat – that had validated the necessity for having an alliance with the U.S., in which Japan seemed to take all its cues from Washington.

The electoral reforms passed by the Hosokawa administration nurtured the development of a viable opposition – the DPJ -- that could challenge the LDP took more than a decade before meaningful change in governance was finally possible. Over the years until it won the Lower House election in 2009 and replaced the LDP as the ruling party, the DPJ continued to gather more votes in each election, including unaffiliated voters. Then, when the Hatoyama government took the helm, it was able to tap into the general public's dissatisfaction with status quo politics in presenting its drastic proposals for revising the Alliance. The public's sentiments represented, however inexpertly, by the Hatoyama administration were real. It would be a mistake for Washington to dismiss these strategic challenges to the traditional security relationship as mere deviations from the norm. Even with the return of the LDP power, a latent dissatisfaction with the patron-client nature of U.S.-Japan relations, as seen in the nature of the Alliance, remains a potential problem.

Part II discusses the electoral reforms of the 1990s and describes how they have enabled previously suppressed subsets of the population to express themselves politically. Part III summarizes the basing issue in general and the history of the Futenma Relocation Project in detail up until the spring of 2013. Part IV examines the traditional security paradigm in detail and compares it with the perspective represented by the Hatoyama administration, and Part V summarizes the paper.

## **Part II: Japanese Democracy**

Unless used as a bargaining tool in bilateral negotiations, domestic politics are typically ignored by policy makers in the international arena, reflecting a bias of country-to-country alliances as existing solely in the realm of 'high politics.' However, in academic circles, Japanese democracy has garnered no shortage of attention, though a comprehensive definition of it has tended to be elusive in most monographs on postwar Japanese politics. Indeed, Japan's democracy has tended to be defined by the nature of LDP politics during the postwar period and less by the activities of the electorate.

### **Description**

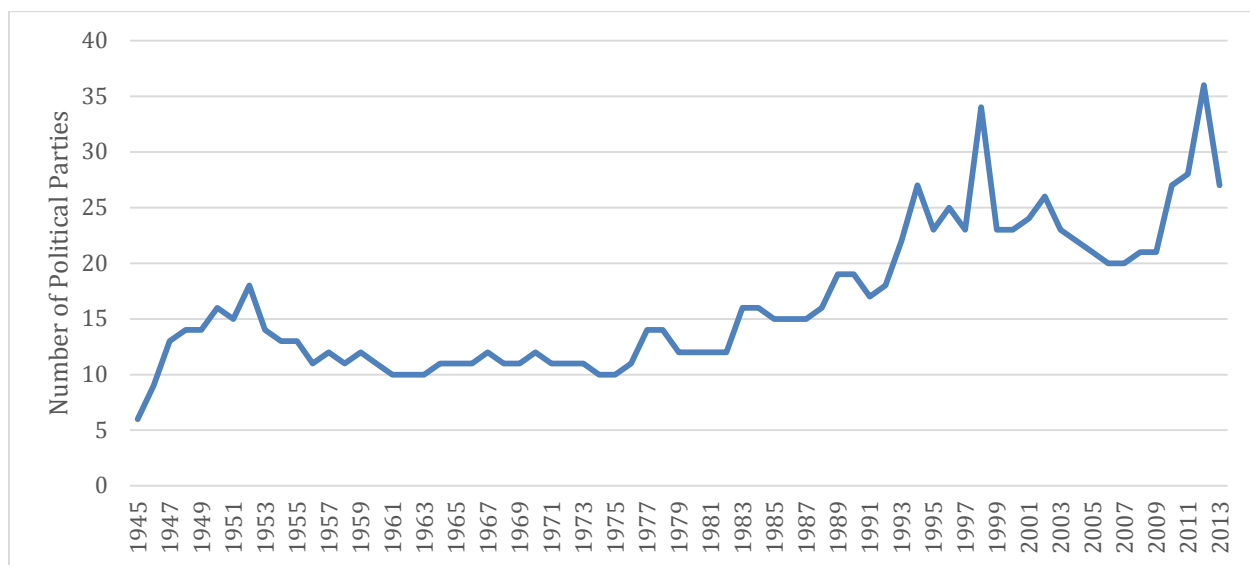
From an institutional perspective, Japanese democracy has remained roughly unchanged since ushered in by the Occupation and the issuance of a new Constitution in 1947. It is structured as a constitutional monarchy with legislative power residing in the Diet and executive power centered in the Cabinet with the Prime Minister at its head. The Diet is comprised of two chambers with a total of 722 seats. The House of Representatives is the larger of the two chambers with 480 seats and the House of Councilors the smaller with 242 seats. Until changed by the electoral reform in 1994, representatives were elected by the general public using a single non-transferrable voting (SNTV) system. The Prime Minister is formally appointed by the Emperor at the direction of the Diet. Conventionally, the president of the Diet's ruling party has been the Prime Minister. The Emperor himself has no real political power, serving instead as "the symbol of the state and of the unity of the people" (Japanese Constitution, Article 1, 1946).

Despite a democratic system modeled on western templates, Japanese democracy has been a puzzle for political scientists over the course of its postwar history. One of its most confounding characteristics has been the dominance of a single party in a multi-party system. The so-called 1955 system in place until the 1990s had the LDP as the sole ruling party and the Japan Socialist Party as the dominant opposition party. Other minor parties until then played only minor roles.

In theory, multi-party systems are fluid examples of democracy, characterized by shifting coalitions and requiring extensive bargaining. However, Japan's Liberal Democratic Party (LDP) has essentially been in power since its creation in 1955 with brief exceptions in 1993-1994 and 2009-2012. It is back in power now under Prime Minister Shinzo Abe, with the New Komeito, a centrist party, as its coalition partner.

Even so, viewed over time, there is evidence that Japan's anomalous characteristics are changing. Figure 2.1 below traces the evolution of the multi-party system up until 2013. The figure emphasizes the spike in democratic activity in the 1990s and paints a picture of increasing democratic participation.

**Figure 2.1: Evolution of Multi-Party System (Total Number of Parties per Year)**



*Source: List of Political Parties in Japan, Wikipedia 2013*

Immediately following the post-Occupation establishment of a new political system, the number of parties in Japan increased to 18 in 1952 before declining to an average of 11.05 from 1955 to 1976. The number of political parties then began growing by roughly 0.5 parties per year from 1977 to 1990. The early 1990s saw an explosion of political parties as the LDP's nearly 50 year monopoly came to an end. There was another burst of party creation following the global financial crisis. A simple t-test of the difference in the number of parties before and after 1994's electoral reform is significant at the 99% level of confidence, although the lack of robust controls limits causal inference. In the last election of December 2012, a total of 12 parties ran candidates for the House of Representatives, yet voters overwhelmingly favored one party, the LDP, which had been thrown out of power only three years before.

### **Summary of Existing Literature on Japanese Democracy**

Classic political works attempting to explain this anomalous history can be divided into three broad camps. Those attributing Japan's unique democratic history to cultural factors emphasize Japan's consensus-oriented decision making process, the dichotomy of *honne* and *tatemae* (explained below) in socialization, and the historic importance of patronage networks as causal determinants of Japan's single-party dominance and candidate-centered politics. A different, more loosely organized group of theories emphasizes the political economy factors of development and exogenous changes in the international system as the factors explaining the peculiarity of Japanese democracy. Finally, more institutionally-minded scholars have analytically described the nuances of those democratic mechanisms that allowed a single party to maintain power for decades.

### **Cultural Explanations**

As argued by T.J. Pempel (1991) and others, the Japanese culture values consensus in making decisions at all levels of organization, both political and social. This emphasis requires strong political tools for aligning party ideology and suppressing alternative viewpoints. One natural byproduct of such a system has been a powerful bureaucracy, through which many of the basic functions of government that might otherwise be arenas for political discussion are institutionalized and isolated from debate. The logic follows that, by empowering the bureaucracy, a consensus-oriented culture resists change, but it also allows power to be long held by a single party in a multi-party system.

Alternatively, authors such as Roger Bowen (2003) and Ethan Scheiner (2005) focus instead on the tension between *honne* (true identity) and *tatemae* (public identity) to explain Japanese democracy, which is seen as basically dysfunctional. Similar to the logic undergirding the consensus-hypothesis summarized above, social pressure to adopt a *tatemae* stance produces greater political conformity than in other examples of democracy.

This hypothesis emphasizes a snowballing effect, in which a dominant political party that is widely popular gains further support via the social pressure to align one's *tatemae* with the prevailing social preferences.

Finally, a subset of the anthropologist-political approach to explaining democracy typified by authors such as Ethan Scheiner (2005) and Larry Wade et al (1992) focuses on the prevalence of candidate-centered politics in Japan. This framework proposes that cultural norms of governance follow a family dynamic, in which political leaders assume the role of patron father-figures and provide basic resources to their constituents. Proponents of this theory point to the relatively large amounts of pork legislation and the dominance of individual representatives in certain areas who are able to maintain political power despite all manner of political gaffs and even criminal activity. It explains also the prevalence of "hereditary seats" in the Diet with one family passing along an electoral district to its scion.

While the cultural arguments summarized above are logically sound insofar as they describe a one-sided and static picture of Japanese democracy, they are all ill-suited to account for the increasingly active civil society, the proliferation of political parties, particularly in recent years, and the political instability since 2006 of a prime minister being changed every year. Moreover,

cultural arguments of all stripes are uniquely vulnerable to accusations of reverse causality in which the causal determinants are actually shaped by the very dependent variables they are assumed to affect.

### **Exogenous Factors**

Authors such as John Dower (2000) and Chizuru Saeki (2008) argue that Japanese democracy cannot be understood without taking into consideration changes in the international environment as Japan developed as a democracy during the postwar period. As an occupied country at the outset of the Cold War, Japan became a critical part of Washington's containment of international Communism policy. This security agenda was manifested both physically in the form of American bases permanently established on Japanese soil, but it also was represented in the form of democracy and capitalism that Japan adopted. America saw Japan as a poster child for western models of governance that could be held in positive contrast to the communist authoritarian models spreading from Moscow.

Ironically, the U.S. had an incentive to retard Japanese democracy in order to ensure that a friendly government stayed in power. The top priority was a reliable military ally on the doorstep of the Soviet Union, not a model of western democratic principles. While not resorting to the excesses of CIA intervention in Latin American governments during the same period, there is ample evidence of Washington tinkering with domestic Japanese politics. Scholars such as Bernard Gordon (2003) summarize theories suggesting that the dominance of the LDP over the course of the Cold War is a product of the international exigencies that necessitated a U.S.-friendly government in Tokyo. In this view, the loss of LDP power in 1993 and the attendant electoral reforms were a byproduct of the end of the Cold War and Japan's diminished geostrategic importance to American foreign policy.

Following a similar line of reasoning, David Engerman (2003) argues that the emphasis on economic development in lieu of democracy naturally muted Japanese democratic expression. The *de facto* power given to business in the beginning of the 1950s reduced the power of formal political parties, which persisted throughout Japan's meteoric rise. As Japan matured into one of the world's strongest economies, its citizens began to demand more from their government, resulting in regulatory reforms starting in the mid-1970s. This thesis explains the increase in democratic participation in the early 1990s by pointing to the onset of Japan's lost decade which de-legitimized the traditional engines of economic growth. The de-linking of economic development from political power allowed as surge in multi-party political activity.

### **Institutional Explanations**

Still other scholars stress the legal, organizational, and institutional mechanisms of Japanese democracy to explain its nature. Such authors as Matthew McCubbins *et al* (1995), Kathleen Thelen (2004), and J. Mark Ramseyer and Frances Rosenbluth (1993) argue that the attributes of pork legislation, candidate-centered politics, and bureaucratic dominance are products not of something uniquely 'Japanese' but rather are reflective of the institutional contours of Japan's postwar democratic system.

Their research examines the electoral reforms of the 1990s, presenting compelling arguments that link these reforms to changes in Japanese democracy that would be difficult to explain using

the cultural arguments outlined above. The late 1980s saw a series of high-profile cases of political corruption in Japan which prompted a national debate on campaign finance, non-government organizations, and electoral reforms. The reforms that followed were most directly responsible for the surge in the number of political parties and subsequent growth of the DPJ as a viable opposition party. Nonetheless, the broader environment that enabled these reforms can still be cited to explain the frameworks summarized above. Three reforms in particular warrant special discussion: namely, electoral reform of 1994, campaign finance reform of 1994, and the non-profit organization law (NPO Law) of 1998.

### **Electoral Reform of 1994**

The most important of the three was 1994's electoral reform, which replaced the traditional SNTV voting system or multiple seat districts with a combination of single-member district plurality (for 300 voting districts) and proportional representation (PR) in 200 voting districts (later reduced to 180 in 2000). This amalgamation was designed to reduce the candidate-centered politics of the past in which multiple candidates from the same party had to differentiate themselves to win local elections. Under the former system, it was possible for members of one party, usually the LDP, to hold more than one seat in a district. Winning campaigns relied heavily on the provision of pork and favoritism to special interest groups. Such politics led to corruption and collusion. It also served to disassociate candidates from their party (Ramseyer & Rosenbluth, 1993). In principle, a proportional representation system de-emphasizes individual candidates in favor of party lines, although the success of this reform is questionable. Ko Maeda (2009) examines the relationship between vote swings in PR and SMD districts to conclude that there has been a clear shift toward party politics in urban areas but less so in rural areas. He argues that this is due to both the heavier reliance on pork in rural areas as well as relatively lower migration rates compared to urban districts.

### **Campaign Finance Reform of 1994**

A second important reform promoting the explosion of political parties was campaign finance reform, also in 1994. Designed to make candidates more reliant on parties for funds, as well as to empower smaller parties, the law gave each party 250 yen per vote multiplied by the total population of Japan (Karl-Heinz Nassmacher, 2006). However, as discussed by Gerald Curtis (1999) and Tomoaki Iwai (2002), Japanese politicians were able to maintain their individual relevance by creating local party chapters to receive campaign contributions which they chaired. In his analysis of the distribution of these new funds, Matthew Carlson (2006) finds that party or faction leaders disseminated capital roughly equally between incumbents and challengers, although they gave significantly less to candidates running in PR districts than to those running in SMD.

### **NPO Law of 1998**

Significant also was the passage of legislation in 1998 relaxing the regulations on, and funding for, civil society groups. The Non-Profit Organization (NPO) Law allowed civil society groups to gain legal recognition without having to incorporate under Article 34 of the Civil Code and fight through a bureaucratic morass. Since its passage, the number of NPOs has grown dramatically, signifying increased public participation in Japanese politics – including local levels – and representing a potential new actor in public policy regarding the U.S.-Japan Alliance (Robert Pekkanen, 2004 pg. 12).

However, as discussed by Kawato and Pekkanen in 2008, the growth in absolute numbers of NPOs does not necessarily guarantee a cohesive or powerful voice for the public in the matters dealing with U.S.-Japan relations. These civil groups, in theory, can influence politics by: 1) augmenting state provision of social services, 2) improving voter relationships to political parties, thereby increasing 3) the social capital of said parties, and 4) influencing policymaking via advocacy and monitoring. Kawato and Pekkanen highlight the under-professionalization of NPOs, emphasizing the relatively small number of policy-relevant research articles produced and their strong local focus. Although recent trends suggest that NPOs are growing in influence, their proliferation has not yet resulted in the maturation of a formal and significant new actor in the U.S.-Japan relationship.

### **Summation**

Current research paints a clear picture of greater political participation in Japan's democratic system. This shift has been precipitated by sociological factors (changing cultural expectations of the representative / constituent relationship), international factors (the end of the Cold War and Japan's changing geostrategic importance), economic factors (Japan's lost decade and the de-legitimization of Japan's traditional engines of growth), and institutional factors (corruption scandals of the 1980s and the corresponding political reforms). While each framework has its merits, the analysis in this paper emphasizes the impact of institutional reforms and the corresponding proliferation of civil society actors.

Independent of the relative merits of each explanatory framework, the trend is inescapable at the national level. The increasing ability of Japan's civil society to express itself and participate in the democratic process brings new challenges to the Alliance. In particular, a growing popularity of alternative strategic perspectives on Japan's security that do not necessarily place as much emphasis on the U.S. military presence can be measured through the election of local and national leaders.

Following this thread, the next section discusses the basing issue in general and the long-delayed Futenma relocation plan in particular, highlighting the impact of greater democratic participation on one of the most vexing issues troubling the bilateral alliance relationship.

### **Part III: US Bases in Japan**

Following the end of World War Two, the American military, with General Douglas MacArthur as Supreme Commander for the Allied Powers (SCAP), occupied and administered Japan until 1951. Japan's military was disbanded and U.S. forces took over Japan's bases. In 1947, the Occupation-drafted Constitution of Japan went into effect, laying the foundation for democracy in Japan, as well as prohibiting any act of war by Japan. The war-renouncing Article 9 forms the basis for Japan's Self-Defense Forces (SDF), whose roles and missions are limited to the exclusive defense of Japan, although debates over the interpretation of its wording continue.

In the wake of the San Francisco Treaty of 1951, Tokyo agreed to a security treaty with the U.S. that provided land for military bases to the U.S. forces even after the Occupation ended in 1952. In return, Washington's promised to defend Japan. The basic framework of this relationship was augmented in 1960 with the Treaty of Mutual Cooperation and Security that called on both states



to respond to an attack on Japan. The permanent stationing of U.S. forces on Japanese territory was the legacy of this treaty (Saeki, 2006).

### **Okinawa**

The main island of Okinawa was the site of one of the last major clashes between American and Japanese forces in World War II, and the only part of inhabited Japanese territory to experience a land battle. The Battle of Okinawa was a particularly bloody and gruesome chapter of the War; the island's population was decimated from the fighting, disease, and mass suicides. The American forces occupied the island after the war and did not return the territory until 1972. During that period, Washington built a series of large military bases on the island that at one point, took up more than a fifth of the land area. Following the reversion to Japan in 1972, a treaty was signed to ensure that U.S. rights to the bases would be maintained (Roy Edgar Appleman, 2000).

Today, of the 52,692 US troops stationed in Japan, 56.9% are located in Okinawa. These bases comprise 10.2% of the main island's geographic area and represent 75% of the total US base presence in Japan as a whole. In comparison, US bases in mainland Japan take up just 0.02% of the geographic area (Kensei Yoshida, 2008). During the period from 1945 to 1972, Okinawa was administered as a US territory in which the dollar was the unit of exchange and cars drove on the right side of the road. Although the reunification with Japan reduced these symbols of American occupation, the U.S. presence in Japan is preponderantly located and felt in Okinawa (Nicholas Sarantakes, 2000).

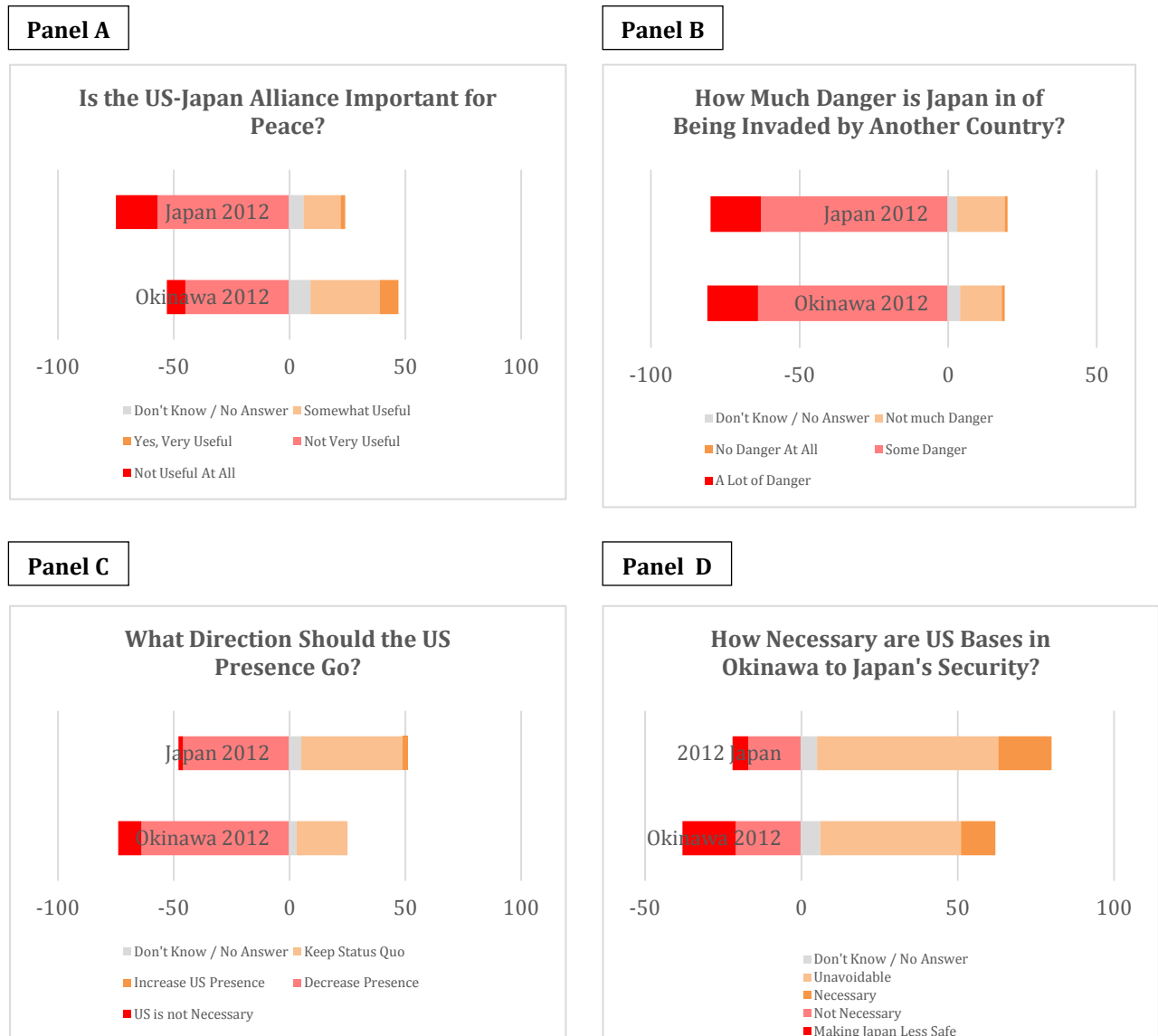
Although the bases confer benefits to residents of the island beyond the simple public good of security, they have been a constant source of friction, particularly due to a perceived prevalence of incidents and accidents. Military exercises occasionally have resulted in accidents that leave casualties and damage in their wake. In 1959, a U.S. jet fighter crashed into a school, killing 17 students and wounding 121. In August 2004, a helicopter from Futenma Air Station crashed into the adjacent Okinawa International University. Though the accident miraculously produced no civilian casualties, it enraged local residents of Ginowan City and the rest of Okinawa. The result was a re-commitment by the Pentagon to speed up the return of Futenma and a new agreement between the U.S. and Japanese governments.

Although noise and environmental damage also have angered Okinawans to the extent that numerous law suits have been filed, and won, the strongest resentment has come from the crimes committed by U.S. servicemen. The rape of a 12 year old girl by 3 soldiers in 1995 set off a national outrage unheard of previously when crimes by U.S. personnel in Okinawa had occurred. It also produced a highly organized anti-base movement that continues to impede attempts to build new structures – the Futenma replacement facility -- even if designed to reduce the U.S. troop presence overall (Chalmers Johnson, 1999).

The cost of the excessive burden borne by Okinawa for hosting US military bases is reflected across a variety of opinion polls as described below in Figure 3.1 (Kei Kono and Toshiyuki Kobayashi, 2013). While mainland Japanese and Okinawans share similar security perspectives in general (see panel A), analysis of the data highlights deep cleavages between the two populations. Interestingly, Okinawans value the U.S.-Japan relationship more strongly than

mainlanders for its importance to peace (see panel B). Yet, they also believe that the U.S. military presence should be decreased (panel C) and they are more negative about the necessity of having U.S. bases in Okinawa for Japan's security (panel D). These preferences highlight not-in-my-backyard (NIMBY) dynamics at play. Okinawans, by virtue of their over-exposure to the bases, may have a greater appreciation for the peace and security benefits provided by the alliance with the U.S., but they also hold more negative views regarding the presence of the bases.

**Figure 3.1: Opinion Poll Data on the U.S.-Japan Alliance by Okinawans and Mainland Japanese in 2012**



**Futenma**

Of the bases in Okinawa, Marine Corps Air Station (MCAS) Futenma is by far the most controversial. It is located in the center of the densely populated Ginowan City and was the site of 2004's helicopter crash. It has become the symbol of the base problem in Okinawa and the rallying point for the anti-base movement in the prefecture and across Japan.

As such, it has become the embodiment of Japan's participatory democratic process, thanks to a stalled relocation project that has yet to be on track for resolution, despite nearly two decades of negotiation and several government-to-government agreements. The ensuing analysis divides the Futenma relocation project into three separate case studies in order to chart the growth of a new popular security perspective that increasingly questions the Alliance in strategic terms. While the tools of delay have always been local NIMBY politics, the overarching discussion has evolved from one in which NIMBY arguments dominated the debate (case study 1: NIMBY politics until 1997) to one in which overall troop reductions were paramount (case study 2: Koizumi Administration) and then, to the explicit questioning of the Alliance per se (case study 3: Hatoyama Administration). To understand the logic of this analysis, a brief history of the project is first needed, though.

### **Relocation Project: Outset**

The Futenma Relocation Facility (FRF) plan was the end result of President Clinton's emergency diplomatic reaction to the 1995 rape incident. Though the perpetrators were not stationed at Futenma, the base was the most visible embodiment of the U.S. military presence under which Okinawans had chafed since the end of the war. The rape incident and ensuing public outcry brought the issue of the America's military presence to the forefront of popular thinking and threatened to seriously damage the Alliance if not handled quickly and effectively.

The U.S. allowed Japanese courts to try the charged soldiers instead of applying the extraterritoriality clause of the Status of Forces Agreement. President Clinton, meeting with then Prime Minister Ryutaro Hashimoto, agreed to close the Futenma base and a special bilateral panel later decided to relocate its several functions elsewhere, closing and returning the land to Okinawa within five years. The agreement contained a promise to reduce the amount of land used by US military bases by 21% by adding other facilities to be returned.

From its outset, the planned FRF raised fundamental questions about U.S. military bases in Japan that had broad implications for the Alliance. The first and most damaging question, which would go on to delay the project for over a decade, was where to relocate the base's functions, especially the helicopter unit, which was to stay on Okinawa. Despite the solidarity expressed by the Japanese public in response to the rape case, particularly among residents of Okinawa, once the destination of FRF was revealed to be inside Okinawa, that unity fell apart as powerful NIMBY concerns erupted. The victims of such NIMBY reactions were the residents of Ginowan City, who enjoyed much public support in principle but were betrayed on every occasion by their countrymen whenever concrete relocation plans were made public. Even one mayor of Ginowan in the 2000s was more concerned with preventing the base from being relocated elsewhere in Okinawa than with actually closing down Futenma expeditiously.

A second question that was glossed over in the initial agreement of 1996 related to the larger issue of the U.S. military presence. The promise to reduce the amount of land used for military bases by 21% was interpreted by US officials as a consolidation effort that would make bases run more efficiently without reducing the overall level of military capabilities. However, for many Japanese, this promise indicated a net reduction in the U.S. military presence. Although anti-base activists had been pushing for the complete removal of all the bases for years, prior to the 1996

agreement, they had been considered a fringe group with goals incompatible with security necessities. And while policymakers in Washington and Tokyo were pursuing their course of action, the Japanese public had already begun to think seriously about the prospects of a significantly reduced U.S. military presence in Okinawa if not all of Japan. It is interesting to note that the DPJ as a fledgling liberal party in 1996 campaigned on a promise to remove all U.S. bases from Japan.

Such thinking seemed rational in the post-Cold War era. The Soviet threat was gone, and the Asia-Pacific region, with the exception of a quirky North Korea, seemed to be heading toward the kind of peace and prosperity, which only years before had been an unattainable dream. In practical terms, many Japanese believed that their country's geostrategic importance to the U.S. containment policy had been significantly reduced by the collapse of the Soviet Union. Though threats posed by North Korea and a Taiwan-obsessed China remained, the prevailing wisdom held that Pyongyang would collapse by the end of the decade and that China's development-oriented foreign policy required diplomatic engagement instead of the zero-sum calculations justifying military containment. By agreeing to a relocation proposal that neither specified the destination for parts of the Futenma Base nor clarified the broader strategy involving the reduction of the U.S. military presence, President Clinton and his advisors created an uphill battle for the implementation of their plan.

### **Case Study 1 - NIMBY Politics: Nago Referendum of 1997**

Even before the relocation agreement was officially signed, U.S. and Japanese negotiators were debating where the best destinations for Futenma's helicopter unit should be. The two most realistic plans both involved sited on Okinawa. The first option was to incorporate the helicopters into an existing base, Kadena Air Base, while the second suggested either incorporation into Camp Schwab, a Marine Corps base in the less populated northern part of the island, or building a runway adjacent to that facility. US military strategists did not support proposals to relocate the heliport to mainland Japan because response times in a crisis situation required the helicopters to be located close to the troops. Furthermore, US negotiators argued against the Kadena option on the grounds that the base was already judged too noisy by the local population and that incorporating slow-moving helicopters into an air-traffic control system designed for high-speed jets would create dangerous logistical problems, especially during a crisis situation.

By the time the relocation agreement was signed in December 1996, negotiators had settled on a sea-based facility off the coast of Camp Schwab, although this was not explicitly referenced in the document. As 1997 began, so did the initial steps to move the helicopter unit to the waters off Camp Schwab. Prime Minister Hashimoto appointed a special emissary, Yukio Okamoto, to serve as a main facilitator between Okinawa prefecture and the central government. But Governor Masahide Ota of Okinawa refused to cooperate, tapping into popular sentiment that wanted not just a reshuffling of facilities but an overall reduction of troops in Okinawa. Ota issued an action plan that would have all U.S. bases removed from Okinawa within 15 years. Ota's position, while extreme, underscored a growing debate over the management of the Alliance to reflect local views – something that had never been done before. And while Ota was careful not to align himself directly with fringe activists, his actions as governor certainly gave

them aid and comfort. For Washington and Tokyo, the message was clear: local politics could no longer be ignored in setting the course for realignment of U.S. facilities in Japan. Over the course of 1997, Okamoto traveled dozens of times to Okinawa to push for local support of the plan for an offshore facility, dangling economic incentives as the reward for cooperation. By the time of Clinton's second inauguration on January 21, 1997, Nago City had accepted the basic plan of an offshore facility near Camp Schwab in Henoko district. But even this acceptance was quickly muddled by debate over the type of facility to be constructed: a mega-float or quick-install platform (QIP) facility versus a land reclamation project. Local contractors were capable of conducting land reclamation but an offshore floating or QIP option would have to be contracted to technologically-capable companies from the mainland. This debate was only the beginning of one delay after another.

A prerequisite to construction was an environmental survey. Underscoring the importance of local buy-in, Governor Ota refused to accept the survey until the local Nago Mayor signed off on it. Then, when it looked like the project was about to start in mid-1997, a group of environmentalists staged a permanent sit-in at the water site and effectively blocked the survey team from drilling. The standoff lasted for years, with the central government unwilling to risk taking action to evict the group from the site.

The tension between local pork barrel largess and environmental protection created growing concern among the residents of Nago City. Land reclamation would offer the most lucrative contracts for local developers but would also be the most damaging option for the coral reefs and the native dugong populations. The delay led to a city-wide referendum for Nago residents, who voted against accepting the heliport by a bare majority of 52%. Citing the referendum, Governor Ota reversed his unofficial support, betraying Prime Minister Hashimoto in the spring of 1998. The FRF project was literally dead in the water.

This first chapter in the long and redundant saga of the issues facing the Futenma relocation project not only exemplifies the consensus-oriented nature of Japanese decision making but it also anticipates the basic dimensions along which future debates would play out. It can be seen as an important reference point in the evolution of growing Japanese democratic expression. While anti-base activists pushed for more far-reaching reductions, their values were only expressed at the prefectural level by the Okinawan governor and, even then, only weakly. The basic resistance to the Camp Schwab option stemmed from local concerns over the environmental damage that would be done. Local developers were drowned out. The conversation, however, steered clear of questioning the importance of the U.S. military presence in general terms or the Alliance *per se* in strategic terms.

### **Case Study 2 - The Shift toward Overall Troop Reductions: The Koizumi Administration**

After 1998, the FRF project sank into a morass of competing interests. Local politics, in which the interests of those most directly affected by the Futenma base -- Ginowan City residents -- were secondary to political grandstanding and NIMBY debates. It took the crash of a U.S. military helicopter into a university campus in August 2004 to return the conversation over Futenma back to the interests of Ginowan residents. The incident galvanized Prime Minister Junichiro Koizumi, until then a passive actor on the FRF issue, into action -- though, as will be demonstrated, his attention was divided.

Koizumi, who took office in 2001, was by far the strongest Japanese prime minister in decades. He sought to redirect his party, the LDP, away from relying on the support of traditional interest groups and toward forging new bonds with the urban electorate, many of whom supported no particular political party. He cut the pork-barrel budget for public works, which favored the rural areas, and privatized Japan's postal system as part of a series of structural reforms. On the security front, he strongly supported the U.S. in its post-9-11 war on terror, even boldly deploying the SDF to Iraq and to waters off Afghanistan to support America's efforts there. The SDF dispatches were the first time since the end of World War II that Japanese troops were deployed abroad. Although Koizumi took care through logistical details that the troops were never in harm's way, the symbolic significance of his decision was controversial at home, and opposed as unconstitutional by the opposition camp in the Diet, including the DPJ. Rumors of a hedging strategy began to gain traction among academic circles even before the Berlin Wall fell, but under Koizumi, these debates took on heightened meaning. As detailed by Richard Samuels and Eric Heginbotham (2002), Koizumi's security policies were less those of a newly assertive ally but more indicative of a cautious partner caught between competing fears of entrapment and abandonment. This binary framework was soon augmented by others, including Christopher Hughes (2004) and Evans Medeiros (2005), who spotted indications of a strategic independence dimension when interpreting Japanese foreign policy.

Despite the proactive nature of Koizumi's foreign and domestic policies, his interest in the Futenma issue was spotty, even following the helicopter accident in 2004. He supported the incorporation of the Futenma relocation plan in the Defense Posture Review Initiative (DPRI) talks which were started in 2002 to update the strategic military aspects of the Alliance. However, far from hastening the resolution of the relocation issue, entangling Futenma and related basing negotiations nearly derailed DPRI discussions on several occasions. Base issues, being highly visible aspects of the U.S. military presence in Japan, are naturally a lightning rod for popular interest and media scrutiny. Owing to bureaucratic wrangling and a handful of unfortunate leaks to the Japanese media that emphasized unpalatable U.S. positions regarding the realignment of military bases in Japan, the DPRI talks required high-level intervention ultimately in order to stay on track.

Koizumi, always in tune with the public mood, began to insist that an overall reduction in troop numbers be part of the negotiations. For Okinawa, such reductions were seen as relieving the island of some of its excessive hosting responsibilities. Though the discussion never widened to address the relevance of the Alliance as a whole, Koizumi's adoption of U.S. force reductions in Japan as a goal in the DPRI talks represents an important stepping stone on the path toward Hatoyama's eventual 'brash idealism.'

As the DPRI talks ground on, Koizumi's sporadic interest gave way to frustration, and on February 19, 2005, he angrily ordered his aides to "Do something on Futenma!" Having languished for almost a decade, the Henoko offshore plan was put back on the drawing board as the most plausible solution, but it soon was overtaken by other suggested locations. Even the Kadena integration plan from 1996 was resurrected for awhile, and one notion entertained briefly was to relocate Futenma's heliport to the remote island of Iejima. Koizumi reportedly even took the tactic of trying to buy local support for whatever plan was agreed upon by dangling the

prospect of a reduced U.S. troop presence. He was aware of a growing chorus of demands from such critics as the new Okinawan governor, Keiichi Inamine, Ginowan Mayor Yoichi Iha, and DPJ leader Katsuya Okada.

As the summer of 2005 wore on, Japanese negotiators piled increasing pressure on their U.S. interlocutors to reduce the overall presence of U.S. forces in Japan. While the negotiations themselves were firmly grounded in detailed logistics, the justifications among the general public increasingly took on broader strategic dimensions. Calls for a reduced US presence carried an implicit question of the overall importance of the U.S.-Japan Alliance. Though not yet at the level of the ensuing Hatoyama administration's view, the groundwork for a viable third dimension to the Japanese perspective on the relationship was laid under Koizumi.

Still, the political agenda was far larger than the stymied relocation plan of a single U.S. military base on Okinawa. Koizumi's privatization of the postal system, which had been instrumental to Japan's economic development since the 19<sup>th</sup> century, was bitterly contested by even members of the Prime Minister's own party, the LDP. He even threw out of the party those lawmakers against postal privatization, calling them "forces of resistance." On September 11, 2005, unable to pass key legislation, Koizumi dissolved the House of Representatives for a snap election that was to be a referendum on his structural reform policies. Still a hero to the electorate, the LDP won a landslide victory, bringing into the Diet over 80 hand-picked freshman lawmakers known as "Koizumi's children." The election victory was a powerful mandate for Koizumi to push through his postal reforms and other policies. Finally rearmed with broad public support, Koizumi was able to breathe new life into the stalled FRF plan.

The most feasible plan at the time was a modified Henoko plan that changed the location and scaled down the size of the runway to be used exclusively by U.S. military forces. However, local politics and special interests again bogged down the proceedings, with the Governor of Okinawa pushing for a dual-use airport. Inamine also wanted to put a 15-year limit on military use of the runway, a non-starter for the U.S. side. He threatened that, if his idea was rejected, he would push for relocation outside of Okinawa. This pitted the Okinawan governor against the Mayor of Nago City who had already conditionally accepted the modified Henoko plan. The situation was further complicated by the ongoing protests of those environmentalist groups that had already successfully stalled the first Henoko relocation plan.

Koizumi's successes – winning the election, bringing about a modest economic recovery, and building a strong personal relationship with President Bush – kept his popularity high, and allowed a more or less free hand in reaching a second agreement with an increasingly anxious U.S. administration in October 2005. Under the agreement, Japan was successful in obtaining a reduction of the U.S. Marine Corps presence in Okinawa. Some 8000 marines and their dependents were to be removed to Guam. Some F-15 Air Force jets stationed at Kadena Air Base would be relocated outside of Okinawa, as well. In return, Futenma would be relocated along the coast of Henoko adjacent to Camp Schwab. The plan reflected both the interests of the residents of Ginowan City and those residing near Kadena, as well as the broader interests of those pushing for an overall reduction in U.S. forces in Japan.

Heading into 2006, the plan seemed solid and implementable. But relocation of Futenma to anyplace inside Okinawa was still unacceptable to many in the prefecture, and the dissent was vociferous. Officials in Tokyo believed that they could smooth over any remaining concerns using traditional carrot-and-stick tactics: dangling more money to receive more local cooperation. But by this time, zealous anti-base activists, many from the mainland whose views did not reflect those of the local inhabitants, had taken the lead in staging protests in the island prefecture. To regain the momentum, Koizumi appointed a senior LDP member Fukushima Nukaga as the new director general of the Defense Agency and empowered him to have full authority over finalizing the details of the relocation plan. Nukaga was a shrewd negotiator who knew how to clinch a deal. Through his patient efforts, the relocation plan, slightly revised to accommodate Henoko concerns, seemed assured. Nukaga's plan was formally approved on May 30, 2006, but its implementation stage soon became entangled in another morass of local goal-post moving techniques designed to delay the project.

### **Case Study 3 – Hatoyama's 'Brash Idealism' and the Third Dimension of Japan's Security Strategy**

The Futenma relocation project again stalled as local interests continued to push for more concessions, more money, and revisions to the plan itself. A key complaint undercutting implementation efforts was that the final decision had been made without local input or concurrence. Nukaga would disagree, since he had lined up approval from both the governor and the Nago City mayor. But many in Okinawa felt that Tokyo had gone over their heads. As such, a major source of delay was discussions over broader issues relating to local representation in Tokyo.

This was not a new issue in Okinawa, for resentment against perceived slights by the Alliance Managers had persisted throughout the postwar period. Tokyo had ignored or only paid perfunctory attention to this discontent. Given this history, it is not surprising that local actors in the democratic process seized upon whatever means possible, starting with ambiguous language contained in the May 30<sup>th</sup> agreement, to subvert the plan.

As a result, the ensuing three years saw little movement on implementing the May 30<sup>th</sup> plan, with local voices raising a number of obstacles as they pursued their specific interests. Finally, in 2009, just when it seemed that the final obstacle of an environmental survey had been cleared, the DPJ was swept into power with a mandate of reviewing all Alliance agreements, starting with the Futenma plan.

Yukio Hatoyama, who became Prime Minister, had campaigned on a dramatic promise to relocate Futenma either out of Okinawa or Japan. By its nature, a political campaign must eschew detailed plans in exchange for sweeping generalizations in an attempt to rally broad support. The DPJ in its election rhetoric took the disparate voices of dissent emanating from Okinawa and fashioned a comprehensive campaign strategy – the Okinawa Vision -- that included such brash promises as moving Futenma far away, as a vote-gathering technique. The creators of the vision probably never really expected that the vision would ever have to be materialized. Nonetheless, what began as a pie-in-the-sky set of campaign promises evolved into a national security strategy that threatened to revamp the Alliance from scratch, starting with the bases in Okinawa. "Brash idealism" had been born.



The moniker of ‘brash’ is by no means baseless. Much of the DPJ’s diplomacy regarding Futenma and the Alliance as a whole was clumsy and inept. Hubris stemming from the DPJ’s landslide electoral victory played a significant role in the Hatoyama administration’s ensuing misjudgments in policy-making. Upon arriving in office, Hatoyama was presented with the completed environmental impact evaluation on the Henoko Plan waiting to be accepted. Believing that their electoral victory mandated a reset of the Alliance that had been promised during the campaign, Hatoyama ignored the survey. He then set off on a course of action that ultimately led to his own downfall.

In addition, the DPJ in the campaign promised to reduce the political power of the bureaucracy. The proposal was not without popular support, for officialdom during the LDP years had been perceived as overly powerful and interfering with the policy and legislative processes that Diet members were supposed to control. But the DPJ administration’s *carte blanche* rejection of bureaucratic actors deprived it of useful talent and skills and importantly, institutional memory. Officials cooled their heels while politicians made most of the decisions, sometimes badly. On the Okinawa basing issue, the Hatoyama administration was left with little understanding or knowledge of the many years of bureaucratic work that had gone into the relocation effort. Essentially, the DPJ in its hubris was doomed to repeat many of the same mistakes that previous administrations had made, and learned to avoid. Unaware or uninterested in the earlier strategic debates over the logistical requirements of troops and equipment, the time needed to reach potential conflict areas from different locations, and the basic infrastructure requirements to field a military force capable of defending Japan, Hatoyama’s administration had to relearn these lessons from scratch. Hatoyama himself reportedly did not even understand the concept of deterrence until an adviser briefed him.

The Obama administration initially gave Hatoyama some room to position himself, acknowledging the validity of a new party’s request to review the relationship in general and the relocation plan in detail. But U.S. hopes for a timely review and expectations initially that Hatoyama would make a decision on Futenma in December 2009, were soon dashed. In a famous summit meeting between Obama and Hatoyama, the Prime Minister asked the U.S. President to “trust” him to make the right decision on Futenma. This promise was immediately undermined the following day during a press conference. More than mere hubris, it seemed that the Hatoyama Administration did not understand the basic expectations of U.S. diplomatic conduct. Hatoyama never regained his political footing in Washington after that.

Nor yet is the ‘idealistic’ characterization unfounded. The DPJ wanted to create a “close and equal partnership,” which on the surface seemed like a dream come true for Washington. But Hatoyama was not talking about Japan picking up more responsibilities in the Alliance. Instead, it meant a paring down of them, with plans to revise the SOFA, review the force structure in Japan, and cut host-nation support for U.S. forces in Japan. For U.S. officials involved in the basing issue, this was a period of excruciating frustration. Issues that had long since been resolved were reopened and the basic framework by which to judge alternative options for the relocation plan was scrapped. Years of work were undone in days. More frustratingly, the initial negotiations with the new administration suggested that Hatoyama did not understand or care about basic strategic requirements. More than simply having to re-debate the operational and

logistical details of any relocation project, the U.S. officials found themselves having to justify this type of discussion as being necessary to the negotiations.

It took the DPJ almost a year to create a basic security calculus necessary to cogently discuss the relocation project. To the United States, Hatoyama seemed willfully ignorant of the larger international context in which an increasingly assertive China was building a blue-water Navy and ranging further afield and North Korean bellicosity was reaching new heights. As the discussions dragged into 2010, with relocation sites popping up one after the other only to be subsequently dropped, it was clear that the search for a new FRG site was going nowhere and that the basic foundations of the debate were eroding.

The ineffectiveness of the DPJ administration under Hatoyama to address competently the relocation issue was in part a consequence of the ruling coalition cobbled together by the party in its electoral victory. This coalition included the Social Democratic Party (SDP), an old-style socialist party that was firmly against any relocation plan within Okinawa. When initial working group talks re-established the basic security paradigms by which any plan should be judged, the Henoko option again became the top choice. But when the SDP head threatened to drop out of the coalition if this plan was accepted, Hatoyama stalled the Futenma plan in order to successfully pass the budget for fiscal 2010.

The political fall-out both at home and abroad was damaging and marked the beginning of the end for the Hatoyama administration. The Obama-Hatoyama relationship was irrevocably damaged, and with growing U.S. frustration, the possibility of Futenma remaining indefinitely open was openly hinted. Hatoyama's delayed Futenma decision in order to pass the budget ironically only postponed the SDP's bolting the coalition once it found out that the Prime Minister was going to accept the Henoko option, all other possibilities having been exhausted. By May, when that happened, public support for the Hatoyama Cabinet had dropped precipitously.

When Hatoyama resigned his post in June 2010, taking responsibility for having reneged in his promise to Okinawa, the DPJ's position had come around almost full circle on the relocation plan. The next prime minister, Naoto Kan, accepted Hatoyama's decision on moving Futenma to the Henoko site, and made efforts to repair the serious damage done the U.S.-Japan relations.

#### **Part IV: Public Perception and Japanese National Security**

Characterizing the Hatoyama administration as both "brash" and "idealistic" is not unfounded. The narrative above has highlighted events and approaches to the Futenma issue that show Hatoyama's weakness as a leader. But the electoral support initially enjoyed by his cabinet was based on campaign promises that many Japanese were quite happy to go along with. Though poorly executed, the DPJ's basic security perspective that it projected during the Hatoyama period can be said to represent a legitimate alternative to the entrapment-abandonment balance of fear duality usually cited to explain the underlying Japanese view of the Alliance.

#### **Strategic Theory**

A diminished U.S. military presence in Japan is not necessarily incongruous with the country's core interests from a logical strategic perspective. From a traditional realist perspective, China's

rise can be interpreted as implicitly threatening American power in relative terms. One does not need to adopt a Hobbesian world view to understand that, as U.S. power declines, so does Japan's assurance of protection. Steve Chan notes that the current theoretical debate over China's rise misuses the terms 'balance' and 'bandwagon' (Chan, 2012). Most of the literature presents China as a rising power that the neighboring states will either bandwagon with or balance against. However, the predominant power is still the United States. As such, pushing Japan to balance might result in Japan deciding to balance against preponderant American power in the region. Although pan-Asianism was largely discredited following Japan's past foray into imperialism, there are sound economic and strategic reasons for Japan to bandwagon with China instead of against it.

Foremost among these is the growing economic interdependence between the two countries. While U.S. markets may have been the engine driving Japan's miracle years of economic development, China now firmly occupies the position of Japan's number one trading partner (Eric Fisman et al, 2012). Such a close economic relationship means that the costs associated with escalating negative diplomatic ties continue to rise. Similarly, as the U.S. declines in relative importance as Japan's major trading partner, the implied costs of Alliance dissolution decline (Chan, 2012).

Japan's basic security calculus may also be shifting. If Japan could reach an accommodation with China over its now tense territorial dispute over the Senkaku Isles, the mutual benefits of having a closer security relationship with China would become apparent. A strong security relationship with Beijing would mitigate Tokyo's maritime fears springing from China's increased naval prowess (Min Guo Koo, 2009). Furthermore, Japan's deepest historical animosities are not against the Chinese but the Russians. Finally, China's rise implicitly threatens the U.S. ability to ensure Japan's protection, despite the so-called "pivot" of American policy toward Asia (Chan, 2012).

Taken together, these theories lay a logical foundation on which a new Japanese security perspective can be built. Obviously, the discussion above exaggerates the reality of Sino-Japanese relations. Although trade is increasingly shifting toward China, it seems unlikely that the territorial disputes will be peacefully resolved in the near future. Furthermore, although Japan's deepest regional resentments may lie with Moscow, the same cannot be said for China whose resentment against Japan's imperialist past would leave a bitter taste even without Tokyo's recurrent feather-ruffling nationalist statements and behavior. Finally, even at its current blistering pace of development, China remains a distant second to U.S. power. An outright rejection of the U.S. in favor of China would be unimaginable given the current and projected power capabilities.

Nevertheless, the discussion above is presented to emphasize the logical framework around which a third modality of Japanese security strategy can be built. Although the extreme of alliance rejection is far-fetched, a more balanced multilateral system of alliances is not only feasible but logical. As such, the assumption of many in Washington that the fundamental approach of the Hatoyama Administration to the Alliance was an aberration is short-sighted. The Hatoyama Administration should instead be viewed as a clumsy first attempt to represent a new

security perspective that seems to meld well with the public's mood in Japan and is strategically defensible in theory.

### **Recent Reversions to Traditional Security Perspectives**

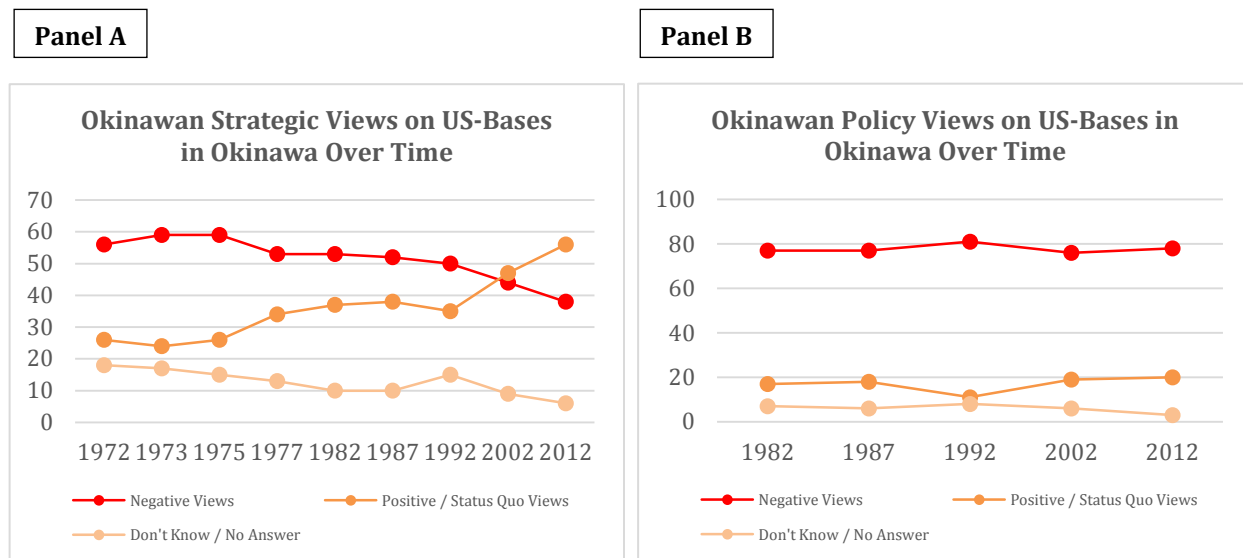
As of 2012, China's aggressive posture in waters near the Senkakus and North Korean bellicosity have been game changers for Japan, which is now rewriting its defense guidelines in order to respond effectively in case of a contingency. The changing environment has reduced the relevance of the theoretical arguments presented above.

The shift of thinking in Japan, both on the mainland and in Okinawa, toward a more traditional view of security can be seen in opinion polls. Though evidence of a new strategic perspective first captured by the Hatoyama Administration persists, the majority of discussions of the basing issue has reverted to NIMBY concerns, reflecting the exogenous changes in the regional security environment.

First, as discussed above, the general threat perception level of mainland Japanese does not differ dramatically from that of Okinawan residents. Roughly 80% of both populations are worried about the possibility of an attack on Japan. With such a figure, it is difficult to justify the notion of idealism dominating the thinking of average Japanese citizens. Moreover, when viewed over time, even the views of Okinawans on the presence of U.S. bases have ameliorated (see Panel A below). Although Okinawans are not as pro-base as mainlanders in a sampling of opinion in 2012, Okinawan views favoring bases, which used to be below a majority, are now almost 60%.

Yet, when Okinawans are asked about the functional aspects of U.S. bases, specifically the future direction of the burden born by Okinawa, the answers tell a different story. As depicted in Panel B, roughly 75% of Okinawans have consistently called for the complete removal or the decrease of US bases over time. The contrast between the higher level strategic views regarding the U.S. bases in Okinawa and the policy-relevant views on troop numbers and facilities underscores NIMBY politics at play. Although Okinawans are sensitive to the larger strategic calculus involved in maintaining the bases, they resist future scenarios that do not include a reduction in troop presence. It is these sentiments that the DPJ and Hatoyama captured in the election campaign in 2009.

Figure 4.1



*Panel A:* When asked the question “How necessary are the U.S. Bases in Okinawa for Japanese security?”, respondents replied with either positive or negative views. ‘Negative views’ include “Not necessary” and “Making Japan less safe”. ‘Positive views’ include “Unavoidable” and “Necessary”.

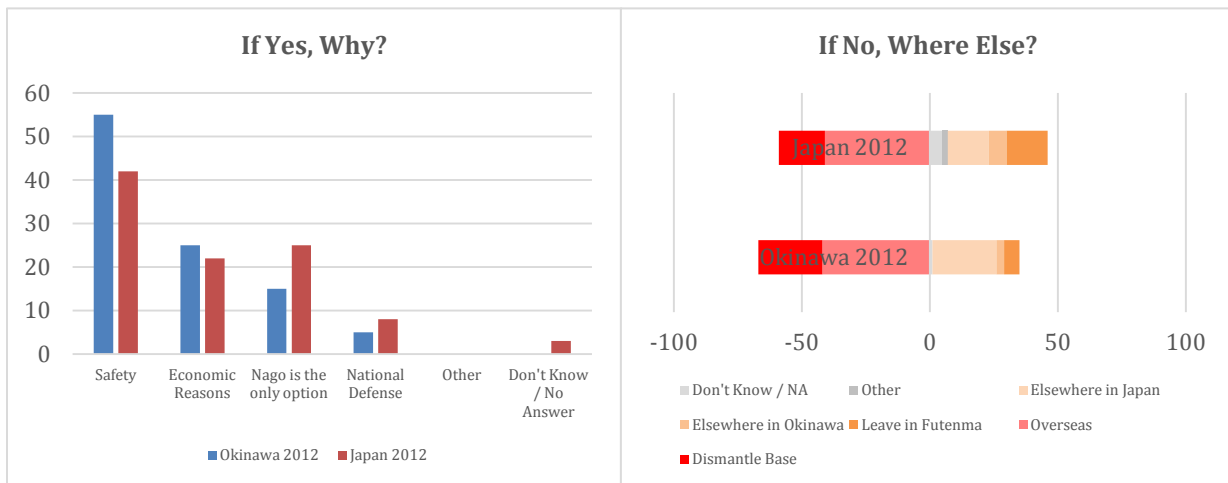
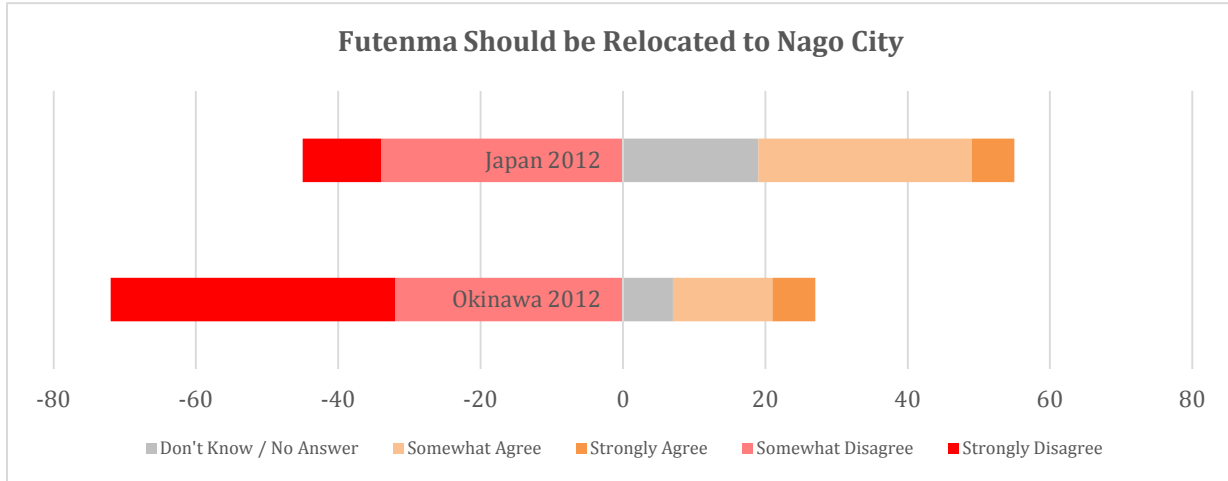
*Panel B:* When asked the question “What should happen to US Bases on Okinawa in the Future?”, respondents replied with either positive or negative views. ‘Negative views’ include “Decrease to level of burden on mainland” and “Get rid of bases entirely”. ‘Positive views’ include “Maintain status quo” and “Increase number of bases”.

On the Futenma relocation issue in particular, a gap between the views of mainland Japanese and Okinawan residents emerges. Over 70% of Okinawans opposed the Nago City destination in 2012, compared to less than 50% of mainland Japanese (see Panel A). In detail, only 11% of total respondents on the mainland strongly disagreed with the statement that ‘Futenma Should be Relocated to Nago City’ while a full 40% of Okinawans strongly disagreed. This contrast, combined with the 19% of mainland respondents who replied ‘Don’t Know / No Answer’ reinforces NIMBY politics at play.

When asked about these opinions in greater detail, those in support of the move predominantly cited safety concerns relating to Futenma’s current location in Ginowan City, followed by economic justifications (see Panel B). Mainland respondents, again reflecting their lack of direct exposure to the issues at hand, responded much more strongly that the Henoko destination was the only option. Interestingly, national defense was the lowest among both Okinawans and mainland Japanese, suggesting that, while the Alliance itself is still viewed as necessary, the strategic rationale for Futenma’s current location (i.e., co-location of troops and helicopters) does not resonate with the public.

Those against the move were also given a follow-up question, asking where else the base should be moved to. Among those against the Nago City relocation destination, the majority of both mainlanders and Okinawans support either completely dismantling the base with no replacement or moving the facilities overseas (see Panel C). Unsurprisingly, the third most popular option among mainlanders was to leave the base in Futenma while the third most popular option among Okinawans was to move the base elsewhere in Japan (not Okinawa). Also of note is that none of the Okinawan respondents either for or against the Nago City option replied ‘don’t know / no answer’ in the follow-up questions, reflecting the relatively strong polarization of the issue on the island.

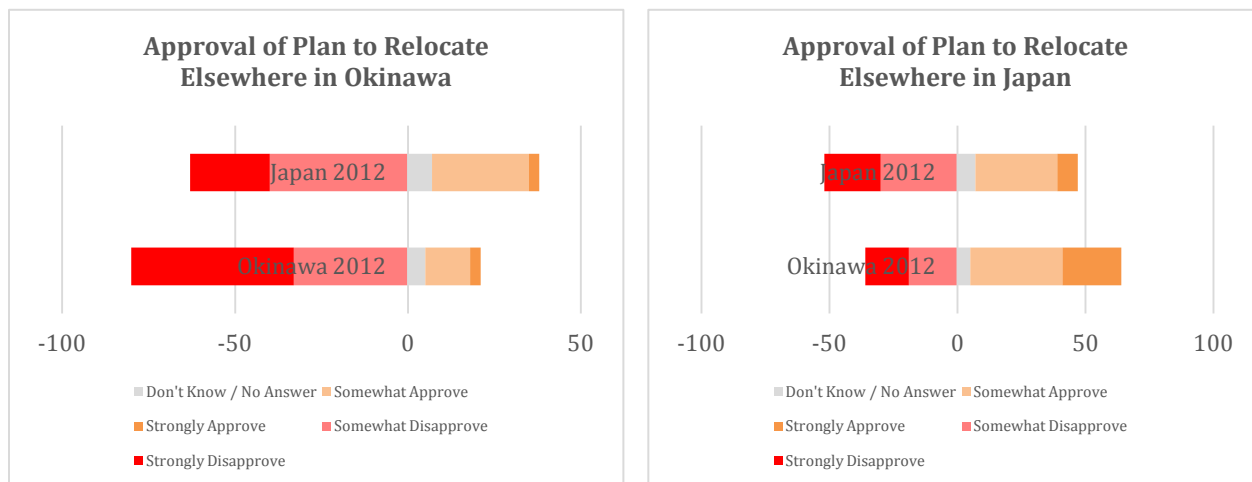
Figure 4.2



The opinion polls cited above emphasize the dichotomy in public perception of the Futenma relocation project against the more theoretical topic of the Alliance. The motivating factors for opinions about the base are specific in nature, highlighting the role of NIMBY politics as the main source of obstacles. However, the rhetoric of Hatoyama’s campaign and the appeal of broader strategic considerations were significant, albeit short lived.

The data summarized below refer specifically to the DPJ efforts under Hatoyama to re-evaluate the existing relocation proposals. The questions were broken down into two parts. The first asked whether the respondents approved the initial attempt to relocate the base outside of Okinawa while the second asked whether the respondents approved the ensuing acceptance of the existing plan following Hatoyama’s resignation. In line with the results presented above, there is a clear gap between Okinawan and mainland Japanese responses with Okinawans vastly preferring the initial attempts to relocate the base off the island.

Figure 4.3



### Conclusion: The Future of Futenma

As of May 2013, the future of the FRF project remains elusive, with the ball now in Okinawa's court: the governor now must sign off on an extensive environmental assessment report – the last hurdle to actually starting the construction at the Henoko site. Optimistic projections peg the earliest potential date for closing Futenma at 2023 (Travis Tritten and Chiyomi Sumida, 2013).

With the return of the LDP to power, its pro-active leader, Prime Minister Shinzo Abe, reportedly is serious about resolving the Okinawa basing issue during his term in office. Still, the history of Futenma has been filled with disappointment for all parties, and there is no reason yet to be even cautiously optimistic. Opposition forces in Okinawa still have the lead and the momentum. The still-born proposal agreed to in 2006 is a stark reminder of the uncertainty springing from an increasingly volatile political environment when it comes to the future of bases on Okinawa.

Still, one cannot dismiss the Abe administration's intention to resolve the Futenma issue by using traditional levels that seemed to work before. In the words of one Japanese diplomat:

“I'm sure the Abe administration will use all the tools it has in trying to persuade the Okinawan people that the government and other parts of Japan are very supportive of Okinawa for their taking up the burden of accepting this replacement facility. The benefit of accepting this replacement facility is not only the return of Futenma but also various other [means] of [economic] support through economic stimulus packages for other parts of Okinawa.”

This quote emphasizes an important aspect of this paper's analysis that needs discussing: namely, the gap in political sensitivity between Tokyo and Okinawa. American officials are not the only ones who risk not taking seriously a changing security perspective implied by the brash idealism demonstrated by the Hatoyama administration. Traditional political and economic levers may no longer work. Okinawans in this case are unlikely to be intimidated by political sticks or pacified by additional carrots in the form of public works spending and development packages.

As described by Kent Calder in *Embattled Garrisons* (2007), compensation politics is a very effective way to maintain smoothly functioning bases as long as the negative and positive externalities are clearly defined. Indeed, Calder uses the U.S. bases in Okinawa as an example of good base-politics management. However, an evolving security perspective may threaten the positive externalities afforded by the military bases, at least in the short run. If this is the case, the standard compensation politics like those described in the official's statement above are less likely to be effective.

This is not to argue that a third dimension to Japan's security perspective is threatening the foundation of the Alliance. Rather, the key to maintaining alliance objectives, including the U.S. military presence in Okinawa, may lie in modifying traditional arguments in support of the Alliance to accommodate growing support in Japan for a strategic-autonomy approach. As the externalities associated with maintaining U.S. bases in Okinawa, particularly the argument for the provision of national security, are challenged, the number of stakeholders in the discussion is likely to grow beyond the ability of Tokyo to satiate with pork barrel legislation and local development projects.

Framed as such, Japan's evolving national security perspective presents an opportunity to restart and modernize the Alliance in a way that the functional negotiations conducted in the Defense Posture Review Initiative were unable to accomplish. Beyond modernizing the physical military capabilities, the U.S.-Japan security arrangements should be refreshed to acknowledge the growing public support of a new strategic perspective that challenges the traditional arguments backing the alliance relationship. Initiating these discussions at a time when the public has swung back toward the traditional security framework allows Washington to negotiate from a position of strength in which alternative arrangements can be discussed insulated from popular discontent with the presence of foreign troops on Japanese soil. The future of East Asian security need not cleave so closely to the Cold War lines it inherited, and the growing skepticism toward traditional justifications for the Alliance, as manifested in 2009, emphasizes the need to find alternative arrangements that can satisfy both the security and prosperity requirements of all parties.

### **Summation**

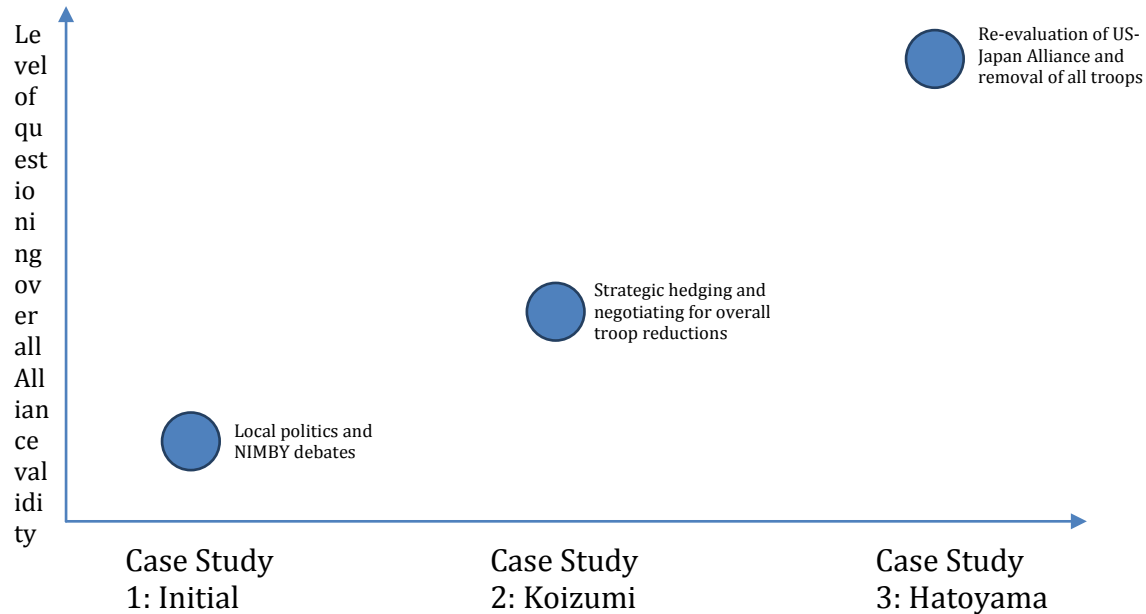
The analysis presented here argues that the basic security perspective of Japan has evolved since the end of the Cold War to include a third option of strategic autonomy. Unlike other U.S. relationships in the broader Asia region (i.e., India), Japan's historical legacy has stunted the political expression of this new option. The long-term presence of U.S. bases and the heavily emphasized geostrategic importance of Japan during the Cold War ensured that viable alternatives to the Alliance were never seriously considered. This suppression can be seen in the dominance of a single, U.S.-friendly political party throughout most of Japan's postwar history and the attendant duality of Japan's national security debate between the fear of entrapment and the fear of abandonment.

The electoral reforms of the 1990s gave new outlets for public expression, breathing life into a national security perspective that is less U.S.-centered. Even the conservative LDP has favored a stronger autonomy for Japan within the Alliance context. The analysis conducted above has



traced the evolution of a new national security paradigm through the framework of a case-study examination of the Futenma relocation issue. Dividing the research into three distinct periods (initial discussions over relocation, the Koizumi Administration, and the Hatoyama Administration) charts a clear evolution of the new security paradigm over time. Figure V.1 below illustrates this concept.

**Figure V.1**



The evolution of Japan's security perspective can be seen most clearly through the lens of the FRF issue. Although the intervening obstacles were consistently local politics and interest groups, the phrasing of the larger arguments suggests a fundamental shift away from NIMBY concerns and toward a comprehensive reimagining of the Alliance. Ironically, the ineptitude of the Hatoyama Administration to effectively represent this new strategic perspective may have helped dampen its development. The media's response in the spring of 2010 was to rearticulate the basic benefits of the Alliance in security terms. Furthermore, 2012 opinion polls highlight a reversion to traditional security perspectives, likely stimulated by security concerns over Chinese activities in adjacent waters and North Korea's nuclear and missile threats.

Still, the evidence presented above suggests that a third dimension to Japan's traditional duality-of-fears framework is neither brash nor idealistic despite these adjectives being well-suited to describe its first national political expression. A strategic autonomy strategy or a hedging strategy is not intrinsically incongruous with Japan's national interests. As Chinese strength continues to increase relative to that of the United States, strategic challenges to the Alliance will grow. While China's recent territorial activism has ensured that the traditional philosophy behind the security alliance remains relevant, it ultimately may be the twists and turns in the Futenma issue that portend the future course of the Alliance.

As such, to simply categorize the Hatoyama administration's term in office as dominated by "brash idealism" is misleading. The DPJ ideas challenging the very fabric of the Alliance, though poorly implemented by Hatoyama, are not a deviation from mainstream thinking in Japan. Figure V.1 above, though stylized, places the Hatoyama administration clearly on the trajectory that started with 1995's rape incident and the ensuing FRF plan. Future U.S. diplomacy toward Japan should be sensitive to this trend and seek to incorporate the security interests of the United States with those of a Japan that increasingly questions the fundamental justification for the traditional alliance.

It appears that Washington has been afforded some extra time to come to grips with the rise of a new security perspective in Tokyo. The current Abe administration's security posture guarantees continuing tensions between Japan and China that favor traditional U.S.-Japan security arrangements – though the U.S. is in this case wary about getting dragged into an unnecessary war between Japan and China over a territorial issue. In Northeast Asia, the anachronistic and saber-rattling government in Pyongyang has managed to ensure that Cold War thinking is not forgotten in the region (Justin McCurry, 2013).

An additional lesson can be learned from the experience of the Hatoyama administration, namely, that the Japanese public is keenly sensitive to political ineptitude. Hatoyama left office with a popularity of 19% or lower in the polls. In the case of Prime Minister Abe, he has been riding high with a popularity of over 70% due mainly to his policies to reboot Japan's economy. The public also seems to support Abe's call for a stronger national defense in view of the more dangerous security environment in the region.

But if his administration slips into nationalistic jargon that is perceived to be threatening regional stability or otherwise harm Japan's core interests, the public will likely react in a similar fashion as they did to Hatoyama's blunders. There is evidence, though, that Abe is aware of this vulnerability and will likely opt to be a "safe driver", at least for the time being.

Still, one cannot rule out another round of political backlash against the LDP government if the economy suddenly turns south, Abe's rhetoric on nationalistic issues stirs up Asian neighbors, or Okinawa reacts sharply to perceived central government strong-arming tactics on the basing issue. A casualty of that could be views toward Japan's security, the relevance of the Alliance, and the presence of foreign troops on Japanese soil. Better that Washington takes the sentiments expressed in 2009-2010 debacle seriously now and prepares to deal with possible future challenges to the bilateral relationship from the grass roots level.

## References

- Appleman, Roy Edgar. *Okinawa: The Last Battle*. Vol. 11. No. 1. Government Printing Office, 2000.
- Brooks, William L. "Cracks in the Alliance? Futenma Log: Base Relocation Negotiations 2009-2010." *Asia-Pacific Policy Papers Series: The Edwin O. Reischauer Center for East Asian Studies* (2011).
- Brooks, William L. "Stress Test for the US-Japan Alliance under the Democratic Party of Japan." *SAIS Review* 32.2 (2012): 121-135.
- Brooks, William L. "The Politics of the Futenma Base Issue in Okinawa: Relocation Negotiations in 1995-1997, 2005-2006." *Asia-Pacific Policy Papers Series: The Edwin O. Reischauer Center for East Asian Studies* (2010).
- Calder, Kent. *Embattled Garrisons: Comparative Base Politics and American Globalism*. Princeton University Press (2007).
- Carlson, Matthew M. "Electoral Reform and the Costs of Personal Support in Japan." *Journal of East Asian Studies* 6.2 (2006): 233-258.
- Chan, Steve. *Looking for Balance: China, the United States, and Power Balancing in East Asia*. Stanford University Press, 2012.
- Constitution of Japan, The. *Article 1. Prime Minister of Japan and his Cabinet*. (1946) URL: [http://www.kantei.go.jp/foreign/constitution\\_and\\_government\\_of\\_japan/constitution\\_e.html](http://www.kantei.go.jp/foreign/constitution_and_government_of_japan/constitution_e.html)
- Curtis, Gerald L. *The Logic of Japanese Politics: Leaders, Institutions, and the Limits of Change*. Columbia University Press, 1999.
- Dower, John W. *Embracing Defeat: Japan in the Wake of World War II*. WW Norton & Company, 2000.
- Engerman, David C. *Staging Growth: Modernization and the Global Cold War*. University of Massachusetts Press, 2003.
- Fisman, Raymond, Yasushi Hamao, and Yongxiang Wang. "The Impact of Cultural Aversion on Economic Exchange: Evidence from Shocks to Sino-Japanese Relations." Available at SSRN 2022214 (2012).
- Gordon, Andrew. *A Modern History of Japan*. New York: Oxford University Press, 2003.
- Heginbotham, Eric, and Richard J. Samuels. "Japan's Dual Hedge." *Foreign Affairs* (2002): 110-121.
- Hughes, Christopher. "Japan's Security Policy, the U.S.-Japan Alliance, and the 'War on Terror': Incrementalism Confirmed or Radical Leap?." *Australian Journal of International Affairs* 58.4 (2004): 427-445.
- Iwai, Tomoaki. "Clearing Up the Murk in Political Finances." *Japan Echo* 29.5 (2002): 29-32
- Johnson, Chalmers. "The Okinawan Rape Incident and the Rekindling of Okinawan Protest Against American Bases." *Okinawa: Cold War Island* (1999). Japan Policy Research Institute.
- Kawato, Yuko, and Robert Pekkanen. "Civil Society and Democracy: Reforming Nonprofit Organization Law." *Democratic Reform in Japan: Assessing the Impact*, Boulder, Lynne Rienner (2008): 193-212.
- Kono, Kei and Toshiyuki Kobayashi. "Okinawa and Security: 40 Years after Reversion – From a

- Survey of Okinawa Residents and a Nationwide Survey.” *NHK Broadcasting Culture Research Institute Public Opinion Research* (2013). Accessed 4/2/2013. URL: [http://www.nhk.or.jp/bunken/summary/research/report/2012\\_07/20120701.pdf](http://www.nhk.or.jp/bunken/summary/research/report/2012_07/20120701.pdf)
- Koo, Min Gyo. "The Senkaku/Diaoyu Dispute and Sino-Japanese Political-Economic Relations: Cold Politics and Hot Economics?." *The Pacific Review* 22.2 (2009): 205-232.
- Maeda, Ko. "Has the Electoral System Reform Made Japanese Elections Party-Centered?." *Political change in Japan: Electoral behavior, party alignment, and the Koizumi reforms*. Stanford: Walter H. Shorenstein Asia-Pacific Research Center (2009).
- McCubbins, Mathew D., and Frances M. Rosenbluth. "Party provision for personal politics: Dividing the vote in Japan." *Structure and policy in Japan and the United States* (1995): 35-55.
- McCurry, Justin. "Is Japan's Shinzo Abe finally acting on his true nationalist colors?" *Christian Science Monitor* (4/25/2013). Accessed: 5/1/2013. URL: <http://www.csmonitor.com/World/Asia-Pacific/2013/0425/Is-Japan-s-Shinzo-Abe-finally-acting-on-his-true-nationalist-colors>
- Medeiros, Evan S. "Strategic Hedging and the Future of Asia-Pacific Stability." *The Washington Quarterly* 29.1 (2005): 145-167.
- Ministry of Defense Interview. Interview with member of the Ministry of Defense with experience working on Futenma Relocation Project in 2006 as part of the MoD's sub-ministry in charge of bases. Name withheld by request. Notes from interview conducted on March 12th, 2013.
- Nakachi, Ayako. "The influence of cultural perception on political awareness: A case study in Okinawa, Japan." (2004).
- Nassmacher, Karl-Heinz. "Regulation of Party Finance." *Handbook of Party Politics*. London: Sage Publications (2006): 446-455.
- Pekkanen, Robert. "Sources of Policy Innovation in Japanese Democracy." *Japanese Political Reform: Progress in Process*. Woodrow Wilson International Center for Scholars, Asia Program Special Report No. 117 (2004): 9-15.
- Pempel, T. J. *Japanese Democracy: A Comparative Perspective*. No. 46. Woodrow Wilson International Center for Scholars, 1992.
- Ramseyer, J. Mark, and Frances McCall Rosenbluth. *Japan's Political Marketplace*. Harvard University Press, 1993.
- Saeki, Chizuru. "Democracy in Okinawa: US-Okinawan Relations in the Cold War." *Virginia Review of Asian Studies* (2006): pg. 1-21.
- Saeki, Chizuru. *US Cultural Propaganda in Cold War Japan: Promoting Democracy 1948-1960*. Edwin Mellen, 2008.
- Sarantakes, Nicholas Evan. *Keystone: The American Occupation of Okinawa and US-Japanese Relations*. No. 6. Texas A&M University Press, 2000.
- Scheiner, Ethan. *Democracy Without Competition in Japan: Opposition Failure in a One-Party Dominant State*. Cambridge University Press, 2005.
- Scheiner, Ethan. "Pipelines of Pork Japanese Politics and a Model of Local Opposition Party Failure." *Comparative Political Studies* 38.7 (2005): 799-823.
- Thelen, Kathleen. *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States, and Japan*. Cambridge University Press, 2004.
- Tritten, Travis J. and Sumida, Chiyomi. "US, Japan agree relocation of Futenma is more than a decade away." *Stars and Stripes* (4/5/2013). Accessed 4/12/2013. URL:

<http://www.stripes.com/news/pacific/us-japan-agree-relocation-of-futenma-is-more-than-a-decade-away-1.215160>

Wade, Larry L., and John R. Owens. "Economic Conditions and Voting in Japanese House Elections." *Journal of Northeast Asian Studies* 11.3 (1992): 3-24.

Wikipedia. List of Political Parties in Japan. 2013. Accessed 3/28/2013. URL:  
[http://en.wikipedia.org/wiki/List\\_of\\_political\\_parties\\_in\\_Japan](http://en.wikipedia.org/wiki/List_of_political_parties_in_Japan)

Yoshida, Kensei. "US Bases, Japan, and the Reality of Okinawa as a Military Colony." *The Asia-Pacific Journal: Japan Focus* (2008).

## **The Impact of Japan's Territorial Dispute with China On the U.S.' Rebalancing toward Asia**

By Yun Han

In his address to the Australian Parliament on November 17, 2011, President Barack Obama announced, "The United States is turning its attention to the vast potential of the Asia-Pacific region ... [and] as a Pacific nation, the United States will play a larger and long-term role in shaping this region and its future, by upholding core principles and in close partnership with our allies and friends."

Four major developments over the past decade have necessitated such strategic rebalancing and setting of new priorities. First, a decade of wars in Afghanistan and Iraq is reaching an end, and American troops are finally coming home. As the U.S. withdraws from years of combat, it has become increasingly apparent that America now needs a new script for its security policy. Second, the U.S.' fiscal crisis that the cost of two wars mainly created is far from over. In order to effectively tackle a ballooning federal budget and national debt, Washington has no choice but to identify the nation's strategic priorities, otherwise the U.S. might be hamstrung by budgetary constraints at times of urgency. Third, while putting its fiscal house in order, Washington needs a new strategy to reassure its allies, partners, and even adversaries that the U.S. will never abandon its commitment to global security. Fourth, the Asia-Pacific has become the host to both the world's most thriving economies, as well as its most burgeoning militaries, which pose opportunities as well as challenges for the U.S. and its alliance partners. In this context, it makes good sense for President Obama to make the strategic decision to rebalance America's now limited public resources toward the Asia-Pacific.

Whether the Obama administration's rebalancing toward the Asia-Pacific aims at engaging or containing China, or both, is subject to debate. But there is no controversy that the rise of China may be the biggest challenge that America now faces, so how adept the President and his advisors are in ensuring that China rises peacefully will be the principal measurement of their success. Equally certain, Japan as a U.S. ally remains a key component for successfully rebalancing to Asia, despite Japan's poor economic performance in recent decades and the damage done to U.S.-Japan relations by the Democratic Party of Japan (DPJ) during its three years as ruling party. Under such circumstances, how the U.S. deals with the escalating territorial dispute between Japan and China may decide the fate of the U.S. rebalancing toward the Asia-Pacific.

### **The Rise of China and the Shaping of the U.S.' Asia Strategy**

The Obama Administration's rebalancing toward the Asia-Pacific can be interpreted as the consolidation of various existing strategic efforts of the United States to accommodate to the relative global power shift toward the region, largely driven by the economic and military rise of China in the 21<sup>st</sup> century.

The Obama Administration's increased emphasis on the region appears to be more of a change in the level of resources and leadership attention devoted to the Asia-Pacific than a change in policy goals, because basic U.S. interests in the region, such as stability, freedom of navigation, the free flow of commerce, and the promotion of democracy and human rights, are basically unchanged. In other words, as the American economy and the Chinese economy grow increasingly interdependent, and as Beijing adopts a more assertive foreign and security policy posture – including a willingness to use its naval power to display its regional might – it is necessary for the U.S. to devote more resources to assuage tensions in relations with China, as well as to encourage China to deepen its integration into the international community. China is the determining factor for the U.S. in all three dimensions of its policy rebalancing.

### **Military Dimension**

The military dimension of the rebalancing reflects the Obama administration's efforts to address China's military modernization in the context of U.S. domestic fiscal constraints. The administration's security approach has three notable features. First, the rebalancing aims to achieve a broader distribution of U.S. military forces in the region, especially to strengthen the U.S. military presence in the southern part of the western Pacific. On January 5, 2012, the Pentagon released its latest Defense Strategic Guidance. In the guidelines, the Pentagon identified "the arc extending from the Western Pacific and East Asia into the Indian Ocean region and South Asia" as a high-priority area and confirmed that, "while the U.S. military will continue to contribute to security globally, [there will be] of necessity a rebalance toward the Asia-Pacific region." This is a direct response to China's naval expansion into the East China and the South China seas and symbolizes the U.S. commitment to stability and freedom of navigation in the Asia-Pacific. The updated definition of the sphere of U.S. geopolitical interests is a crucial component of the Defense Department's new Air-Sea Battle (ASB) concept, which intends to increase the joint operating effectiveness of the naval and air forces, particularly in operations for countering anti-access/area-denial strategies. This would include, for example, Chinese efforts to disable U.S. military influence in the area within the so-called "first island chain" sealing off the Yellow Sea, East China Sea, and South China Sea -- an arc running from the Aleutians in the north to Borneo in the south.

The second notable feature of the military rebalancing is its emphasis on the flexibility of the U.S. forces in the region, another key component of the ASB concept. The new plan underscores rotational deployments and naval access agreements and other forms of engagement with foreign militaries. This smaller, more agile, expeditionary, self-sustaining, and self-contained new deployment plan reportedly shows the Obama administration's concerns on both the rigidity and the high maintenance costs of Cold War, European-style treaty regimes, including the maintaining of permanent bases in Japan and South Korea. As the inaugural step, President Obama reached an agreement with Australian Prime Minister Gillard to base a small force of 200 to 250 Marines at an Australian military facility at Darwin on six-month rotations. The force is to be gradually expanded to a full Marine Air Ground Task Force of 2500 personnel. Additionally, "Freedom", the first of the Littoral Combat Ships, a new class of U.S. coastal warships, will be deployed for roughly ten months to Singapore from the spring of 2013.

Together with flexibility, the rebalancing also stresses the sustainability of the U.S. military presence in the Asia-Pacific. The solution is to enhance partners' capabilities through more

flexible security assistance mechanisms and through cooperative counter-terrorism, counter-drug, and counter-insurgency operations. The “partners” include such familiar names as like Australia, Japan, the Philippines, Singapore, and South Korea, as well as potential ones like India, Indonesia, New Zealand, Vietnam, and Burma. Ironically, if a line is drawn on a map connecting all America’s partners in the Asia-Pacific, there clearly is a geographical encirclement of China. As a consequence, even though the essence of enhancing partner capabilities is to reduce the cost of maintaining regional security and hence to achieve sustainability of the U.S. military presence in the Asia-Pacific while improving the quality of the security force, the rebalancing can easily be summarized as a strategy to contain China’s growth.

This is a classic security dilemma. The stronger and more credible the U.S. military presence is in areas that China considers its natural sphere of influence, the more China feels it necessary to strengthen its anti-access capabilities and to be assertive with its territorial claims, for example, its claim to the Senkaku/Diaoyu Islands against Japan.

### **Diplomacy**

The second diplomatic dimension of the Obama administration’s rebalancing toward the Asia-Pacific aims to convey two messages. The first message, for the region as a whole, insists that reductions in U.S. defense spending will not come at the expense of the Asia-Pacific.

Additionally, the U.S. will resist any attempt at regional hegemony, whether related to an increasingly aggressive China or nuclear –crazed North Korea. Based on the Department of State’s record, in order to communicate such unchanged commitment, Secretary Hillary Clinton in her first three years in office made 36 visits to countries in the Asia and Pacific region, twice as many as her predecessor Condoleezza Rice made in the same timeframe. In July 2009, Secretary Clinton signed the United States’ Instrument of Accession to the Treaty of Amity and Cooperation in Southeast Asia, which codified the U.S.-ASEAN partnership. Furthermore, in November 2011, President Obama became the first U.S. president to attend the East Asia Summit. By strengthening its bilateral ties with Asian countries and deepening its participation in regional institutions, Washington improved its image and encouraged leaders in the region, particularly in Southeast Asia, to welcome a greater U.S. role in the region.

At the same time, the Obama Administration also wanted to reassure China that the U.S. finds it of national interest to have deep cooperative ties with it and welcomes its peaceful rise. As the President remarked to his Chinese counterpart Xi Jinping at a White House meeting in February 2012, “a strong and prosperous China is one that can help to bring stability and prosperity to the region and to the world.” In China, views are divided regarding the U.S. rebalancing to Asia, but in general, the civilian leadership shares the perception that “overall the situation is favorable for China’s peaceful development,” as stated by Premier Wen Jiabao in his annual report to the National People’s Congress delivered on March 5, 2012. He meant that Beijing does not consider the U.S. rebalancing has significantly eroded China’s external environment. The Ministry of National Defense, in contrast, takes a more skeptical stance and has interpreted the U.S. military rebalancing as a “Cold War mentality” which is “detrimental to the mutual trust and cooperation between countries in the region.” So far the moderate view has been dominant, but as the situation in the East China Sea intensifies, a conspiracy theory has been created that Tokyo’s recent provocative China policy was hatched by Washington so that the U.S. can benefit



from worsened Sino-Japanese relations. Fed such rumors, the Chinese public seems to be leaning toward the critical stance held by the military.

### **Economic**

The Trans-Pacific Partnership Agreement (TPP) represents the economic dimension of President Obama's rebalancing toward the Asia-Pacific. The Congressional Research Service (Manyin et al, 2012) maintains:

If successful, a broadly-based TPP could provide the United States with a number of economic, diplomatic, and strategic benefits. The trade agreement would increase U.S. access to the growing markets of Asia, help stimulate the growth in U.S. exports, generate export-related jobs, and foster an economic recovery, while enhancing the protection of U.S. intellectual property rights and ensuring that U.S. companies are competing in a more fair and impartial regional market. (p. 22)

Undoubtedly, the ultimate goal is to incorporate China into the TPP framework. Thus, a successful TPP means increased U.S. access to the huge market of China where rules of free and fair competition would be upheld.

Moreover, countries in the region, especially Southeast Asian countries, are both exhilarated by the tremendous economic opportunities coupled with China's growth and perplexed by China's overwhelming economic power. Under such circumstances, the U.S.-led TPP negotiations become even more attractive because the TPP competes directly against China-led alternative regional economic integration models like the ASEAN+3 and ASEAN+6. Thus, diplomatically, the TPP agreement also demonstrates U.S. commitment and engagement in the region, thereby promoting deeper ties between the U.S. and other member nations (CRS, 2012, p. 22). Eventually, the potential risks associated with the transport of goods and services in the Asia-Pacific region will conceivably be reduced, as the TPP members will share a common interest in maintaining a reliable and safe flow of cargo across the Indian and Pacific oceans, accomplishing the policy goal of free flowing commerce and freedom of navigation in the Asia-Pacific.

### **The U.S.-Japan Alliance and the Success of U.S. Rebalancing toward Asia**

If China is the primary cause of the U.S. strategic shift to the Asia-Pacific, Japan is the key to the success of the rebalancing. Economically, Japan is one of the United States' most important partners. It is America's second-largest merchandise export market as well as the second-largest source for U.S. merchandise imports in the region. In addition, Japanese investors are the second-largest foreign holders of U.S. treasuries, helping to finance the U.S. deficit and sustain the U.S. economic growth. At the same time, Japan is also an important economic partner for China, and Japanese companies have established production facilities in China that assemble finished goods largely from intermediates exported from Japan. The products are exported worldwide, with the U.S. as a major destination. Further, Japan is a crucial link in the regional production networks and one of the largest and established sources of official development assistance (ODA) and foreign direct investment for Asian countries. It has been a leading proponent of regional economic development and integration through bilateral and multilateral channels, like the Asian Development Bank and the Chiang Mai Initiative. Therefore, Japan's participation in the TPP will significantly enhance the legitimacy of the agreement and expedite

the accomplishment of TPP goals. Now that Japan has announced its participation in the TPP negotiations, it has become an even more critical element in the Obama Administration's rebalancing to Asia strategy.

President Obama and Prime Minister Abe, in their summit meeting in Washington in earlier 2013, reaffirmed that Japan is one of the U.S.'s closest allies and that the bilateral alliance remains the lynchpin for regional security and U.S.-Japan cooperation in the Asia-Pacific. The U.S.-Japan alliance is multifaceted. First, the Treaty of Mutual Cooperation and Security between the United States and Japan (U.S.-Japan Security Treaty), signed in 1960, justifies the U.S. military presence in the Asia-Pacific. Moreover, in the immediate postwar era, the Security Treaty has been seen by wary Asians as a means of preventing Japan's possible future remilitarization and resurgence as an aggressive power. Today, the U.S. military presence in the region under the Treaty is viewed as playing a pivotal role in deterring possible Chinese aggression in pursuit of unification with Taiwan, as well as China's maritime activities and territorial disputes in the East and South China seas. The U.S.-Japan Alliance is important for dealing with the missile and nuclear threat from North Korea. And most recently, it has diplomatic relevance as the U.S. seeks to persuade China and Japan to reduce bilateral tensions that have spiraled over the territorial dispute. Hence, for countries in the region, the U.S.-Japan Security Treaty remains a reaffirmation of the U.S. commitment to the peace and stability of the Asia-Pacific.

As an ally, Japan has been sharing a substantial portion of financial burden to maintain the U.S. military presence in the Asia-Pacific. Through the Host Nation Support (HNS) arrangement, Japan covered between 74 and 78 percent of the costs of stationing U.S. troops in Japan between 1999 and 2003. Despite its fiscal difficulties, the Japanese government decided in 2010 to continue HNS at historical levels by agreeing to provide 188 billion yen annually (\$2.2 billion at 82 yen to one dollar) through fiscal 2016 to compensate the costs of stationing troops in Japan, as well as to cover over 70% of utility costs of the bases.

Japan's contributions to the alliance are not limited to financial support. Since the end of the Cold War, Japan has been playing an increasingly active role in backing the U.S. commitment to global security affairs. As the first step, the Japanese and U.S. governments between 1995 and 1997 engaged in a process to essentially redefine the Security Treaty, reorienting the alliance generally towards enhanced regional security. Specifically, Japan committed itself to an expanded role in non-combat or logistical support in case of a regional contingency not directly involving aggression against Japanese territory. Between 2001 and 2006, Prime Minister Junichiro Koizumi further extended Japan's commitment to global security by passing special legislative measures to allow Japan to deploy its Self-Defense Forces (SDF) overseas to provide logistical support for the U.S. war in Afghanistan and reconstruction in Iraq after conflict subsided in 2003. During the three year rule by the Democratic Party of Japan (2009-2012), commitments reflecting the party's liberal bent were also made as a contribution to global security. The DPJ government authorized two major peacekeeping operations – the United Nations Stabilization Mission in Haiti (MINUSTAH) in January 2010 and the United Nations Mission in the Republic of South Sudan (UNMISS) in September 2011. In addition, the government authorized the Maritime SDF to engage in anti-piracy missions off the coast of Somalia in the Indian Ocean and the Gulf of Aden in the Middle East.

It goes without saying that even under successive DPJ governments, which took a cautious view initially to alliance cooperation, Japan as an ally has wholeheartedly supported the U.S.' rebalancing toward the Asia-Pacific. First, after the first DPJ prime minister Yukio Hatoyama's disastrous mishandling of alliance affairs, including especially the Okinawa basing problem, subsequent prime ministers Naoto Kan and Yasuhiko Noda, reset the bilateral security arrangements to their default mode and repaired strains with Washington that had been caused by Hatoyama. As a result, the process of relocating the U.S. Marine Corps Air Station Futenma in Okinawa has been restarted, though progress remains elusive. In the Joint Statement of the U.S.-Japan Security Consultative Committee issued on April 27, 2012, Secretary of State Clinton, Secretary of Defense Panetta, Minister for Foreign Affairs Gemba, and Minister of Defense Tanaka confirmed that a total of approximately 9000 U.S. Marines are to be relocated from Okinawa to locations outside of Japan (Ministry of Foreign Affairs). The relocation agreement marks a major step toward a successful rebalancing, because the relocation of U.S. Marines from Okinawa to Guam and rotational deployments in regional countries like Australia and Singapore allows the U.S. to rebalance its forces into a posture that is "geographically distributed, operationally resilient, and politically sustainable," which will strengthen U.S. military presence in the Asia-Pacific. Additionally, the relocation will alleviate the burden on residents of Okinawa and hence improve the image of alliances with the U.S. both inside Japan and in the region.

The present LDP government led by Prime Minister Shinzo Abe seems determined to finally resolve the Futenma issue, and remove the principal obstacle to further deepening the alliance.

Meanwhile, given the power vacuum created by the reduction of U.S. military presence in Northeast Asia, Japan's Ministry of Defense (MOD) has accelerated its efforts to enhance the joint operation capabilities of Japan Ground Self-Defense Force, Japan Maritime Self-Defense Force, and Japan Air Self-Defense Force both independently and with the U.S. military to respond to attacks on offshore islands to the southwest of Japan. The MOD defense concept of remote-island defense is consistent with the U.S. Air-Sea Battle concept to check and prevent China's naval expansion into the area of the First Island Chain, which includes islands that are part of Japan.

Defense analysts argue that Japan's ability to effectively block the China's naval operations near these islands, such as by deploying anti-ship cruise missiles, will be significant in possibly preventing a future military conflict between the U.S. and China. Such a deployment by Japan could dissuade China's navy from preemptively seizing the westernmost portions of the southwestern island chain to help stage a coercive campaign against Taiwan. Still other analysts contend that such a scenario creates a security dilemma: As the capabilities of the SDF to project force in the area grow stronger, the more China's national interests will be affected. This could result in stimulating China to further enhance its own military presence in the area and hence lead to further tensions arising in the East China Sea.

In an October 2011 joint statement by Secretary of Defense Leon Panetta and Minister of Defense Yasuo Ichikawa, the U.S. and Japan committed the alliance to "dynamic defense cooperation (DDC)." another crucial -- as well as potentially destabilizing -- component of the U.S. military rebalancing. The U.S' military rebalancing stresses building capability joint military operations with allies and partners. Accordingly, under the DDC, the SDF and the U.S.

forces have completed exercises with other regional partners. For example, in July 2011, the United States, Japan, and Australia conducted their first joint military drill in the South China Sea; and in June 2012, a joint military exercise involving the U.S., Japan and South Korea was conducted off the Korean Peninsula. Such exercises have built solidarity among the participating countries and the collective will to tackle regional problems, focusing on areas of increasing tension. This reinforces the credibility of the U.S. having a military presence in the region.

Under the DDC, Tokyo and Washington have agreed to increase shared use of facilities in both countries. Such cooperation will not only improve interoperability between the SDF and the U.S. military, but also increase the chances for expanding the scope of the U.S.-Japan alliance and hence further enhance U.S. presence in the region. Moreover, under the DDC, Japan is to join bilateral intelligence, surveillance, and reconnaissance activities with the U.S., which will give the two countries information superiority over regional countries and thus significantly improve the capability of U.S. troops to project power in the region. Again, the escalation of the territorial dispute with China has played a principal role in driving Japan toward the concept of dynamic U.S.-Japan defense cooperation. Similarly, the closer and the more powerful the U.S.-Japan alliance becomes, the greater necessity China may feel to increase its defense budget.

In the 2011 Joint Statement, Japan agreed to increase the strategic use of its ODA to help Southeast Asian countries on the security front. For example, the Japanese government has used ODA money to provide the Philippines, Malaysia, and Vietnam with such maritime equipment as patrol boats for their coast guards and a maritime communications system. By doing so, Japan has contributed to the improvement of regional infrastructure that can be tapped as potential alternative access points for U.S. forces. The result further enhances the effectiveness of the U.S. military presence in the region. The other side of the coin is that the more effective the U.S. military presence becomes, the more paranoid China may become.

### **Territorial Dispute Affects U.S. Interests in the Asia-Pacific**

The success of the U.S. rebalancing towards the Asia-Pacific now depends on how smartly Washington deals with the escalation of the territorial dispute between Japan and China. In order to best realize its fundamental interests of stability, freedom of navigation, the free flow of commerce, the promotion of democracy and human rights in the region, the United States needs to convince China to be a more cooperative and contributing member of the international community. America's diplomatic approach may be backed by a forceful posture in the region – its military presence -- but Washington officials definitely wish to avoid confrontations with China. With rising tensions between Japan and China over the Senkaku isles (Diaoyu in Chinese), the U.S. has become worried that conflict could break out between the two countries due to the potential for miscalculation or accidents between the two navies in the East China Sea. There is concern that such would drag the U.S. through its treaty obligations to Japan into a military confrontation or even a war between Japan and China. According to news reports, senior U.S. officials warned Japan in 2012 not to purchase three of the disputed islands, for fear this would set off China.

### **Senkaku/Diaoyu Islands**

The Senkaku or Diaoyu Islands are a group of eight uninhabited isles located in the East China Sea, approximately 410 kilometers southwest of Japan's southern-most prefecture, Okinawa, 330

kilometers east of the Chinese mainland, and 170 kilometers northeast of Taiwan. The islands together have an area of about 7 square kilometers. The sovereignty of the islands matters because they are close to strategically important shipping lanes, offer rich fishing grounds, and are believed to be adjacent to significant oil and natural gas deposits, based on an 1969 United Nations Economic Commission for Asia and the Far East report. The islands are currently administrated by Ishigaki, a city in Okinawa Prefecture located 170 kilometers from the islands.

### **Escalation in 2012-2013**

In April 2012, Tokyo Governor Shintaro Ishihara, using the opportunity of a visit to Washington DC, announced that the Tokyo metropolitan government would use public money to buy three of the eight Senkaku Islands from their private owner. Tokyo would then build installations such as a telecommunications base, a port, and a meteorological station to demonstrate Japan's control over the islands. By the end of August, more than \$20 million had been raised. As an attempt "to prevent friction from heightening with Beijing and Taipei," the Noda administration on September 11, effectively "nationalized" the three islands by purchasing them for \$26 million.

During mid-September, anti-Japanese protests and boycotts of Japanese products were organized across China to coincide with the 81<sup>st</sup> anniversary of the Mukden Incident, regarded as a staged event engineered by Japanese officers as a pretext for invading Manchuria. In some cities, protests escalated to the burnings of Japanese vehicles and other criminal acts. Faced with searing domestic anti-Japan sentiment, even soft-liners in the Chinese government were compelled to take hard stances.

Starting in the fall of 2012, China increased its deployment of patrol ships under the Maritime Surveillance and Fisheries Law Enforcement Command to waters near the islands. Their purpose was to assert jurisdiction in "China's territorial waters." Chinese ships have often been tracked entering waters that Japan claims as part of its 12 nautical mile territory, and Chinese military surveillance planes have also been spotted entering Japanese airspace. Japan reacted to the patrol ships by strengthening the presence of the Japanese Coast Guard in the area. Coast guard officials also confirmed a plan to use superannuated MSDF destroyers to bolster patrols around the disputed islands. Tension peaked on January 30, 2013 when a Chinese frigate "unintentionally" directed its weapon-targeting radar at a MSDF vessel while the two sides were merely 3 kilometers apart. That incident, which could have started a war had the officer fired at the Japanese vessel, scared observers. For that reason, many fear that if the two sides continue to increase their forces in the area at the current pace, sooner or later there will be an unfortunate incident. Given U.S. obligations to the defense of Japan codified in the security treaty, a clash between Japan and China over the Senkakus will hinder long-term U.S. national interests by undercutting the rebalancing toward the Asia-Pacific.

### **U.S. Position and Treaty Obligations**

Officially, the United States "does not take a position" on the ultimate sovereignty of the Senkaku Islands. This position of taking no position has been restated since the early 1970s when the isles were reverted administratively to Japan. When Japan and China normalized their relations in 1972, the sovereignty of the islands first came into question. The U.S. government recognizes that the Agreement between the United States of America and Japan concerning the Ryukyu Islands and the Daito Islands (known as the Okinawa Reversion Treaty) signed on June

17, 1971, contained “terms and conditions for the reversion of the Ryukyu Islands, including the Senkakus.” A key policy statement went: “The United States believes that a return of administrative rights over those islands to Japan, from which the rights were received, can in no way prejudice any underlying claims” (Okinawa Reversion Treaty Hearings, 1971). The phrase, “underlying claims,” means the claims made by Japan, mainland China, and Taiwan. In essence, the United States has made no claim to the Senkaku Islands and considers that any conflicting claims to the islands are a matter for resolution by the parties concerned.

The United States, despite an official position of neutrality regarding territorial claims made by different parties, has the obligation to defend the Senkaku Islands so far the islands are under Japan’s administrative control. This is because the U.S.-Japan Security Treaty became applicable to the Ryukyu Islands, including the Senkaku Islands, upon conclusion of the Okinawa Reversion Treaty. Secretary Clinton reaffirmed this treaty responsibility to Foreign Minister Kishida in their meeting in January 2013:

With regard to regional security, I reiterated the longstanding American policy on the Senkaku Islands and our treaty obligations. As I’ve said many times before, although the United States does not take a position on the ultimate sovereignty of the islands, we acknowledge they are under the administration of Japan and we oppose any unilateral actions that would seek to undermine Japanese administration, and we urge all parties to take steps to prevent incidents and manage disagreements through peaceful means.

### **Escalation and Impacts on U.S.-Japan and U.S.-China Relations**

The Senkaku/Diaoyu Islands dispute has presented both an opportunity and a challenge for the U.S. rebalancing toward the Asia-Pacific. On the positive side, the more Japan perceives itself threatened by China’s naval expansion due to direct incursions near the disputed island territory, the more benefits Japan will see coming from a stronger U.S. presence in the region. And the greater willingness Japan has to support the U.S. to strengthen its presence in the Asia-Pacific, either indirectly through increased contributions to the alliance or directly through enhancing its own defense capability and presence in the region, the less cost the U.S. has to bear in order to achieve an effective rebalancing.

This rationale has already been proved in 2010. After the landslide victory in the lower-house election in August 2009, the Democratic Party of Japan replaced the Liberal Democratic Party as the ruling party of Japan. Leaders of the DPJ had a different vision of Japan’s external environment from their LDP counterparts. Prime Minister Hatoyama, advocated a diplomacy of *yuai* (fraternity) with Asian countries and envisioned an European Union-style “East Asian Community.” He was reportedly convinced by former DPJ President Ichiro Ozawa that Japan should become a “normal nation” by reducing its security dependence on the U.S. in terms of maintaining a regional order in East Asia. He concluded that Japan’s future should lie in firming up cooperative ties with China, while tilting away from the U.S. He envisioned an equilateral triangular relationship among Japan, China and the United States.

Accordingly, the Hatoyama Administration embarked on a course of reviewing the alliance relationship with the U.S. He criticized the agreement with the U.S inked by the former ruling party that would relocate Futenma Air Station to a shoreline site adjacent to Camp Schwab in a

less populated part of Okinawa. Hatoyama promised Okinawa that Futenma would be moved “out of the prefecture, if not out of Japan.” The Prime Minister also decided to not extend the Anti-Terrorism Special Measures Law, allowing overseas SDF dispatches, and he terminated the MSDF refueling mission in the Indian Ocean, disregarding entreaties from Washington. Ozawa led a delegation of well over 100 DPJ lawmakers to Beijing to ingratiate the party with Chinese leaders.

The DPJ’s blatantly pro-China policy soon lost ground during the administration of Prime Minister Naoto Kan. In September 2010, a Chinese fishing boat rammed two JCG patrol vessels near the disputed Senkaku Islands. The Japanese local government decided to arrest the captain of the trawler in accordance with domestic laws. This resulted in an unexpectedly strong protest from Beijing, which insisted that Japanese domestic laws not be applied to an incident that had taken place in “China’s territorial waters.”

The Kan Administration was completely unprepared for China’s strong reaction, and in the end released the captain without charges. Under fire then from the media, public and other political parties for being “weak-kneed” toward China, the DPJ government reversed its foreign policy of moving closer to Beijing. The Ozawa faction in the DPJ which was pro-China already had been ostracized by Kan in making cabinet and other key appointments. The Ministry of Defense took the lead in setting the security policy agenda.

In December 2010, a newly revised and strikingly bold National Defense Program Guidelines made it explicit that “China’s military modernization and intensifying maritime activities are ‘of concern for the regional and global community,’ and ‘the Japan-US Alliance remains indispensable in ensuring the peace and security of Japan.’” Japanese fears of the rise of China had trumped Hatoyama’s pan-Asian ideology, and rescued the U.S.-Japan alliance from further damage. In fact, Chinese naval expansion in the East China Sea continued to play a paramount role in the reshaping the DPJ’s foreign and security policy agenda. By the end of the administration of the next prime minister, Yasuhiko Noda, in December 2012, “deepening the Japan-U.S. Alliance” was not just words anymore, but had become the DPJ’s favorite motto, included in its Manifesto of campaign promises in the December 2012 general election. Now that the LDP is back in power in 2013, Prime Minister Shinzo Abe, who is a wholehearted supporter of the Alliance, is eager to accelerate the implementation of the “dynamic” element in U.S-Japan defense cooperation, undoubtedly with the Chinese “threat” in mind.

Still, there is danger in letting the “China threat” syndrome run its course. The standoff between Japanese and Chinese warships remains tense in the disputed waters near the Senkakus. An open clash could still occur. In addition, the territorial dispute has the potential of adversely affecting U.S.-China relations at a time when Washington would like ties with Beijing to be warmer.

From China’s perspective, even without the territorial issue, the deeper the U.S-Japan alliance evolves, the greater it feels threatened by that aspect of the U.S. rebalancing toward Asia. China also feels inadequate due to domestic constraints to assume the full responsibilities of a major power. For example, Beijing’s posture toward the Korean Peninsula remains ambivalent. It welcomes the U.S. military presence on the Korean Peninsula as a means of keeping an aggressive North Korea in check. Nothing could be more damaging to Chinese interests than the

destabilization or conflict on the Peninsula. China also counts on the U.S. to block North Korea from realizing its nuclear ambitions, preferably through multilateral approaches, such as the Six Party Talks. But Beijing for strategic interests does not want North Korea to collapse, either, and part of its reason for aiding that country is to ensure its survival. China welcomes U.S. involvement in the Indian Ocean to protect the free flow of commerce from piracy and terrorism, since China's oil and other shipping come through those waters, too. And given the wartime bloodshed caused by Japan in China, Beijing still sees the Alliance as preventing Japan's remilitarization.

### **Interpretations of the Escalation**

Although the Senkaku Islands are of little economic value by themselves, the waters around them in Japan's exclusive economic zone are a rich fishing ground and the sea-bottom is believed to possess substantial oil and gas deposits. Such factors have made the barren isles attractive to both Japan and China, both of which are short of such resources. In addition, although the islands are geographically miniscule, their strategic location is critical, because they are located right in the first island chain where China is trying to establish naval control – setting off concerns in Japan and the U.S. over freedom of navigation. China already has labeled the isles as part of its “core interests,” which place them in the same category as Tibet and Taiwan.

The island dispute in recent years has increasingly become entangled, and thus politicized, in the history issue between Japan and China. The Senkakus have become a structural issue in Sino-Japanese relations. Still, such factors alone are insufficient to explain the escalation of the dispute in the past year. The further eruption of the territorial dispute in 2012 and 2013 is the consequence of failed attempts by the two countries to adapt to the relative power shift that has resulted from the rise of China and the relative stagnation of Japan since the 1990s.

### **China's Rise**

China's rapid growth since the 1980s is better interpreted in per capita terms. Based on the World Bank's World Development Indicators for 2013, China, over the past ten years, has maintained an astonishing average annual GDP growth rate of approximately 10%, in spite of the global recession triggered by the subprime mortgage crisis in the U.S. Hence, China's per capita GDP has more than doubled from \$3,180 in 2003 to \$8,390 in 2011. However, the Chinese people's average income is still only a quarter of that of the Japanese (\$34,670 in 2011), whose country's annual GDP growth rate has been negligible during the same period.

China has had to deal with political and social destabilizing factors common in developing authoritarian regimes. One example is income inequality. Today, China may have become a hub for millionaires, but over 100 million of its people still live below the abject poverty line of \$2 (1.3 billion population X 9% poverty gap). Unemployment is another destabilizing factor. In 2010, 4% of the total labor force was unemployed, with 20% of them having only a tertiary education. Given the huge population base, this means more than 10 million well-educated, possibly pluralist-minded youths in China could not find jobs.

Moreover, with the popularization of Internet, it is increasingly hard for the central government to control freedom of speech as before. The public is aware of and sharply critical of the rampant corruption among government officials and the privileged lives those officials have. So far,



Beijing has been able to keep a lid on the demands by the expanding middle class for political freedom by supplying material benefits, but this tactic requires the central government to sustain or even to raise the country's spectacular growth rate. Paradoxically, while it is the rise of China that has hitherto legitimized the Communist Party's authoritarian rule, it is the rise of China that has raised the political consciousness of the middle class. It is also the rise of China that has pushed up production costs in China and the resulting additional pressure on the Party to search for alternative ways to sustain export-oriented growth.

Under such circumstances, a "blame-thy-neighbor" tactic becomes politically attractive, and Japan's "criminal record" makes any kind of disputes with that country an ideal option to shift public attention from domestic problems to external issues. Moreover, given the economic potential and strategic value of the waters around the disputed islands, Beijing has used the Senkaku dispute as competitive substitute for earlier anti-Japanese themes, aware that the Chinese people were becoming immune to periodic renewed campaigns centered on the comfort women and Nanjing massacre issues. By elevating the Senkakus to the level of being one of China's core interests thus enhances the Party legitimacy, because by so doing, the Party can satisfy rising nationalist sentiments in the country. At the same time, Beijing can use the momentum of such emotions to further its resource security and military expansion ambitions in the region. The same rationale is applied to the U.S. The Communist Party, by underscoring the perceived external threat from the U.S. and its encirclement policy, as seen in the rebalancing to Asia, is able to direct public attention away from internal deficiencies. In fact, the U.S. involvement in the territorial dispute only has strengthened Beijing's claim to the public about an American threat. Understanding that Beijing is using such a device helps explain why there have been no signs of state intervention to restrict the spread of that conspiracy theory.

### **Japan Sinking**

In contrast to China's rapidly rising global influence, Japan has been relegated to the backwaters of global currents by some critics, who categorized it as slipping into a tier-two slot on the global scene. The Japanese economy has not been performing well since the so-called "lost decade" of the 1990s, although Japan's economic base built by the previous decades remains remarkable solid and arguably capable of being rebooted. One factor delaying Japan's recovery has been the chaotic state of domestic politics, with seven prime ministers taking office in the last seven years and the synergy that used to exist among politics, the bureaucracy, and business seemingly long gone. Japan's troubles were intensified in March 2011, when the country was hit by the massive earthquake and tsunami in northern Japan and the energy crisis created by the nuclear accident accompanying the disaster.

In addition, Japan's external relations have tended to be stuck in a time tunnel: Though twenty years have passed since the fall of the Berlin Wall, Japanese political elites are still debating over whether Japan should become a "normal" nation and searching for ways to contribute to the international community. In short, Japan is woefully lacking a strategic vision for its future.

In such a domestic environment, one may argue that for Japanese politicians, a "blame-thy-neighbor" tactic may seem to be a convenient political tool. Scholars have argued that the political elites of East Asian countries during times of legitimacy vulnerability have shown a tendency to resort to exploiting territorial disputes in order to capitalize on nationalist and

irredentist sentiments. The revival by South Korea of the Takeshima/Dokdo island dispute with Japan in 2012 is a textbook example of such a rationale. To some extent, electoral cycles also drove the resurgence of the territorial dispute between China and Japan. In China, power transition was taking place between the “fourth generation” Hu-Wen Administration and the “fifth generation” Xi-Li Administration in 2012. The Communist Party thus found Tokyo Governor Shintaro Ishihara’s planned island purchase a well-timed distraction from domestic destabilizing factors caused by labor-management and other domestic issues in China.

The same situation seemed to occur in Japan, when the Noda administration found itself under stress from domestic policy mistakes and plummeting support rates. Under pressure from nationalists and relying on a foreign minister with no background in foreign policy, Prime Minister Noda made a major policy blunder of nationalizing three of the islands so that Ishihara would not get them first. This of course set off the worst round in the Senkaku row since the dispute resurfaced in 2010.

The Senkaku dispute has another dimension, which makes it qualitatively different than the Takeshima row between Tokyo and Seoul. The Senkaku issue is aggravated by the psychological impact on the Japanese people of the relative power shift between Japan and China. As the world looks on with wonder at the sudden rise of China and the growing self-confidence of its people, the Japanese feel that their long-held and esteemed self-image of being “privileged” Asians and most advanced non-Western nation in the world, which Westerners treat as their equals is rapidly eroding. Japan is no longer the model for an advanced Asian economy. In fact, China surpassed Japan as the second largest economy in the world in 2010.

The once highly complementary economic relationship between Japan and China is breaking down because of their increasingly fierce competition across the globe for energy resources and targets for foreign direct investments. In the manufacturing realm, “Made in China” has long ago upstaged “Made in Japan” branding of products. At the same time, China’s military power has grown substantially and, even though its army and navy are not yet the equivalent of Japan’s SDF, China’s capability to project its limited force in an effective manner against Japan’s SDF in certain scenarios has been generally acknowledged. The combined psychological impact of seeing China rising and Japan being bypassed has resulted in an increasing number of average Japanese beginning to interpret China’s military modernization in a hostile way. Today, based on the latest Yomiuri-Gallup poll, 88% of Japanese “don’t trust China” and 79% of them believe China will become a military threat. This places a great responsibility on Japanese leaders, in this case Prime Minister Abe, who is known as a nationalist, to ensure that nationalistic sentiments in Japan do not further poison relations with China over the territorial and other contentious issues.

Although the “blame-the-neighbor” game is a convenient political tool to distract public attention from domestic problems for the time being, in the long run it is politically unsustainable. Countries gain from cooperation and healthy competition rather than perpetuating conflicts, especially when their own economy and their neighbor’s are highly interdependent and when two countries are sharing security concerns over a neighboring countries aggressive acts, in this case North Korea’s dangerous nuclear weapon and missile programs.

Governments survive because they are able to overcome various domestic constraints and improve the national welfare not because they are good at escaping from problems. The long run solution for the Chinese Communist Party to maintain regime stability is to continue to domestic market reforms and to open its economy to international norms rather than to prolong its life by spreading propaganda of evil Japanese and scheming Americans. Likewise, for the Abe administration, focus should be on an effective growth strategy and not on playing to a nationalist audience by opening the Pandora's Box again of Yasukuni Shrine or raising such loaded questions as to whether Japan had been "aggressive" in World War II. The Japanese economy cannot emerge from its doldrums by isolating Japan from its East Asian neighbors. Therefore, now that the power transition period is over, it is urgent that the two governments should start to practicing restraint of such behavior and get on with the hard work of repairing tattered relations.

### **Conclusions**

This paper has examined the United States' strategic rebalancing toward the Asia-Pacific against the backdrop of the escalating territorial dispute between China and Japan and the deepening economic interdependence of the three countries. It is clear that the rise of China has played a predominant role in shaping President Obama's new Asian strategy and that the U.S.-Japan alliance is a decisive factor in determining the fate of this rebalancing. In this context, recent heightening tensions between China and Japan, due to the escalation of their territorial dispute, presents both an opportunity and a challenge for the U.S. On one hand, the intensified situation in the East China Sea re-emphasizes the positive aspects of a deeper U.S.-Japan alliance and thus catalyzes further bilateral security and economic cooperation, thus enhancing the U.S.' presence in the Asia-Pacific. On the other hand, the U.S should be aware that deeper U.S.-Japan ties might create a security dilemma for China and lead to further escalation. Such a development would undermine U.S. interests of maintaining a stable and prosperous Asia-Pacific.

In addition, the escalation of territorial dispute is the result of failed attempts by Japan and China to adapt to new domestic and international realities that have emerged in the recent past. Lastly, given the increasingly volatile situation on the Korean Peninsula as Pyongyang continues to play brinkmanship games with its nuclear weapon and missile programs, both Tokyo and Beijing should make immediate efforts to relocate their resources now focused on a counterproductive territorial dispute to a broad bilateral agenda that contributes instead to the maintenance of peace and stability in the Asia-Pacific.

### **The Takeshima/Dokdo Territorial Dispute between Japan and South Korea**

Takeshima, known as Dokdo in South Korea and the Liancourt Rocks in the United States, is a group of islands that is situated on the Sea of Japan, known as the East Sea in South Korea, at a latitude of 37° 14'N and a longitude of 131° 52'E, 157 kilometers northwest of Oki Island, Shimane Prefecture, Japan and 87.4 kilometers southeast of Ulleung Island, North Gyeongsang Province, South Korea. The combined area of the two main islands, the East Island (Onnajima in Japanese, Dongdo in Korean) and the West Island (Otokojima in Japanese, Seodo in Korean), and numerous small reefs is 0.21 square kilometers. Both islands are scarce in vegetation and drinking water resources, but the EEZ around is a rich fishing ground.

On August 10, 2012, President Lee Myung-bak became the first South Korean president to visit the islands. In response, Japan recalled its ambassador to South Korea and summoning the South Korean ambassador to Japan, lodged a protest. In late August, Japan officially proposed to South Korea that the two countries refer the dispute to the International Court of Justice but was officially rejected by South Korea. On February 22, 2013, Japan celebrated its annual Takeshima Day and consequently caused mass demonstrations and boycotts of Japanese products in South Korea. The United States “does not take a position on the ultimate sovereignty of the Liancourt Rocks” and encourages Japan and South Korea to “address their differences peacefully” (Assistant Secretary of State Kurt Campbell, testimony, 2012).

The resurgence of the Takeshima/Dokdo dispute in 2012 was the product of the South Korean electoral cycle and was barely related to the U.S. rebalancing toward the Asia-Pacific. Nor will it have any significant impact on the rebalancing. As former CEO of Hyundai, President Lee made a series of pro-business decisions and pragmatic policies, including signing a Republic of Korea-U.S. Free Trade Agreement. His policies were beneficial to the South Korean economy as a whole but were achieved at the expense of small business. Consequently, close to the end of his term, his support rate dropped to alarmingly low levels. Therefore, in order to restore public confidence in his Saenuri Party for the party's 2012 presidential election candidate Park Geun-hye, President Lee decided to kowtow to nationalistic sentiments in the country. The signs were already there when he abruptly postponed signing the ROK-Japan General Security of Military Information Agreement, which he had personally been supportive of. He did so less than one hour before the two sides were to sign the agreement in June 2012. On the Japanese side, Prime Minister Abe responded forcefully to continuous provocations by South Korean politicians, and he managed not to attend or to send his Cabinet members to the inauguration ceremony for Park Geun-hye. Yet, despite the nationalistic clamor, both governments have carefully avoided touching upon the truly politically and economically sensitive fishery issue associated with the Takeshima/Dokdo dispute. Thus, it is safe to conclude that political leaders of South Korea and Japan have cautiously managed the overflow from the Takeshima/Dokdo dispute in 2012 to their own political benefit.

Notes: 1) Information from “The Issue of Takeshima,” Ministry of Foreign Affairs, Japan and “Facts about Dokdo,” Dokdo, South Korea

## References

- “Asia’s balance of power: China’s military rise.” (2012, April 7). *The Economist*. Retrieved from <http://www.economist.com/node/21552212>
- Bush, R. C. (2010) *The Perils of Proximity: China-Japan Security Relations*. Washington DC: Brookings Institution Press.
- Chanlett-Avery, E., Manyin, M. E., Cooper, W. H., and Rinehart, I. E. (2013, February 15). “Japan-U.S. Relations: issues for Congress.” *Congressional Research Service*. Retrieved from <http://www.fas.org/sgp/crs/row/RL33436.pdf>
- “China frigate locked radar on Japan navy.” (2013, February 5). *The Telegraph*. Retrieved from <http://www.telegraph.co.uk/news/worldnews/asia/china/9849620/China-frigate-locked-radar-on-Japan-navy.html>
- Chung, C. P. (2012). “China-Japan relations in the post-Koizumi era: a brightening half-decade?” *Asia-Pacific Review*, 19(1), 88-107.
- Compton, M. (2011, November 18). “President Obama at the East Asia Summit.” *The White House Blog*. Retrieved from <http://www.whitehouse.gov/blog/2011/11/18/president-obama-east-asia-summit>
- “Democratic Party of Japan Manifesto 2012.” Retrieved from <http://www.dpj.or.jp/english/manifesto/manifesto.html>
- “Does Beijing’s hard-line stance over the Diaoyu Islands dispute target the United States?” (2012). *Chinascopes*.
- Fergusson I. F. and Vaughn, B. (2010, June 25). “The Trans-Pacific Partnership agreement.” *Congressional Research Service*. Retrieved from <http://fpc.state.gov/documents/organization/145583.pdf>
- Goh, E. (2011). “How Japan matters in the evolving East Asian security order.” *International Affairs*, 87(4), 887-902  
<http://www.state.gov/p/eap/rls/rm/2012/09/197982.htm>
- Gregson, W. Jr. (2012, January 31). “Understanding the U.S. pivot to Asia.” *Brookings Institution Conference*. Retrieved from [http://www.brookings.edu/~media/events/2012/1/31%20us%20asia/20120131\\_us\\_asia\\_panel\\_two.pdf](http://www.brookings.edu/~media/events/2012/1/31%20us%20asia/20120131_us_asia_panel_two.pdf)
- Herman, S. (2012, June 21). “South Korea, Japan, US hold military drills.” *Voice of America*. Retrieved from <http://www.voanews.com/content/various-drills-underway-involving-south-korean-military/1216300.html>
- “Japan angers Korea by marking Takeshima Day.” *DW*. Retrieved from <http://www.dw.de/japan-angers-korea-by-marking-takeshima-day/a-16622321>
- Japan Ministry for Foreign Affairs. Japan-China relations: current situation of Senkaku Islands. Retrieved from <http://www.mofa.go.jp/region/asia-paci/senkaku/index.html>
- Japan Ministry for Foreign Affairs. (2012, April 27). Joint statement of the Security Consultative Committee. Retrieved from [http://www.mofa.go.jp/region/n-america/us/security/scc/pdfs/joint\\_120427\\_en.pdf](http://www.mofa.go.jp/region/n-america/us/security/scc/pdfs/joint_120427_en.pdf)
- Japan Ministry of Foreign Affairs. (2012). The issue of Takeshima. Retrieved from <http://www.mofa.go.jp/region/asia-paci/takeshima/>
- Japan Ministry of Defense. “島嶼防衛について (about the *tosho boei*).” Retrieved from <http://www.mod.go.jp/j/approach/others/shiritai/islands/index.html>

- Japan, S. “Korea both show tough-soft approach to Takeshima Day ceremony.” (2013, February 23). *The Asahi Shimbun*. Retrieved from Ryall, J. (2013, February 22). [http://ajw.asahi.com/article/behind\\_news/politics/AJ201302230061](http://ajw.asahi.com/article/behind_news/politics/AJ201302230061)
- Ken J. (2012, June 3). “Japan, and ASEAN’s maritime security infrastructure.” *East Asia Forum*. Retrieved from <http://www.eastasiaforum.org/2012/06/03/japan-and-asean-s-maritime-security-infrastructure/>
- Koo, M. G. (2009). “The Senkaku/Diaoyu dispute and Sino-Japanese political-economic relations: cold politics and hoteconomics?” *The Pacific Review*, 22(2), 205-232.
- Kudo, R., Sonoyama, F., and Okudera, A. (2013, May 10). “Coast guard to deploy retired MSDF ships to counter Chinese incursions.” *The Asahi Shimbun*. Retrieved from <http://ajw.asahi.com/article/asia/china/AJ201303050086>
- Manyin, M. E., Daggett, S., Dolven, B., Lawrence, S. V., Martin, M. F., O’Rourke, R., and Vaughn, B. (2012, March 28). “Pivot to the Pacific? the Obama Administration’s ‘rebalancing’ toward Asia.” *Congressional Research Service*. Retrieved from <http://www.fas.org/sgp/crs/natsec/R42448.pdf>
- Manyin, M. E. (2013, January 22). “Senkaku (Diaoyu/Diaoyutai) Islands dispute: U.S. treaty obligations.” *Congressional Research Service*. Retrieved from <http://www.fas.org/sgp/crs/row/R42761>
- “Noda government to buy Senkaku Islands for 2 billion yen.” (2012, September 5). *The Asahi Shimbun*. Retrieved from [http://ajw.asahi.com/article/behind\\_news/politics/AJ201209050013](http://ajw.asahi.com/article/behind_news/politics/AJ201209050013)
- “Q&A: China-Japan Islands row.” (2013, January 22). *BBC*. Retrieved from <http://www.bbc.co.uk/news/world-asia-pacific-11341139>
- Republic of Korea Gyeongsangbuk-Do province office division of Dokdo policy. (2001). “Facts about Dokdo.” Retrieved from [http://en.dokdo.go.kr/korean\\_dokdo\\_facts\\_about\\_dokdo.do](http://en.dokdo.go.kr/korean_dokdo_facts_about_dokdo.do)
- Roberts, D. (2012, September 17). “Anti-Japan protests flare in China over disputed islands.” *Bloomberg Businessweek*. Retrieved from <http://www.businessweek.com/articles/2012-09-17/anti-japanese-protests-flare-in-china-over-disputed-islands>
- Samuels, R. J. (2007). *Securing Japan: Tokyo’s Grand Strategy and the Future of East Asia*. Ithaca and London: Cornell University Press.
- Satake, T. and Ishihara, Y. (2012). “America’s rebalance to Asia and its implications for Japan-US-Australia security cooperation.” *Asia-Pacific Review*, 19(2), 6-25.
- “Senior China official calls Senkakus core interest.” (2013, April 28). *Jiji Press*.
- “Shinzo Abe must resist dangerous distractions.” (2013, April 28). *Financial Times*. Retrieved from <http://www.ft.com/intl/cms/s/0/cc6d09a4-ae76-11e2-bdfd-00144feabdc0.html#axzz2TBezXPow>
- “South Korea’s Lee Myung-bak visits disputed islands.” (2012, August 10). *BBC*. Retrieved from <http://www.bbc.co.uk/news/world-asia-19204852>
- “South Korea postpones historic military pact with Japan.” (2012, June 29). *BBC*. Retrieved from <http://www.bbc.co.uk/news/world-asia-18640476>
- “South Korea rejects Japan’s ICJ proposal.” (2012, August 31). *The Japan Times*. Retrieved from <http://www.japantimes.co.jp/news/2012/08/31/national/south-korea-rejects-japans-icj-proposal/#.UY8U2algMII>

- Takahata, A. (2009, November 13). "A shaky start for Hatoyama's *yuai* diplomacy." *The Tokyo Foundation*. Retrieved from <http://www.tokyofoundation.org/en/articles/2009/a-shaky-start-for-hatoyamas-yuai-diplomacy>
- "The White House Office of the Press Secretary (2011, November 17)." Remarks by President Obama to the Australian Parliament. *The White House*. Retrieved from <http://www.whitehouse.gov/the-press-office/2011/11/17/remarks-president-obama-australian-parliament>
- The White House Office of the Press Secretary. (2012, February 14). "Remarks by President Obama and Vice President Xi of the People's Republic of China before bilateral meeting." Retrieved from <http://www.whitehouse.gov/the-press-office/2012/02/14/remarks-president-obama-and-vice-president-xi-peoples-republic-china-bil>
- The White House Office of the Press Secretary. (2013, February 22). "Remarks by President Obama and Prime Minister Abe of Japan after bilateral meeting." Retrieved from <http://www.whitehouse.gov/the-press-office/2013/02/22/remarks-president-obama-and-prime-minister-abe-japan-after-bilateral-mee>
- The World Bank. (2013). "World development indicators." Retrieved from <http://databank.worldbank.org/data/views/reports/chart.aspx>
- The Yomiuri-Gallup poll. (2013). "Do you trust China?" "Which country or area do you think will become a military threat?" Retrieved from lecture slides of Prof. William L. Brooks from the Paul H. Nitze School of Advanced International Studies Johns Hopkins University.
- "US, Australia agree to military force deployment." (2011, November 15). *Voice of America*. Retrieved from <http://www.voanews.com/content/us-australia-agree-to-military-force-deployment-133946093/148236.html>
- U.S. Department of Defense. (2012). "Sustaining U.S. global leadership: priorities for 21<sup>st</sup> century defense." Retrieved from [http://www.defense.gov/news/Defense\\_Strategic\\_Guidance.pdf](http://www.defense.gov/news/Defense_Strategic_Guidance.pdf)
- U.S. Department of State. (2012, September 20). "Maritime territorial disputes and sovereign issues in Asia – testimony of Kurt Campbell before the Senate Foreign Relations Committee Subcommittee on East Asian and Pacific Affairs." Retrieved from
- U.S. Department of State. (2013, January 18). "Hillary Rodham Clinton remarks with Japanese Foreign Minister Fumio Kishida after their meeting." Retrieved from <http://www.state.gov/secretary/rm/2013/01/203050.htm>
- U.S. Department of State Bureau of Public Affairs Office of the Spokesman. (2009, July 22). "United States accedes to the Treaty of Amity and Cooperation in Southeast Asia." Retrieved from <http://www.state.gov/r/pa/prs/ps/2009/july/126294.htm>
- U.S. Department of State Office of the Assistant Secretary of Defense (Public Affairs). (2011, October 25). "Joint press conference with Secretary Panetta and Japanese Minister of Defense Ichikawa in Tokyo, Japan." Retrieved from <http://www.defense.gov/transcripts/transcript.aspx?transcriptid=4912>
- U.S. Department of the Treasury. (2013). "Major foreign holders of Treasury securities." Retrieved from <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt>
- U.S. Government Printing Office. (1971) "Okinawa Reversion Treaty Hearings before the Committee on Foreign Relations United States Senate Ninety-Second Congress First

- Session on The Agreement between the United States of America and Japan concerning the Ryukyu Islands and the Daito Islands, October 27, 28 and 29, 1971.”
- “US, Japan, Australia plan South China Sea drill. (2011, July 8).” *AFP*. Retrieved from [http://www.google.com/hostednews/afp/article/ALeqM5ijF5-kpgjM\\_4UmJeWA05Yu1sfKtg?docId=CNG.b25e50471bf7cd80f49ff0b9169e31d7.121](http://www.google.com/hostednews/afp/article/ALeqM5ijF5-kpgjM_4UmJeWA05Yu1sfKtg?docId=CNG.b25e50471bf7cd80f49ff0b9169e31d7.121)
- “U.S. warned government against buying Senkaku Islands: Campbell.” (2013, April 10). *The Japan Times*. Retrieved from [http://www.japantimes.co.jp/news/2013/04/10/national/u-s-warned-government-against-buying-senkaku-islands-campbell/#.UY\\_Q\\_algMII](http://www.japantimes.co.jp/news/2013/04/10/national/u-s-warned-government-against-buying-senkaku-islands-campbell/#.UY_Q_algMII)
- Wen J. B. (2013, March 5). “Report on the work of the government – the 5<sup>th</sup> session of the 11<sup>th</sup> National People’s Congress.” Retrieved from [http://online.wsj.com/public/resources/documents/2012NPC\\_GovtWorkReport\\_English.pdf](http://online.wsj.com/public/resources/documents/2012NPC_GovtWorkReport_English.pdf)
- Wolf, J. (2012, May 10). “U.S. plans 10-month warship deployment to Singapore.” *Reuters*. Retrieved from <http://www.reuters.com/article/2012/05/10/us-usa-singapore-warship-idUSBRE8481IE20120510>
- Yoshihara, T. and Holmes, J. R. (2012). “Asymmetric warfare, American style.” *Proceedings Magazine*, 138(4-1). Retrieved from <http://www.usni.org/magazines/proceedings/2012-04/asymmetric-warfare-american-style>
- Yoshimatsu, H. (2012). “Japan’s China policy in domestic power transition and alliance politics.” *Asian Affairs: An American Review*, 39(2), 106-126.



## Japan's Economic Partner of Choice: The United States or China?

By Sean Cate

### Introduction

There is often talk of what the economic relationship between Japan and China means for the politics between the two countries, and what it could mean for Japan's overall relationship with the United States. Some believe, such as former Prime Minister Yukio Hatoyama, that Japan's future involves a relative shift away from the United States and towards China due to the logic of economics. Others believe that economics can't overcome the difference in values between Japan and China. There is talk of cold politics and hot economics between the two countries. And there is talk of hot economics leading to hot politics and cold politics leading to cold economics.

What is missing from such discussions is an in depth analysis of the economic situation. Many seem to proceed from superficial assumptions about the economics. In particular, when looking at the China case, one could start by making a comparative examination of the economic appeal of China compared to that of the United States. This is because "importance" and "appeal" are relative terms. To give them meaning in this context, China needs to be evaluated against another economic relationship of Japan's. As the United States was long thought to be Japan's most important economic relationship and is still generally considered its most important overall relationship, as well as a strategic competitor of China's, it is logical to use it for a comparison.

Since the growth in importance of the Chinese market to Japan receives a great amount of attention and the enduring appeal of the economic relationship with the U.S. receives little, the rewards to the relationship with China are often exaggerated, while the rewards to the relationship with the U.S. do not receive sufficient recognition. As a counter to that, this paper will seek to balance the argument by examining the drawbacks to Japan of the economic relationship with China and the gains to Japan of economic ties with the United States. That is not to say that there are no weaknesses to the appeal of the U.S. market and genuine rewards to economic interactions with China, but only that these aspects already receive sufficient focus. In addition, it seems reasonable to assume that the strengths of the appeal of the U.S. economic relationship outweigh the weaknesses, and that the gains from the relationship with China just might be outweighed by the costs, relative to investment in the U.S. or other countries.

The paper will start by taking a brief look at trade flows between Japan and China and Japan and the U.S. and what they signify. It will then detail the appeal of the relationship with the U.S. The third section will then explore the drawbacks of the Chinese market, and it will look at both relatively Japan-specific issues and general structural issues. The final section will look at the direction of current trends, and then briefly discuss the geopolitical goals of the countries involved, before wrapping up discussion.

### **The statistics of ostensible relative decline**

Looking at simple trade in goods and services is a good way to begin examining Japan's economic relationships with the U.S. and China. Trade in goods and services is the most basic and historically the most important form of international economic interaction. It is also the type of interaction that people think of most when they consider bilateral relationships between countries. So this paper will start there and then move on to deeper analysis.

China's entrance into the WTO organization in December 2001 accelerated the development of Japan's economic relationship with that country which had begun in earnest in the mid-to-late 1990s in response to China's increasing economic openness.<sup>1</sup> The WTO accession resulted in the lowering of tariffs, the elimination of some non-tariff barriers, and the deregulation of the entry process for foreign businesses.<sup>2</sup> Tariff reductions began in 2002.<sup>3</sup> That year, automobile exports to China increased by 75% over 2001.<sup>4</sup> Trade between the two countries grew at a frantic pace. From 2001 to 2012, Japanese exports to China had real growth of over 200% (Figure 1, below).<sup>5</sup> During that same time, exports to the U.S. declined over 20%.<sup>6</sup> These are the types of figures that many people reference when they posit the declining economic importance of the U.S. relative to China. While it is true that the numbers represent a very large increase in economic activity between Japan and China, particularly figures such as the increase in car sales, gross trade flows statistics can also be misleading.

---

<sup>1</sup> Hitoshi Sasaki and Yuko Koga. "Trade between Japan and China: Dramatic Expansion and Structural Changes," *Economic Commentary*, Bank of Japan Research and Statistics Department, August 2003, accessed May 10, 2013.

[http://www.boj.or.jp/en/research/wps\\_rev/ec/data/rkt03e03.pdf](http://www.boj.or.jp/en/research/wps_rev/ec/data/rkt03e03.pdf)

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

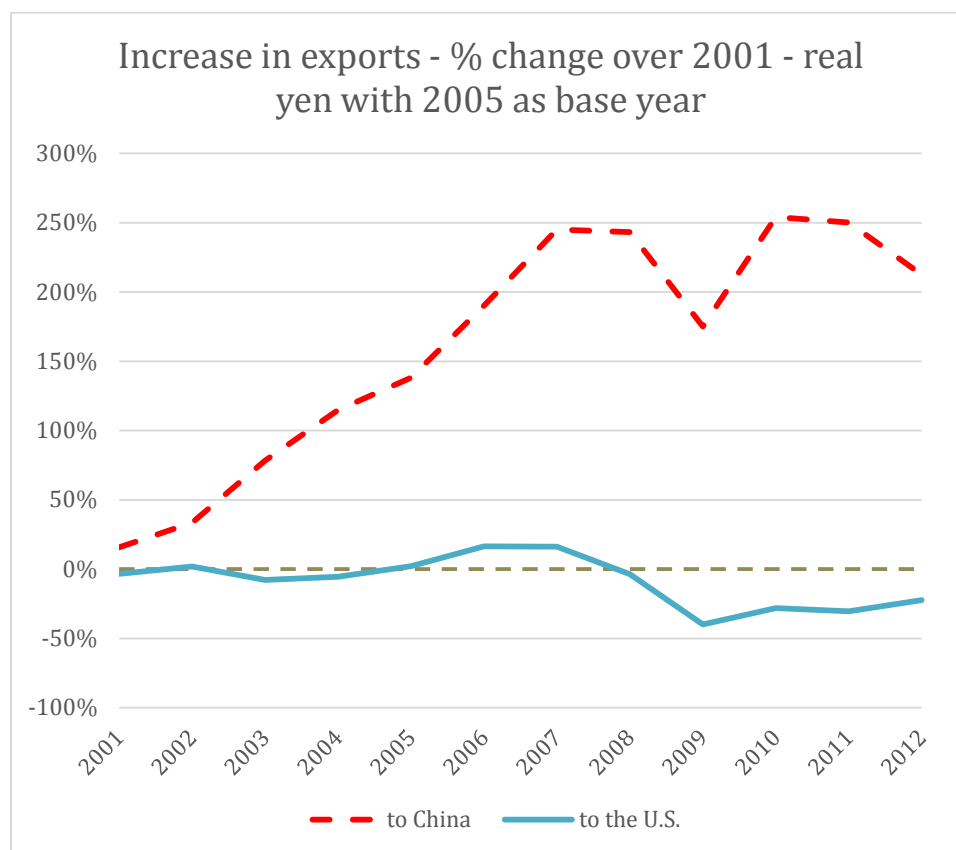
<sup>4</sup> "China' Economy and the WTO: All Change," *The Economist*, December 10, 2011, accessed May 10, 2013.

<http://www.economist.com/node/21541448>

<sup>5</sup> "Trade Statics of Japan," 2001-2012 data, Japan Ministry of Finance, accessed May 10, 2013,

[http://www.customs.go.jp/toukei/shinbun/happyou\\_e.htm](http://www.customs.go.jp/toukei/shinbun/happyou_e.htm); calculations own.

<sup>6</sup> Ibid.

**Figure 1**

*Source: MOF Data; calculation own<sup>7</sup>*

### Outdated measures of trade

The statistics of trade that have been most popular in the past can misrepresent modern trade flows. Modern trade in Asia with the emergence of China into the world economy is dominated by trade in intermediate goods. However, traditional trade statistics measure trade on a gross basis, looking at total values that cross borders. The total value is attributed to its final assembly point, but the entire product might not have been produced there, as intermediate goods from other countries could have gone into the production process. This can cause a distortion in the trade numbers.

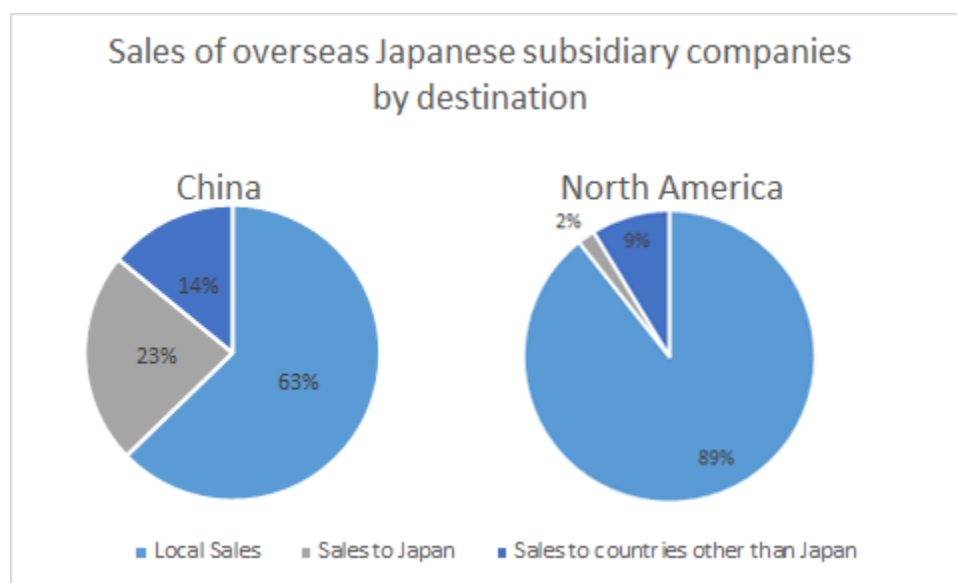
Recently, as a response to this, measuring trade in “value added” has become popular. “Value added” looks at net trade: i.e., the amount of value that was added to a product within the country, rather than its total value coming out of the country.<sup>8</sup> In January 2013, the OECD and WTO began publishing a database that tracks “trade in value added.” This database is the first of its kind that gives a thorough statistical alternative to standard trade statistics. It allows a more accurate view of trade flows among Japan, China, and the U.S.

<sup>7</sup> Data from Japan Ministry of Finance “Trade Statistics of Japan” deflated by CPI data from IMF “International Financial Statistics” for Japan 2001-2012, accessed May 10, 2013, <http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=169393>; calculations own.

<sup>8</sup> “Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks,” World Trade Organization and IDE-JETRO, 2011, accessed, May 10, 2013, [http://www.wto.org/english/res\\_e/booksp\\_e/stat\\_tradePAT\\_globvalchains\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/stat_tradePAT_globvalchains_e.pdf)

China has become a hub of final production in Asia. In the case of Japanese companies, many have set up subsidiaries in China to which intermediate goods are shipped for final assembly into products that will then be exported out of China. Much of this is still destined for the U.S. This makes Japan's exports to the U.S. seem lower and China's appear higher. It also causes Japan's exports to China to appear larger than they really are. Goods that are transferred to China for assembly and re-exported to the U.S. are really an export to the U.S., not China. From the value added standpoint, the U.S. has remained the number one source of Japanese exports.<sup>9</sup> An OECD report from January 2013 found that Japan's trade surplus with China is mostly eliminated by counting in value added and that the trade surplus with the United States increases 60%.<sup>10</sup> Figure 2 below shows the difference in destination of goods produced by Japanese companies in China and the United States for the last quarter of 2012, with much of the production in China being exported out. The total amount produced in the North American market was also \$5 billion larger than in China (including Hong Kong).<sup>11</sup> Activity in the U.S. represents the vast majority of activity in the North American market.<sup>12</sup>

**Figure 2**



The above graphs also reveal another distortion of the statistics. A large amount of Japanese companies' sales to the North American market are assembled in North America. The full value

<sup>9</sup>Almost 20% of Japan's exports were shipped to the U.S. in value-added terms, and 15% to China in 2009 (and 2009 was the year that China passed the United States as Japan's number one export destination, with almost \$16 billion more in imports from Japan, at roughly \$109 billion versus \$93 billion for the U.S.

Source: "OECD/WTO Trade in Value-Added (TiVA) Database: Japan," Organization for Economic Co-operation and Development and World Trade Organization, January 16, 2013, accessed May 10, 2013, <http://www.oecd.org/sti/ind/TiVA%20Japan.pdf>

<sup>10</sup> Ibid.

<sup>11</sup> "Trends in Overseas Subsidiaries: Quarterly Survey of Overseas Subsidiaries, October-December 2012" Statistics, Research and Statistics Department, Minister's Secretariat, Ministry of Economy, Trade and Industry, March 28, 2013, accessed March 10, 2013, <http://www.meti.go.jp/english/statistics/tyo/genntihou/pdf/h2c3m3ye.pdf>; calculations own

<sup>12</sup> "Trade Statistics of Japan"

<sup>13</sup> "Trends in Overseas Subsidiaries"; calculations own

of the goods produced in the U.S. by Japanese subsidiaries is not counted as an export of Japan to the U.S. Only the value of whatever intermediate goods produced in Japan that are used to assemble these products is counted as an export of Japan.

### **Value of U.S. as an economic partner**

The data previously presented shows that the U.S. is still the biggest destination for Japanese export goods. This is certainly worth taking note of. However, it should not be accorded too much importance. The real appeal of the U.S. to Japan as an economic partner cannot be seen in simple export figures. There are more unique and enduring strengths. These are the result of structural features of the U.S. and Japanese economies. Similarly, the weakness of China as a partner isn't simply that its imports from Japan by value added are lower than the gross numbers. The weaknesses are fundamental structural problems.

### **The Knowledge economy**

The most important of these structural features that aligns the U.S. and Japan is that they can now be considered primarily knowledge-based economies.<sup>14</sup> Modern economies are built on intellectual property (IP), also known as “intangible assets.”<sup>15</sup> Intangible assets are not only things like copyrighted entertainment and research and development; but also patents on new inventions, designs, and engineering; know-how specific to firms and processes; organizational skills that increase work efficiency; and computerized databases of information.<sup>16</sup> Naturally, the security of the ownership of these assets is important to knowledge-based economies. However, securing intellectual property is much more difficult than securing physical property. This difficulty can prevent the full realization of the benefits of gains from trade as businesses take extra steps to safeguard proprietary knowledge. This could prevent them from trading sensitive products that can be reversed engineered, setting up production in local markets in order to adapt better to the market and reduce exchange rate risks, and locating research and development in other countries to benefit from foreign knowledge. These foregone benefits are a cost of unsecure IP.

Japan in particular has a lot to lose from the theft of intangible assets and a lot to gain from the utilization of them. In the 2000s, Japan invested 43 trillion yen in intangible assets.<sup>17</sup> This amounted to 9% of the Japanese GDP for the time period.<sup>18</sup> In 2005 (the only year data could be found), Japan led the world in investment in intangible assets.<sup>19</sup> In 2008 the total value of its

---

<sup>14</sup> According to a 2011 OECD report, companies in Japan and the U.S. have intensively invested in intangible assets, which have had substantial beneficial effects on productivity. Source: “New Sources of Growth: Intangible Assets,” Organization for Economic Co-operation and Development, September 2011, accessed May 10, 2013, <http://www.oecd.org/sti/inno/46349020.pdf>

<sup>15</sup> Kevin A Hassett and Robert J. Shapiro, “What Ideas are Worth : The Value of Intellectual Capital and Intangible Assets in the American Economy,” Sonecon, accessed May 10, 2013, [http://www.sonecon.com/docs/studies/Value\\_of\\_Intellectual\\_Capital\\_in\\_American\\_Economy.pdf](http://www.sonecon.com/docs/studies/Value_of_Intellectual_Capital_in_American_Economy.pdf)

<sup>16</sup> Wim Vosselman, “Measuring Intangible Investment,” Organization for Economic Co-operation and Development, 1998, accessed May 10, 2013, <http://www.oecd.org/sti/ind/1943309.pdf> and “New Sources of Growth”

<sup>17</sup> Tsutomu Miyagawa and Shoichi Hisa, “Measurement of Intangible Investment by Industry and Economic Growth in Japan,” Policy Research Institute, Ministry of Finance, Japan, *Public Policy Review*, Vol.9, No2, March, 2013, accessed May 10, 2013, [http://www.mof.go.jp/english/pri/publication/pp\\_review/ppr021/ppr021e.pdf](http://www.mof.go.jp/english/pri/publication/pp_review/ppr021/ppr021e.pdf)

<sup>18</sup> Ibid. And: “New Sources of Growth: Knowledge-Based Capital Driving Investment and Productivity in the 21st Century,” OECD, May 2012, accessed May 10, 2013, <http://www.oecd.org/sti/inno/50498841.pdf>

<sup>19</sup> “New Sources of Growth”

intellectual capital was 136 trillion yen.<sup>20</sup> If we use the estimated return in the United States on intangible assets (as a figure for Japan could not be found) of 20%, then the flow generated by 136 trillion yen would be over 27 trillion yen, and no doubt the stock, and therefore the flow, is higher now.<sup>21</sup>

The Japanese government realizes the importance of intangible assets to future economic growth. In 2002, Prime Minister Junichiro Koizumi set up the Strategic Council on Intellectual Property in the Prime Minister's Official Residence (Kantei). The council published a report that year that identified intellectual property as the key to Japan's 21<sup>st</sup> century prosperity. The report specifically identifies the importance of protecting IPR overseas.<sup>22</sup>

In this context, the U.S. is a valuable partner for Japan. As a country also reliant on intangible assets for its growth, it serves the United States' interests to enact strong laws protecting intellectual property.<sup>23</sup> The U.S. pushes for stronger enforcement of IPR overseas and tries to lead by example by protecting IP at home in the hopes that other will follow suit.<sup>24</sup> This means that Japanese companies can more safely trade with the U.S. and move production to the U.S. to hedge against currency risk and better serve and adapt to the local market. They can also move research and development to the United States to take advantage of indigenous innovation without the risk of IP theft.

That brings up the other strength of the U.S. in this context: the U.S. is one of the most innovative countries in the world. There are many reasons for this, including well-developed capital markets that support start-ups, the system of government-university and business-university research partnerships (of the top ten global universities ranked by number of patent applications, all of them are U.S. universities), a risk-embracing culture, a population of early adopters, a relative meritocracy, an open society that attracts talent from around the world to innovate and start businesses, and free flows of information and ideas.<sup>25</sup> The U.S. is the largest recipient of international patent filings under the Patent Cooperation Treaty, with about one-third of total global filings - over 49,000. Japan is second with almost 38,000, while China is fourth with over 17,000.<sup>26</sup>

<sup>20</sup> Tsutomu and Shoichi, "Measurement of Intangible Investment"

<sup>21</sup> Hasset and Shapiro, "What Ideas are Worth"

<sup>22</sup> "Intellectual Property Policy Outline," Strategic Council on Intellectual Property, July 3, 2002, accessed May 10, 2013, [http://www.kantei.go.jp/foreign/policy/titeki/index\\_e.html](http://www.kantei.go.jp/foreign/policy/titeki/index_e.html)

<sup>23</sup> See: American Inventors Protection Act of 1999, accessed May 10, 2013 <http://www.uspto.gov/ip/global/>; Office of Policy and External Affairs – Enforcement, The United States Patent and Trademark Office, accessed May 10, 2013,

<http://www.uspto.gov/ip/global/enforcement/index.jsp> and "2010; Joint Strategic Plan on Intellectual Property Enforcement, Executive Office of the President of the United States, June 2010, accessed May 10, 2013,

[http://www.whitehouse.gov/sites/default/files/omb/assets/intellectualproperty/intellectualproperty\\_strategic\\_plan.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/intellectualproperty/intellectualproperty_strategic_plan.pdf)

The estimated value of the intangible assets in the U.S. economy in 2011 was \$13.75 trillion to \$14.5 trillion. Source: Hasset and Shapiro, "What Ideas are Worth"

<sup>24</sup> "Intellectual Property: Protection and Enforcement," World Trade Organization, accessed May 10, 2013,

[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm7\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm7_e.htm); Gordon M. Snow, "Statement Before the Senate Judiciary Committee Washington, D.C." June 22, 2011, accessed May 10, 2013, <http://www.fbi.gov/news/testimony/intellectual-property-law-enforcement-efforts>

<sup>25</sup> "Why Innovation is Tough to Define – and Even Tougher to Cultivate," *Knowledge@Wharton*, April 20, 2013, accessed May 10, 2013, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=3242>; Gerard J. Tellis, "Is the U.S. Really Losing Its Competitive Edge?," *Forbes.com*, January 02, 2013, accessed May 10, 2013,

<http://www.forbes.com/sites/ciocentral/2013/01/02/is-the-u-s-really-losing-its-innovative-edge/>

<sup>26</sup> "2012 Yearly Review," World Intellectual Property Organization, 2013, accessed May 10, 2013, [http://www.wipo.int/export/sites/www/freepublications/en/patents/901/wipo\\_pub\\_901\\_2012.pdf](http://www.wipo.int/export/sites/www/freepublications/en/patents/901/wipo_pub_901_2012.pdf)

The importance of this is recognized in Japan. The previously mentioned 2002 document by the Strategic Council on Intellectual Property repeatedly refers to the U.S. as a model, making 25 references to it.<sup>27</sup> Japanese businesses often relocate research and development facilities to the U.S. to benefit from centers of innovation. A study from 2004 of Japanese companies found that having a U.S. subsidiary that focused on research and development (R&D) in the United States increased the number of patents obtained in both Japan and the United States.<sup>28</sup> It was also found by the same study that the more R&D done by the subsidiary in the U.S., “the higher the knowledge flows from [the] local environment to the subsidiary.”<sup>29</sup> This is important because it shows that companies can benefit from existing knowledge in the U.S. economy. So the U.S. is an attractive partner in this context because it respects Japanese IPR and can help Japan develop new IP.

### **Regulatory Environment**

The United States has a stable regulatory environment that is relatively free from the political risk that can be found in many developing countries. It also shares many similarities with Japan, which allows for regulatory harmonization. This decreases the transactional costs of trade.<sup>30</sup> Additionally, for 2012, the U.S. ranked 4<sup>th</sup> in the World Bank’s “Ease of Doing Business Index.”<sup>31</sup> It was ranked 7<sup>th</sup> in the World Economic Forum’s “Global Competitiveness Index.”<sup>32</sup> The only country that scored higher in both those indexes was Singapore, which doesn’t have the additional appeal of being the world’s largest market.

### **Japan as a “Banking Nation:” Financial Markets and Income Generating Assets**

Countries that run current account surpluses will also run corresponding capital account deficits to make the balance of payments, well, balance. This means that they export capital to the rest of the world and receive claims on future earnings in return. As Japan has been one of the world’s largest exporter nations for decades, it has also been the world’s largest creditor nation for over twenty years.<sup>33</sup> It had \$3.19 trillion in net foreign assets at the end of 2011.<sup>34</sup> These assets yield returns that go back to Japan as foreign income. For a long time, Japan was first and foremost an export nation, and was a creditor nation as a byproduct. However, now these assets are becoming increasingly important to Japan’s economic future. It may now be the case that what may be called its “bank nation” identity will become most important. If it wasn’t for income from abroad, Japan would have run a current account deficit in 2011 and 2012 (see Figure 3).

<sup>27</sup> “Intellectual Property Policy Outline”

Also see:

Ichiro Nakayama, “Intellectual Property Strategy in Japan,” Organization for Economic Co-operation and Development, August 29, 2003, accessed May 10, 2013, <http://www.oecd.org/sti/sci-tech/12762973.pdf>; Strategic Council on Intellectual Property, accessed May 10, 2013, [http://www.kantei.go.jp/foreign/policy/titeki/index\\_e.html](http://www.kantei.go.jp/foreign/policy/titeki/index_e.html)

<sup>28</sup> Sam Kurokawa, Satoshi Iwata, and Edward B. Roberts, “Global R&D Activities of Japanese MNCs in the U.S.: A Triangular Approach,” accessed May 10, 2013, [http://www.gsim.aoyama.ac.jp/~bew/Kurokawa\\_Iwata\\_Roberts\\_revised2.pdf](http://www.gsim.aoyama.ac.jp/~bew/Kurokawa_Iwata_Roberts_revised2.pdf)

<sup>29</sup> Ibid.

<sup>30</sup> For example, see: U.S.-Japan Economic Harmonization Initiative, accessed May 10, 2013, <http://www.ustr.gov/countries-regions/japan-korea-apec/japan>

<sup>31</sup> “Economy Rankings 2012,” Doing Business, World Trade Organization, accessed May 10, 2013, <http://www.doingbusiness.org/rankings>

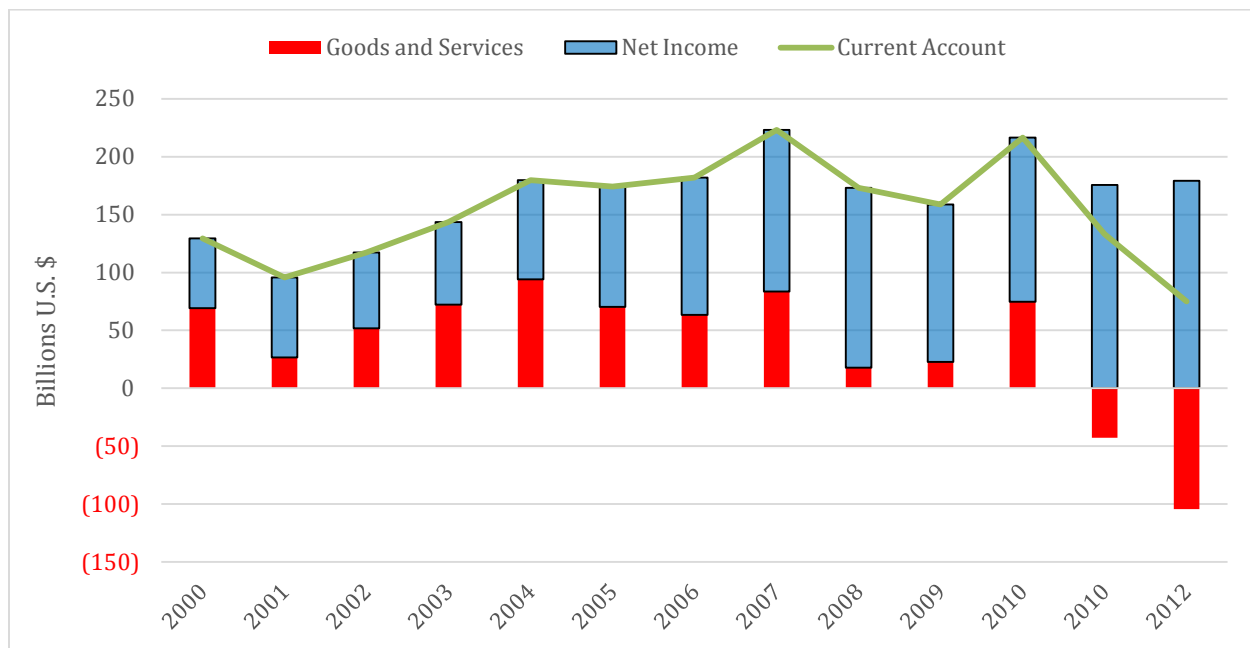
<sup>32</sup> Klaus Schwab, “The Global Competitiveness Report: 2012-1013,” World Economic Forum, 2012, accessed May 10, 2013, [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2012-13.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2012-13.pdf)

<sup>33</sup> See: Takashi Nakamichi, “Japan Retains Status as Biggest Creditor,” May 22, 2012, accessed May 10, 2013, <http://online.wsj.com/article/SB10001424052702304791704577419731445193166.html>

<sup>34</sup> Ibid.

This makes the United States hugely important to Japan, as it is the location of Japan's biggest stock of foreign assets. At the end of June 2012, Japanese entities owned \$1.84 trillion of U.S. equities and debt.<sup>35</sup> As of February 2013, Japan owned \$1.097 trillion in U.S. government Treasury Securities.<sup>36</sup> Japan also has a significant stock of outward FDI in the United States (see Figure 4). The stable regulatory framework and relatively low political risk mentioned before make the U.S. an appealing place to keep these assets, even after the Global Financial Crisis. Another aspect of the U.S. economy that makes it an appealing place to keep assets for Japan is that the U.S. has the largest, and one of the most developed financial, markets in the world.

**Figure 3**



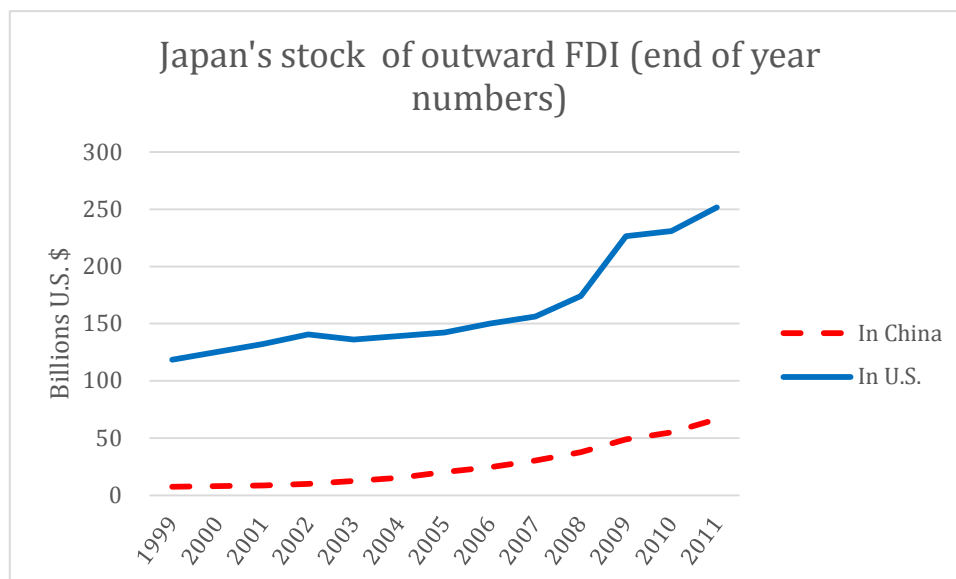
Source: JETRO Data; calculation own<sup>37</sup>

<sup>35</sup> Greg Robb, "Japan Top Owner of U.S. Assets," Marketwatch.com, February 28, 2013, accessed May 10, 2013, [http://articles.marketwatch.com/2013-02-28/economy/37349004\\_1\\_japan-treasury-data-assets](http://articles.marketwatch.com/2013-02-28/economy/37349004_1_japan-treasury-data-assets)

<sup>36</sup> "Major Foreign Holders of Treasury Securities," United States Treasury Department, accessed May 10, 2013, <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt>

<sup>37</sup> "Japan's Trade Balance of Goods and Services" Japanese Trade and Investment Statistics, Japan External Trade Organization (JETRO), accessed May 10, 2013, [http://www.jetro.go.jp/en/reports/statistics/data/eservice1\\_201302.xls](http://www.jetro.go.jp/en/reports/statistics/data/eservice1_201302.xls); calculations own.



**Figure 4**

Source: JETRO Data; calculation own<sup>38</sup>

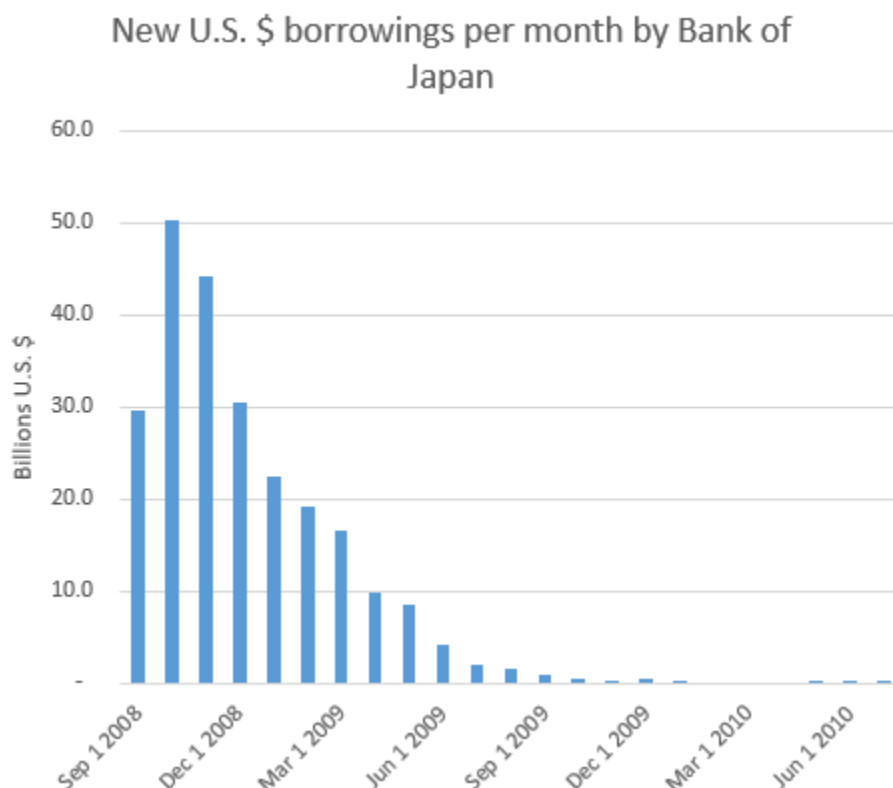
Additionally, Tokyo being a global financial hub has created another connection. There is significant trading of dollars in Tokyo and Japanese banks utilize and extend dollar funding. This is where the status of the U.S. dollar as a reserve currency makes the United States important to Japan. During the Global Financial Crisis, the United States Federal Reserve created a currency swap line with Japan in which the Fed provided needed dollar liquidity to the Japanese financial system. This swap line has been extended through February 1, 2014 and was used again in 2012 because of disruptions in financial markets caused by instability in Europe.<sup>39</sup> The latest borrowings can be seen in Figure 5 below.

<sup>38</sup> "FDI Flow (Based on Balance of Payments, net): Historical Data: Outward," Japanese Trade and Investment Statistics, Japan External Trade Organization (JETRO), accessed May 10, 2013,

[http://www.jetro.go.jp/en/reports/statistics/data/country1\\_e\\_cy12.xls](http://www.jetro.go.jp/en/reports/statistics/data/country1_e_cy12.xls); calculations own.

<sup>39</sup> Federal Reserve Press Release, December 13, 2012, accessed May 10, 2013,

<http://www.federalreserve.gov/newsevents/press/monetary/20121213a.htm>

**Figure 5**

*Source: Fed Data; calculation own*<sup>40</sup>

### **Energy**

Energy security is a critical issue for Japan. The shale gas boom in the United States has the possibility to make the U.S. a friendly source of needed energy that for Japan. This issue deserves much attention, as it could play a major role in the Japan-U.S. economic relationship. It holds out the promise of significant benefits for Japan. There are high expectations that this energy will be exported to Japan, raising the importance of the U.S.

### **Obstacles to a mutually beneficial economic relationship with China**

China has received much attention for its tremendous rates of economic growth. Japanese businesses were previously eager to get into such a large, rapidly growing market. However, in recent years, the political risk attached to investment in China has become a serious factor in Japan and is seen by many as a growing impediment to a mutually beneficial economic relationship between Japan and China. However, the bigger obstacles are more prosaic and not unique to Japan: structural issues that limit the ability of foreign firms to succeed in the Chinese market.

### **The Japan-unique political risks**

<sup>40</sup> “Central Bank Liquidity Swap Data,” United States Federal Reserve, accessed May 10, 2013, <http://www.federalreserve.gov/newsevents/files/cbls.xls>; calculations own.

### Economics as Politics – The Internal/External Dynamic

While foreign policy friction between Japan and China is not the main limitation of China as an economic partner, it is still significant. China has publically used economics as a weapon in its political disputes. For example, it has blocked banana imports from Philippines, fish from Norway, and taken extensive actions against Japan, including stopping rare earth exports.<sup>41</sup> By doing this, China makes it so that the Japan-China economic and political relationships *cannot* be separated. This, in no small part, has led to the recognition by Japanese companies of what has been termed “China Risk.”<sup>42</sup>

The China Risk was not taken into account in the 1990s, when Japanese companies were enthusiastically rushing into China.<sup>43</sup> Now, however, such an air of unconcern has largely disappeared. The extensive economic damage done to Japanese businesses in China during the 2012 violent nationalist “protests” over the Senkaku nationalization did the most to change the view of Japanese business towards China. More than a dozen major Japanese companies temporarily ceased operations in China during that time (including Honda, Nissan, Toyota, Mazda, Mitsubishi, Yamaha, Komatsu, Hitachi, Panasonic, Aeon, Fast Retailing, Ryohin Keikaku, Seven & I, and Canon).<sup>44</sup> Arson, sabotage, and looting against Japanese businesses were rampant.<sup>45</sup> More than \$100 million of Japanese property was damaged.<sup>46</sup> The views among most China watchers are that the violent nationalistic “protests” that erupted had the backing of the Chinese Communist Party.<sup>47</sup> The Chinese government also stopped issuing visas to Japanese companies, held up inspections of Japanese goods coming into China, and denied Japanese companies bidding on projects.<sup>48</sup>

Another notable incident occurred in 2010. In response to a dispute involving the area of the Senkakus, China restricted the export of rare earth metals to Japan. These are critical components in many electronics goods, and China has a near monopoly on them and is willing to use such as an economic weapon.<sup>49</sup> One could probably say this was when the Japanese political system recognized the China Risk.

What makes it even more difficult for Japan to deal with these actions is that they are more intended to play to a domestic (nationalistic) audience than to send a message to Japan. The anti-Japan stance of the government taps similar popular sentiment in China.<sup>50</sup> The Chinese government faces many difficult domestic problems, such as income disparity, minority unrest,

<sup>41</sup> Hitoshi Tanaka, “Myths of Decline: Why Japan Matters as China Rises,” *East Asian Insights*, Japan Center for International Exchange, December 2012

<sup>42</sup> For a brief description of “China Risk” from a Japanese perspective see: Ke Long, “Re-Acknowledging the China Risk: Proposal for Japanese Companies’ Investment Strategy in China: Abstract, December 2012, accessed May 10, 2013, <http://jp.fujitsu.com/group/fri/en/economic/publications/report/2012/report-398.html>

<sup>43</sup> Kikuchi

<sup>44</sup> Gordon G. Chang, “Is China Burning?,” *Forbes*, September 23, 2013, accessed May 10, 2013, <http://www.forbes.com/sites/gordonchang/2012/09/23/is-china-burning/>

<sup>45</sup> Ibid.

<sup>46</sup> Koichiro Gemba, “Japan-China Relations at a Crossroads,” *International Herald Tribune*, November 21, 2012

<sup>47</sup> For example, see: C. Custer, “China’s Anti-Japan Riots are State-Sponsored. Period.,” *ChinaGeeks.com*, September 17, 2012, accessed May 10, 2013, <http://chinageeks.org/2012/09/chinas-anti-japan-riots-are-state-sponsored-period/>

<sup>48</sup> Gordon G. Chang, “Is China Burning?”

<sup>49</sup> Keith Bradsher, “Amid Tension, China Blocks Crucial Export to Japan,” *The New York Times*, September 23, 2010, accessed May 10, 2013, <http://www.nytimes.com/2010/09/24/business/global/24rare.html?pagewanted=all>

<sup>50</sup> Joseph Kahn, “China is Pushing”

and environmental degradation. In order to deflect attention from such issues, the Party uses the nationalism card to direct popular frustrations towards an external source and enhance the legitimacy of its hold on power. So the Party's external policy choices which seem irrational are quite rational, since the goal is actually domestic. The uncertainty that this causes is spilling over more and more into the economic relationship. With Japan the favorite target of such xenophobic actions, Japanese business now finds itself facing almost alone an increasingly risky environment in China. Certainly, American business does not feel that there is a similar China Risk.

### **Supply chain disruptions**

China has benefitted greatly from the "Factory Asia" phenomenon. Within this system, as discussed above, China is often the final assembly point where intermediate goods from throughout the region are brought together to be made into a completed product. As such, China is a vital cog in the supply chain for businesses doing final assembly there. Japanese companies have particularly specialized in this type of production network. However, these supply chains are highly vulnerable to political risks, as they are easily disrupted by shocks. China being the final assembly point, the value added created throughout the production chain can be held up should disruptive events occur there. Often, only a small amount of value is being added in China. So it may not be worth it to many companies to risk the holdup of the entire value of a shipment just for an assembly plant in China that adds little value to the final product.

### **Non-Japan-specific structural problems**

Over the medium term, the greatest obstacles to Japanese businesses benefitting from the Chinese market are not the political risks mentioned above. They are mainly structural problems with the Chinese economy that in general affect all foreign companies operating in China.

### **Legal and Regulatory**

The Chinese legal and regulatory systems are fraught with uncertainty for foreign companies. China often makes unannounced changes to regulations and issues them often not through written dissemination but by word-of-mouth.<sup>51</sup> In addition, China's antimonopoly law has jurisdiction over more than just consumer welfare (the standard means of evaluation in advanced economies), but also over the vague areas of "economic security" and "social stability."<sup>52</sup> Foreign businesses in China must deal with such ambiguities in their operations. They also face restrictions on investment in many sectors of the Chinese economy, where the state wants to favor domestic companies.<sup>53</sup> Even in permitted areas of investment, regulations often place a significant burden on foreign firms.<sup>54</sup> Furthermore, regulators can restrict or deny foreign investment based on their own "judgment."<sup>55</sup> All foreign investment in China must be approved by the government and often domestic industries have a say in this process, which creates an obvious conflict of interest.<sup>56</sup> According to a U.S. State Department report, "foreign investors rank inconsistent and arbitrary regulatory enforcement and lack of transparency among the major

<sup>51</sup> "2012 Investment Climate Statement – China," Bureau of Economic and Business Affairs, United States Department of State, June 2012, accessed May 10, 2013, <http://www.state.gov/e/eb/rls/othr/ics/2012/191128.htm>

<sup>52</sup> Ibid.

<sup>53</sup> "What are the Main Problems Facing EU Exporter to China in the Area of Non-Tariff Barriers?," European Union Directorate General for Trade, October, 2006, accessed May 10, 2013, [http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc\\_130827.pdf](http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc_130827.pdf)

<sup>54</sup> Ibid.

<sup>55</sup> "2012 Investment Climate Statement"

<sup>56</sup> Ibid.

problems they face in China's market."<sup>57</sup> On the legal side of things, the courts aren't independent from the other parts of the government and suffer from corruption.<sup>58</sup> Business disputes must be heard in economic courts, where foreign firms are always at a disadvantage. Japanese companies suffer from all of these difficulties when doing business in China.

### **Preferential treatment for domestic firms**

The economic playing field in China is thus tilted in favor of domestic companies. For one thing, China's State Assets Law requires policies that will assure dominance of state owned enterprises in industries "vital to national security and national economic security."<sup>59</sup> State-owned enterprises also have monopolies in many sectors. Additionally, they receive credit at subsidized rates.<sup>60</sup> China also employs a number of non-tariff barriers to trade that can make exporting to China difficult.<sup>61</sup> For instance, China is able to use labeling standards, product certification, and import delays as barriers.<sup>62</sup> This makes it difficult for Japanese and other foreign firms to do business with China.

### **Standards Disharmony**

China has standards that often differ from international norms and that impose high compliance costs on foreign firms, often necessitating lengthy processes of factory inspections and the turning over of extensive, and often sensitive, information to the government.<sup>63</sup>

The harmonization of standards has become a major objective in international economic partnership agreements. This is because, with nearly all major trading nations in the World Trade Organization, tariffs on traded goods are by-and-large already pretty low. So there are not usually huge gains to be made from tariff reductions themselves. This leads trade negotiators pursue reductions in non-tariff barriers to trade in what are called "next generation" trade agreements. They are called this because they are more extensive than the previous generation of trade agreements. Japan is currently pursuing such agreements.<sup>64</sup>

It would be exceedingly difficult for Japan to harmonize standards with China, which is still a partial-command economy. From the 1980s to the mid-2000s, the private sector in China was advancing, but the last few years have seen resurgence in the prominence state-owned enterprises (SOEs).<sup>65</sup> China's institutional structure favors SOEs due to deliberate choices of the government. The Global Financial Crisis in 2008 also consolidated the power of SOEs and solidified the linkages to the Party, as the SOEs were used to implement the government's

---

<sup>57</sup> Ibid.

<sup>58</sup> Ibid.

<sup>59</sup> Ibid.

<sup>60</sup> Ibid.

<sup>61</sup> "What are the Main Problems"

<sup>62</sup> "Ibid.

<sup>63</sup> "2012 Investment Climate Statement"

<sup>64</sup> Nobuhiko Sasaki, "Recent Topics On Japan's Trade Policy," February 4, 2013, accessed May 10, 2013, [https://www.jef.or.jp/PDF/20130204\\_NobuhikoSasaki.pdf](https://www.jef.or.jp/PDF/20130204_NobuhikoSasaki.pdf)

<sup>65</sup> "How the Resurgence of State-Owned Enterprises Threatens China's Economy," *ChinaEconomicReview.com*, August 3, 2012, accessed May 10, 2013, <http://www.chinaeconomicreview.com/swept-under>; Michael Wines, "China Fortifies State Businesses to Fuel Growth," *The New York Times*, August 29, 2010, accessed [http://www.nytimes.com/2010/08/30/world/asia/30china.html?hp&\\_r=0](http://www.nytimes.com/2010/08/30/world/asia/30china.html?hp&_r=0)

economic policies and were the recipients of most of the \$586 billion stimulus package.<sup>66</sup> China still has around 17,000 at least partially state owned enterprises.<sup>67</sup> Of the one hundred largest publically listed Chinese companies, 99 are majority owned by the state.<sup>68</sup> Due to all this, some see the previous advances of the private sector as being partially rolled back.<sup>69</sup> The term *guojin mintui*, meaning “the state advances and the private sector retreats,” has come to be used by some to describe the current climate in China.<sup>70</sup> State-owned enterprises have accumulated their own political power, which can resist efforts to scale them back.<sup>71</sup> In addition, a patronage system has developed that dispenses high paying jobs to favored Party members. As a result, most government contracts go to SOEs.<sup>72</sup> It is not surprising that there is a strong constituency for maintaining the current system.

There are two other reasons why China has become a less appealing partner for Japan. One is that as long as the current business environment exists, China would not be able to enter into a high quality Free Trade Agreement (FTA) of the type that Japan is seeking with other trade partners. Those who benefit from the current system would resist the reforms necessary for China to join such an FTA. The second is that the same vested interests will also fight to prevent further opening of the economy. Many businesses, including Japanese, went into China with expectations of continued market-based reforms. Those hopes have been dampened. The image of the burgeoning Chinese market has been sullied.

## Corruption

Systemic corruption in China also hinders and frustrates Japanese businesses there. China ranked number 80 in Transparency International “Corruption Perceptions Index 2012.”<sup>73</sup> An opinion piece in the *Japan Times* recently claimed that corruption in China infects “most schools, hospitals, banks, universities, companies, public transport, the courts and the police.”<sup>74</sup> Despite high-profile prosecutions, corruption is likely to remain a significant problem as long as China maintains a system of concentrated power (both in business and government) that allows many rent-seeking opportunities.<sup>75</sup>

## Economic Espionage/IP Theft

<sup>66</sup> “Nationalisation Rides Again,” *The Economist*, November 12, 2009, accessed May 10, 2013, <http://www.economist.com/node/14859337>

And Michael Wines, “China Fortifies State”

And “China’s Stimulus Package,” *The Economist*, November 12, 2008, accessed May 10, 2013, [http://www.economist.com/blogs/theworldin2009/2008/11/chinas\\_stimulus\\_package](http://www.economist.com/blogs/theworldin2009/2008/11/chinas_stimulus_package)

<sup>67</sup> “International Conference on the Resurgence of State-Owned Enterprises,” World Federation of Trade Unions, 11 December, 2010, accessed May 10, 2013, <http://www.riab.kerala.gov.in/soekerala-docs/Strengthening%20Environment,%20Social%20and%20Governance%20Policies%20of%20SOEs.pdf>

<sup>68</sup> Michael Wines, “China Fortifies State”

<sup>69</sup> Ibid.

<sup>70</sup> Simon Rabinovitch, “Private Sector Battles March of Chinese State,” *The Financial Times*, November 11, 2012, accessed May 10, 2013, <http://www.ft.com/intl/cms/s/0/eb5687c0-2bed-11e2-a91d-00144feabdc0.html#axzz2SwM8VQdq>

<sup>71</sup> Michael Wines, “China Fortifies State”

<sup>72</sup> Ibid.

<sup>73</sup> “Corruption Perceptions Index 2012,” Transparency International, 2012, accessed May 10, 2013,

<http://cpi.transparency.org/cpi2012/results/>

<sup>74</sup> Thorsten Pattberg, “Can China’s New Government End Corruption?,” *The Japan Times*, April 6, 2013, accessed May 10, 2011, <http://www.japantimes.co.jp/opinion/2013/04/06/commentary/can-chinas-new-government-end-corruption/#.UYdNGjhXH0Y>

<sup>75</sup> Shujie Yao, “Hello 2013: To Fight Corruption, China Must Fight the Causes of Corruption,” *The Financial Times*, January 14, 2013, accessed May 10, 2013, <http://blogs.ft.com/beyond-brics/2013/01/14/hello-2013-to-fight-corruption-china-must-fight-the-causes-of-corruption/#axzz2SUWW6l4O>

As mentioned above, a major issue for Japanese companies is the protection of intellectual property. China is notorious for its extensive and aggressive industrial espionage and relentless quest for acquiring foreign intellectual property.<sup>76</sup> While it is against WTO rules to “require” technology transfers in exchange for market access, China gets around this by requiring that foreign companies establish joint ventures. The Chinese company in the joint venture then insists that the foreign company transfer technology to the joint venture as a condition for participation.<sup>77</sup> There are also some policies in place at the national and sub-national levels that make it so foreign companies are expected to file for patents in China in order to get preferential treatment in government procurement contracts.<sup>78</sup> The government also uses taxes to encourage technology transfer: 150% tax deduction for foreigners making R&D expenditures in China and lower effective tax rates for companies that transfer technology.<sup>79</sup> China also has a tactic that involves using workers who will stay at a foreign company for sometimes years and learn the work processes and institutional know-how and then take that knowledge to a Chinese company.<sup>80</sup> China also uses a similar strategy to steal research and development from foreign companies who do R&D in China.<sup>81</sup>

Recently, cyber espionage has made front-page headlines in the international press. It has not supplanted the more traditional versions of theft.<sup>82</sup> It has been alleged that the losses of IP to physical theft by employees at foreign companies in China are even more extensive than the losses to cyber theft.<sup>83</sup>

### Costs growth

Besides the political, legal, regulatory, and IP issues, there are more prosaic issues making China less attractive. One of these is wage growth. It is estimated that in the last ten years wages have more than tripled in China.<sup>84</sup> From 2010 to 2011, manufacturing wages grew 14.4%.<sup>85</sup> Non-

---

<sup>76</sup> A consultant firm released a report this year that alleged that a Chinese hacking group that is part of the PLA stole information from over 140 organizations in twenty different countries: Jody Westby, “Mandiant Report on Chinese Hackers is Not News but Its Approach Is,” *Forbes*, February 20, 2013, accessed May 10, 2013, <http://www.forbes.com/sites/jodywestby/2013/02/20/mandiant-report-on-chinese-hackers-is-not-news-but-its-approach-is/> see also:

“Foreign Spies Stealing U.S. Economic Secrets in Cyberspace,” Office of the National Counterintelligence Executive, October, 2011, accessed May 10, 2011, [http://www.ncix.gov/publications/reports/fecie\\_all/Foreign\\_Economic\\_Collection\\_2011.pdf](http://www.ncix.gov/publications/reports/fecie_all/Foreign_Economic_Collection_2011.pdf)

<sup>77</sup> Dennis C. Shea, “The Impact of International Technology Transfer on American Research and Development,” Testimony before the Committee on Science, Space, and Technology Subcommittee on Investigations and Oversight United States House of Representatives, December 5th, 2012, accessed May 10, 2013,

<http://science.house.gov/sites/republicans.science.house.gov/files/documents/HHRG-112-SY21-WState-DShea-20121205.pdf>

<sup>78</sup> Ibid.

<sup>79</sup> Ibid.

<sup>80</sup> Dennis C. Shea, “The Impact”

<sup>81</sup> Ibid.

<sup>82</sup> Ibid.

Kawasaki has been particularly critical of Chinese actions in this regard. See:

Norihiko Shirouzu, “Train Makers Rail Against China’s High-Speed Designs,” *The Wall Street Journal*, November 17, 2010, accessed May 10, 2013,

<http://online.wsj.com/article/SB10001424052748704814204575507353221141616.html>; for the story of Siemens, Kawasaki, Alstom, and Bombardier which were on the losing side of technology transfer in the high-speed rail-industry.

<sup>83</sup> “Who Needs Cyber-Spying?,” *The Economist*, February 23, 2013, accessed May 10, 2013,

<http://www.economist.com/news/china/21572250-old-fashioned-theft-still-biggest-problem-foreign-companies-china-who-needs>

<sup>84</sup> Mark Gimein, “If U.S. Wages Rose as Fast as China’s, Factories Would Now Pay \$50 an Hour,” *Bloomberg*, March 27, 2013, accessed May 10, 2013, <http://go.bloomberg.com/market-now/2013/03/27/if-u-s-wages-rose-as-fast-as-chinas-factories-would-pay-50-an-hour/>

<sup>85</sup> “The 22<sup>nd</sup> Survey of Investment Related Costs in Asia and Oceania (FY 2011 survey),” Overseas Research Department

manufacturing wages grew 9.9%.<sup>86</sup> However, while the entire region has seen wage increases, there are still low-cost destinations such as Myanmar, Vietnam, and Cambodia. China's 2012 "Employment Promotion Plan (2011-2015)" targeted an average 13% annual increase in worker minimum wage during the period.<sup>87</sup> From 2006-2010, it increased an average of 12.5% annually.<sup>88</sup>

In addition to wage growth, tax costs for foreign businesses have risen. China unified its corporate income tax system last year, raising the previous low rates that foreign businesses enjoyed in some cases from 15 to 25 per cent.<sup>89</sup> And since 2009, many tax incentives that foreign firms enjoyed have been eliminated.<sup>90</sup>

A major reason Japanese companies have set up factories in China was for the low costs. But China no longer has a large advantage in this area. Japanese firms were lured, too, by the potential size of the Chinese market. Once in the market, however, Japanese companies find it difficult to expand their business in China due to increased competition from SOEs and increased hostility from the state and population. So both the major advantages that were attracting Japanese businesses to China are being eroded.

### **Aging population**

Currently, China is relatively young, with a median age of 30. However, the population is just beginning a massive aging, as the consequences of the one-child policy instituted by Mao in 1977 take effect.<sup>91</sup> It is expected that within 40 years a third of the population (500 million out of 1.5 billion) will be over 60.<sup>92</sup> China has until now been enjoying a "demographic dividend," which is a large working age population and a low dependency ratio (ratio of those out of the labor force to those in it). This demographic dividend is now ending.<sup>93</sup> In 2010, the working age population was 72% of the total population.<sup>94</sup> In 2012, for the first time in recent decades, the workforce declined, shrinking by 0.6%.<sup>95</sup> It is expected to decline to 61% of the total population by 2050.<sup>96</sup> This will raise wages due to increased labor shortages and depress savings as workers

Japan External Trade Organization (JETRO), Apr 2012, accessed May 10, 2013, [http://www.jetro.go.jp/en/reports/survey/pdf/2012\\_06\\_01\\_biz.pdf](http://www.jetro.go.jp/en/reports/survey/pdf/2012_06_01_biz.pdf)

<sup>86</sup> Ibid.

<sup>87</sup> Ibid.

<sup>88</sup> Deirdre Wang Morris, "China's Aging Population Threatens Its Manufacturing Might," CNBC.com, October 24, 2012, accessed May 10, 2013, <http://www.cnbc.com/id/49498720>

<sup>89</sup> Rabiul Hoque, "China Plus One Strategy: A Window of Opportunity," *The Financial Express*, March 03, 2013, accessed May 10, 2013, <http://www.thefinancialexpress-bd.com/index.php?ref=MjBfMDNfMDNfMTNfMV82XzE2MTgzNg>

<sup>90</sup> "China Plus One," *FTI Journal*, February 2013, accessed May 10, 2013, <http://ftijournal.com/article/china-plus-one>

<sup>91</sup> "Chiina's Predicament: Getting Old Before Getting Rich," *The Economist*, June 25, 2009, accessed May 10, 2013, <http://www.economist.com/node/13888069>; Deirdre Wang Morris, "China's Aging Population";

The one child policy actually allows for around 1.47 children per woman because of exemptions. It is estimated that if all restrictions were lifted, this would only rise to around 1.62, see: "Peak Toil," *The Economist*, January 26, 2013, accessed May 10, 2013, <http://www.economist.com/news/china/21570750-first-two-articles-about-impact-chinas-one-child-policy-we-look-shrinking>

<sup>92</sup> Malcom Moore "China's Ageing Population: 100-Year Waiting List for Beijing Nursing Home," *The Telegraph*, January 16, 2013, accessed May 10, 2013, <http://www.telegraph.co.uk/news/worldnews/asia/china/9805834/Chinas-ageing-population-100-year-waiting-list-for-Beijing-nursing-home.html>

<sup>93</sup> Eve Cary, "China's People Problem," *The Diplomat*, February 05, 2013, accessed May 10, 2013, <http://thediplomat.com/china-power/chinas-people-problem/>

<sup>94</sup> Deirdre Wang Morris, "China's Aging Population"

<sup>95</sup> Eve Cary, "China's People Problem"

<sup>96</sup> Deirdre Wang Morris, "China's Aging Population"



bear the cost of supporting a high dependency ratio.<sup>97</sup> The problem of aging will exacerbate both the problem of rising wage costs to Japanese businesses and deteriorating outlook for growth in the Chinese market.

## **To the future**

### **Which direction is the trend going?**

Many Japanese businesses see the need to hedge against China Risk. This hedging of uncertainty with regards to China, which is not limited to the business sector, has given rise to the “China plus one strategy.” Under this strategy, which can be traced back to as early as 2008, companies keep their Chinese operations but expand their production networks to even lower cost countries, particularly in Southeast Asia.<sup>98</sup> The trend has recently picked up with an air of urgency among many Japanese companies operating in China.<sup>99</sup> In October 2012, Japanese direct investment in China fell 30% to 63.4 billion yen, while investment in Southeast Asia more than doubled to 201.9 billion yen.<sup>100</sup> In November 2012, a poll by Teikoku Databank of Japanese companies operating in China recorded one out of six wanting to scale down or close their operations in China.<sup>101</sup>

After the U.S. lifted sanctions on Myanmar (Burma) in 2011, there has been a sharpening of interest in it by Japanese companies due to its low labor costs, location close to other emerging economies, and high literacy rates.<sup>102</sup> The “China plus one strategy” has recently even evolved into the “China plus” strategy in which companies seek to diversify production to two, three, four, or more countries.<sup>103</sup> In addition to diversifying the risks of supply chain disruptions, the “China plus strategy” also helps with cost control, due to rising wages in China, and facilitates access to new markets.<sup>104</sup>

In the Japan External Trade Organization’s 2012 survey of manufacturers in the U.S., 60% expected their business to expand in the next year or two. The diffusion index, a measure of business confidence, was at 29.9.<sup>105</sup> The same survey in China found a diffusion index score of 1.2, and 52.3% of Japanese businesses expected to expand.<sup>106</sup>

Even in traditional measure of trade, the picture is changing. From July 2012 onward (even before the latest incident with the Senkakus), Japanese gross exports to China began decreasing and gross exports to the U.S. increasing. By November of last year, gross exports to China were

---

<sup>97</sup> “Peak Toil”

<sup>98</sup> Chris Devonshire-Ellis, “Corporate America’s China Plus One Strategy,” ChinaBriefing.com, January 31, 2008, accessed May 10, 2013, <http://www.china-briefing.com/news/2008/01/31/corporate-america%E2%80%99s-china-plus-one-strategy.html>

<sup>99</sup> Hiroko Nakata, “Firms Move Some Eggs Out of China Basket,” *The Japan Times*, December 19, 2012, accessed May 10, 2013, [http://www.japantimes.co.jp/news/2012/12/19/reference/firms-move-some-eggs-out-of-china-basket/#.UYth\\_NPD\\_IV](http://www.japantimes.co.jp/news/2012/12/19/reference/firms-move-some-eggs-out-of-china-basket/#.UYth_NPD_IV)

<sup>100</sup> Ibid.

<sup>101</sup> Hiroko Nakata, “Firms Move”

<sup>102</sup> Ibid.

<sup>103</sup> Leonie Barrie, “PSF 2011: ‘China Plus’ Strategy Challenges Apparel Execs” Just-Style.com, April 4, 2011, accessed May 10, 2013, [http://www.just-style.com/analysis/china-plus-strategy-challenges-apparel-execs\\_id110738.aspx](http://www.just-style.com/analysis/china-plus-strategy-challenges-apparel-execs_id110738.aspx)

<sup>104</sup> “China Plus One”

<sup>105</sup> “Survey of Japanese-Affiliated Companies in Asia and Oceania (FY 2012 Survey),” JETRO, January 2013, accessed May 10, 2013, [http://www.jetro.go.jp/en/reports/survey/pdf/2013\\_01\\_01\\_biz.pdf](http://www.jetro.go.jp/en/reports/survey/pdf/2013_01_01_biz.pdf)

<sup>106</sup> “Results of JETRO’s 2012 Survey on Business Conditions of Japanese-Affiliated Firms in the U.S. and Canada,” JETRO, December 13, 2012, accessed May 10, 2012, <http://www.jetro.go.jp/en/news/releases/20121213255-news>

down almost 10% from the year before and gross exports to the U.S. up 14%<sup>107</sup> Gross exports to the U.S. were bigger by January 2013 and remained so into March (the last month with data available at the time of this writing)<sup>108</sup> So overall, the trend is positive with respect to the U.S. and fairly negative with respect to China.

### **Towards a Closer Partnership with U.S.**

Whereas China's vested interests prevent that country from signing high-quality FTAs, Japan and the U.S. have decided to enter into such an agreement with each other and other countries in the form of the Trans-Pacific Partnership (TPP). If the TPP is successful, integration of the U.S. and Japanese economies will intensify in a significant way. The rising importance of America to the Japanese economy and vice versa will increase in the energy field, as well, since Japan now seems likely to become a major recipient of American LNG, produced from shale gas (a topic covered in another paper in this yearbook).

### **The Geopolitics of Japan's China Relationship**

Although this paper is concerned with the economic relationships of Japan and the U.S. and China, the role of politics cannot be denied -- as seen in the issue of "China Risk"-- and needs to be briefly discussed in terms of the political goals of a country influencing economic policy. Japan's views of China are ambivalent, for it is seen as both a potential threat and potential opportunity. It knows that China tends to bully those neighbors if they approach from a position of weakness, so Japan feels the need for the kind of leverage that a close relationship with the U.S. can provide. With the U.S. at its back, Japan can then interact with China from a position of strength. Whether this tactic actually works or not is another story.

The U.S. needs allies to amplify its presence in Asia and offset its declining relative power with regards to country that is its chief competitor in the region -- China. The coincidence of such goals of the U.S. and Japan influence their economic policies through a shared belief that strong bilateral economic ties have strategic implications and bolster the alliance overall. This explains in part the enthusiasm both countries feel about Japan's membership in the TPP -- a free-trade regime that over time will have strategic implications for the U.S. and Japan.

While China wants be able to assert itself and maximize its growing power in the region, it still needs advanced technology and know-how, as well as access to markets -- i.e., access to the U.S. and Japanese economies. So ultimately, rising China will have no choice but to balance its desire for political assertiveness against its desire to maintain high economic growth rates and satisfy the growing demands of its people.

### **Conclusion**

Taking a Japanese perspective, this paper has examined that country's increasingly complicated economic relations with China and the United States. It has weighed the pluses and minuses of maintaining such ties with China versus the still vibrant appeal of the American economy, as well as the alliance-based relationship. The paper has sought to make the case that the

---

<sup>107</sup> "Japan's Trade in Goods (Monthly)" Japanese Trade and Investment Statistics, JETRO, accessed May 10, 2013, <http://www.jetro.go.jp/en/reports/statistics>; calculations own

<sup>108</sup> Ibid.

challenges of continuing to pursue a China market strategy are becoming significant, making the American market even more appealing

The picture, though, is not as simple as comparing one bilateral relationship to another. The global integrated market consists of complex production networks supply-chains, and “trade in tasks” --where different countries specialize in different parts of the production process. Such a reality has diluted to a certain degree the “exclusiveness” of the U.S.-Japan economic relationship, in the sense that there are many more trading partners involved now and a wider range of alternative economic options available. While this paper focused on China’s problem areas, it still is a nation of over 1.3 billion people that has great potential for growth. It will continue to be important to the economies of the United States and Japan.

In today’s globalized economy, relationships between countries have become more than bilateral; they are part of a vast and expanding web of economic activities. But even within this emerging world pattern, the strength of the traditional U.S.-Japan relationship endures due to fundamental interests that continue to converge in many areas on the regional as well as the global scale.

## References

- “2012 Investment Climate Statement – China,” Bureau of Economic and Business Affairs, United States Department of State, June 2012, accessed May 10, 2013, <http://www.state.gov/e/eb/rls/othr/ics/2012/191128.htm>
- “2012 Yearly Review,” WIPO, 2013, accessed May 10, 2013, [http://www.wipo.int/export/sites/www/freepublications/en/patents/901/wipo\\_pub\\_901\\_2012.pdf](http://www.wipo.int/export/sites/www/freepublications/en/patents/901/wipo_pub_901_2012.pdf)
- American Inventors Protection Act of 1999, accessed May 10, 2013 <http://www.uspto.gov/ip/global/>
- Barrie, Leonie. “PSF 2011: ‘China Plus’ Strategy Challenges Apparel Execs” Just-Style.com, April 4, 2011, accessed May 10, 2013, [http://www.just-style.com/analysis/china-plus-strategy-challenges-apparel-execs\\_id110738.aspx](http://www.just-style.com/analysis/china-plus-strategy-challenges-apparel-execs_id110738.aspx)
- Bradsher, Keith. “Amid Tension, China Blocks Crucial Export to Japan,” *The New York Times*, September 23, 2010, accessed May 10, 2013, <http://www.nytimes.com/2010/09/24/business/global/24rare.html?pagewanted=all>
- Cary, Eve. “China’s People Problem,” *The Diplomat*, February 05, 2013, accessed May 10, 2013, <http://thediplomat.com/china-power/chinas-people-problem/>
- “Central Bank Liquidity Swap Data,” United States Federal Reserve, accessed May 10, 2013, <http://www.federalreserve.gov/newsevents/files/cbls.xls>; calculations own.
- Chang, Gordon G. “Is China Burning?,” *Forbes*, September 23, 2013, accessed May 10, 2013, <http://www.forbes.com/sites/gordonchang/2012/09/23/is-china-burning/>
- “China’s Economy and the WTO: All Change,” *The Economist*, December 10, 2011, accessed March 10, 2013. <http://www.economist.com/node/21541448>
- “China Plus One,” *FTI Journal*, February 2013, accessed May 10, 2013, <http://ftijournal.com/article/china-plus-one>
- “China’s Predicament: Getting Old Before Getting Rich,” *The Economist*, June 25, 2009, accessed May 10, 2013, <http://www.economist.com/node/13888069>
- “China’s Stimulus Package,” *The Economist*, November 12, 2008, accessed May 10, 2013, [http://www.economist.com/blogs/theworldin2009/2008/11/chinas\\_stimulus\\_package](http://www.economist.com/blogs/theworldin2009/2008/11/chinas_stimulus_package)
- “Corruption Perceptions Index 2012,” Transparency International, 2012, accessed May 10, 2013, <http://cpi.transparency.org/cpi2012/results/>
- Custer, C. “China’s Anti-Japan Riots are State-Sponsored. Period.” ChinaGeeks.com, September 17, 2012, accessed May 10, 2013, <http://chinageeks.org/2012/09/chinas-anti-japan-riots-are-state-sponsored-period/>
- Devonshire-Ellis, Chris. “Corporate America’s China Plus One Strategy,” ChinaBriefing.com, January 31, 2008, accessed May 10, 2013, <http://www.china-briefing.com/news/2008/01/31/corporate-america%E2%80%99s-china-plus-one-strategy.html>
- “Economy Rankings 2012,” Doing Business, World Trade Organization, accessed May 10, 2013, <http://www.doingbusiness.org/rankings>
- “FDI Flow (Based on Balance of Payments, net): Historical Data: Outward,” Japanese Trade and Investment Statistics, JETRO, accessed May 10, 2013, [http://www.jetro.go.jp/en/reports/statistics/data/country1\\_e\\_cy12.xls](http://www.jetro.go.jp/en/reports/statistics/data/country1_e_cy12.xls); calculations own.
- Federal Reserve Press Release, December 13, 2012, accessed May 10, 2013, <http://www.federalreserve.gov/newsevents/press/monetary/20121213a.htm>

- “Foreign Spies Stealing U.S. Economic Secrets in Cyberspace,” Office of the National Counterintelligence Executive, October, 2011, accessed May 10, 2011, [http://www.ncix.gov/publications/reports/fecie\\_all/Foreign\\_Economic\\_Collection\\_2011.pdf](http://www.ncix.gov/publications/reports/fecie_all/Foreign_Economic_Collection_2011.pdf)
- Gimein, Mark. “If U.S. Wages Rose as Fast as China’s, Factories Would Now Pay \$50 an Hour,” *Bloomberg*, March 27, 2013, accessed May 10, 2013, <http://go.bloomberg.com/market-now/2013/03/27/if-u-s-wages-rose-as-fast-as-chinas-factories-would-pay-50-an-hour/>
- Hassett, Kevin A. and Shapiro, Robert J. “What Ideas are Worth: The Value of Intellectual Capital and Intangible Assets in the American Economy,” Sonecon, accessed March 10, 2013, [http://www.sonecon.com/docs/studies/Value\\_of\\_Intellectual\\_Capital\\_in\\_American\\_Economy.pdf](http://www.sonecon.com/docs/studies/Value_of_Intellectual_Capital_in_American_Economy.pdf)
- Hoque, Rabiul. “China Plus One Strategy: A Window of Opportunity,” *The Financial Express*, March 03, 2013, accessed May 10, 2013, <http://www.thefinancialexpress-bd.com/index.php?ref=MjBfMDNfMDNfMTNfMV82XzE2MTgzNg>
- “How the Resurgence of State-Owned Enterprises Threatens China’s Economy,” *ChinaEconomicReview.com*, August 3, 2012, accessed May 10, 2013, <http://www.chinaeconomicreview.com/swept-under>
- IMF “International Financial Statistics” for Japan 2001-2012, accessed March 10, 2013, <http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=169393>
- “Intellectual Property Policy Outline,” Strategic Council on Intellectual Property, July 3, 2002, accessed May 10, 2013, [http://www.kantei.go.jp/foreign/policy/titeki/index\\_e.html](http://www.kantei.go.jp/foreign/policy/titeki/index_e.html)
- “Intellectual Property: Protection and Enforcement,” World Trade Organization, accessed May 10, 2013, [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm7\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm7_e.htm)
- “International Conference on the Resurgence of State-Owned Enterprises,” World Federation of Trade Unions, 11 December, 2010, accessed May 10, 2013, <http://www.riab.kerala.gov.in/soekerala-docs/Strengthening%20Environment,%20Social%20and%20Governance%20Policies%20of%20SOEs.pdf>
- “Japan’s Trade in Goods (Monthly)” Japanese Trade and Investment Statistics, JETRO, accessed May 10, 2013, <http://www.jetro.go.jp/en/reports/statistics/>; calculations own
- “Joint Strategic Plan on Intellectual Property Enforcement,” Executive Office of the President of the United States, June 2010, accessed May 10, 2013, [http://www.whitehouse.gov/sites/default/files/omb/assets/intellectualproperty/intellectualproperty\\_strategic\\_plan.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/intellectualproperty/intellectualproperty_strategic_plan.pdf)
- Kahn, Joseph. “China is Pushing and Scripting Anti-Japanese Protests,” *The New York Times*, April 15, 2005, accessed May 10, 2013, [http://www.nytimes.com/2005/04/15/international/asia/15china.html?\\_r=0](http://www.nytimes.com/2005/04/15/international/asia/15china.html?_r=0)
- Kikuchi, Tsutomu. Interview on March 22, 2013
- Kurokawa, Sam; Iwata, Satoshi; and Roberts, Edward B. “Global R&D Activities of Japanese MNCs in the U.S.: A Triangular Approach,” accessed May 10, 2013, [http://www.gsim.aoyama.ac.jp/~bew/Kurokawa\\_Iwata\\_Roberts\\_revised2.pdf](http://www.gsim.aoyama.ac.jp/~bew/Kurokawa_Iwata_Roberts_revised2.pdf)
- Long, Ke. “Re-Acknowledging the China Risk: Proposal for Japanese Companies’ Investment Strategy in China: Abstract, December 2012, accessed May 10, 2013, <http://jp.fujitsu.com/group/fri/en/economic/publications/report/2012/report-398.html>
- Matsuda, Yasuhiro. Interview on March 21, 2013

- Miyagawa, Tsutomu and Hisa, Shoichi. "Measurement of Intangible Investment by Industry and Economic Growth in Japan," Policy Research Institute, Ministry of Finance, Japan, *Public Policy Review*, Vol.9, No2, March, 2013, accessed May 10, 2013, [http://www.mof.go.jp/english/pri/publication/pp\\_review/ppr021/ppr021e.pdf](http://www.mof.go.jp/english/pri/publication/pp_review/ppr021/ppr021e.pdf)
- Moore, Malcom. "China's Ageing Population: 100-Year Waiting List for Beijing Nursing Home," *The Telegraph*, January 16, 2013, accessed May 10, 2013, <http://www.telegraph.co.uk/news/worldnews/asia/china/9805834/Chinas-ageing-population-100-year-waiting-list-for-Beijing-nursing-home.html>
- Morris, Deirdre Wang. "China's Aging Population Threatens Its Manufacturing Might," CNBC.com, October 24, 2012, accessed May 10, 2013, <http://www.cnbc.com/id/49498720>
- Nakamichi, Takashi. "Japan Retains Status as Biggest Creditor," May 22, 2012, accessed May 10, 2013, <http://online.wsj.com/article/SB10001424052702304791704577419731445193166.html>
- Nakata, Hiroko. "Firms Move Some Eggs Out of China Basket," *The Japan Times*, December 19, 2012, accessed May 10, 2013, [http://www.japantimes.co.jp/news/2012/12/19/reference/firms-move-some-eggs-out-of-china-basket/#.UYth\\_NPD\\_IV](http://www.japantimes.co.jp/news/2012/12/19/reference/firms-move-some-eggs-out-of-china-basket/#.UYth_NPD_IV)
- Nakayama, Ichiro. "Intellectual Property Strategy in Japan," August 29, 2003, accessed May 10, 2013, <http://www.oecd.org/sti/sci-tech/12762973.pdf>
- "Nationalisation Rides Again," *The Economist*, November 12, 2009, accessed May 10, 2013, <http://www.economist.com/node/14859337>
- "New Sources of Growth: Intangible Assets," Organization for Economic Co-operation and Development, September 2011, accessed March 10, 2013, <http://www.oecd.org/sti/inno/46349020.pdf>
- "New Sources of Growth: Knowledge-Based Capital Driving Investment and Productivity in the 21st Century," OECD, May 2012, accessed May 10, 2013, <http://www.oecd.org/sti/inno/50498841.pdf>
- "OECD/WTO Trade in Value-Added (TiVA) Database: Japan," Organization for Economic Co-operation and Development and World Trade Organization, January 16, 2013, accessed March 10, 2013, <http://www.oecd.org/sti/ind/TiVA%20Japan.pdf>
- Office of Policy and External Affairs – Enforcement, The United States Patent and Trademark Office, accessed May 10, 2013, <http://www.uspto.gov/ip/global/enforcement/index.jsp> and "2010
- Pattberg, Thorsten. "Can China's New Government End Corruption?," *The Japan Times*, April 6, 2013, accessed May 10, 2011, <http://www.japantimes.co.jp/opinion/2013/04/06/commentary/can-chinas-new-government-end-corruption/#.UYdNGjhXH0Y>
- "Peak Toil," *The Economist*, January 26, 2013, accessed May 10, 2013, <http://www.economist.com/news/china/21570750-first-two-articles-about-impact-chinas-one-child-policy-we-look-shrinking>
- "Proposals for Japan's Trade Strategy," Nippon Keidanren, April 19, 2011.
- Rabinovitch, Simon. "Private Sector Battles March of Chinese State," *The Financial Times*, November 11, 2012, accessed May 10, 2013, <http://www.ft.com/intl/cms/s/0/eb5687c0-2bed-11e2-a91d-00144feabdc0.html#axzz2SwM8VQdq>
- Ramzy, Austin. "Anti-Japanese Sentiment Gains Strength in China," *Time*, September 22, 2010,

- accessed May 10, 2013, <http://www.time.com/time/world/article/0,8599,2020721,00.html>
- “Results of JETRO’s 2012 Survey on Business Conditions of Japanese-Affiliated Firms in the U.S. and Canada,” JETRO, December 13, 2012, accessed May 10, 2012, <http://www.jetro.go.jp/en/news/releases/20121213255-news>
- Robb, Greg. “Japan Top Owner of U.S. Assets,” Marketwatch.com, February 28, 2013, accessed May 10, 2013, [http://articles.marketwatch.com/2013-02-28/economy/37349004\\_1\\_japan-treasury-data-assets](http://articles.marketwatch.com/2013-02-28/economy/37349004_1_japan-treasury-data-assets)
- Sasaki, Hitoshi and Koga, Yuko. “Trade between Japan and China: Dramatic Expansion and Structural Changes,” *Economic Commentary*, Bank of Japan Research and Statistics Department, August 2003, accessed March 10, 2013. [http://www.boj.or.jp/en/research/wps\\_rev/ec/data/rkt03e03.pdf](http://www.boj.or.jp/en/research/wps_rev/ec/data/rkt03e03.pdf)
- Sasaki, Nobuhiko. “Recent Topics On Japan’s Trade Policy,” February 4, 2013, accessed May 10, 2013, [https://www.jef.or.jp/PDF/20130204\\_NobuhikoSasaki.pdf](https://www.jef.or.jp/PDF/20130204_NobuhikoSasaki.pdf)
- Schwab, Klaus. “The Global Competitiveness Report: 2012-1013,” World Economic Forum, 2012, accessed May 10, 2013, [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2012-13.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2012-13.pdf)
- Shea, Dennis C. “The Impact of International Technology Transfer on American Research and Development,” Testimony before the Committee on Science, Space, and Technology Subcommittee on Investigations and Oversight United States House of Representatives, December 5th, 2012, accessed May 10, 2013, <http://science.house.gov/sites/republicans.science.house.gov/files/documents/HHRG-112-SY21-WState-DShea-20121205.pdf>
- Shirouzu, Norihiko. “Train Makers Rail Against China’s High-Speed Designs,” *The Wall Street Journal*, November 17, 2010, accessed May 10, 2013, <http://online.wsj.com/article/SB10001424052748704814204575507353221141616.html>
- Snow, Gordon M. “Statement Before the Senate Judiciary Committee Washington, D.C.” June 22, 2011, accessed May 10, 2013, <http://www.fbi.gov/news/testimony/intellectual-property-law-enforcement-efforts>
- Strategic Council on Intellectual Property, accessed May 10, 2013 [http://www.kantei.go.jp/foreign/policy/titeki/index\\_e.html](http://www.kantei.go.jp/foreign/policy/titeki/index_e.html)
- “Survey of Japanese-Affiliated Companies in Asia and Oceania (FY 2012 Survey),” JETRO, January 2013, accessed May 10, 2013, [http://www.jetro.go.jp/en/reports/survey/pdf/2013\\_01\\_01\\_biz.pdf](http://www.jetro.go.jp/en/reports/survey/pdf/2013_01_01_biz.pdf)
- Tanaka, Hitoshi. “Myths of Decline: Why Japan Matters as China Rises,” *East Asian Insights*, Japan Center for International Exchange, December 2012
- Tanaka, Hitoshi. Interview on March 22, 2013
- Tellis, Gerard J. “Is the U.S. Really Losing Its Competitive Edge?,” *Forbes.com*, January 02, 2013, accessed May 10, 2013, <http://www.forbes.com/sites/ciocentral/2013/01/02/is-the-u-s-really-losing-its-innovative-edge/>
- “The 22<sup>nd</sup> Survey of Investment Related Costs in Asia and Oceania (FY 2011 survey),” Overseas Research Department Japan External Trade Organization (JETRO), Apr 2012, accessed May 10, 2013, [http://www.jetro.go.jp/en/reports/survey/pdf/2012\\_06\\_01\\_biz.pdf](http://www.jetro.go.jp/en/reports/survey/pdf/2012_06_01_biz.pdf)
- “Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks,” World Trade Organization and IDE-JETRO, 2011, accessed, March 10, 2013, [http://www.wto.org/english/res\\_e/booksp\\_e/stat\\_tradePAT\\_globvalchains\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/stat_tradePAT_globvalchains_e.pdf)
- “Trade Statics of Japan,” 2001-2012 data, Japan Ministry of Finance, accessed March 10, 2013,

- [http://www.customs.go.jp/toukei/shinbun/happyou\\_e.htm](http://www.customs.go.jp/toukei/shinbun/happyou_e.htm)
- “Trends in Overseas Subsidiaries: Quarterly Survey of Overseas Subsidiaries, October-December 2012” Statistics, Research and Statistics Department, Minister’s Secretariat, Ministry of Economy, Trade and Industry, March 28, 2013, accessed March 10, 2013, <http://www.meti.go.jp/english/statistics/tyo/genntihou/pdf/h2c3m3ye.pdf>; calculations own
- U.S.-Japan Economic Harmonization Initiative, accessed May 10, 2013, <http://www.ustr.gov/countries-regions/japan-korea-apec/japan>
- Vosselman, Wim. “Measuring Intangible Investment,” Organization for Economic Co-operation and Development, 1998, accessed March 10, 2013, <http://www.oecd.org/sti/ind/1943309.pdf>
- Watts, Jonathan. “Violence Flares as the Chinese Rage at Japan,” *The Guardian*, April 16, 2005, accessed May 10, 2013, <http://www.guardian.co.uk/world/2005/apr/17/china.japan>
- Westby, Jody. “Mandiant Report on Chinese Hackers is Not News but Its Approach Is,” *Forbes*, February 20, 2013, accessed May 10, 2013, <http://www.forbes.com/sites/jodywestby/2013/02/20/mandiant-report-on-chinese-hackers-is-not-news-but-its-approach-is/>
- “What are the Main Problems Facing EU Exporter to China in the Area of Non-Tariff Barriers?,” European Union Directorate General for Trade, October, 2006, accessed May 10, 2013, [http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc\\_130827.pdf](http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc_130827.pdf)
- “Who Needs Cyber-Spying?,” *The Economist*, February 23, 2013, accessed May 10, 2013, <http://www.economist.com/news/china/21572250-old-fashioned-theft-still-biggest-problem-foreign-companies-china-who-needs>
- “Why Innovation is Tough to Define – and Even Tougher to Cultivate,” *Knowledge@Wharton*, April 20, 2013, accessed May 10, 2013, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=3242>
- Wines, Michael. “China Fortifies State Businesses to Fuel Growth,” *The New York Times*, August 29, 2010, accessed [http://www.nytimes.com/2010/08/30/world/asia/30china.html?hp&\\_r=0](http://www.nytimes.com/2010/08/30/world/asia/30china.html?hp&_r=0)
- Yao, Shujie. “Hello 2013: To Fight Corruption, China Must Fight the Causes of Corruption,” *The Financial Times*, January 14, 2013, accessed May 10, 2013, <http://blogs.ft.com/beyond-brics/2013/01/14/hello-2013-to-fight-corruption-china-must-fight-the-causes-of-corruption/#axzz2SUWW6l4O>
- Yatsuda, Futoshi and Kato, Hiroshi “Impact of the Intellectual Property System on Economic Growth: Country Report Japan,” WIPO, accessed May 10, 2013, [http://www.wipo.int/export/sites/www/about-ip/en/studies/pdf/wipo\\_unu\\_07\\_japan.pdf](http://www.wipo.int/export/sites/www/about-ip/en/studies/pdf/wipo_unu_07_japan.pdf)



## **Implications of Abenomics for the U.S.-Japan Relationship**

By Haitham Jendoubi

The Liberal Democratic Party of Japan's (LDP) House of Representatives election victory in December 2012 has ushered in a group of economic growth strategies branded "Abenomics", after LDP party president and current prime minister, Shinzo Abe. These various strategies, to the extent that they have been made explicit, have met with enthusiasm by the Japanese public, with Abe's popularity rating in the polls soaring above 70% in early 2013. Abenomics has also boosted the spirits of Japan's private sector, with the stock market spiking and traditional measures of business sentiment improving markedly since the beginning of the year.

Prime Minister Abe's economic prescription for Japan, first articulated in the LDP's party platform, came to be known as "Abenomics" by both its supporters and detractors, a portmanteau word modeled on "Reaganomics". The policy package consists of three "arrows," a reference to a Japanese legend involving a powerful daimyo who lived during Japan's Warring States period in the 16th century. When asked by the warlord, the sons were able to break one arrow but not all three when put together. Abe's set of three arrows consists of a bold monetary policy to combat deflation, expanded fiscal stimulus, and structural reforms to promote private investment and long-term growth. To a large degree, faith in these goals, which were thematically introduced during the election campaign, helped carry the LDP to a decisive victory and handed the premiership to Abe, who had served as Prime Minister briefly in 2006-2007. After two decades of poor economic performance, Abe promised to return Japan economically to its previous decades of glory in the world markets.

So far, the impact of Abenomics on Japan's diplomacy, in particular its bilateral relationship with the United States, has been muted – with only the first of the arrows – monetary policy – out of its quiver in the early 2013. Early efforts by the Abe administration to end Japan's 15-year-old deflation have elicited limited reactions, mainly critical comments centered on a rapid concomitant depreciation in the yen. The second arrow, a planned fiscal stimulus package on the order of 10.3 trillion yen in fiscal 2012 alone, has yet to attract official attention in the U.S., although Japan's continuously rising national debt burden has long raised alarms among numerous economists. Finally, the last arrow of longer-term "growth-oriented" strategies, such as supporting research in green technology and increasing the flow of risk money to "strategic sectors", is only started to come out in press leaks in early 2013. Such measures are likely to be welcomed to the extent that they coincide with long-standing U.S. priorities for Japan to reform laggard sectors, both for the sake of accelerating a key ally's economic growth as well as improving the business environment for firms that export to or invest in Japan. With the LDP likely to fare well in the elections for the House of Councillors in July 2013, the chances that these reforms will actually be instituted have increased.

American businesses operating in Japan, similar to the Japanese public and industry leaders, have cautiously welcomed Abenomics as an opportunity for Japan to recover its growth path bolstered by an atmosphere of innovative policy measure and optimistic consumer and business

sentiment. According to an influential member of the U.S. business community in Japan, “Sometimes the political mood makes as much difference as the actual policies”. For their part, foreign fund managers (including U.S. managers) are taking a second look at Japanese equities—some for the first time in recent memory. In this context, Abenomics is likely to at least modestly improve bilateral ties with the United States to the extent that it is successful in ending Japan’s recent economic stagnation and spurring sustained economic growth. If it succeeds, it may stimulate policymaker interest in Japan as an economic partner – already revived by Japan’s willingness to join the U.S.-led Trans-Pacific Partnership agreement (see the paper by Zhe Liu in this yearbook). However, like any bold and unproven strategy, Abenomics, as is known now, presents certain downside risks that could destabilize the bilateral relationship. This will be discussed below.

### **Monetary Arrow**

The monetary policy arrow of Abenomics is the one that has yielded immediate results due to the nature of asset flows in the context of Japan’s open capital account. In essence, the policy is aimed at achieving modest inflation after approximately 15 years of falling prices in Japan. This inflation would allow real interest rates to fall, which in turn is expected to spur investment in the real economy. (See Box 1 for a discussion of the merits and feasibility of ending deflation.) In a January 2013 joint statement with the Bank of Japan (BOJ), the Ministry of Finance (MOF) set a target of 2% annual increases in the country’s consumer price index.

Inflation targeting by the BOJ is not unprecedented; it adopted a 1% inflation target in February 2012, with little or no result. This time, however, market confidence in a sharp break from past BOJ policy arose from a fortuitous coincidence in Abe’s inauguration and the end of previous BOJ Governor Masaaki Shirakawa’s tenure. As a result, Abe was able to appoint a new governor, as well as two new deputy governors, in March 2013. The joint statement in the last days of the Shirakawa BOJ, for its part, was likely the product of a veiled threat by Abe’s administration to revise the BOJ law to limit the independence of the central bank should its policies prove insufficiently bold.

As of April 2013, it appears that the substantial monetary expansion envisaged by Prime Minister Abe is coming to fruition even faster than some market participants had anticipated. In its first policy meeting under a new dovish governor, former Asian Development Bank Governor Haruhiko Kuroda, the BOJ exceeded most analysts’ expectations by:

- (1) Reiterating the political agreement reached with the Abe administration to target 2 percent consumer price level growth (inflation) with a “time horizon” of two years,
- (2) Changing its operating target from the uncollateralized overnight call rate (roughly analogous to the Fed funds rate) to the monetary base (currency plus central bank reserves) and announcing its intention to roughly double the base in two years, and
- (3) To buy longer-term government securities (up to 5-year notes) in order to spur longer-term investment.

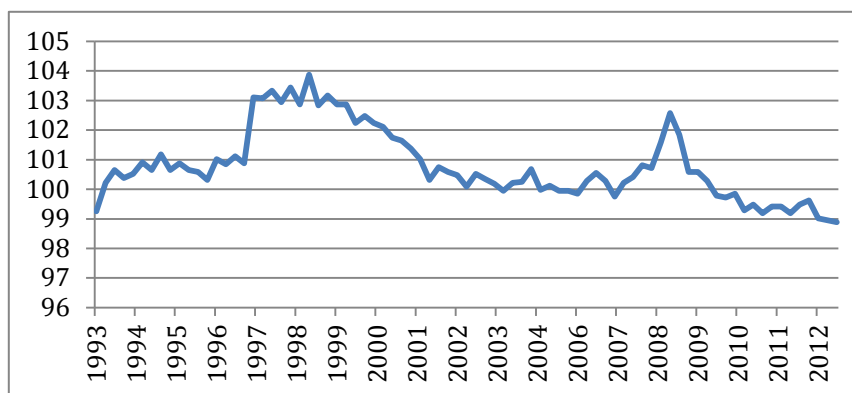
The results of Abe’s election and continued comments on monetary policy have been dramatic, causing the yen to depreciate approximately 16% against the dollar from Abe’s election as of May 3, 2013, and hit the psychological level of 100 yen to the U.S. dollar on May 10. Ahead of

a Group of 20 (G-20) meeting in February, Finance Minister Taro Aso showed concern by describing the yen's depreciation against the dollar as "too fast".

**Box 1: Why is Japan Trying to End Deflation, and What Role can Monetary Policy Play?**

Among Japanese and foreign observers alike, views diverge regarding both the desirability and the feasibility of reversing Japan's trend of more than 15 years of declining consumer prices (see Graph 1).

**Graph 1. Consumer Price Index of All Items in Japan (2010 = 100)**



Although the Abe administration has chosen the eradication of deflation as a key policy objective, deflation's negative effects on the Japanese economy have long been a policy objective of successive governments and favorite topic for economic critics. Keio University economist Heizo Takenaka, an economic advisor serving on an Abe's commission on growth policy who used to be Prime Minister Junichiro Koizumi's economic tsar in the early 2000s, highlights the pernicious effects of deflation on consumption, going so far as to label it "the primary cause of the economic stagnation of Japan". The BOJ has been a stubborn notable exception, going so far as to release a study in Japanese and English that finds little link between the real interest rate (which reflationary policy is meant to depress) and consumer spending in Japan.

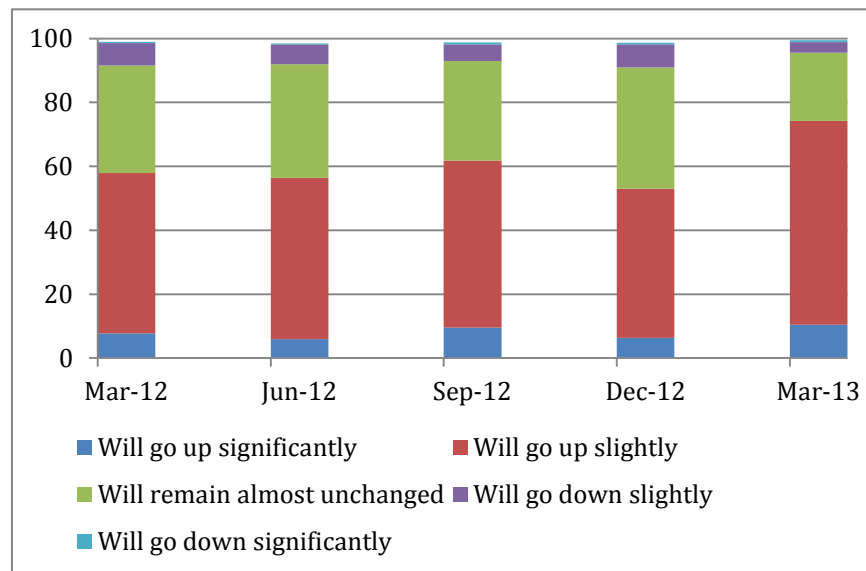
Most Japanese economists would agree that deflation is corrosive to economic activity because it raises the opportunity cost of real investment due to a steady increase in the real value of the yen. There are those who differ even on this point, however. The Nomura Research Institute's chief economist Richard Koo says that reflationary policies will not necessarily work in driving output. He argues that deflation has not caused an appreciable delay in private consumption, much of which is not discretionary, and that investment is sluggish mostly due to balance sheet shock -- a desire among businesses to pay down debts incurred during the 2009 downturn -- and not deflation. Elsewhere, Koo has argued that even monetary policy itself may not be a reliable instrument in Japan when bank lending --the transmission mechanism from increased central bank reserves to a larger monetary base -- is lagging.

If there is a range of views on the desirability of reflation, opinions diverge even more on the question of its feasibility. Bill Gross, a co-chief investment officer of leading bond trader PIMCO, has expressed doubt that the 2 percent inflation target is achievable without drastic steps

to further depreciate the yen. Moreover, the Japan Center for Economic Research in its latest long-range forecast predicts inflation to be lower than 2 percent for 10 years—in effect rejecting the 2 year timeframe touted by Abe and Kuroda. Meanwhile, Japan’s premium business organization, Nippon Keidanren, appears reluctant to agree to Abe’s entreaty to raise wages of company workers, saying that such must wait until a sustainable economic recovery is in sight. A vice president of the Research Institute for Advancement of Living Standards, a labor-oriented think-tank, explains, “If wages don’t increase, inflation cannot be accomplished in the first place”. Fujitsu’s think-tank puts the necessary increase in wages at 3.5% if Abenomics is to succeed. If wage increases lag, Abenomics’ central goal will be unattainable. If inflation is achievable without wage increases, there will be a retreat in consumer spending.

On the other hand, some increase in price levels is likely to occur through foreign exchange channels. Moderate yen depreciation is likely to complement inflation as the yen price of imports, especially energy supplies, rises. This will exert upward pressure on consumer price levels even in the absence of wage pressures. Indeed, a quarterly Bank of Japan consumer sentiment survey shows rising expectations of inflation among consumers for the first time in three quarters (see Graph 2).

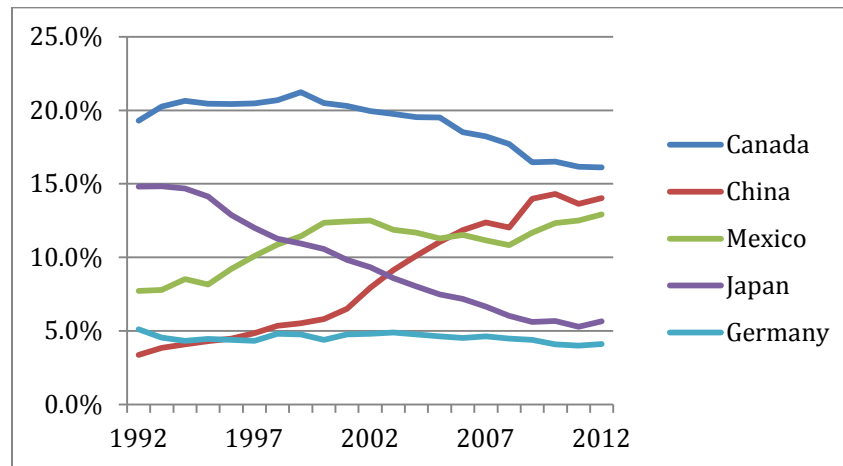
**Graph 2. Responses to BOJ Survey Question: “To What Extent Will Price Levels Change One Year From Now?”**



### U.S. Response

Despite some stern official language, the United States has generally adopted a stance of benign neglect regarding Japan’s new monetary policy. U.S. policymakers have not shown a keen interest in Japan’s reflationary project. There may be several reasons for this. First, the U.S. attitude may reflect the relative decline of U.S.-Japan trade as a percentage of total U.S. trade volumes. According to the Congressional Research Service, “Although Japan remains important economically to the United States, its importance has slid as it has been edged out by other trade partners”.

**Graph 3. Top Bilateral Goods Trade Flows (Sum of Import and Export USD Values)  
As a Percentage of Total U.S. Flows**



### **U.S. Views Japan as a “Special Case”**

Second, there is a permissive atmosphere surrounding Japan’s monetary goals due to the unique circumstances surrounding Japan’s lengthy battle with deflation, which is unique in postwar economic history. Another developed country, Australia, has voiced explicit support for Japan’s reflationary strategy “insofar as they are deploying fiscal and monetary policy to try to drive stronger economic growth”. This willingness to consider Japan’s particular circumstances also extends—in a limited fashion—to exchange rate policy. In the past, the G7 group of industrialized nations have even carried out coordinated currency interventions (which the U.S. Treasury led) to prevent a precipitous rise in the yen after the Great East Japan Earthquake of 2011—a rise that appeared to run counter to financial fundamentals and reflected speculators rushing to close short yen positions, among other influences.

The G7 also turned a blind eye to continued unilateral currency intervention by Japan in 2011. Then Finance Minister Jun Azumi even underscored that Treasury Secretary Timothy Geithner had not raised objections in the September 2011 G7 meeting of finance ministers in Marseille (though he was reported to have smiled during Azumi’s remarks there). It is telling of the relative willingness of U.S. and European authorities to indulge Japan’s monetary policy that several weeks earlier, European Central Bank President Jean-Claude Trichet had cautioned Japan against unilateral action. On the whole, the United States has been less vocal (or at least less public) in its criticism of Japan’s exchange rate policy.

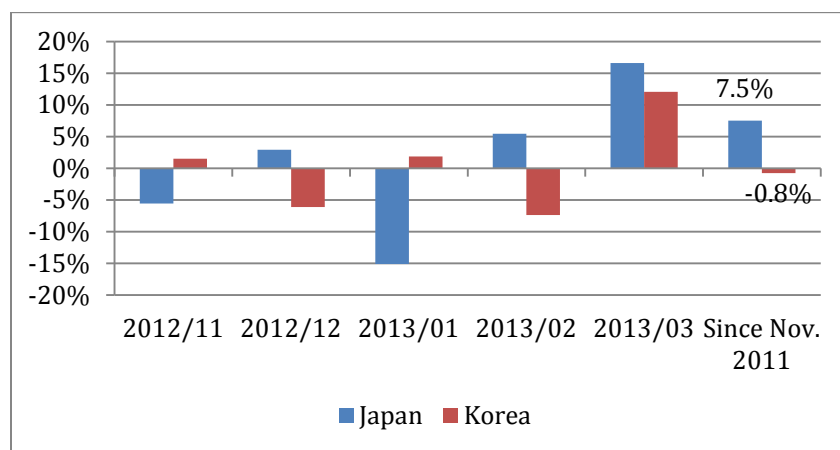
This indulgence may not necessarily continue indefinitely, however, even if Japan avoids direct foreign exchange intervention via outright dollar purchases or Treasury purchases. Bill Gross predicts that significant further yen depreciation will be required in order to achieve the Abe administration’s 2 percent inflation target. He notes that he is “not sure that other G-7 countries are willing to permit that [...] They’ve got to control it to some extent”. In fact, the Treasury Department’s latest semi-annual exchange rate report directs relatively harsh language toward Japan:

“We will continue to press Japan to adhere to the commitments agreed to in the G-7 and G-20, to remain oriented towards meeting respective domestic objectives using domestic instruments and to refrain from competitive devaluation and targeting its exchange rate for competitive purposes.” -Treasury Secretary Jack Lew echoed this sentiment at the May 2013 G7 meeting in London.

On the other hand, European and Asian countries have had no compunction in criticizing Japan for its monetary policy, especially export competitors such as South Korea and Germany. German Chancellor Angela Merkel, speaking at the Davos Conference in late January 2013, said, “I don’t want to say that I look toward Japan completely without concern at the moment [...] in Germany, we believe that central banks are not there to clean up bad policy decisions and a lack of competitiveness”. European Central Bank governing council member and Bundesbank President Jens Weidmann directly cautioned Japan against “politicizing” yen exchange rates and lamented what he saw as a loss of central bank independence in Japan. A spokesman for Germany’s ruling party, the Christian Democratic Union, warned that Japan risks retaliatory action by G20 nations.

South Korean officials have been even more vocal about spillover effects from a rapidly increasing won-yen cross rate, with Finance Minister Hyun Oh Seok asserting that Japan’s weakening currency has had a larger impact on his country’s real economy than North Korean military provocations, perhaps with some justification (see Graph 4). At the 2013 Davos conference, Canadian Finance Minister Jim Flaherty also publicly acknowledged that he had communicated his concerns with the pace of Japan’s monetary policy shift to his Japanese counterpart.

**Graph 4. Monthly Percent Change and Five-Month Cumulative Percent Change in USD Value of Exports for Japan and Korea**



Officials in the Chinese government have also signaled that they view Japan’s policy as a beggar-thy-neighbor response to spur export-led growth at the expense of its competitors. Speaking about one month before the first Kuroda policy meeting, Gao Xiqing, president of sovereign wealth fund China Investment Corporation, warned that “treating the neighbors as your garbage bin and starting a currency war would not only be dangerous for others but eventually be bad for yourself”.

On the other hand, China's State Administration of Foreign Exchange (SAFE), the administrative body with control over foreign exchange reserves, has given a less negative assessment of the yen-dollar rate that puts the latest depreciation into historical context. SAFE notes that similar dollar-yen depreciations have often followed appreciations of the scale seen since 2008, but notes the possibility of a currency war if other Asian economies "follow Japan's way." SAFE stresses that yen depreciation cannot address Japan's structural problems.

One reason China has been more subdued in its criticism than Korea may be that a weaker yen allows China-based manufacturers easier access to yen-priced intermediate goods. Another is that Japan and China compete less directly in the high technology subsector than, say, Japan and Korea.

### **Yen Overvalued Against the Dollar Before Abenomics Began**

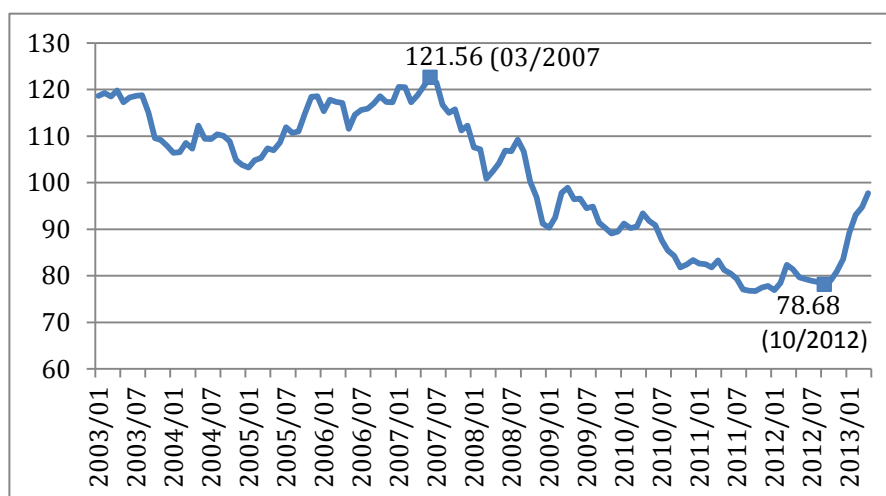
Third, there is a prevailing sense in the media and finance practitioners that the yen at its pre-Abe levels of 75 to 85 yen to the dollar was overvalued. According to Japan's 2012 IMF Article IV Consultation, an analysis of Japan's current account suggests "that the yen is moderately overvalued from a medium-term perspective". In accordance with this view, the IMF believes fears of competitive currency devaluations as a result of Japan's new monetary policy are "overstated", and that the movement in yen exchange rates is simply a byproduct of domestic economic imperatives. The IMF had also signaled a certain measure of acceptance of Japan's unilateral currency interventions following the triple disasters of March 2011.

If one believes the yen was previously overvalued, then, there was room for the yen to appreciate before reaching its "equilibrium rate". Policymakers are of course loath to comment on what this equilibrium rate might be, but Japanese industry also tends not to discuss exchange rates publicly. On the whole, since the launching of the Abe administration, the yen-dollar exchange rate has not been a source of friction in the bilateral relationship since the start of Abe's term.

This was not true in the past, when Japan was a target for criticism. For example, the December 2011 Treasury foreign exchange report urged that "[r]ather than reacting to domestic 'strong yen' concerns by intervening to try to influence the exchange rate, Japan should take fundamental and thoroughgoing steps to increase the dynamism of the domestic economy, increase the competitiveness of Japanese firms – including those in utilities and services – and raise potential growth". (See Box 2 for a discussion of whether the yen was in fact overvalued before Abenomics began.)

### **Box 2: Was the Yen Overvalued?**

The yen appreciated significantly and rapidly against the dollar in the latter half of 2008, rising from an average of JPY/USD = 109 in August 2008 to JPY/USD = 90 in January 2009—an appreciation of 21%—and remained in the 75-95 range for most of the subsequent three years (see Graph 5). Many observers in Japan see this period as a "strong-yen" period, with the yen trading dearer than "market fundamentals" would suggest.

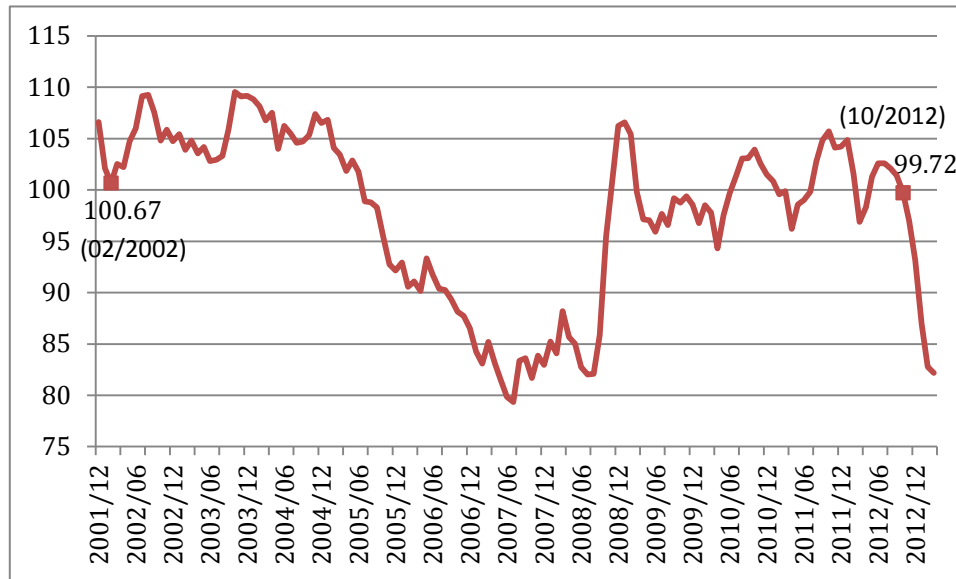
**Graph 5. Nominal Bilateral Exchange Rate (Yen per Dollar)**

Was the yen overvalued before Abe’s election? Adam Posen, President of the Peterson Institute for International Economics and a Japan specialist, argues that it was. Speaking several days after the LDP’s return to power in December 2012, Posen advocated a more robust central bank signaling mechanism as well as purchases of corporate bonds, longer-dated government bonds, and even foreign-denominated assets, in the context of what he considered to be an exchange rate (presumably with the dollar) in disequilibrium. “You look at buying things in a foreign currency because the yen is overvalued and Japan has just sat there and taken it for several years”. The IMF has held a similar stance; in June 2012, an IMF official stated that “our analysis suggest that the yen is moderately overvalued from a medium-term perspective”.

Japanese officials, however, are less willing to label the 2008-2012 yen exchange rate as overvalued. They point out that despite large swings in the exchange rate against the dollar, a more complete picture of Japan’s exchange rate conditions is given by an effective exchange rate—for example, a comparison to a trade-weighted basket of foreign currencies. On this basis, the yen is no more “overvalued” than it was 10 years ago.

Speaking in March 2013 when the yen was trading at about 95 per dollar, Heizo Takenaka, a highly-respected economist who spearheaded the process of Japan’s bank deleveraging under Prime Minister Koizumi in the early 2000s, called the depreciation of the previous three months “a moderate correction of a serious appreciation in the prior five years”, even when considering real and effective exchange rates. Indeed, the real effective exchange rate (REER), a common measure of exchange rates that takes into account other bilateral rates in addition to dollar-yen rate as well as price level differentials, suggests that the yen did appreciate modestly during the period in question. However, the index as of November 2012 (the month in which Prime Minister Yoshihiko Noda dissolved the lower house of parliament and called for snap elections) was at a similar level as in the early 1990s (see Graph 6). In other words, the pre-crisis yen level can plausibly be thought of as below its long-term equilibrium, and thus efforts to “correct an overvaluation” could be considered a devaluation going *beyond* equilibrium bilateral rates.



**Graph 6. Yen Real Effective Exchange Rate (REER) (2010 = 100)**

U.S. may see merit in Japan’s monetary policy if it spurs growth. Conversely, there may be reasons why the United States would welcome Japan’s attempt to end deflation. Foremost among these is a desire to see Japan—a key ally in the Asia-Pacific region—resume economic growth. Indeed, due to the global economic downturn as well as the effects of the Great East Japan Earthquake in March 2011, Japan only averaged 0.7% annual real GDP contraction from 2008 to 2012.

Various senior U.S. officials have voiced their support for higher growth in Japan, either for its salutary effect on worldwide growth or as a strategic imperative with implications for U.S. policy towards East Asia. Even Kansas Fed President Esther George, a monetary policy hawk who was the lone vote against the current regime of unlimited asset purchases, has suggested that stronger economic growth in Japan would have consequences on the global growth outlook. Elsewhere, the managing director of the International Monetary Fund, Christine Lagarde, has described the expansionist reforms announced by the Bank of Japan in its April 4 policy meeting as a “welcome step” from the point of view of global growth.

Japan’s growth also bears upon the United States’ defense policy in the Asia-Pacific region. Amid the “pivot towards Asia” articulated by the United States government in 2009, the United States has often emphasized the value it places on its bilateral relationship with Japan and other Asian allies—both in diplomatic and national security contexts. Defense Secretary Chuck Hagel has linked the U.S.-Japan Alliance with bilateral economic cooperation in his remarks after meeting Japanese Defense Minister Itsunori Onodera.

Japan’s defense budget is one of the Pentagon’s benchmarks, but in recent years, while the People’s Republic of China has expanded its annual defense spending by a cumulative annual growth rate of more than 12% in the decade up to 2011, Japan’s expenditures fell a total of 4% (see Graph 7). The Abe administration’s fiscal year 2013 budget provides for the first increase in defense spending in 11 years, but a sustained reinforcement in Japan’s defense capabilities—if

indeed it is possible given Japan's entitlement spending and aging population—will necessarily require robust economic growth into the medium term.

**Graph 7. Nominal Defense Spending**  
(Year-on-Year Percent Change and Change over 10 Years)



On the sidelines of the February 2013 Group of 20 conference in Moscow, Federal Reserve Chairman Ben Bernanke indirectly signaled support for Japan's monetary policy by drawing a clear line between reflationary tactics for domestic purposes and other policy instruments (presumably those that target the exchange rate). Speaking shortly before the same G20 meeting, Treasury Undersecretary for International Affairs Lael Brainard explicitly endorsed Japan's efforts at ending deflation, but stressed that it is "important that structural reforms accompany macroeconomic policies to achieve these goals". When Treasury Secretary Lew on March 8, 2013 met with Finance Minister Aso, he reportedly did not raise any alarms regarding the depreciation of the yen. At least one influential market participant, PIMCO CEO Mohamed El-Erian, views the outcomes of recent G20 meetings that accepted Japan's policies "domestic tools [in service of] domestic objectives" as the handiwork of a U.S.-led coalition.

### **Japan Flirts with Exchange Rate Targeting**

There appear to be two red lines beyond which even the United States would take exception to Japan's new monetary policy: explicit exchange rate targeting and direct interference in the currency markets. On explicit exchange rate targeting, there have been several instances when Japanese policymakers, even Prime Minister Abe himself, have spoken of "correcting the strong yen" in the same breath as "beating deflation". One day after the LDP's decisive victory in the lower-house elections on December 16, 2012, Abe (then still only the party president) declared, "The mission we have been handed is to end deflation, correct the strong yen, grow the economy, and create jobs".

In a Bloomberg News interview in January 2013, Vice Minister in charge of fiscal and economic policy Yasutoshi Nishimura said that a yen to the dollar rate of 100 "would not be a problem". The following month, LDP lawmaker Kozo Yamamoto, a close associate of Abe, asserted in mid-February 2013 that a yen-dollar rate of 95 to 100 would be about the equilibrium. Koichi Hamada—a professor at Yale University who was known to have Abe's ear on monetary matters during the election campaign and now serves as an economics advisor—has made explicit public statements on the detrimental effect for exporters of the erstwhile strong yen. At a foreign

correspondents dinner, he commented that a sustainable yen-dollar exchange rate would be “100 yen or 95 yen”. Even Kazumasa Iwata, a shortlisted candidate for BOJ governor, went on record to say that a rate of 90 to 100 would reflect equilibrium.

Such official statements dropped off long before the yen actually began to reach those ranges. In February 2012, when the Group of Twenty held its summit meeting in Moscow, the assembled leaders declined to single Japan out for criticism for its officials’ comments on the foreign exchange rate, but there was no doubt that Japan was on their minds. According to one analyst, the statement produced by that G20 finance ministerial was in essence a veiled dressing-down of Japan for “talking down” its currency by making references to specific desirable exchange rates. Indeed, Bloomberg News reported that the Japanese delegation in Moscow was on the defensive, arguing that Abe’s “aggressive” monetary policy was aimed at domestic deflation and did not target any specific exchange rate.

In a G7 meeting on the sidelines of the Moscow meeting, Acting Treasury Secretary Lael Brainard cautioned against “loose talk about currencies,” a criticism ostensibly aimed at Japan. The G7 statement from that meeting was initially interpreted by financial markets as tacit approval for Japan’s foreign exchange guidance, but clarifying remarks by G7 finance ministry officials later suggested it was meant more as a rebuke.

After the February G20 statement, Japanese officials studiously avoided mentions of exchange rate targets. Indeed, Abe’s candidate for BOJ governor declined to comment on desirable yen levels, and has continued to make similar denials as governor. Nevertheless, in descriptive (as opposed to prescriptive) statements to the Diet, BOJ Governor Kuroda has framed the yen’s precipitous decline against all its most-traded counterparts as a “correction”, echoing the IMF’s view that it had been moderately overvalued against the dollar at  $USDJPY = 80$  to  $90$ . Professor Hamada, on the other hand, appears to have disregarded official requests from the government to keep quiet on the exchange rate and on March 13, 2013, called for a yen rate of 98 to 100.

### **Exchange Intervention Briefly Raised as Possibility**

The second case, direct interference in currency markets, has been raised as a possibility in public comments by economic figures who became candidates for the Bank of Japan leadership, such as former deputy governor Kazumasa Iwata of the Japan Center for Economic Research. In particular, Iwata raised the possibility of the Bank of Japan buying foreign currency-denominated assets as a way to devalue the yen and contribute to inflation. This has also been a bone of contention between Prime Minister Abe and Finance Minister Aso. Abe, in comments to the Upper House Budget Committee, would like BOJ to buy foreign bonds as a possible tactic to reflate the economy, while Aso thinks that is a bad idea. Aso’s view finally prevailed, to the relief of outside observers who feared such an action would start a currency war.

During his confirmation period in early March 2013, Haruhiko Kuroda made it a point to declare that the Bank of Japan under his leadership would not buy foreign bonds. After winning confirmation, Kuroda confirmed that he was not contemplating foreign bond purchases, pointing out the availability of other policy options and highlighting that “it would be problematic from the point of view of international terms of agreement as [such purchases] would be considered currency intervention”.

### **Unclear Effect of Higher Inflation on National Debt**

Some private economists in the United States and Japan have voiced concerns that Japan's new monetary policy would have uncertain and potentially disruptive effects on demand for public debt (i.e., Japan government bonds or JGBs). The Chicago Mercantile Exchange has highlighted the possibility that success in achieving inflation would also tend to destabilize Japan's budget as debt service payments rise, as well as the danger that higher bond yields (and thus a higher debt burden) will be necessary to prevent uncontrolled depreciation of the yen.

Goldman Sachs Chief Japan Economist Naohiko Baba argues that part of the demand for JGBs has traditionally been a need to deploy large cash balances kept by corporations in deposits in Japanese banks; if Abenomics manages to spur domestic private investment, it will necessarily lower these balances and thus depress demand for JGBs. In effect, Abenomics could become a victim of its own success if some measure of fiscal consolidation is not achieved before wholesale deposits begin to decline and raise government borrowing costs.

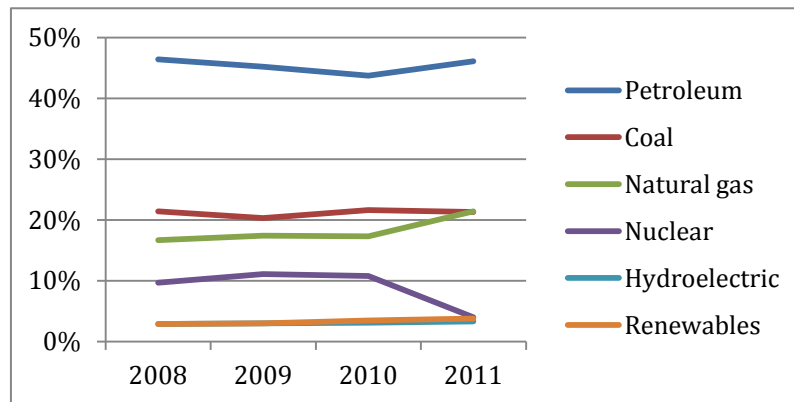
Criticism of Abenomics has found a sympathetic ear in the upper house of the Japanese Diet (which is dominated by opposition parties, though they do not have a majority). Keio University Professor Seki Obata, a prominent economist, expressed pointed criticism of Abenomics in an upper-house budget committee public hearing and called on the Bank of Japan to end its drastic new easing policy, which he labeled "risky".

Other economists judge this scenario less likely, pointing out that reflationary policy is meant to expand nominal GDP faster than the debt stock. No one really knows, though, whether nominal GDP will in fact outpace the debt stock—which in turn depends on the rate of increase in debt service payments, and thus effective interest rates on government debt.

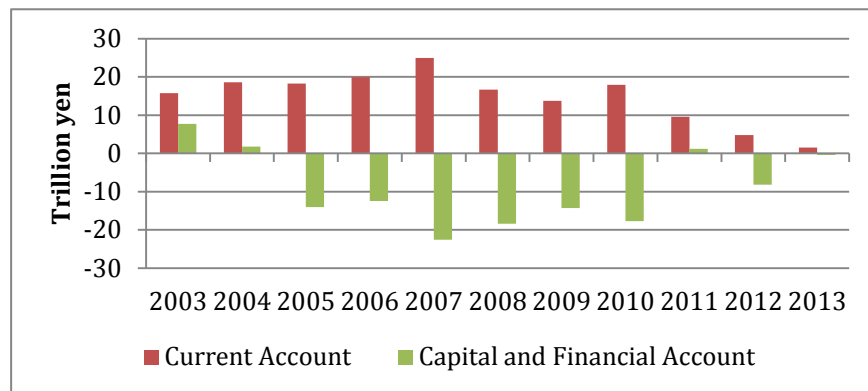
Indeed, the Japanese government itself maintains that sustainable fiscal policy is a crucial element in the execution of Abenomics. The government, in its joint statement with the BOJ in January 2013, went so far as to commit to "steadily promoting measures aimed at establishing a sustainable fiscal structure with a view to ensuring the credibility of fiscal management." Newly-minted BOJ Governor Haruhiko Kuroda also has drawn attention to the issue in statements to the Diet, even calling Japan's debt trajectory "unsustainable", perhaps to avoid giving the impression that the BOJ's expanded purchases of JGBs is meant to plug the government's large budget gap. In a media interview, Heizo Takenaka pointed out, "There is also a risk that the yen will depreciate considerably past 100 if there is no fiscal consolidation after expansive monetary and fiscal policy." He highlighted a potential unmooring of inflation expectations if both the BOJ and the government continue expansionary policies.

### **Current Account May Suffer From Yen Depreciation**

The March 2011 earthquake and tsunami off Japan's northeastern coast caused power outages and core meltdowns at the Fukushima nuclear power plant, leading to a drastic reevaluation of Japan's nuclear energy policy and the idling of the nation's entire nuclear capacity. As a result, Japan's energy mix has shifted towards hydrocarbon imports, with the highest proportional increase in liquefied natural gas (LNG). Partly due to this development, Japan posted its first trade deficit in 30 years in 2011.

**Graph 8. Breakdown of Japan's Energy Sources**

As the yen has weakened in recent months, the yen price of dollar-linked imports of petroleum and natural gas has risen, exacerbating Japan's trade deficit. Though Japan maintains a current account surplus due to its large investment income, the future of Japan's energy imports is still uncertain, and the monthly current account has dipped into deficit in each of the three months of November 2012, December 2012, and January 2013. Should persistent current account deficits occur in the absence of substantial official reserve transactions by the Bank of Japan, these deficits may eventually force capital outflows to finance the shortfall, contributing to pressure on the yen to weaken further (see Graph 9).

**Graph 9. Japan's Current, Capital and Financial Accounts**

### Ambiguous Impact of Weak Yen on Japanese Industry

While U.S. business has been mostly agnostic regarding the exchange-rate effects of Abenomics' reflationary mission, some believe that a more favorable foreign exchange environment for Japanese manufacturers (i.e., a weaker yen) may be a curse rather than a blessing. This is because it will keep smaller, less-efficient exporters afloat, instead of letting creative destruction reign if the yen were stronger.

On the other hand, one grievance that U.S. industry has voiced in the past has been the relative difficulty of investing in Japan. All else being equal, a weaker yen will help foreign investors

(including U.S. corporations) to win bids for Japanese businesses in public share purchases, private equity deals, and mergers and acquisitions. There are, however, remaining institutional barriers such as cross-shareholding which will continue to present obstacles to such inward investment.

### **Unhappy American Automakers**

While the general U.S. mood has been neutral regarding Japan's recent changes in monetary policy, certain industries—mostly those with long-standing complaints against Japan pertaining to market access—have made their displeasure with Japan's reflationary strategy known. Criticism from U.S. automakers may stem from either a desire to stave off competition at home from high-end luxury passenger car imports, which are often still produced within Japan, or an attempt to maintain export competitiveness in third-party markets such as Europe.

The head of the largest U.S. automobile manufacturers' lobby, the American Automotive Policy Council (AAPC), has publicly called on President Obama to threaten the Japanese ruling party with retaliation for efforts to weaken the yen, including countervailing duties. Such criticisms are often related to dissatisfaction by U.S. authorities and lobbyists with the openness of Japan's automobile market, and currency manipulation is duly noted among the "non-tariff barriers" enumerated by the AAPC. The president of the Alliance for American Manufacturing publicly opposed Japan's participation in Trans-Pacific Partnership (TPP) talks in part due to its monetary policy. "[...] the Abe administration has proposed managed inflation and quantitative easing, monetary policies that amount to currency manipulation. A weaker yen is a tool Japan has often relied upon to push down imports and boost exports". An open letter to President Obama from eight senators and 35 representatives criticized Japan's entry into TPP talks partly on the basis of its "currency manipulation".

Members of Congress have echoed these concerns as well. Democratic Senator Debbie Stabenow, whose home state of Michigan is the cradle of the U.S. auto industry, heavily criticized Japan for "currency manipulation" in comments to Acting U.S. Trade Representative Demetrios Marantis during a Senate Finance Committee hearing. Stabenow also cited an estimate given by a major auto CEO that this so-called "currency manipulation" adds \$2,500 to the price of American vehicles (ostensibly when priced in Japanese yen). (Stabenow also introduced a Senate bill in 2007 called the "Japan Currency Manipulation Act".)

### **Fiscal Arrow**

The fiscal "arrow" of Abenomics consists of large-scale public works to boost aggregate demand and increase output in Japan. In addition to a fourth supplementary budget for fiscal year 2012 worth 10.3 trillion yen, the cabinet has approved a fiscal year 2013 budget of 92.6 trillion yen. In announcing the new spending package, Prime Minister Abe said it "shows a clear commitment to economic revitalization" and that it is "not pork-barrel" spending. It remains to be seen at this writing what kind of projects will be funded by Abe's new fiscal package.

### **U.S. Worried Japan Will Waste More Money on Useless Public Works Projects**

For most U.S. observers, Abe's proposed fiscal arrow, like the monetary arrow, has not raised eyebrows. Some critics with memories of Japan's past public works largess questioned the wisdom of "dumping cement on the Japanese countryside" -- a reference to past public works

expenditures that have focused on building or rebuilding roads, bridges, and other infrastructure in remote and depopulated areas of the country. They are concerned that the additional public expenditures Abe is promising would be squandered, rather than spent on projects with high potential gains in efficiency, such as renovating aging infrastructure in urban areas. Some critics worried that it is likely to result in more “welfare for the old LDP clients” rather than making improvements that would benefit Japanese international competitiveness.

Adam Posen, the president of the Peterson Institute for International Economics and a vocal proponent of Japan’s new monetary policy, has lamented Abenomics’ fiscal arrow, saying that “persistent fiscal policies that fail to adapt to changing cyclical conditions result in long-term damage”. Even Koichi Hamada, the Yale professor who is seen as the architect of Abe’s monetary policy and is now a formal adviser to the administration, has been cool towards the fiscal arrow of Abenomics, urging that these expenditures be channeled into productive infrastructure and not “pork-barrel construction as in the past”.

### **Will Fiscal Stimulus Be Much Different From Past Packages?**

The breakdown of the supplementary budget announced by the Cabinet Office in January 2013, aside from disaster reconstruction connected to Great East Japan Earthquake of 2011, appears to prioritize regional renewal through transfers to local governments, small and medium enterprise growth, infrastructure spending and agricultural supports. These spending priorities do not diverge sharply from previous supplementary budgets, and are unlikely to translate to a productive shift in the allocation of Japan’s factor resources in the medium term. The main budget for fiscal 2013 will show whether there is a qualitative change in public works spending.

### **Expanded Fiscal Policy Increases National Debt**

While there is little reason to doubt the Japanese government’s projections of output gains from its expanded public expenditures (2% of GDP, as of 2012), these expenditures will add at least 10 trillion yen to a public debt burden of approximately 709 trillion yen (as of 2012). Japan’s government already spends approximately 24% of its annual budget in servicing its debt, as of 2012. It is unclear how much higher this debt can rise without compromising private sector confidence in Japan’s ability to repay.

Former Council of Economic Advisers chair Martin Feldstein has spoken out against Abe’s fiscal stimulus, expressing skepticism that such short-term measures will contribute to “sustained real GDP growth of 2% a year”. Feldstein also cautions that an attempt to inflate away the debt burden could well be met by a private sector that demands ever-higher interest rates to buy government bonds. A similar view is held by the Japanese financial sector, encapsulated by Sumitomo Mitsui Asset Management senior economist Hiroaki Muto: “There’s a risk that long-term bond yields will rise unless the government takes measures to restore fiscal health”.

### **Some Argue that Debt is Beneficial to Ending Deflation**

One argument being floated is that a large debt burden is actually an *advantage* when it comes to raising inflation expectations. In essence, the fact that the government stands to benefit from the central bank monetizing its deficits (which traditionally is associated with the risk of hyperinflation) lends additional credibility to the government’s goal of moderate inflation.

### **Growth Arrow**

The third arrow of Abenomics—“a growth strategy to stimulate private investment”—is at this writing the least elaborated and most uncertain of the policy levers. According to public statements by the Abe administration, it will consist of deregulation, government support for energy-efficient and renewable energy technologies, a revamping of the tax system to encourage production and investment in equipment, and a “drastic expansion of the provision of risk money to strategic sectors”.

### **Reforms Seen as Indispensable for Growth**

The private sector in Japan has trained its eyes on the evolution of Abe’s growth strategy, viewing it as the keystone of Abenomics. In an opinion piece, Daiwa Securities Chief Economist Mitsumaru Kumagai asserts:

“At the present time, Abenomics consists principally of a monetary and public expenditure shot in the arm. However, for Abenomics to lead to sustainable economic growth, structural reform measures such as the loosening of regulations and participation in TPP—in other words, the strengthening of the third arrow—are indispensable. Unless the Abe administration is able to fundamentally reform the character of the Japanese economy, I fear that stock market highs and the weak yen will be a transient phenomenon.”

PIMCO CEO Mohamed El-Erian has saluted Abenomics but laid the burden of proof of its long-term viability squarely on “meaningful structural reforms”. In fact, he suggests that the extent to which decision-makers outside of Japan are willing to acquiesce in a weaker yen environment will depend on how seriously Japan pursues its structural reform agenda.

Foreign governments have also stressed that Japan must make a real commitment to non-monetary measures; Brazilian Finance Minister Guido Mantega warned: “Japan has to do the other part [besides monetary easing]. Otherwise it would just be the quantitative easing, which would intensify the trade war”.

An early reform that may presage the Abe administration’s attitude towards broader reforms is power sector deregulation. Most of Japan’s 10 power companies, which until now have maintained de facto monopolies over the entire electricity value chain within their regions, will be unbundled between 2015 and 2020 into generation, transmission, and retail companies in an effort to promote greater competition and lower energy prices for end-users. Residential consumers will also be able to choose their supplier.

A limited number of reforms are not aimed at economic expansion at all, but at fiscal consolidation. For example, the administration also plans to raise the tax on corporate dividends and capital gains from 10% (the level it has been since 2003) back to 20% in an effort to narrow the budget gap. Revenue generation will be an indispensable part of any medium-term economic program. The challenge facing the Japanese government is to lay the groundwork for budget discipline without threatening the nascent economic recovery.



### **Entrenched Interests Will Push Back Against Reforms**

The Japanese press has tended to be critical about the reform arrow, some segments charging that proposed changes loosen restrictions on firing employees before measures to promote rehiring are in place. Opposition parties, particularly the ousted Democratic Party of Japan (DPJ) and the Japanese Communist Party have criticized proposals by the government's industrial competitiveness council to allow companies to fire employees without cause provided they pay them compensation.

TPP is also being slammed by interest groups. Opponents of Japan's participation in TPP are well-organized and vocal, staging large and visible protests across Japan. At least one opposition party has begun courting the farm vote, Lifestyle Party. Its head, Ichiro Ozawa, has pointed out that groups opposed to TPP should not support the party that favors it.

### **Timing**

The growth strategy is slated to be unveiled in mid-2013, roughly coincident with upper-house elections in July 2013. It is possible that the Abe administration will defer more controversial decisions until after the July elections. Such a decision, depending on the outcome of the election, could give the government the political capital and perceived mandate to force through a more ambitious set of structural reforms than it would have dared before the election.

### **U.S. Reaction to Strategic Measures**

Measures to deregulate certain industries are likely to be met with measured approval from U.S. firms seeking further market access in Japan. But American companies with long experience in Japan are naturally skeptical that thorough-going reforms will be instituted absent further evidence of political will. Will Abe prove them wrong?

The growth arrow of Abenomics has the potential to dramatically improve Japan's economic ties with the United States once the provisions are elucidated around mid-2013 and seriously pursued. The reforms anticipated could affect ongoing TPP negotiations, where Japan's formal adhesion will require at least a partial restructuring of its uncompetitive agriculture sector. Businesses in the U.S. see a potential for breakthroughs on what the United States considers non-tariff barriers in medical devices, insurance, and other sectors. In its most recent semiannual foreign exchange report, the Treasury Department highlighted that "[m]acroeconomic stimulus will be supportive in the short-term but cannot be a substitute for *structural reform* that raises productivity and trend growth" (emphasis added).

### **What Lies Ahead**

Prime Minister Abe will be judged both at home and abroad based on what he delivers, and his tenure's effect on U.S.-Japan relations will be determined by many different policy channels, not least of which is cooperation on strategic defense. It should be noted, however, that the first two arrows of monetary and fiscal policy are practically universally regarded by Japan hands in industry and government as stop-gap measures, at best—the key will be the third arrow of structural reforms, which largely coincide with the U.S. position on a range of liberalization initiatives within Japan.

Indeed, the very legend from which the “three arrows” imagery is lifted may afford insight into the future of Abenomics. A powerful daimyō lord, Mōri Motonari, summoned his three sons to his bedside and bade each of them break a single arrow, which each of them did with ease. He then asked them to break a bundle of three arrows, which none could do; the moral was that the three sons must stand together to remain strong. If the analogy is made to Abenomics, the implication is clear—Japan will require all three arrows if its economic growth is to accelerate. The United States is unequivocally interested in having Japan as a strong and growing partner in the region. With that in mind, Washington will be counting more on the efficacy of Abenomics’ structural reforms than on the monetary and fiscal policy arrows to enhance the bilateral relationship.

## **Abe's Risky Decision to Join U.S.-led TPP Negotiations**

By Yaowaluk Suthimanus

### **Introduction: Kan Ducks, Noda Punts but Abe Cuts the Gordian Knot**

Japan's torturous path toward participation in the Trans-Pacific Partnership (TPP) talks started with a surprise announcement from Prime Minister Naoto Kan prior to the APEC meeting in Yokohama in mid-November, 2010. Kan may have woken dozing lawmakers when he stated on October 20, 2010 in a Diet policy speech his interest in Japan joining the then nine-country free-trade-agreement talks. His intentions, however, did not go very far. Due to strong objections mainly from powerful agricultural interests, Kan was forced to postpone a planned announcement at the APEC summit meeting in Yokohama signaling a desire to join the TPP. At that time, the anti-TPP interest groups launched a media campaign publicizing the negative consequences of joining the U.S.-led free trade regime on Japan's agricultural sector and other uncompetitive businesses. Significantly, the massive earthquake, tsunami and nuclear accident that hit northern Japan on March 11, 2011, delayed Kan's effort to move toward a final decision on TPP, which was supposed to happen by June. As a result, the TPP decision process ground to a halt.

Prime Minister Yasuhiko Noda, who succeeded Kan in late 2011, wanted to send a clear message stating Japan's intention of joining the TPP to Obama and leaders of other countries involved in the TPP talks at the APEC summit in November. His government was eager, but he was tripped up by his own Democratic Party of Japan, which was divided on the issue. Noda eventually decided to hold off on making the decision, fearing it would lead to the collapse of his administration, which was already in trouble over other domestic issues. Moreover, his government then was becoming entangled in the complicated, domestic issue of integrated tax reforms and revamping of the fiscal and social security systems. He also inherited the enormous problem of managing an energy crisis brought about by the nuclear accident and the shutting down of every nuclear plant in the country for fear of another incident. In his APEC meeting with President Obama, Noda only committed Japan to consider entering TPP negotiations through prior consultations with other participants.

His intention was to make a final decision by the time he met Obama in Washington in April 2012, but the delay allowed anti-TPP forces in the country and his own party to gain the upper hand. Consumer organizations and agricultural coops staged demonstrations in Tokyo's Hibiya Park, and the Japan Agricultural Cooperatives (JA) Group waged a nationwide anti-TPP campaign. JA's main goal was less to protect Japanese farmers but more to shore up its own TPP-threatened interests in the financial insurance business, where a large part of its profits comes from.

Ultimately, it was the Noda administration plummeting popularity in late 2012 that undermined any chance of the public swinging over to support a risky venture like TPP. Convinced that Japan would be ruined by its overwhelming national debt, Noda had spent most of the year working to convince the nation to raise the consumption tax, in order to pay it down. Noda

planned to raise the consumption tax in stages. His bold decision was misguided because the public was unconvinced that Japan needed to raise taxes while the economy was near recession lows. He left office over that issue, having called a snap election in December, leaving the TPP issue for his successor to resolve. That person was Shinzo Abe, who came into office as Prime Minister when his party, the Liberal Democratic Party (LDP) won a landslide victory over the DPJ on December 16, 2012.

### **Abe's Bold Decision**

Prime Minister Abe came into office with a clear agenda that included joining TPP talks as a matter of national interest. He promised President Obama in February that Japan would join the TPP negotiations and kept his promise on March 15 when he made the formal announcement. He had successfully made the case for joining with his party and coalition partners. He argued that, "joining the TPP can open the door to 3.2 trillion yen in much needed GDP growth." He believed also that joining TPP also would lessen Japan's dependence on trade with China, at a time when confrontation with that country over a territorial issue was souring bilateral ties. Abe also stressed that Japan needed to join at this moment "so that the world's third largest economy can take the lead in rule-making' before TPP talks wrap up late this year."

Abe was clever to first garner grudging support from the anti-TPP groups in the ruling Liberal Democratic Party (LDP). He promised to protect Japan's agriculture sector and the public health insurance system during the negotiations with other members of the TPP. The agreement in principle will abolish all tariffs without exception, but Japan hopes to ease that rule in the negotiations. Abe has created expectations that Japan would pull out of the negotiations if the Japanese government could not obtain exceptions on sensitive items.

The LDP subsequently passed a resolution that urged the premier to keep protective tariffs on certain farm products and protect Japan's system of universal health insurance. The party called for "close communication between the government and the LDP once Japan joins the TPP talks."

Clearly, Abe is now relying on other TPP members, including the U.S., to grant him the minimum exceptions regarding the protected trading areas so that he can sell the resulting treaty to domestic constituencies and the Diet. Abe seems confident that despite the TPP goal of 100 percent zero-based tariffs, Japan will receive exceptions on key items to reflect domestic political realities because the United States will have sensitive items up for exemption, as well. At this writing, the Obama administration has already notified the U.S. Congress of intent to include Japan in the TPP, and Japan is expected to join the rule-setting talks in July 2013. Meantime, the U.S. reportedly will carry out bilateral parallel negotiations with Japan regarding the automotive sector and other areas seen as closed to foreign goods.

### **Public Support after Abe's Official Announcement**

Despite his announcement on March 15, 2013, that Japan would join the TPP talks, Abe has maintained his high public support rate, as seen in opinion surveys of three major dailies released on March 18, three days later. An Asahi poll found that 71 percent of the people supported the Prime Minister's decision, and 53 percent would approve Japan actually joining that FTA. Similarly, a Yomiuri poll found that 60 percent of the public supported Japan's entry in the TPP; and a Mainichi survey put the level of TPP support at 63 percent.

Each poll found that the popularity of the Abe Cabinet remained strong. In the Asahi poll, the approval rating of the cabinet increased by three points from February to 63 percent. In the Yomiuri poll, the cabinet approval rating was 72 percent, and it reached 70 percent in the Mainichi survey. Such high approval ratings seem to have been mainly influenced by high public expectations for Abe's economic stimulus policies -- "Abenomics" -- which have de facto incorporated the TPP agreement into a long-range growth policy.

With the public supportive of joining the TPP, LDP critics of the agreement have had to recede for the time being. Party members in general are pleased that the TPP will not have a negative impact for the LDP in the Upper House election this July. At that time, anyway, Japan will just be entering formal talks, with the results not known until October or later this year.

Whatever the results of the TPP negotiations may be, the impact in the agricultural sector will be profound. It is possible that worried farmers will vote against the LDP in the July election. The LDP is aware of a possible backlash and is reportedly planning to assure farmers in the rural areas that the LDP will introduce measures to bolster the agricultural sector, already in serious decline. There is talk of a safety net providing financial support to farmers regardless of production or market prices to be introduced before the election in order to convince farmers to vote for the LDP.

### **What is the TPP?**

The TPP is a proposed free trade agreement under negotiation as of May 2013 by Australia, Brunei, Chile, Canada, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, Vietnam, and now Japan. South Korea was asked by the U.S. to consider joining the TPP but declined for the time being. The TPP is intended to be a high-quality agreement aimed at tackling trade issues in the 21st century.

The TPP became a key part of the Obama administration's trade policy in 2010. The United States has taken a leadership role in setting up negotiations as well as putting the agreement into effect. The TPP was initially launched in 2006 by Chile, New Zealand, Singapore and Brunei (P4) and later was joined by the United States, Peru, Australia, Vietnam and Malaysia. The TPP will abide by 29 chapters of agreed-upon rules that are able to settle disputes based on an impartial, multi-party mechanism. It allows participants 10 years to put the agreement into effect. It is also one of the core components of the Obama administration efforts to "pivot" toward Asia. Moreover, whereas the countries in the WTO list the goods they want to liberalize, participating countries in the TPP list what they cannot liberalize. That is, most of all traded goods are included in the negotiations. Through TPP, the United States hopes that it can be active in shaping the regions' rules and norms.

According to economist Peter A. Petri, the TPP is one of three new game-changing negotiations. The three new "mega- negotiations" are the Trans-Pacific Partnership, Regional Comprehensive Economic Partnership (RCEP 16) and Trans-Atlantic and Investment Partnership (TTIP 28). Petri argues that the outcome of the TPP negotiations would not be a zero-sum game, but a positive sum with huge benefits for each trading partner. TPP will lead to a regional comprehensive partnership and stimulate regional cooperation, and all three partnerships will stimulate mutual economic growth.

The overall goal of the TPP is to reduce government intervention, correct domestic regulations that bar foreign firms from coming into a market, and to help balance liberalization to address the comparative advantages of emerging and advanced markets.

### **Why is It Important?**

A comprehensive TPP agreement will go further than any previous trade pact, since it not only tears down remaining barriers to trade but also creates new international standards in such areas as labor and the environment. The U.S. has adopted the TPP as a new strategy to resolve existing trade disputes and issues that could not be resolved by other trade architectures like the Doha Round of the World Trade Organization (WTO). It is hoped that the TPP will fill the role that the WTO and the stalemated Doha Round have not been able to accomplish. The TPP in essence is a backdoor way of completing the WTO's Doha Round.

By taking the lead in shaping regional trade tools, the United States will be able to counter other proposed regional trade institutions, such as ASEAN plus three and ASEAN plus six. Hence, the TPP is expected to be a qualitative trade regime that will not only boost trade and investment flows in the Asia-Pacific region, but also enhance the U.S.' position there. The TPP could be a tool to bring the United States into the ongoing process of Asia-Pacific integration.

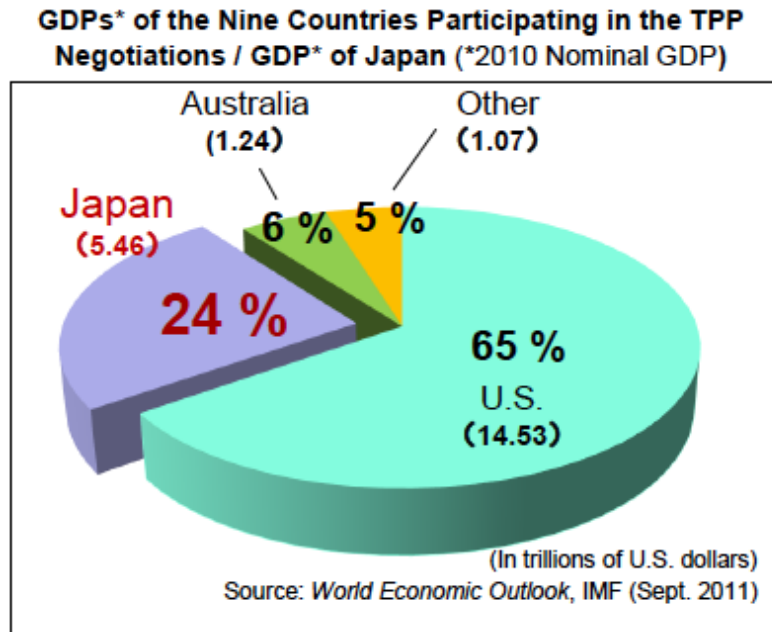
Asia is vital to the trade and security interests of the United States. Further, the Asia-Pacific region is the key to global economic growth as it accounts for 60 percent of global GDP and nearly 50 percent of international trade. Moreover, Asia-Pacific trade in goods and foreign investment has increased by 300 percent and 400 percent, respectively, since 1990. In addition, it is likely that Asia-Pacific Economic Cooperation (APEC) members will join the TPP in the near future, which will certainly increase the share of global trade. Twenty one APEC members account for about 44 percent of the world trade and 40 percent of the world's population. It seems reasonable to predict that the TPP is the stepping stone to the next regional trade agreement covering all of Asia-Pacific.

### **Why Should the United States Welcome Japan?**

Japan's participation in the TPP enhances the credibility and viability of the TPP. Although Japan's economic dynamism has long ago slipped significantly, the country is still the second largest economy in Asia and the third largest economy in the world. Its supply chains and production networks string all across the region, especially Southeast Asia. As a result, from a U.S. perspective, including Japan in the TPP is major plus. With Japan in the TPP, the trading bloc's share of world GDP will be close to 40 percent. Japan's participation in the TPP also entices other countries in the region to join it in order to have access to the Japanese market.

On the other hand, if the United States failed to bring Japan into the TPP fold, Japan might consider other options, which would be disadvantageous to the interests of the United States. Japan might consider joining the ASEAN +3 and the ASEAN +6. Additionally, other nations might be skeptical about the depth of the U.S.-Japan relations, affecting US credibility within Asia beyond the TPP.

Moreover, as stated earlier, the TPP is considered to be a stepping-stone for a larger Free Trade Area of the Asia Pacific (FTAAP) by 2020, which could become a building block for something even larger. Therefore, including Japan in the TPP will ensure that Japan is a part of the FTAAP.



### Implications for China

Economic ties between Japan and China have already surpassed that of Japan and the United States. It is thus in America's strategic interest to welcome Japan since TPP membership will increase the relative importance of Japan as a trading partner. The TPP will promote strong economic cooperation, as well, among the members, including the United States, Japan, and other South-East Asian countries. This will put pressure on China to join or be isolated.

If the TPP is carried through successfully, China will have no choice but to join in the end. If so, it will have to accept the rules set by original TPP members. Thus, TPP could be used as a tool to coerce China to agree to the international liberalization standards. China's entry into the TPP can help promote economic and political stability within the region. According to Petri's optimistic scenario, China would probably join TPP around 2020-2025.

**Chart: Comparing World Economies between the United States and China.  
China and the United States (in 2025, \$2007 bill)**

	Baseline 2025	Change from baseline		
		TPP16	RCEP	FTAAP
United States	20,273	108	0	267
China	17,655	-84	297	678
World	103,223	451	644	1922

As seen from the figure, China will want to join FTAAP because its economy will grow significantly. The benefits will greatly multiply once China joins the FTAAP. To achieve this goal, the United States needs Japan as part of the TPP. Without Japan's participation in the TPP, the United States may lose its incentive to carry the TPP through to the end goal. The United States already has comprehensive FTAs with four of the existing TPP members. The benefits the United States will have from including Japan will be significantly larger than the benefits it will get from other current TPP members who do not have FTAs with the United States.

### **Auto industry**

U.S. opponents to Japan's entry to the TPP say it would only contribute to the huge and growing trade imbalance between the United States and Japan. The most vocal of them is the U.S. auto industry, which argues that Japan has non-tariff barriers on imports of automobiles, and should it join the TPP, Japan will have free access to the U.S. market – zero-tariffs on all vehicles -- whereas U.S. automakers will still not be able to market in Japan. They claim that Japan “remains the most closed auto market among developed nations.” U.S. automakers cite the fact that in the past the United States could only send one vehicle to Japan for every 150 vehicles that Japan sent to the U.S. They note that European and Korean automakers face the same barriers in Japan. Therefore, Japan in the TPP would not address its unfair trading practices. American automakers further argue that the TPP would only further raise the unemployment rate in Michigan, the location of many auto assembly plants. Michigan's jobless rate was 8.8 percent in February 2013, higher than the U.S. rate of 7.7 percent according to the Bureau of Labor Statistics. Ford, the largest exporter within auto industry, raised concern and urged all employees in manufacturing and supporting operations to contact the White House, senators and congressman to oppose adding Japan to the TPP.

But whether Japan is excluded or participates in the TPP will not likely have any effect on job creation in the U.S. auto industry. The Chevrolets and Fords sold in such TPP-participating countries such as Australia, New Zealand, Malaysia and Vietnam come from factories in the local area.

Even though Japan wants its auto industry to benefit from the TPP agreement and therefore wants the United States to remove its tariffs on passenger cars and trucks -- at present set at 2.5 percent and 25 percent, respectively – it has already agreed to let the United States keep the current tariff rates in order that Congress will approve Japan's entry into the TPP.

In fact, Japan's participation in the TPP could benefit the U.S. auto industry. Almost 70 percent of the vehicles Japan sells in the United States are built in North America. The Japanese auto industry has been integrated with U.S. local production since the 1980s. Additionally, while the Japanese have not bought many U.S. cars, they bought 69,787 Japanese cars that were built outside of Japan. Thousands of Japanese-brand cars were built within the United States.

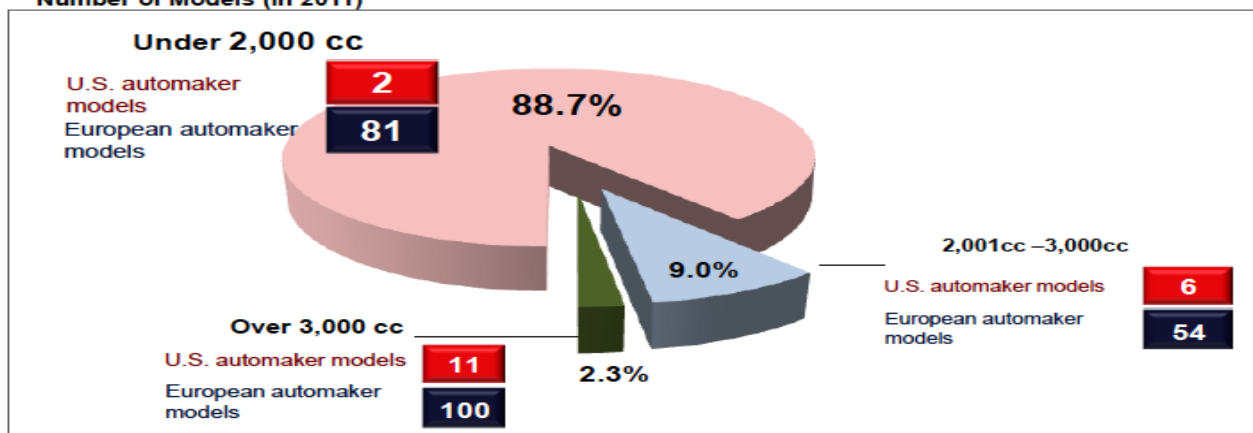
Therefore, expanding Japan's manufacturing base in the United States through membership in the TPP would actually create many American jobs. More Japanese autos made in the U.S., too, would contribute to job creation. The American public seems to agree, for in a poll sponsored by the U.S. Trade Representative's Office in late December 2011, it was found that 86 percent of Americans favor Japan's TPP participation.



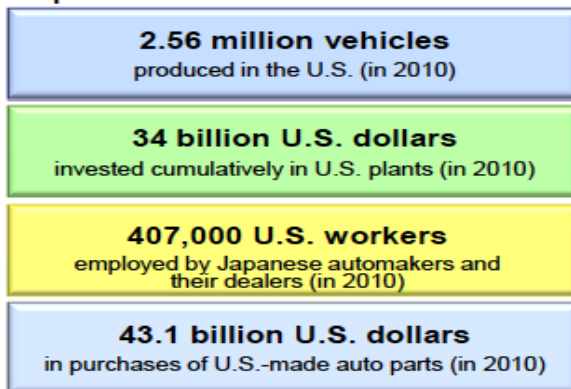
The Japanese government insists that Japan's auto market is open to auto imports: "No restrictive customs or other regulations apply to imported vehicles" and emphasizes its intent to work with other countries to address any issues of concern." The fact is that the auto market in Japan reflects different consumer tastes and needs, which are dissimilar from those of Americans. Japanese consumers prefer smaller models of up to 2,000 cc in engine capacity.

But U.S. automakers have never adapted their models to match the passenger car market in Japan. On the other hand, European automakers have successfully introduced models in a targeted response to the demands of Japanese consumers. The number of dealerships selling European cars has increased, whereas the ones selling U.S. vehicles have decreased overtime. From 1996 to 2011, the number of U.S. dealerships decreased by 76 percent, while the number of European dealerships increased by 72 percent. The trend of European vehicles in Japan's home market and the trend of American vehicles in Japan are going in opposite directions. Therefore, the argument goes that the U.S. auto industry could successfully compete with European automakers in Japanese market if it was willing to develop car models that suited the needs and preferences of Japanese consumers.

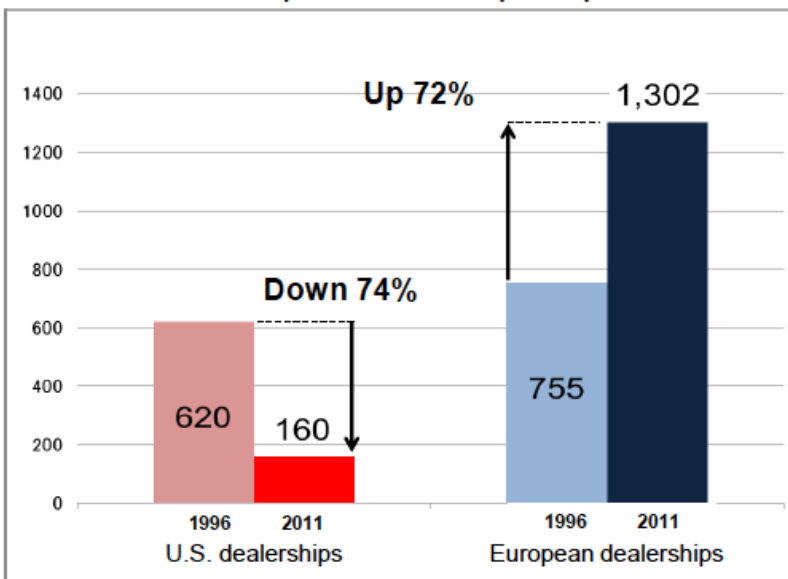
**Breakdown of Japan's Domestic Market for Passenger Cars, by Vehicle Class (cc) and Number of Models (in 2011)**



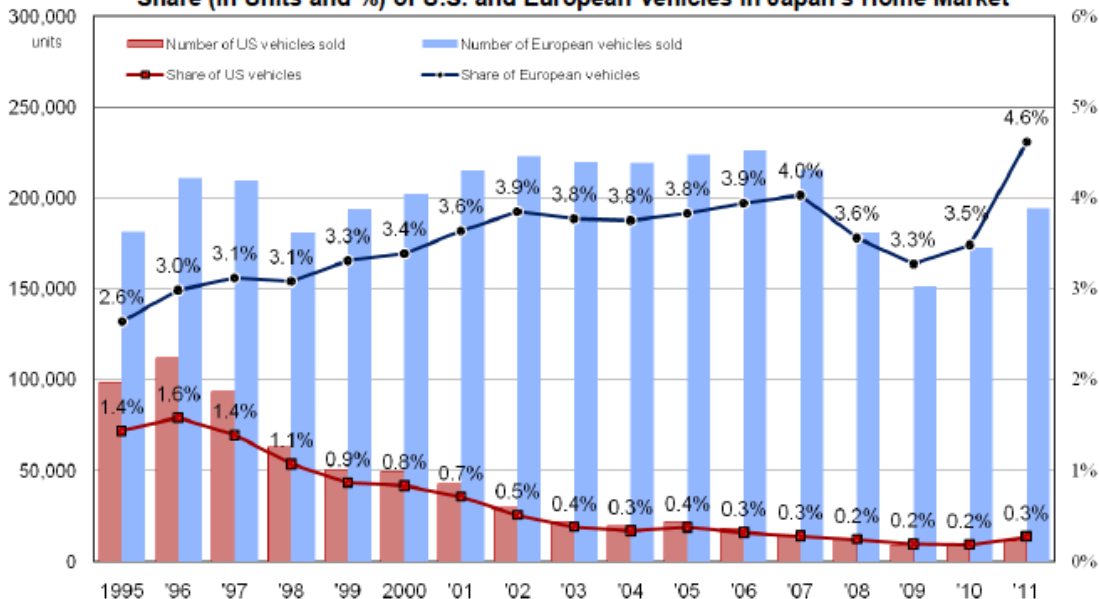
#### Japanese Automakers' Activities in the U.S.



**Number of U.S. and European Auto Dealerships in Japan's Home Market**



**Share (in Units and %) of U.S. and European Vehicles in Japan's Home Market**



**Beef**

Over the past six years, Japan first banned and then allowed limited shipments of beef imports from the United States due to the discovery of BSE (mad cow disease) in a U.S. cow. This issue was included by the U.S. as a trade issue during U.S.-Japan consultations prior to Japan's decision on whether to join the TPP. Beef, though, is an issue that is likely to fade away since the Food Safety Commission in Japan has agreed to ease restrictions to allow greater shipments of beef from the United States.

### **Why Should Japan Join the TPP? A checklist**

*Political benefits: Restore its reputation, strengthen its relationship with the United States, and maintain its competitiveness in the world market*

Japan's earlier efforts to assume a leadership role in promoting a regional economic architecture have been stillborn, mainly for political reasons. It has promoted bilateral FTAs with other Asian countries, with some success in Southeast Asia, but as seen in the proposed East Asian Community by then Prime Minister Yukio Hatoyama in 2009, conceptualizing and then implementing a multilateral scheme has been elusive. Even in the WTO, Japan's position has declined. With the TPP, Japan could make a comeback and take the lead along with the United States in setting the rules of the free trade agreement, and then becoming an active player within the region. In other words, the TPP can help Japan rebuild its economic position in the region and the world.

The TPP has given Japan an opportunity to further strengthen its long-standing close trade ties with the United States. TPP would in effect be an enhanced FTA between Japan and the United States. Now that the United States has signed an FTA with South Korea, Japan has felt left behind in the Asian race to negotiate and sign FTAs. With its FTA with the U.S., South Korea can compete with Japanese automakers much effectively than before, exporting its vehicles and other key products tariff free. With an eye on the Republic of Korea, Japan sees the TPP as a means of restoring its trading-power image, strengthening economic ties with the United States, and ratcheting up its competitiveness in the world market.

*Economic benefits from the TPP: opportunity for reforms and an opportunity to increase its economic growth*

With its aging population and fewer babies being born, Japan can only rely on an export-led strategy to boost its economy. Domestic demand can never fill the bill. Rising demand from current TPP members is the key to offset the domestic gap. Approximately one-fourth of Japan's global exports go already to the nine countries currently in the TPP. Moreover, 76 percent of Japan's total exports are destined for APEC's 21 countries. The amount of Japanese FDI in countries in the Asia-Pacific accounts for 60 percent of Japan's global FDI. Hence, through the TPP, Japan can further expand its markets in the Asia-Pacific much more easily than before, thereby allowing it to move beyond regionalism.

Japan could also use the TPP to signal other countries that Japan is willing to truly open its market. This will draw investors from abroad and help Japan revitalize its economy.

### **Agricultural reforms long overdue**

Japan's agricultural sector is long overdue for reform if it is to survive. Such reforms in past were never instituted in part because of protection of sensitive products and in part because of the lack of political will. Faced with pressure from the world to open protected parts of the agricultural market, every prime minister in the past has succumbed to domestic forces instead. Under the Noda administration, the Ministry of Agriculture, Forestry and Fisheries (MAFF) fed the fears of anti-TPP groups by releasing its own scary computer-simulation data concluding that food production would drop by nearly 4.1 trillion yen and Japan's food self-sufficiency would

drop from the current 40 percent to 14 percent, once Japan joined the TPP. GDP would further decline by 7.9 trillion yen and employment would also shrink by 3.4 million workers.

MAFF was criticized soundly by pro-TPP economists who noted that the ministry used the price of Chinese rice over a decade ago to run the simulation. It is clear to even anti-TPP economists in Japan that the agricultural sector will continue to decline even if Japan chose to skip the TPP. So, it is misleading to see the TPP as the chief contributor to fewer employment opportunities in the agricultural sector in Japan. But steps must be taken and soon to modernize farming in Japan so that the sector not only recovers some of its strength but also is able to produce enough high-quality products for exporting to other TPP members.

Even with drastic reforms, it will take time for the agricultural sector to become competitive, but TPP member countries are allowed ten years to prepare. Although Japan can expect to protect its “sacred items” or rice and sugar for a certain period of time, these “sensitive” areas will be forced to open up when Japan enters the TPP. The tariff on rice imports is a whopping 778 percent, which is an untenable level and will have to be dropped. Therefore, the TPP is just the right stimulus for long-overdue reforms that can ultimately save the agricultural sector, and make it internationally competitive without protective tariffs.

Even now, according to seasoned analysts of the agricultural sector, there is a corps of professional farmers who can compete efficiently after trade liberalization. Recall that certain products are protected; others are not, and have had to compete, even against imported goods. Some of the less competitive farmers may have to leave the business, but with reforms kicking in, new farmers with competitive skills and technology, will come in to replace them. The doomsday scenario is a fiction, say many Japanese economists.

### **Rice**

The biggest fear about Japan joining the TPP is that the rice farmers would be overwhelmed by cheap imports and that most would never survive. This, too, is a myth. In fact, only the United States and Australia have the potential for producing rice that rival Japanese strains. Both are the only countries that can produce short-grained Japonica rice, which Japanese consumers prefer. Nonetheless, these two rice-producing countries face other obstacles in selling rice in Japan even if Japan removes all the tariffs. Japanese customers have a strong preference for consuming domestic brands over foreign rice. According to a poll by the national daily Yomiuri Shimbun in November 2011, a total of 89 percent of the 3,000 randomly selected Japanese respondents said that they would choose Japanese rice over foreign brands even if those foreign brands cost less after rice imports were liberalized. Another question is whether those countries will spend the time and effort to produce more rice for export to Japan, with possibly a retail price not too much more expensive than high-quality domestic brands, if the market potential is limited. Japan may import more rice, but it would be the kind used for producing crackers, cheap rice wine, and fast-food chains. Table rice is likely to remain dominated by domestic high-quality strains of Japonica.

### **Energy Sector: TPP Implications for U.S. LNG Exports**

Another benefit that Japan can expect to receive from joining the TPP is access to U.S. shale gas, which would be shipped to Japan in the form of LNG. During his early 2013 summit meeting,

Prime Minister Abe asked President Obama to would approve US exports of natural gas to Japan. Abe is concerned about Japan's energy security in the wake of the Fukushima nuclear accident that closed down almost all of Japan's nuclear power plants. Access to cheap U.S. shale gas in the form of LNG would eliminate Japan's need to scour the globe for gas at high prices. President Obama did not then make any promises. But he stressed importance of Japan as the U.S.' ally, and he pointed out that he always takes that into consideration when making decisions.

Generally, the U.S. by law will only export energy, in this case LNG countries with which it has an FTA. If Japan joins the TPP – in effect an FTA with the U.S., it can expect LNG exports from the United States. This will help balance its sources of energy and prevent future energy supply disruptions. Now that Japan has committed itself to joining TPP, the Department of Energy, which had been examining Japan's request for shale-gas purchases, has granted it a waiver; and shipments will start once LNG facilities are built and ready in a few years.

### **Quantitative Estimation of Benefits**

With trade flows increasing among TPP members at zero-tariff levels, what will be the economic benefit to Japan? The Japanese government's official estimate is that the benefits from joining the TPP will boost GDP by 0.66%. Private economists tend to place the economic benefits at a higher level. The highest estimate by one group of economists, using a sophisticated new model, is that zero-tariff benefits will boost GDP by 1.96%. Hence, the government's estimate may underestimate the benefits Japan will receive after it joins the TPP.

Economist Kenichi Kawasaki has developed his own model to calculate the economic benefits of Japan joining the TPP. He concludes that after 10 years, sustainable gains from the new business opportunities would kick in. Most of the benefits will fall on consumers in the form of lower import prices and a wider variety of goods to choose from.

### **Room for Negotiated Exemptions for Rice and Other Sensitive Products**

At their summit, Abe and Obama announced that all goods would be subject to negotiations, based on the basic principle of the TPP. There would not be need for a country to make a prior commitment to unilaterally drop all tariffs upon joining TPP. This wording, which implies possible concessions, seems to have convinced Abe to make an earlier decision on TPP than others had expected. If Abe had had to promise to eliminate all tariffs without exception prior to joining TPP negotiations, his party would have balked. The President's agreement to ambiguous wording was music to Abe's ears.

### **Examples of Exemptions**

In fact, other countries engaged in the TPP negotiations have not agreed to remove tariffs on all goods and services. Brunei, for example, crossed all alcohol and tobacco products off the list. Chile and New Zealand are seeking 10 years to remove all tariffs on their sensitive products accounting for 20-30 percent of their trade "such as agricultural products, petroleum products, textiles/footwear, and transport equipment." In other comprehensive trade negotiations such as the FTA between the United States and Australia, both countries make dairy products and sugar exceptions to the rules. Therefore, Japan reasons that it should be possible for it, too, to obtain critical concessions on sensitive goods.

### **Voices in the Region**

Four of the TPP members are ASEAN states: Brunei, Malaysia, Singapore and Vietnam. All of them want Japan to join sooner rather than later and repeatedly have urged Japan to do so. This is because they value their countries being part of Japan's production networks in Asia which have become a critical element in their respective economies. They look to Japan to be a counterweight to the United States in trade negotiations. In other words, they prefer to have another major power besides the United States at their back.

ASEAN countries have long been a hub for Japan's manufacturing industries. Nonetheless, members who did not join the TPP are cut off from its benefits. Thailand, for example, has expressed interests in joining the TPP, but it does not want Japan as a member because of concern over its trade being diverted elsewhere. In other words, once in the TPP, Japan may consider diversifying its supply chains away from Thailand and towards Malaysia and Vietnam, other TPP members. As a result, the TPP is likely to split ASEAN into haves and have nots in terms of regional trade flows.

While ASEAN members who are also TPP members strongly support Japan's inclusion in the TPP, Australia and New Zealand are reluctant to welcome Japan as a member. There is concern that those two countries may make the negotiation process rocky for Japan.

### **Broad Range of Issues for TPP**

If the TPP is to be a success, it will need to effectively deal with a wide range of areas now being negotiated. These go far beyond trade in goods to include: services, investment, specifically, investor-state dispute resolution, intellectual property, government procurement, labor, environmental issues, and rules of origin (such as textiles from Vietnam).

Another problem is that as membership grows, the tendency to dilute the high quality of the trade pact may appear. Despite the fact that the TPP is led by the United States, it is still questionable whether the TPP, once in effect, will operate smoothly. The TPP is a comprehensive agreement that aims to expand membership to other countries, not only limited to developed countries. Although the United States aims to construct a qualitative TPP, it is happy to consider every country for membership that promises to reform and conform to TPP rules. As the TPP aims to include as many countries as possible, the United States may not be able to maintain its desired level of quality of the TPP as the numbers grow. Moreover, because the TPP has gone farther than any previous trade pacts, it raises concern whether participating countries can meet the higher international standards of technology trade, intellectual property and environment required for TPP membership.

### **Implications for Sino-Japanese Relations**

For Japan, some proponents of the TPP cite strategic reasons for joining the U.S. led pact. They have an eye of Japan's rocky relations in recent years with China and the need to move closer to the U.S. in order to counter rising China's growing influence in the region. Some analysts perceive that Japan's determination to enter the TPP talks sends a clear message to China that Japan is now closely linked with the United States militarily and economically. The Senkaku Island dispute with China and other bilateral problems have already pushed Japan toward the

United States in its defense policy. With China in mind, Tokyo has welcomed the U.S. pivot or rebalancing toward Asia. The TPP and its benefits such as access to cheap U.S. shale gas is another factor drawing Japan closer to the United States. In the end, China may find itself being left out in the cold—encircled strategically and isolated economically, in the view of those TPP proponents in Japan.

China, too, may view Japan's stronger ties with United States on the defense and economic fronts as a threat to its own national interests. On TPP specifically, China may be concerned that the new trade rules could become the new global standard, which China eventually may be forced to accept.

But China may also benefit by staying out if the TPP rules on country of origin remain weak. Because the products of some countries contain a substantial amount of input from China, increased trade flows under the TPP could also boost the Chinese economy. China might not see it as critical to become part of the TPP as long as it could supply goods to the member countries that would be sold under that country's label. The countries relying on China for products or product assembly will continue to do so. The issue has a potential to allow China to bypass the TPP and will eventually require the members of the partnership to come together to resolve the issue.

### **Conclusion**

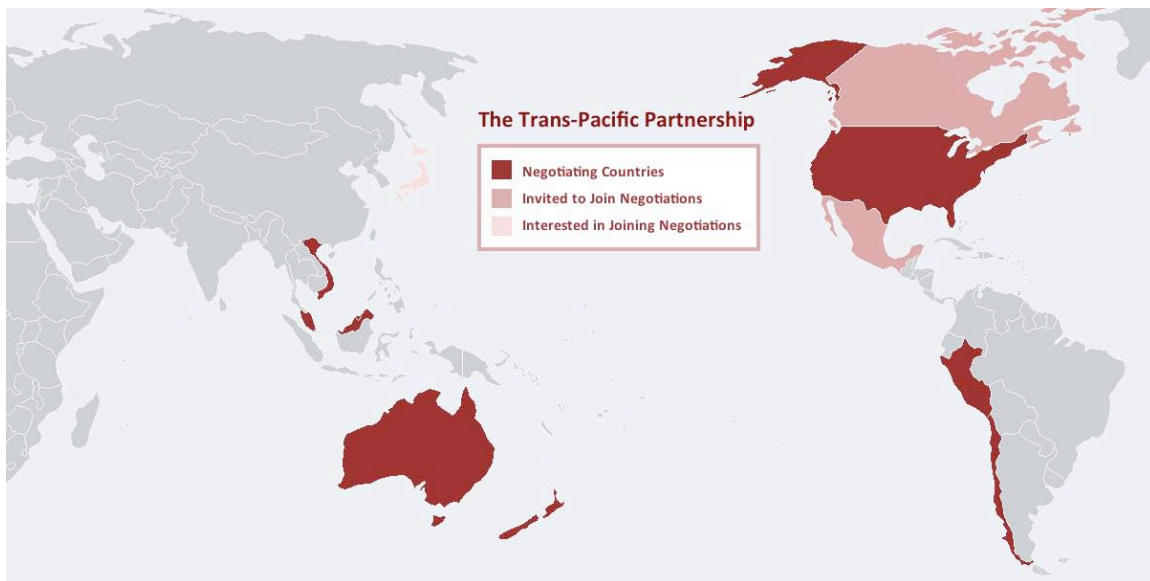
At this writing, Prime Minister Abe has obtained the political freehand for Japan to participate in the TPP, pending the outcome of the rule negotiations late this year. In theory, Japan could pull out if the rules are not set to favor its protected areas in the farm sector, but that is not likely to happen. Japan will ultimately have to go along with the consensus. On Japan's participation, the Obama administration has already notified the Houses of Congress. This will allow the United States to begin its official negotiations with Japan in late July at the earliest -- after the Upper House elections in Japan. It seems likely at this point that Tokyo will sign off on the final TPP agreement in a timely fashion.

The sticking point for Japan may be whether it can reach agreements with other TPP members on the conditions of its entry. Other countries besides the United States will have its own demands on Japan. Ultimately, the greater good of admitting Japan into the TPP fold will most likely prevail. Failure to welcome Japan into the TPP would tarnish its reputation. Even though the process may take longer than expected, Japan is likely to overcome the obstacles and successfully conclude the negotiation process.

Still, some officials in the U.S. government with TPP responsibilities reportedly remain skeptical about Japan's sincerity. They share views expressed by some other member countries about such issues as Japan's remaining regulatory barriers, and its allowing Japan Post to receive favored treatment in selling insurance and government subsidies – considered unfair practices. Japan will have to show itself willing to fully remove government intervention in the private sector. In fact, it is impossible for any country to benefit just by joining the TPP. Japan's joining will be only the beginning of a required transformation that may involve domestic pain and structural adjustments in certain segments of the economy. Other countries will be doing the same. The Abe administration in Japan must decide whether it is willing and able to meet the standard

commitment embedded in the TPP and will truly open its historically closed market. If Japan is able to meet the commitment and is successful in reviving its economy, it will be able to raise its position in the new international trading order.

### The Trans-Pacific Partnership members<sup>109</sup>



<sup>109</sup> “The Trans-pacific Partnership Agreement.” Publicknowlede. Accessed: 1 May 2013. <http://tppinfo.org/>



## References

- Billiones, Cherrie Lou. "Japan and US reach agreements on auto exceptions in TPP." Japandailypress.com. 6 March 2013. Accessed: 7 May 2013. <http://japandailypress.com/japan-and-us-reach-agreements-on-auto-exceptions-in-tpp-0624657>
- "Bolster Japan-US ties to up Stability." Yomiuri Shimbun/Asia News Network. 28 February 2013.
- Brooks, William L. (1) "The Great Political Debate in Japan over Joining TPP," Cato-JEF Conference U.S. Japan Economic Relations in an Era of Political Uncertainty, Sluggish Growth, and Shifting Demographics. 14 February 2013. Washington, DC.
- Brooks, William L. (2) "Abe's Bold Decision on TPP Wins Public Approval. April 2013.
- Cawthon, Bill. "Detroit 3 Oppose Japan Invite to Trade talks." ACARPLACE.com. 24 January 2012. Accessed: 6 March 2013. <http://www.acarplace.com/news/2012/01/detroit-3-oppose-japan-invite-to-trade-talks/>
- Cooper William H. and Mark E. Manyin. "Japan's Possible Entry into the Trans-Pacific Partnership and Its Implications." *CRS Report for Congress*. Congressional Research Service. 24 August 2012. Accessed: 7 March 2013. [www.crs.gov](http://www.crs.gov).
- "Defend Japan's Interests in TPP talks." Japantimes.co.jp. 27 April 2013. Accessed: 27 April 2013. <http://www.japantimes.co.jp/opinion/2013/04/27/editorials/defend-japans-interests-in-tpp-talks/#.UY1efoJAu9m>
- Fergusson, Ian F., William H. Cooper, Remy Jurenas and Brock R. Williams. "The Transpacific Partnership Negotiations and Issues for Congress." *CRS Report for Congress*. Congressional Research Service. 15 April 2013. Accessed: 20 March 2013. <http://www.fas.org/sgp/crs/row/R42694.pdf>
- "Free Trade is Good for Everyone: Making the Trans-Pacific Partnership a Win-Win-Win for all Member Countries." JAMA: Japan Automobile Manufacturers Association, Inc. March 2012. Accessed: 8 April 2013. [http://www.jama-english.jp/publications/tpp\\_pr\\_feb2012.pdf](http://www.jama-english.jp/publications/tpp_pr_feb2012.pdf)
- Interview with Prof. Kikuchi in Japan on 16 March 2013.
- Kawasaki, Kenichi. Seminar at JIIA. "The TPP and the new landscape of world trade." Chiyoda-ku, Tokyo, Japan. 19 March 2013.
- Keck, Zachary. "Various Congressional Democrats Oppose Japan's TPP Bid." *The Diplomat*. 18 March 2013. Accessed: 30 March 2013. <http://thediplomat.com/pacific-money/2013/03/18/various-congressional-democrats-oppose-japans-tpp-bid/2/>
- Mie, Ayako. "LDP election strategy: double farming income." *Japan Times*. 25 April 2013. Accessed: 25 April 2013. <http://www.japantimes.co.jp/news/2013/04/25/national/ldp-election-strategy-more-farming-subsidies/#.UY1ZRYJAu9k>
- McAlinden, Sean P. and Yen Chen. "The Effects a U.S. Free Trade Agreement with Japan would have on the U.S. Automotive Industry." Center for Automotive Research. 21 August 2012.
- Mori, Takeo. Seminar at JIIA. "The TPP and the new landscape of world trade." Chiyoda-ku, Tokyo, Japan. 19 March 2013.
- Naoki, Tanaka. "TPP May Spark Japanese Political Restructuring." February 2011. "Obama Administration Notifies Congress of Intent to Include Japan in Trans-Pacific Partnership Negotiations." Office of the United States Trade Representative. 24 April

2013. Accessed: 24 April 2013. <http://www.ustr.gov/about-us/press-office/press-releases/2013/april/congressional-notification-japan-tpp>
- Petri, Peter A. Seminar at JIIA. "The TPP and the new landscape of world trade." Chiyoda-ku, Tokyo, Japan. 19 March 2013.
- Petri, Peter A., Michael G. Plummer and Fan Zhai. "The Transpacific Partnership and Asia-Pacific Integration: A Quantitative Assessment." *East-West Center Working Papers: Economics Series*. No. 119. 24 October 2011. Accessed: 20 March 2013. [http://www.usitc.gov/research\\_and\\_analysis/documents/petri-plummer-zhai%20EWC%20TPP%20WP%20oct11.pdf](http://www.usitc.gov/research_and_analysis/documents/petri-plummer-zhai%20EWC%20TPP%20WP%20oct11.pdf)
- "TPP: What is it and Why does it matter?" BBC News. 14 March 2013. Accessed: 17 March 2013. <http://www.bbc.co.uk/news/business-21782080>
- "The Trans-pacific Partnership Agreement." Publicknowlede. Accessed: 1 May 2013. <http://tppinfo.org/>
- William, Brock R. "Trans-Pacific Partnership (TPP) Countries: Comparative Trade and Economic Analysis." *CRS Report for Congress*. Congressional Research Service. 29 January 2013. Accessed: 8 March 2013. <http://www.fas.org/sgp/crs/row/R42344.pdf>
- Wingfield, Brian. "Michigan Lawmakers Oppose U.S. Pact with Japan on Autos." Bloomberg news. 12 April 2013. Accessed: 20 April 2013. <http://www.bloomberg.com/news/2013-04-13/michigan-lawmakers-oppose-u-s-pact-with-japan-on-autos.html>
- "What's new February 2012." Ministry of Foreign Affairs of Japan. February 2012. Accessed: 29 April 2013. <http://www.mofa.go.jp/whats/2012/index2.html>
- Zelberg, Max. "A Golden Opportunity: Japan and the Trans-Pacific Partnership." *The United States and Japan in Global Context: 2012*. Reischauer Center. Johns Hopkins University. Washington: DC. p. 94-104. Accessed: 2 May 2013. <http://www.reischauercenter.org/publications/yearbooks/>

## **U.S.-Japan Nuclear Cooperation in the Wake of the Fukushima Accident**

By David Wells

### **Overview of Nuclear Energy Policy in Japan and the U.S**

Japan's nuclear policy mix has remained substantially unchanged since its origins in the 1950s. Japan has consistently promoted nuclear energy production, attempted to create an entire fuel cycle, and abstained from building nuclear weapons. The earthquake and tsunami that wrecked the Fukushima Dai-Ichi nuclear power plant in March 2011 created a major increase in anti-nuclear sentiment among the Japanese public and politicians that still remains fairly high. During the Democratic Party of Japan (DPJ) administration of Prime Minister Naoto Kan, this translated to a political decision to radically shift away from nuclear power, but Kan's successor Yasuhiko Noda, opted for a pragmatic policy of restarting some of the reactors that met safety requirements. The Liberal Democratic Party (LDP) administration of Prime Minister Shinzo Abe plans to further resurrect the nuclear power industry, though progress will be slow with some plants discovered to be sitting on active geological fault lines.

Before the nuclear crisis at the Fukushima nuclear power plant in March 2011 Japan had 54 reactors at 18 plants. Fourteen new plants were planned or being built. Of the then 52 reactors in 2003, 23 were pressurized water reactors and 29 were boiling water reactors. Japan's 54 reactors have a total generating capacity of about 49,110 megawatts. Nuclear energy has generated on average about 30 percent of all electricity in Japan since nuclear power usage peaked at 36.8 percent in fiscal 1998.

According to the pre-Fukushima energy plan approved in June 2010 the number of nuclear reactors was to be increased to at least 14 to 68 by 2030. The plan also proposed raising the percentage of nuclear power used in total electricity generation from 26 percent to at least 50 percent. By increasing the supply of nuclear power, which does not require fossil fuel and other conventional energy resources, the government intended to raise the percentage of so-called self-sufficient energy from under 40 percent to 70 percent and cut greenhouse gas emissions. In the wake of the Fukushima crisis this plan has been reviewed and the new mix will contained a severely limited use of nuclear power.

Before the crisis, Japanese policy aimed to reach to have a third of all reactors use a closed nuclear fuel cycle where spent fuel is reprocessed and later fabricated into mixed-oxide fuel, or MOX fuel. Only 2% of the reactors prior to the accident used this process. A key component of MOX fuel is plutonium, a byproduct from the uranium fuel used in nuclear reactors.<sup>110</sup> By utilizing a closed nuclear fuel cycle, Japan will be able to continuously reuse spent fuel through reprocessing. The closed nuclear fuel cycle limits reliance upon foreign uranium imports and costly fossil fuels.

---

<sup>110</sup> World Nuclear Association

Before the 2011 crisis, all of Japan's operating nuclear reactors were light water reactors whose fuel is natural uranium that has been enriched to increase the amount of uranium 235 from 3 percent to five percent. Burning nuclear fuel in light-water reactors produces plutonium. As of 2009 Japan produces about 1,000 tons of spent nuclear fuel, including uranium and plutonium, a year. The amount of plutonium possessed by Japan both at home and abroad is 31.8 tons. As of the end of 2004, Japan had a stockpile of 43.1 tons of plutonium, up 2.3 tons from 2003, and 110 tons of unprocessed nuclear fuel rods, containing plutonium. Of the 43.1 tons of plutonium, 5.7 tons are kept in Japan and 37.4 tons are kept in Britain and France; 29.3 tons are fissionable.

Japan has a stockpile of 30 tons of plutonium on its soil. Most of it is fissile plutonium from spent nuclear fuel rods that accumulates at a rate of about a half a ton a year. Of the 30 tons, 14 tons is from France and 11.4 tons is from Britain. The two countries have sent their plutonium to Japan to be recycled. Japan has been sharply criticized for accepting plutonium transported on ship from other countries.

The Ministry of Economy, Trade, and Industry's pre-Fukushima long-term energy plan emphasized the development of fast breeding nuclear reactors. Utilizing MOX fuel, fast breeder reactors create plutonium during operation. This leads to a cycle of sustainability that is attractive to a country without an abundance of fossil fuels. In Japan, there are no commercialized fast breeding reactors operating today. There is a MOX fuel fabrication plant located in Rokkasho. The Japanese government constructed the experimental Monju reactor to further the country's fast breeder reactor technology. Current Japanese policy plans for the commercialization of fast breeder reactor technology by 2050.

Japan currently ships large amounts of its spent fuel to the United Kingdom and France for reprocessing. A shipment from France reportedly arrived secretly in Japan as recently as May 2013. The only civilian reprocessing plant in Japan is in Rokkasho and has never operated since construction began in 1992. Numerous safety concerns and delays have hindered the Rokkasho reprocessing facility; the safety issues tainted the perception of Rokkasho and delayed Japanese efforts to reprocess spent fuel.

Nuclear energy does not contribute to global warming through the emission of CO<sub>2</sub>, but it does create a problem in long-term waste disposal. Japanese policy to reduce CO<sub>2</sub> omissions over the last couple of decades has necessitated reliance upon nuclear energy. Through reprocessing, spent nuclear waste becomes less radioactive, but this does not lessen the cost of disposal. Japan does not have a long-term disposal site for highly radioactive waste. Currently, nuclear power plants, located throughout the country, store radiated waste in pools near the reactors, with the largest depository located in Rokkasho.

Following the initial tsunami, the Fukushima Daiichi Plant degenerated into a dangerous situation. As the situation at Fukushima worsened, the media highlighted breakdowns in safety regulations, regulatory oversight, and executive leadership. A report by the Fukushima Nuclear Accident Investigation Commission excoriated the management of the crisis, labeling it man-made.<sup>111</sup> As a result of the Fukushima crisis, public opinion towards nuclear energy in Japan

---

<sup>111</sup> New York Times

turned against its use as dangerous. Such feelings have eased somewhat since 2011, but the country remains split on the issue.

The transition from the Kan to Noda government signaled a change in energy policy. Prime Minister Noda set a more realistic approach towards nuclear energy than his predecessor Naoto Kan.<sup>112</sup> The Noda administration planned on a gradual restart of nuclear reactors throughout Japan following regulators' approval.

<b>Japanese Question Reliance on Nuclear Power, Handling of Fukushima Crisis</b>				<b>A Weakened Japan and Disappointing Recovery</b>			
<i>Should use of nuclear power in Japan be...</i>	<b>2011 2012 Change</b>			<i>Has the March 2011 earthquake/tsunami made Japan stronger or weaker?*</i>	<b>2011 2012 Change</b>		
	%	%			%	%	
Reduced	44	70	+26	Stronger	58	39	-19
Maintained	46	25	-21	Weaker	32	47	+15
Increased	8	4	-4	Neither (Vol)	6	12	+6
Don't know	2	1	-1	Don't know	4	2	-2
<i>Approval of government's handling of Fukushima crisis</i>				<i>Approval of government's earthquake/tsunami recovery efforts</i>			
Approve	25	17	-8	Approve	--	37	--
Disapprove	69	80	+11	Disapprove	--	60	--
Don't know	6	3	-3	Don't know	--	4	--

PEW RESEARCH CENTER Q108 & Q109.

PEW RESEARCH CENTER Q6 & Q7.

\* In 2011, question asked "As a result of the March 11<sup>th</sup> earthquake and tsunami, do you believe Japan will become a stronger nation or a weaker nation?"

### Reprocessing and MOX-Fuel in Japan

In 1977, Japan completed its closed nuclear fuel cycle by constructing the state-maintained nuclear fuel reprocessing facility in Tokai, Ibaraki. Though modest in its capacity at 90 tons of waste a year, the Japanese government constructed Tokaimura to display the country's ability to reprocess safely and to develop reprocessing and MOX fuel fabrication technology further. The Japanese government owns and regulated the Tokaimura reprocessing plant.

To utilize the plutonium separated from reprocessing, the Japanese government initiated a transition towards MOX-fuel powered nuclear energy plants. The Japanese government constructed the light water reactor Fugen and small-scale fast breeding reactor Joyo to experiment with MOX-fuel-powered reactors. In 1988, the ratified Agreement for Cooperation Concerning the Civil Use of Atomic Energy between the U.S. and Japan allowed for the construction of the privately owned reprocessing facility at Rokkasho in Aomori, Japan. Unlike Tokaimura, the private company Japan Nuclear Fuel Limited constructed Rokkasho.

<sup>112</sup> <http://www.pewglobal.org/2012/06/05/japanese-wary-of-nuclear-energy/>

Reprocessing facilities do not have a good track record in Japan. The Tokaimura reprocessing plant witnessed an explosion in 1997. Japan Nuclear Fuel Limited's Rokkasho reprocessing facility experienced numerous security concerns and 19 delays in its construction. Rokkasho has never operated at full capacity since construction began in 1992. Despite the setbacks to reprocessing, the Japanese government maintained its policy to keep a closed nuclear fuel cycle.

Through the recently formed Mitsubishi Fast Breeding Reactor (FBR) group, the Japanese government will allow the private sector to be in charge of the development of fast breeder reactors into the future. Mitsubishi FBR will construct a fast breeder reactor demonstration plant by 2025. In 2050, Mitsubishi FBR Systems plans on having a fully commercial fast breeder reactor plant in operation. The Japanese government will consign the troubled Monju reactor to Mitsubishi FBR in 2050.

Policy and reality do not meet in Japan's goal for the widespread commercialization of fast breeder reactors. The Japanese government's experimentation with fast breeder reactors stalled from the many difficulties plaguing the Monju plant and the Tokaimura explosion. Nearly 15 years following its construction, Monju has operated only a few months without incident. Economically, direct disposal is cheaper than reprocessing and MOX-fuel fabrication. The poor adaptation of fast breeding reactor technology, accumulating waste and plutonium at Japanese nuclear reactors, and setbacks in construction of Rokkasho have colored future Japanese nuclear energy policy. Joyo, the small-scale experimental fast breeder reactor, supported Japan's case for MOX fuel and a closed nuclear fuel cycle. The Monju and Rokkasho examples provide reason to abandon the closed nuclear fuel cycle and fast breeder reactor technology.

The Nuclear Regulation Authority (NRA) in May 2013 decided to order an indefinite suspension of the use of the Monju prototype fast-breeder reactor. Nevertheless, the Japanese government has not changed its policy.

The Nuclear Regulation Authority handed the Japan Atomic Energy Agency (JAEA) an official notice prohibiting restart and instructing the company to improve its safety measures at Monju.

JRA's five commissioners unanimously agreed that JAEA is not ready to sufficiently secure the safety of Monju. They said the operator had repeatedly failed to conduct mandatory inspections on an array of equipment and come up with improvement plans.

The DPJ government tried to terminate Monju under its nuclear phase-out plan, but Prime Minister Shinzo Abe's government quickly reversed course as it pushed to restart commercial reactors that have been idle since the March 2011 nuclear disaster at the Fukushima Daiichi plant. Before issuing the order, NRA chairman Shunichi Tanaka told reporters that Monju's operator lacked a "safety culture" and deserved severe action.

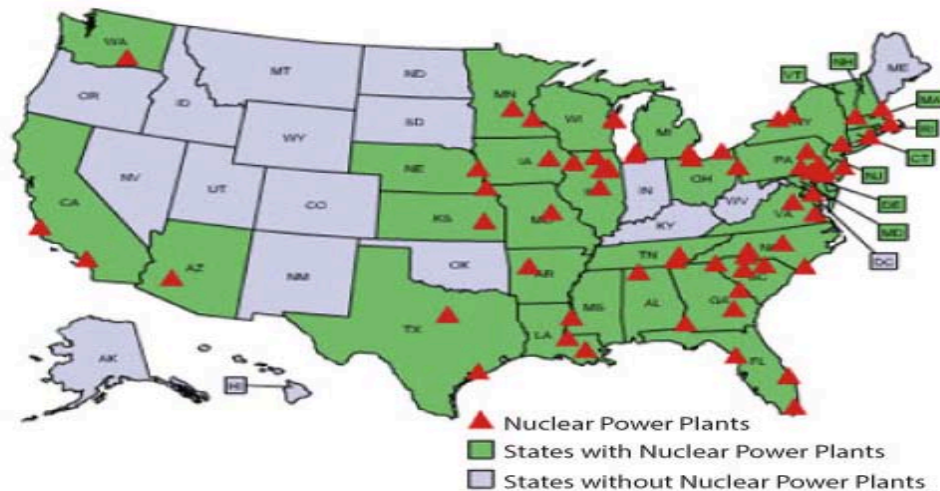
### **Overview of Nuclear Energy in the U.S.**

The U.S. invested heavily into nuclear energy following World War II. There are currently 104 nuclear power plants operating at 65 sites in the U.S. Four are currently under construction.<sup>113</sup>

<sup>113</sup> <http://www.world-nuclear.org/info/Country-Profiles/Countries-T-Z/USA--Nuclear-Power/#.UULi-FuWkhc>

The U.S. is the largest gross user of nuclear energy in the world. Nuclear energy constitutes nearly 19% of energy supply. The U.S. utilizes an open nuclear fuel cycle but has military reprocessing facilities. Stressing non-proliferation as part of the nuclear agenda, current policy in the U.S. prevents commercialized reprocessing and a closed fuel cycle.

### U.S. Commercial Nuclear Plants



Source: U.S. Energy Information Administration.

114

In the 2000s, nuclear energy was in a renaissance. Despite the notoriety and public awareness of the Fukushima nuclear crisis within the U.S., public opinion towards nuclear energy is still positive.<sup>115</sup> In February 2012, for the first time in three decades, U.S. regulators approved two new nuclear power plants in Georgia. From 1979, the Three Mile Island Crisis prevented new construction starts of nuclear power plants.

The shale gas revolution altered the U.S. energy situation. Fracking technology drove natural gas prices down, making nuclear energy appear less attractive. Due to a fall in private investment, increased safety mechanisms, and lower natural gas prices, the nuclear energy renaissance stalled. On top of lower natural gas prices, the price for nuclear power plant construction tripled over the last decade.<sup>116</sup>

### Politics of Shutdown (2011-2013)

The Tohoku earthquake produced a massive tsunami that initiated the crisis at the Fukushima Daiichi Nuclear Power and took the lives of thousands. The Japanese public's calm and collectedness impressed a global audience. In contrast to the inspiring display of solidarity and strength by the Japanese at-large, disarray plagued the upper echelons of the Japanese government. Communication and coordination lacked due to the hierarchical nature of the

<sup>114</sup> EIA website

<sup>115</sup> <http://www.gallup.com/poll/153452/americans-favor-nuclear-power-year-fukushima.aspx>

<sup>116</sup> The Implications of Fukushima for the US

Japanese bureaucracy. Officials hesitated to take responsibility for the developing crisis. The improper handling of the Fukushima crisis elicited calls from the Japanese Diet for the resignation of Prime Minister Kan.<sup>117</sup>

Currently, 9 percent of Japan's electricity is generated from renewable energy, of which 8 percent is from hydroelectric power. The rest is generated from nuclear power (26 percent), liquefied natural gas or LNG (28 percent), coal (25 percent) and petroleum (13 percent). Under Japan's Basic Energy Plan that was revised in June 2010, the 2030 targets for Japan's energy sector were: 1) renewable energy to increase to 20 percent of the generation mix; 2) nuclear power to increase to 50 percent; 3) LNG and coal would be reduced to approximately 10 percent of electricity generation; and 4) oil generating the remainder of the energy mix.

The 2010 Basic Energy of Japan called for an increase in nuclear power to supply 53% of the country's total energy needs by 2030. In July 2011, Democratic Party of Japan (DPJ) member Prime Minister Naoto Kan dismissed the idea of furthering nuclear energy in Japan. Kan presented a plan to make renewables, geothermal, wind, and photo-voltaic energy provide over 20% of total energy production as a condition for his resignation. The Kan administration proposed a feed-in tariff program to increase investment in renewables to replace nuclear power as part of Japanese energy provision. Kan's nuclear policy called for the cancellation of 14 reactors planned for construction. For the Liberal Democratic Party of Japan attacked the Kan government, particularly the Prime Minister's Office, as well as TEPCO, for mishandling the Fukushima crisis. His popularity slipping to new lows in each month's opinion polls, Kan finally resigned in August 2011, a little over a year after taking office.

Prime Minister Yoshihiko Noda, succeeding Kan, came into office amid widespread skepticism in the country about the state of Japan's energy policy, vehement criticism from the opposition parties in the Diet, and spiking energy costs across Japan. Noda for the time being followed Kan's plan to lessen dependence on nuclear energy by delaying construction of new power plants and tightening licensing requirements. Noda defined his energy strategy by three "N's": no dependency on nuclear power plants, no new construction of new power plants, and no more replacements of old power plants. On May 5, 2012, for the first time in decades, no nuclear reactors were on line providing energy in Japan. On May 30, 2012, to alleviate the high costs of energy and mitigate the rolling black outs, the Noda administration cautiously approved the restart of two reactors.<sup>118</sup>

International observers and members of the domestic bureaucracy questioned the ability of Japan to pivot away from nuclear energy. A policy based on a nuclear allergy and not common sense was seen as endangering Japan's ability to remain competitive economically.<sup>119</sup> Industry, consumers, and the entire energy infrastructure of Japan had been planned around nuclear as a significant provision of energy.

---

<sup>117</sup> "Japan Held Nuclear Data, Leaving Evacuees in Peril," *New York Times*, August 8, 2011. [http://www.nytimes.com/2011/08/09/world/asia/09japan.html?\\_r=1&pagewanted=print](http://www.nytimes.com/2011/08/09/world/asia/09japan.html?_r=1&pagewanted=print).

<sup>118</sup> [http://www.nytimes.com/2011/05/11/world/asia/11japan.html?\\_r=0](http://www.nytimes.com/2011/05/11/world/asia/11japan.html?_r=0)

<sup>119</sup> Shimanuki



Noda acknowledged the restart of nuclear reactors as necessary to prevent an energy crunch. Japan imports approximately 84% of its total energy needs.<sup>120</sup> With no nuclear plants, that percentage would reach close to 100%. Still, for political purposes, the Noda administration downplayed the indispensability of nuclear energy to resource-poor Japan in the future.

### **The Costs of Fukushima**

The aftermath of Fukushima is startling in both cost and technical challenges. TEPCO estimates the cost of the Fukushima disaster at over \$137 billion.<sup>121</sup> It will take the Japanese government, in conjunction with TEPCO and international nuclear experts, decades to decommission the Fukushima plant. Workers and Self-Defense Force personnel who put themselves in danger to help ameliorate the deteriorating situation at Fukushima Daiichi face health risks from radiation exposure. Future illnesses as a result of radiation exposure place TEPCO and the government in liability.

The Tohoku Earthquake and subsequent tsunami destroyed thousands of homes. Evacuees numbered over 150,000, and compensation for hardship and displacement has been disorganized.<sup>122</sup> Using public funds, the Japanese government essentially nationalized TEPCO. The Japanese taxpayer is predominantly responsible for the costs of the tsunami and displacement in Fukushima.<sup>123</sup>

Contaminated foodstuffs, including vegetables and tap water, diffused beyond the Tohoku area. By late February 2012, the Japanese government detected radioactively contaminated food in Tokyo.<sup>124</sup> Fisheries in the area are susceptible to irradiated water, airborne radiation, and nationwide fear for food coming from the Tohoku area. As of March 2013, 44 countries still maintained restrictions on food imports from Japan.<sup>125</sup>

Current issues at the Fukushima Daiichi plant include: pooling radiated water in the basements of the reactors, disposal and storage of contaminated water, and reconstruction of damaged infrastructure inside of the plant.<sup>126</sup> At present, nearly 75 gallons of ground water per minute flow into the basement of the Fukushima reactor. As the water enters the basement, the water becomes irradiated. Contaminated water must be held in containers to prevent the spread of radiation to the environment.<sup>127</sup> Large tanks surround the Fukushima plant, storing 280,000 thousand tons of contaminated water.<sup>128</sup> TEPCO, owner of the Fukushima plant, finances cleanup operations with Japanese government-provided funds.

In December 2011, the Japanese government decided upon a three-stage plan to decommission the Fukushima Daiichi nuclear plant. The plan was as follows:

---

<sup>120</sup> world-nuclear

<sup>121</sup> Inajima, T., & Song, Y. (2012, November 7). Fukushima \$137 Billion Cost Has Tepco Seeking More Aid. *Bloomberg News*. Retrieved from <http://www.bloomberg.com/news/2012-11-07/fukushima-137-billion-cost-has-tepco-seeking-more-aid.html>

<sup>122</sup> <http://www.abc.net.au/news/2013-02-19/companies-not-paying-compensation-at-fukushima/4528150>

<sup>123</sup> *ibid.*

<sup>124</sup> *ibid.*

<sup>125</sup> <http://blogs.wsj.com/japanrealtime/2013/03/11/fukushima-watch-food-exports-still-restricted-by-radiation-fears/>

<sup>126</sup> NRA interview

<sup>127</sup> <http://www.nytimes.com/2013/04/30/world/asia/radioactive-water-imperils-fukushima-plant.html>

<sup>128</sup> <http://www.nytimes.com/2013/05/08/opinion/global/Japans-Shift-From-Nuclear-Energy.html>

- Phase 1 (within 2 years): Commence fuel Removal from spent fuel pools
- Phase 2 (within 10 years): Commence fuel debris removal from the reactors
- Phase 3 (within 30 to 40 years) Terminate the decommissioning process

As the effects of climate damage materialize, the total cost of the Fukushima disaster will emerge.

### **The New Nuclear Regulation Authority (NRA)**

Fukushima altered the status quo of domestic nuclear regulation. The Ministry of Economy, Trade, and Industry (METI), the Ministry of Education, Culture, Sports, Science and Technology (MEXT), and the Nuclear Regulatory Commission (NRC) oversaw the nuclear industry before the Fukushima crisis. The Prime Minister's cabinet also played a role in oversight. The cushy relationship between TEPCO and government regulators was reinforced by the Amakudari system, where retired government employees join private companies often in their old field. These former officials had laxly enforced the regulations, creating potentially dangerous conditions in power plants. To prevent another Fukushima, the Nuclear Regulation Authority (NRA), currently a branch of MEXT but with an independent committee and budget, became the regulating body of the nuclear industry in November 2012.

Former bureaucrats of METI, MEXT, and the NRC staff the newly created NRA. Leadership at the NRA includes: Dr. Kuniyuki Shimazaki, an expert on earthquake prediction, Dr. Toyoshi Fuketa, an expert on nuclear safety, Dr. Kayako Nakamura, a medical doctor with a specialty on the effects of radiation, Kenzo Oshima, diet-appointed investigator of the Fukushima accident and former ambassador, and NRA Chairman Dr. Shunichi Tanaka, former expert at the Japan Atomic Energy Research Institute. Within energy regulation in Japan, the NRA is now the strictest and most comprehensive body. Prime Minister Abe's energy policy calls for a three-year review of all nuclear reactors in Japan. Following approval by the NRA investigators, a nuclear power plant can restart operations. The NRA is in the process of formulating new standards and regulations to be published by July 2013.

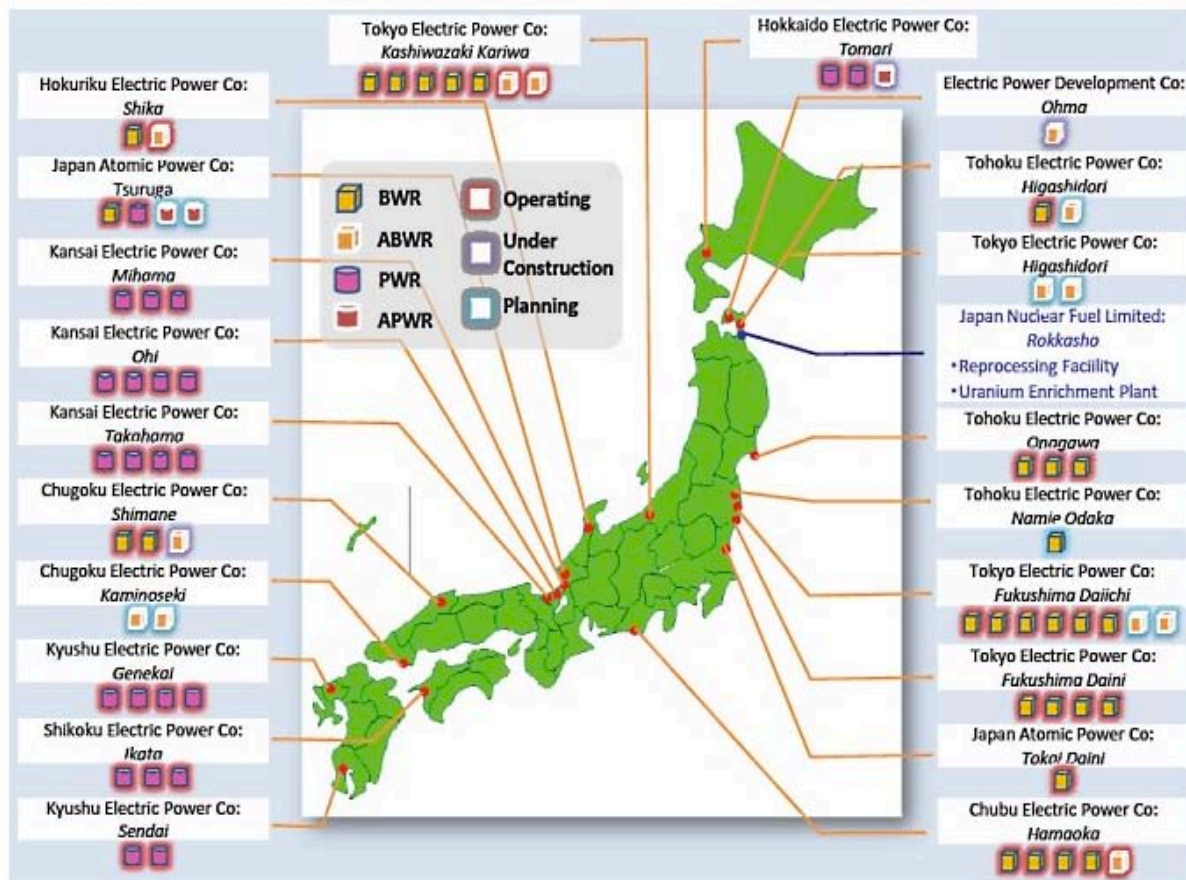
The Japanese government mandated the NRA to ensure the separation of regulation and utilization in the nuclear industry, unification of previous nuclear energy regulations to one department, information disclosure with high transparency, transformation of nuclear regulations, and enhancement of the nuclear emergency preparedness system. Transformation of the nuclear regulations includes reinforcement of countermeasures for major accidents, implementation of nuclear safety regulations based on latest knowledge, and the introduction of a 40-year-limit in the operation of a nuclear power plant. The NRA will have the authority to grant an extension to the 40-year limit after a follow-up safety review.

Construction and decommissioning of nuclear power plants is very expensive. There are numerous interests at stake in the approval process. The Japanese government assigned less than a dozen bureaucrats to investigate idling reactors for possible restart.<sup>129</sup> Despite the funding and support for the newly formed NRA, it is improbable for such a small group of people to investigate all the idled reactors by the summer of 2016.

---

<sup>129</sup> *ibid.*

### Nuclear Power Plants in Japan<sup>130</sup>



#### Japan's Post-Fukushima Energy Make-up

The Tohoku Earthquake and subsequent crisis at the Fukushima Daiichi nuclear power plant highlighted the many issues surrounding energy provision in Japan. Following the events of March 11, nuclear power plants across Japan fell into paralysis. Of the 54 nuclear reactors, only two now operate at full capacity. When Prime Minister Naoto Kan in the summer of 2011 declared an end to nuclear energy, his impetuous move threw long-term energy planning into tumult. Blackouts became regular throughout the eastern part of the country. Due to an anachronistic grid infrastructure, the western area of Japan could not transfer significant amounts of energy to the eastern part of Japan, including Tokyo. In response to the crisis, the Japanese government will increase the number of converters necessary to allow the western part of Japan to supply more energy to the east.

In 2010, nuclear energy provided 29% of total energy in Japan. In 2012, nuclear energy fell to 2% of total energy provision. Japan began importing large amounts of LNG to meet energy needs. From 25% in 2011 to 48% in 2012 of total energy, LNG imports grew rapidly. Japan's shift towards LNG came due to the limited capacity of coal-fired power plants.<sup>131</sup> A few months after

<sup>130</sup> <http://www.world-nuclear.org/info/Country-Profiles/Countries-G-N/Japan/#.UYwApCtVQhc>

<sup>131</sup> Komoto, Interview

the Fukushima crisis, TEPCO attempted to raise electricity prices on businesses and consumers to cover rising costs but was met with hostile opposition. TEPCO began raising electricity rates in September 2012.<sup>132</sup>

The Japanese government is considering the large-scale use of clean coal to replace nuclear as part of total energy provision. LNG produces less CO<sub>2</sub> than coal. U.S.-Japan cooperation through LNG exports from the U.S. to Japan has become a priority for the Japanese government. Prime Minister Shinzo Abe requested such exports when he visited the U.S. in February 2013 for a summit meeting with President Obama. In May 2013, METI minister Toshimitsu Motegi visited the U.S. to speak with the Department of Energy to discuss LNG and urge for an export license by the U.S. to Japan. DOE has now issued such a waiver to Japan (normally only countries with free trade agreements with the U.S. are eligible for energy exports).

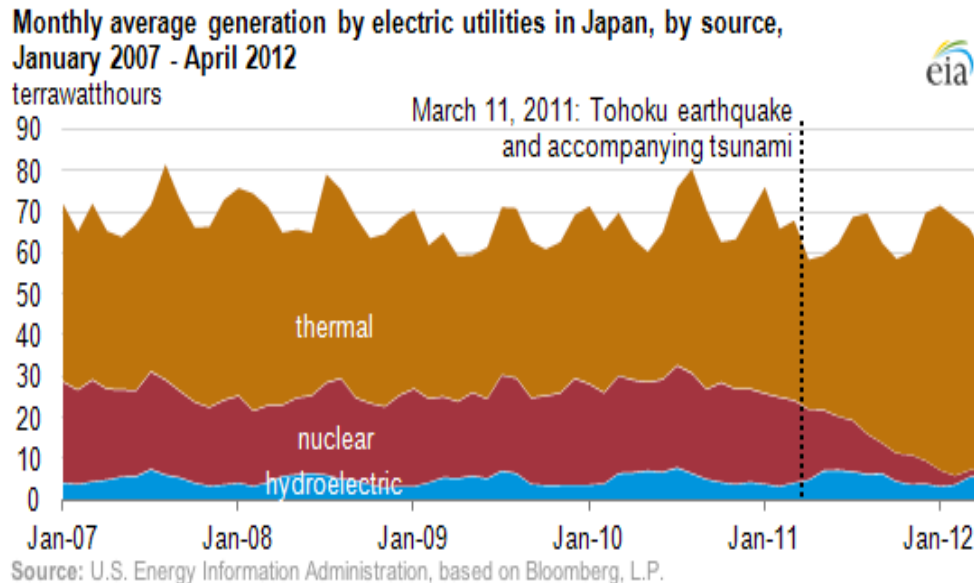
Japan's long reliance on nuclear energy came as a result of the 1973 global oil crisis. The sudden skyrocketing cost of fossil fuels encouraged the Japanese government to invest in nuclear energy as a long-term sustainable alternative. Today, petroleum constitutes 42% of total Japanese energy provision. Over 80% of Japan's oil supply comes from the Middle East.<sup>133</sup> In 2011, Fukushima similarly shocked the Japanese government. METI, as the bureaucratic branch for energy planning in Japan, considered shifting prices in fossil fuels, uranium, and renewable energy in its energy planning calculus. To combat the rising prices of fossil fuels, the Japanese government encouraged investment into renewable technology through a feed-in tariff program.

China, Japan, and South Korea are all reliant upon fossil fuels from the Middle East. The scramble for regional fossil fuels creates disruption in regional stability. The Sino-Japan relationship has been complicated by energy competition. China's expansion to Southeast Asia and its integral waterways propel the Japanese government to search for resources close to home. The unexploited large amounts of natural gas and oil in the East China Sea could provide a significant source of energy, but China and Japan remain at odds over oceanic boundary lines, their territorial dispute, and China's strategic intentions in the area. Such frictions have prevented Japan from including the resources in the E. China Sea in current energy planning.

---

<sup>132</sup> Sasekawa SPF report

<sup>133</sup> <http://www.eia.gov/countries/cab.cfm?fips=JA>



The U.S.-Japan relationship is strong when both countries' economies thrive. The susceptibility of Japan due to its strong reliance upon the Middle East for oil supplies highlights the need for U.S. exports of LNG to Japan. Japan is one of the largest consumers of LNG in the world as a result of the Fukushima crisis. Currently, Japan pays nearly three times the price than that found in the U.S. for LNG. By allowing for exports of LNG, the U.S. and Japan can strengthen the bilateral economic relationship while strengthening the long-term economic and political bond between the two countries.<sup>134</sup>

### **Cooperation between the U.S. and Japan**

The 1968 Agreement for Cooperation between the Government of the U.S. and the Government of Japan Concerning Peaceful Uses of Nuclear Energy was the first cooperative accord between the two countries in the field of nuclear energy. Japan ratified the Nuclear Non-Proliferation Treaty in 1976. In 1977, an agreement between the U.S. and Japan allowed the Japanese government to construct a small-scale experimental reprocessing facility at Tokaimura. President Jimmy Carter's administration was opposed to commercialize reprocessing in Japan. The Japanese government later lobbied the Reagan administration for approval in the construction of a commercial reprocessing plant. The 1988 U.S.-Japan Nuclear Energy Agreement is notable as it allowed for Japan to construct a commercial reprocessing plant. The 1988 Agreement allowed Japan to become the only country in the world with a commercial reprocessing plant without possessing a nuclear weapon. As reprocessing is necessary for a closed nuclear fuel cycle, Japanese policy was predicated on its ability to gain approval from the U.S. The 1988 Agreement replaced the 1968 Agreement for Cooperation.

In 2007, the U.S.-Japan Joint Nuclear Energy Action Plan set forth an agreement to further civil nuclear energy cooperation while preventing nuclear weapon proliferation. The Joint Action Plan's goal was to address nuclear-energy issues through a three-stage process. But the

<sup>134</sup> <http://www.eia.gov/todayinenergy/detail.cfm?id=6470>

Fukushima crisis disrupted the Joint Action Plan. Japan's nuclear policy was affected by the plans of President Obama during his first term to promote further nuclear disarmament through the Strategic Arms Reduction Treaty. Japan, too, began to shift towards an emphasis on nuclear nonproliferation. Following the massive earthquake in 2011, nuclear cooperation took on a somber tone. The massive effort by the U.S. forces in Japan to help earthquake stricken northern Japan, dubbed Operation Tomodachi (Friendship), also provide supplies and support during the Fukushima crisis. Civilian U.S. nuclear experts also flocked to Japan to provide help and guidance as needed. In July 2012, Japan and the U.S. formalized that experience by forming a Bilateral Nuclear Cooperation Committee. The current agreement for such cooperation will continue until 2018, when negotiations to renew it will occur.

### **Operation Tomodachi and the Bilateral Response to Fukushima**

During the first week of Fukushima crisis, the U.S. forces in Japan in conjunction with Japan's Self Defense Forces, launched Operation Tomodachi, based on a direct order from Obama. Operation Tomodachi was a support program providing non-compensated relief supplies, logistical support, and technical knowledge to Japan. Within 8 days, the U.S. government contributed over 24,000 personnel and 24 Navy vessels.<sup>135</sup> Operation Tomodachi marked the first time that U.S. forces in Japan were placed under the direct command of the Japanese government. Operation Tomodachi was more than a symbolic gesture by the U.S.; it served as a poignant reminder of the importance of the alliance relationship.

Confusion reigned in the Japanese government during the weeks following the Tohoku earthquake. The Japanese government initially refused America's offers of aid due to the expectation that such required compensation. Despite the initial refusal, the U.S. contributed \$95 million in uncompensated aid to Japan throughout the crisis.<sup>136</sup> Prime Minister Naoto Kan focused a domestic-oriented response to the crisis, ignoring a 20-item offer list from the U.S. during the first stages of the Fukushima crisis.<sup>137</sup> The U.S. sent 11 experts to help with the worsening situation at the Fukushima Daiichi plant. A crisis such as Fukushima requires an expedited response, but the 11 experts were unable to communicate with the Japanese government in critical days that followed the tsunami.<sup>138</sup> The U.S. government was also unable to coordinate with TEPCO. The U.S.'s rapid response times and policy of maximum caution to crises can serve as a model for Japan. The problems in communication and logistics demonstrate an opportunity for further cooperation in developing a U.S.-Japan bilateral response to a crisis like Fukushima.

As the Fukushima plant experienced meltdown, the U.S. enforced a much larger evacuation area for U.S. citizens compared to the Japanese government's evacuation area. The U.S. mandated a 50-mile evacuation zone to Japan's 12 miles.<sup>139</sup> A dysfunctional, hierarchical assessment of Fukushima stalled the Japanese government's response and efforts. As accurate details of the problems at the Fukushima plant trickled to the top, the U.S. began mobilizing forces and personnel towards the affected area. American experts assessed the situation developing in Fukushima more accurately with less information than the Japanese government.

<sup>135</sup> DoD Assessment of Fukushima

<sup>136</sup> Dod Assessment (Congressional Research Service)

<sup>137</sup> SPF, Report

<sup>138</sup> SPF Report, Sasekawa

<sup>139</sup> <http://www.newsobserver.com/2011/03/17/1059140/japan-races-to-get-power-to-reactors.html>

Operation Tomodachi was a success in that it reset the U.S.-Japan relationship after the DPJ government under Prime Minister Yukio Hatoyama's disastrous and largely stillborn policies to move away from the U.S. and toward China. Directly following the triple disaster, polls in Japan showed an increase in good feelings toward the U.S. by the Japanese public. There were many problems that occurred during the crisis, predominantly on the Japanese side, but the U.S. and Japan ultimately learned to smooth out differences and successfully tackle the enormous task of rescue, recovery, and revival in northern Japan. The areas for improvement were subsequently recognized both in terms of responding to a national crisis as well as the coordination between the two military forces that would be needed should there be a future contingency in the region affecting Japan.



Source: Prepared by CRS based on U.S. Department of State; National Geospatial Intelligence Agency; and GeoCommons data.

### Areas for Cooperation: The U.S.-Japan Joint Nuclear Action Plan

The U.S.-Japan Joint Nuclear Energy Action Plan agreed to by the administrations of President George W. Bush and the first Abe government set a three-phase plan for further cooperation into the future. The Joint Action Plan proposed cooperating in researching: Fast Reactor Technology, Fuel Cycle Technology, Simulation and Modeling, Small and Medium Reactors, Safeguards & Physical Protection, and Waste Management.

Under the criteria listed for each Phase in the Joint Action Plan, U.S.-Japan nuclear cooperation is still in Phase II. The Plan in outline is as follows:

*Phase I – Near Term (2007-June 2008; Report due in April 2008): Complete*

Phase 1 went according to schedule.

*Phase II – Mid-Term (July 2008-June 2011): Incomplete*

With the Fukushima Daiichi plant crisis, Japanese nuclear energy planning was thrown into tumult, preventing Japan from continuing on beyond Phase II. The last and third meeting under the Joint Action Plan was March 23, 2010.

*Phase III- Longer Term (July 2011 and forward): Unimplemented (ambiguity)*

Due to the Fukushima Dai-Ichi Plant crisis, Phase III never started.

**The U.S.-Japan Bilateral Commission on Civil Nuclear Cooperation**

The Bilateral Commission on Civil Nuclear Cooperation is the active cooperative agreement between the governments of the U.S. and Japan. Under the newly inaugurated Commission, a newly created Civil Nuclear Energy R&D Working Group will be in charge of coordinating efforts between the two countries. The U.S.-Japan Joint Nuclear Action Plan is the official framework under which the Bilateral Commission on Civil Nuclear Cooperation operates. The Bilateral Committee set up by the Obama and Noda administrations is the modus operandi for interaction between the two countries in nuclear cooperation. There are ongoing Foreign Ministry discussions with the U.S. Department of Energy on whether to continue consulting the Joint Action Plan, which was formed under Global Nuclear Energy Partnership, now known as the International Framework for Nuclear Energy Cooperation. Some areas of the Joint Nuclear Action plan are not covered under the Bilateral Commission. This ambiguity belies the importance of the Bilateral Commission.

The Bilateral Commission is broken down into working groups, with various divisions of the Japanese government and the U.S. government responsible for their respective topics. The Civil Nuclear Energy R&D Group, Decommissioning and Environmental Working Group, Emergency Management Working Group, Nuclear Security Working Group, Safety and Regulatory Issues Group meet under the conditions set by the Bilateral Commission.

The Civil Nuclear Energy Research and Development Group, co-chaired by the U.S. Department of Energy and the Japan MEXT/METI, cooperate on furthering technology in the nuclear energy field. The Civil Nuclear Energy Research and Development Group cooperates on advanced Reactors, fuel Cycle Technologies, light-water reactor sustainability, safe and secure operations of existing plants, fuel cycle management, waste issues, and global deployment of new reactors. The Decommissioning and Environmental Working group is co-chaired by the U.S. Department of Defense/Environmental Protection Agency and the Japanese METI/Ministry of Energy. Bilateral cooperation focuses on facility decommissioning, spent fuel storage, and long-term consequence management. The Emergency Management Working Group is co-chaired by the American National Nuclear Security Administration and Japanese Cabinet Secretariat. The group works towards: emergency preparedness, emergency and crisis preparedness, search capabilities, and consequence management.

The Nuclear Security Working group is co-chaired by the U.S. National Security Staff and the Japanese Ministry of Foreign Affairs. Engagement in nonproliferation includes: physical protection, transportation security, safeguards implementation, nuclear security summits, and



road-map implementation. The Safety and Regulatory Issues Group is co-chaired by the U.S. Nuclear Regulatory Commission and the Japanese Cabinet Secretariat. The working groups cooperate on research of legal and regulatory frameworks, impact of radiation, safety culture, radiation protection, seismic safety and design, risk assessment, and emergency preparedness.

Working groups are in communication throughout the year, and an official bilateral annual conference is held as part of the Bilateral Commission. The next meeting will be in Washington, DC during the summer of 2013. The Ministry of Foreign Affairs of Japan and the Department of Energy in the U.S. coordinate the various working groups. The Bilateral Commission will operate through the exchange of scientific and engineering information, exchange of equipment, exchange of personnel for research and development, joint projects in experiments, and other yet-to-be-determined forms.<sup>140</sup>

### **The Closed Fuel Cycle Debate between the U.S. and Japan**

The 1988 Agreed Framework between the U.S. and Japan regarding civil nuclear energy allowed Japan to utilize commercial reprocessing towards a closed nuclear fuel cycle. Despite regional objections, the U.S. approved of the construction of a commercial reprocessing plant in Japan. The Japanese government's lack of success in developing reprocessing technology affects U.S. negotiations with other countries seeking commercial reprocessing.

Before the Fukushima crisis, the U.S. government took an accommodating approach to the domestic Japanese energy situation despite objections from South Korea and China. South Korea and China expressed concerns that Japan would produce a nuclear weapon as a result of the plutonium produced from reprocessing. To maintain regional stability, Japan attempted to ameliorate immediate nonproliferation concerns with a pledge in 1991 that would prevent accumulation of surplus plutonium.<sup>141</sup>

The Fukushima crisis and the shutdown of nuclear power plants across Japan shifted criticism from reprocessing and nonproliferation to the safety of the power plants. Cries from South Korea regarding the dangers associated with large-scale reprocessing quieted due to the more immediate crisis at hand. The apparent failures at the Rokkasho reprocessing facility did little to dissuade South Korea from lobbying for its own chance to reprocess and fabricate uranium and plutonium into MOX fuel. With the DPJ at the head of Japan in 2011, the shying away from nuclear energy meant a lower production of nuclear waste. Without nuclear energy, Japan would dispose of its plutonium stockpile, destroying South Korea's case for equal treatment under the U.S.-Republic of Korea Agreed Framework. Japan could no longer justify possessing plutonium as a nonnuclear weapon state if it abandoned nuclear energy.

On January 17, 2013 METI Minister Toshimitsu Motegi stated:

“Regarding the nuclear fuel cycle, the efficient use of uranium, minimizing the amount of high level waste and rendering high level waste less harmful has great significance.

---

<sup>140</sup> The Official Bilateral Agreement

<sup>141</sup> Federation of American Scientists, <http://www.fas.org/nuke/guide/japan/nuke/>

This will not be changed. The reprocessing plant and the storage facility, both in Aomori Prefecture, will continue to be built towards completion.”<sup>142</sup>

In an unprecedented reversal of support, during meetings with METI in the U.S. in April 2013, Acting Secretary of Energy Daniel Poneman expressed concern regarding the restart of the Rokkasho reprocessing facility in October 2013.<sup>143</sup><sup>144</sup> Despite the Bilateral Commission having a separate working group on nonproliferation issues, the U.S. is suspicious of the Japanese government’s ability to manage that facility, though the U.S. would never publicly express such concerns.

Poneman’s criticism of Rokkasho is legitimate in the context of regional relations and concerns of nonproliferation but also hurts the bilateral relationship between the U.S. and Japan. Fast breeder reactor technology, still nascent and not close to being commercialized, is only fathomable in a closed nuclear fuel cycle. Japan is willing to invest in this technology, apparent from the huge sums of money thrown into the dilapidated Monju reactor. The U.S. needs to look inward at the political debate regarding energy security and energy independence to understand the Japanese push towards fast breeder reactors that utilize MOX-fuel. Energy supply sustainability is a key concern for Japan. Japan’s queasiness regarding its reliance upon the tumultuous Middle East region echoes America’s preoccupation with its own energy concerns.

Furthering of fast breeder reactor technology could only serve both the U.S. and Japan’s interests in the context of long-term energy supply. The U.S. has chosen cheaper direct disposal over commercialized reprocessing in its domestic energy policy, but it gains valuable information from observing Japan’s experiment with reprocessing. The U.S. supplies 100% of Japan’s non-irradiated fuel elements and cartridges for nuclear reactors to Japan, an integral part of the bilateral relationship.

For the Bilateral Commission to succeed as a means of furthering cooperation between the U.S. and Japan while strengthening the overall alliance, an understanding of the energy requirements of both countries is important.

Japan’s susceptibility to supply chain disruptions in waters through which its ship pass, such as the South China Sea, as well as the high prices of LNG and oil, push it towards reprocessing and fast breeder reactors. These areas of cooperation are explicitly stated in the Bilateral Commission’s terms. This lack of mutual understanding defeats the purpose of the Bilateral Commission, both a symbolic and technical agreement to further civil nuclear energy.

### **The South Korea Factor**

The U.S.-ROK 123 Agreement of 1972 is the cooperative agreement between the U.S. and the South Korean equivalent to the 1968 and later 1988 Agreed Framework between the U.S. and Japan. Like Japan in the 1980s, South Korea is lobbying the U.S. government to allow for uranium enrichment and permission to recycle spent nuclear fuel through commercial

---

<sup>142</sup> METI provided document, Komoto Interview

<sup>143</sup> <http://online.wsj.com/article/SB10001424127887324582004578456943867189804.html>

<sup>144</sup> *ibid.*

reprocessing.<sup>145</sup><sup>146</sup> While the deadline for negotiations was pushed back from 2014 to 2016, the U.S. government is reluctant to extend the same privileges and rights to reprocess for South Korea as it did to Japan in the 1980s. The growing concern from the Obama administration regarding Japanese reprocessing portends poorly for South Korea. If Japan Nuclear Limited Fuels stabilizes the Rokkasho reprocessing facility, it will become more difficult for the U.S. to justify not allowing South Korea the right to enrich uranium and commercially reprocess.

Nonproliferation is a key concern for the United States in the South Korean case. Pooled plutonium amassed in large amounts in South Korea bodes poorly for regional stability. Today, direct disposal of spent fuel is cheaper than the construction of a reprocessing and MOX fuel fabrication plant. The push towards reprocessing by South Korea is viewed askance, as it was for Japan. Evident by the delay in a further 123 agreement with South Korea, the Obama administration is opposed to South Korean uranium enrichment and reprocessing for nonproliferation concerns. Japan as the only nation to have a nuclear weapon used against it understandably has concerns of nuclear weapon introduction as part of government policy. South Korea would not possess the same nuclear allergy, especially with the recent belligerence of its northern neighbors.

### **The Private Sector and Cooperation to Construct Reactors Abroad**

On May 3, 2013, METI Minister Yoshimitsu Motegi visited the U.S. to meet with the Department of Energy to urge exports of LNG from the U.S. to Japan. Minister Motegi's agenda also included discussion of U.S.-Japan cooperation in civil nuclear energy. In his speech at the Brookings Institution, Motegi emphasized of the importance of the bilateral relationship in government-to-government interaction and the economic opportunities available in other countries in the context of nuclear energy provision. Motegi spoke of the importance of the image of Japan's nuclear industry. According to Minister Motegi, Japan needs to exhibit the capability of producing safe and efficient nuclear power plants to restore its damaged reputation.

The Japan International Cooperation Agency (JICA) and U.S. Agency for International Development (USAID) negotiate with developing countries regarding the transfer of nuclear technology and the selling of power plants. Both the U.S. and Japan must have a nuclear arrangement with a country for an American or Japanese company to construct a power plant there. Nuclear energy will play a huge role in the developing world as fossil fuel prices increase and environmental concerns develop. The sale of nuclear reactors to other countries is a significant component of the civil nuclear relationship between the U.S. and Japan.

Japanese companies have significant stake in the domestic American nuclear market. In October 2006, Toshiba Group purchased a majority stake in Westinghouse, an American nuclear power company known for its AP1000 reactors.<sup>147</sup> The Toshiba Group already has participated in the construction of 112 nuclear reactors throughout the world.<sup>148</sup> In 2007, GE and Hitachi formed GE Hitachi Nuclear Energy. The Economic Simplified Boiling Reactor, an advanced design from the collaboration of the two companies, is under review by the U.S. Nuclear Regulatory

<sup>145</sup> [http://www.nytimes.com/2013/04/25/world/asia/south-korea-and-us-fail-to-reach-nuclear-energy-deal.html?\\_r=0](http://www.nytimes.com/2013/04/25/world/asia/south-korea-and-us-fail-to-reach-nuclear-energy-deal.html?_r=0)

<sup>146</sup> <http://csis.org/publication/us-and-south-korea-agree-extension-123-civil-nuclear-agreement>

<sup>147</sup> <http://www.bloomberg.com/news/2011-09-06/shaw-intends-to-exercise-put-options-to-sell-westinghouse-stake-to-toshiba.html>

<sup>148</sup> <http://www.toshiba.co.jp/env/en/energy/nuclear.htm>

Commission. In February 2012, the U.S. Nuclear Regulatory Commission approved the construction of two new Westinghouse AP1000 advanced boiling water reactors at the Vogtle nuclear station. For the first time since the Three Mile Island Crisis in 1979, the Nuclear Regulatory Commission approved a new nuclear reactor project in the United States. The Department of Energy provided \$8.3 billion in loan guarantees to Westinghouse. More AP1000 reactors for construction are under review in the U.S.<sup>149</sup>

The global success of the Westinghouse AP1000 benefits both the U.S. and Japan.<sup>150</sup> There are currently four AP1000 reactors under construction in China to begin operation in 2014 with four more planned for construction. Private investment in the nuclear industry in Japan will be difficult without public support for nuclear industry. The first approval of a nuclear reactor in the U.S. since the Three Mile Island Crisis bodes well for the nuclear industry in the U.S., a key component in the U.S.-Japan civil nuclear energy relationship.

### **Conclusion**

The Fukushima Daiichi Plant accident dramatically altered Japan's energy equation. The public's confidence was lost not only because of the government and TEPCO's lack of crisis management, but also from the revelations that have come afterward. The Japanese government's inability to regulate and oversee the nuclear industry eroded the perception of safety in nuclear energy generation. The recently created Nuclear Regulation Authority is the central government's attempt at regulation similar to the U.S.' Nuclear Regulatory Commission. As an independent body free from the hierarchical bureaucracy that had characterized the regulatory environment prior to Fukushima, the NRA over time has the potential to revive the Japanese public's confidence in the nuclear industry.

The U.S. assessment of the Fukushima crisis, despite a lack of direct input of information, was more precise than the Japanese Government's. The Kan Administration's insistence on independently handling the developing events at Fukushima following the tsunami prevented critical exchanges of information and logistics between the two governments. While Operation Tomodachi was a successful effort that strengthened the alliance and boosted the image of the U.S. and U.S. forces in Japanese eyes, the apparent lag in communication and cooperation over the Fukushima accident should not have happened.

Japan's status as the only country without nuclear weapons to engage in commercial reprocessing provides the U.S. with a unique asset. Despite the problems with the Monju fast breeder reactor and the Rokkasho reprocessing facility, America's future use of nuclear energy could one day rely upon a sustainable, closed fuel cycle. The technology that Japan develops could be transferred to U.S. power companies some day. The U.S. should ensure the Japanese government's right to maintain a closed nuclear fuel cycle with commercial reprocessing regardless of South Korea's push for commercialized reprocessing and uranium enrichment approval.

---

<sup>149</sup> <http://www.bloomberg.com/news/2011-09-06/shaw-intends-to-exercise-put-options-to-sell-westinghouse-stake-to-toshiba.html>

<sup>150</sup> The Implications of Fukushima for the US

Through the working groups of the U.S.-Japan Bilateral Commission on Civil Nuclear Cooperation, the two countries are committed to joint development of nuclear technology. The Bilateral Commission allows for smooth exchanges of personnel and technology. Consultations will create confidence and familiarity among nuclear experts of both countries, integral to a quick response and communication in the case of emergency. Security in the nuclear industry of Japan needs objective analysis, something the U.S. can provide.

Under Prime Minister Abe, the future of the nuclear industry seems a lot brighter than under his predecessor. Restarting idle plants are planned for the summer of 2016. In the meantime, Japan needs to start updating its energy infrastructure, upgrade old nuclear power plants to meet modern standards, and begin decommissioning nuclear power plants susceptible to earthquakes or tsunamis. The communication links between Japan and the U.S. during the Fukushima crisis revealed major areas for improvement, as does the ability for relevant agencies of the U.S. government to directly communicate with power companies with nuclear plants. The governments of Japan and the U.S. should start coordinating to make the adjustments needed to ensure the safety of nuclear power generation in both countries.

## References

- The World Nuclear Association (n.d.). *Nuclear Power in Japan | Japanese Nuclear Energy*. Retrieved from <http://world-nuclear.org/info/Country-Profiles/Countries-G-N/Japan/#.UYxkJitVQhc>
- Rokkasho n-fuel plant completion delayed. (2012, September 20). *The Daily Yomiuri*.
- The Pew Research Center (n.d.). *Japanese Wary of Nuclear Energy | Pew Global Attitudes Project*. Retrieved from <http://www.pewglobal.org/2012/06/05/japanese-wary-of-nuclear-energy/>
- The World Nuclear Association (n.d.). *Nuclear Power in the USA*. Retrieved from <http://www.world-nuclear.org/info/Country-Profiles/Countries-T-Z/USA--Nuclear-Power/#.UULi-FuWkhc>
- The U.S. Energy Information Administration (n.d.). *EIA's Energy in Brief: What is the status of the U.S. nuclear industry*. Retrieved from [http://www.eia.gov/energy\\_in\\_brief/article/nuclear\\_industry.cfm](http://www.eia.gov/energy_in_brief/article/nuclear_industry.cfm)
- Rascoe, A. (n.d.). *U.S. approves first new nuclear plant in a generation| Reuters*. Retrieved from <http://www.reuters.com/article/2012/02/09/us-usa-nuclear-nrc-idUSTRE8182J720120209>
- Nanto, D., Cooper, W., Donnelly, J., & Johnson, R. (2011, April 20). *Congressional Research Service*. Retrieved April 10, 2013
- The Gallup Organization (2012, March 26). *Americans Still Favor Nuclear Power a Year After Fukushima*. Retrieved April 5, 2013, from <http://www.gallup.com/poll/153452/americans-favor-nuclear-power-year-fukushima.aspx>
- Fackler, M. (2011, May 10). Japan's Leader Cancels Plan for New Nuclear Plants. *The New York Times*. Retrieved April 5, 2013, from [http://www.nytimes.com/2011/05/11/world/asia/11japan.html?\\_r=0](http://www.nytimes.com/2011/05/11/world/asia/11japan.html?_r=0)
- Fackler, M. (2013, April 29). Radioactive Water Imperils Fukushima Plant. *The New York Times*. Retrieved April 30, 2013, from <http://www.nytimes.com/2013/04/30/world/asia/radioactive-water-imperils-fukushima-plant.html>
- Nakano, J. (2012). Civilian Nuclear Energy Cooperation between the U.S. and Japan. In *The New Nuclear Agenda: Prospects for US-Japan Cooperation*. Washington, District of Columbia: Stimson Center.
- Sanger, D., Wald, M., & Tabuchi, H. (2011, March 17). Officials in Japan might understate nuclear crisis. *The New York Times* [New York]. Retrieved from <http://www.newsobserver.com/2011/03/17/1059140/japan-races-to-get-power-to-reactors.html>
- Aftergood, S., & Garbose, J. (n.d.). Nuclear Weapons Program - Japan. *The Federation of American Scientists*. Retrieved June 1, 2012, from <http://www.fas.org/nuke/guide/japan/nuke/>
- Choe, S. (2013, April 24). South Korea and U.S. Fail to Reach Deal on Nuclear Energy. *The New York Times* [New York]. Retrieved from [http://www.nytimes.com/2013/04/25/world/asia/south-korea-and-us-fail-to-reach-nuclear-energy-deal.html?\\_r=0](http://www.nytimes.com/2013/04/25/world/asia/south-korea-and-us-fail-to-reach-nuclear-energy-deal.html?_r=0)
- Solomon, J., & Inada, M. (2013, May 1). Japan's Nuclear Plan Unsettles U.S. *The Wall Street Journal* [New York]. Retrieved from <http://online.wsj.com/article/SB10001424127887324582004578456943867189804.html>

- Cha, V. (2013, April 24). *U.S and South Korea Agree to an Extension of the 123 Civil Nuclear Agreement* | Center for Strategic and International Studies. Retrieved May 5, 2013, from <http://csis.org/publication/us-and-south-korea-agree-extension-123-civil-nuclear-agreement>
- Parker, P. (2011). *The 2011 Import and Export Market for Non-Irradiated Fuel Elements and Cartridges for Nuclear Reactors in Japan*. The Icon Group.
- Akiyama, N., Sato, H., Naito, K., Naoi, Y., & Katsuta, T. (2012). *The Fukushima Nuclear Accident and Crisis Management: Lessons for Japan-U.S. Alliance Cooperation*. Retrieved from The Sasakawa Peace Foundation website:  
[http://www.spf.org/jpus/img/investigation/book\\_fukushima.pdf](http://www.spf.org/jpus/img/investigation/book_fukushima.pdf)
- Warnock, E. (2013, March 11). Fukushima Watch: Food Exports Still Restricted by Radiation Fears. *The Wall Street Journal* [New York]. Retrieved from <http://blogs.wsj.com/japanrealtime/2013/03/11/fukushima-watch-food-exports-still-restricted-by-radiation-fears/>
- “Japan Held Nuclear Data, Leaving Evacuees in Peril,” *New York Times*, August 8, 2011.  
[http://www.nytimes.com/2011/08/09/world/asia/09japan.html?\\_r=1&pagewanted=print](http://www.nytimes.com/2011/08/09/world/asia/09japan.html?_r=1&pagewanted=print).
- Willacy, M. (2013, February 19). Residents paying back Fukushima compensation. *ABC News*. Retrieved from <http://www.abc.net.au/news/2013-02-19/companies-not-paying-compensation-at-fukushima/4528150>
- World Nuclear News (2013, January 29). *Chinese AP1000 containment capped*. Retrieved May 10, 2013, from [http://www.world-nuclear-news.org/nn-chinese\\_ap1000\\_containment\\_capped-2901134.html](http://www.world-nuclear-news.org/nn-chinese_ap1000_containment_capped-2901134.html)
- Inajima, T., & Song, Y. (2012, November 7). Fukushima \$137 Billion Cost Has Tepco Seeking More Aid. *Bloomberg News*. Retrieved from <http://www.bloomberg.com/news/2012-11-07/fukushima-137-billion-cost-has-tepco-seeking-more-aid.html>

## Japan's Post-Fukushima Quest for Stable LNG Supply: America or Russia?

By Yuki Onogi

### Introduction

Japan's quest for energy supplies following the Fukushima nuclear accident is a story that is still unfolding. This paper attempts to shed light on how Japan is trying to corner supplies from Russia and the United States, focusing on the short- and medium-term LNG market.<sup>151</sup> It begins with a broad discussion of recent policy issues and then segues in to Japan's energy demand and imports before and after Fukushima as affected by shifts in political leadership from the Democratic Party of Japan (DPJ) to the Liberal Democratic Party (LDP). After examining the nature of the global gas market, the paper then focuses on the shale gas revolution in the U.S. and the legal and financial obstacles to U.S. exports of LNG to Japan. It then shifts to examining Russia's natural gas market and the challenges Japan faces in acquiring Russian LNG exports.

Japan faces a dilemma in relying on U.S. energy exports. Over the medium-term, Japan will likely be able to tap into the U.S' shale-gas market and receive much needed LNG exports. But over the short-term, the product is simply not available because the infrastructures, including LNG ports, have not been constructed. Over the long-term, other issues arise, such as possible legal constraints, opposition from energy self-sufficiency advocates, and high domestic energy demand. Russia, despite the political risk, could serve Japan well in terms of LNG trade in the short-term, mid-term and even long-term due to its high investment in energy development in the Far East. LNG from Australia and Canada over time will be competitive to that coming from the U.S. and Russia and these countries will increase LNG market shares in the Asia-Pacific region, pushing out Malaysia and Qatar. Though Indonesia has been a major LNG exporter, it will lose that position over the medium- to long-run due to increased domestic energy consumption.

Given that Japan has been the dominant player in Asia's LNG market, this paper advocates that Japan utilize its strong position for price negotiation as well as diversification in order to compete against emerging LNG importers, such as China.

### Energy Policy under the DPJ and LDP

After the Fukushima disaster, Prime Minister Naoto Kan announced that nuclear energy would be phased out in Japan and that renewable energy would rise from about 1% to 20% by 2020, mainly utilizing a feed-in-tariff scheme. His goal was ambitious but, at the same time, unattainable, most energy economists concluded. According to a scenario analysis by the Agency for Natural Resources and Energy (ANRE), renewable energy could account for 18-19% in every scenario. Though this percentage is close to the goal, it is still not 20%. Moreover, scenario analysis by Science Council of Japan predicted that investment in renewable energy, in any scenario between the immediate abolishment of nuclear energy to its promotion, would cost up

---

<sup>151</sup> This paper frequently uses the term, the short-run, medium-run and long-run. Though these words can be vague, the short-run refers to the period between now and approximately 5 years later. The medium-run means that between approximately 5 years and 10 years later, while the long-run refers to the period beyond 10 years later.



to 5 trillion yen per year. Since the Japanese Government has suffered from a serious fiscal deficit for over two decades, it would be extremely difficult to allocate such huge expenditures annually from the tax revenues of the Japanese citizens. In this regard, most critics of the policy immediately concluded that Kan never took the feasibility of his announcement into account.

After Kan's resignation in part for alleged mishandling the aftermath of the Fukushima accident, Yasuhiko Noda took over as prime minister. He also publicized his intentions to abolish nuclear energy in Japan by 2030, playing on the public's renewed nuclear allergy following the horrific nuclear scare. ANRE also publicized four choices for nuclear energy policy: (1) to eliminate nuclear power plants by 2030; (2) to reduce the proportion of nuclear energy and adjust it based on the result of renewable and nuclear energy output; (3) to reduce but keep a certain proportion of nuclear energy; and (4) to distribute social cost among consumers and allow them to choose the best option for electricity. Among the four choices for nuclear energy policy, Noda decided to choose the second. However, he never got around to taking action to implement this policy choice. And even though ANRE announced it would release the basic energy plan for Japan in the summer of 2012, it was never issued because of political instability, leading to the snap election in December and the DPJ's ignominious defeat, putting the LDP back in power. Internal conflict over major policies within the DPJ, stagnant economic growth, gridlock in the Diet due to political infighting, and Noda's allegedly failed diplomacy toward neighboring states caused voters to desert the DPJ in the mid-December election.

When the LDP came back into power in December under Prime Minister Shinzo Abe – back for a second time – the LDP government immediately set about updating the energy policy to reflect current realities and proclaimed the restoration of nuclear energy in Japan, based on strict safety standards. The Abe administration top priority has been to revive Japan's perennially ailing economy by a series of economic policy measures dubbed "Abenomics" that include setting a modest inflation target and increasing the money supply. Abe also intends to accelerate reconstruction of post-earthquake northern Japan which had also lagged under the Noda administration.

ANRE plans to publish the newest version of Japan's Energy Fundamental Plan in the summer of 2013. Even though the Abe administration intends to revive idle nuclear facilities to reduce Japan's dependency on fossil fuel imports, Japan over the short to medium term still has to import a large quantity of LNG from various countries to fill the nuclear energy gap. The Abe administration has been sensitive to political risk in choosing energy suppliers since the terrorist incident in Algeria in January 2013. A terrorist attack on an Algerian natural-gas site killed ten Japanese citizens and was one of the most lethal such incidents suffered by Japan in decades, intensifying calls to expand the country's security capabilities in case of terrorist or hostage situations overseas.

### **Japan's Energy Consumption before and after Fukushima**

Japan is currently the world's largest importer of LNG, second largest importer of coal and the third largest net importer of oil. It is also the world's fourth largest energy consumer. Since Japan contains little reserves of fossil fuels, it has to import a significant amount of natural resources from all over the world. Japan's total energy consumption in 2010 was 42% from oil, 22% from

coal, 18% from natural gas and 13% from nuclear energy. Autos and petrochemical production account for approximately 50% of Japan's oil consumption.

Japan has heavily relied on Persian Gulf states for its oil imports. Gulf States in 2009 accounted for 77% of Japan's oil imports. Austria has been the dominant coal supplier to Japan. While Japan's LNG imports are more diversified than the other fuels (Graph 2), Japan still has to rely on 100% energy imports to sustain its economic growth. In addition, now that climate change is of critical concern to the international community, Japan has had to change its energy security mix to include: (1) measures to reduce dependency on fossil fuel imports; (2) diversification of Japan's energy mix; and (3) reduction of CO<sub>2</sub> emissions to meet international commitments. The final goal seemed attainable until Fukushima, especially since nuclear energy does not release much CO<sub>2</sub> emissions. Japan's investment in nuclear energy made sense, until disaster struck at Fukushima.

However, the Fukushima disaster significantly changed Japan's perspective on nuclear energy. The disaster initially took out 22 gig watts (GW) of capacity (12 GW from nuclear energy; 8 GW from coal; 1 GW from gas; and 1 GW from oil). Since this disaster, the Agency for Natural Resources and Energy (ANRE) under the Ministry of Economic, Trade and Industry (METI) wrote scenarios for Japan's future energy with emphasis on investment in renewable energy. However, there is a time lag between the current situation and the goal, where renewable energy can replace nuclear energy and fossil fuels. Prior to the Fukushima disaster, nuclear energy, accounted for 30% of Japan's electricity. Since all, except two of Japan's nuclear reactors, had been offline by March 2012, the increase in gas and coal fired power generation will be the only solution to power shortages.

The increase in fossil fuel import can cause both economic and environmental harm to Japan. Japan's dependency on oil from the Persian Gulf increased from 77% in 2009 to 82% after Fukushima. This trend is also present in LNG trade (Graph 2 and 3). Japan's LNG import increased from 69.2 million tons in 2010 to 78.5 million tons in 2011, while Japan's expenditure for LNG increased from 3.5 trillion yen to 4.8 trillion yen in 2011. In other words, Japan in 2011 imported 13.5% more LNG than in 2010 and paid 37% higher than in 2010. Japan's LNG import price has risen consistently (Graph 3). Its price is higher than that of coal, even though ratio between the two has shrunk. Even though the coal price is relatively cheap, its CO<sub>2</sub> emissions are also high.

According to the Special Report on Renewable Energy Sources and Climate Change Mitigation, oil-based plants produce 510-1170 g CO<sub>2</sub> eq/kWh, while coal-based plants emit 675-1689 g CO<sub>2</sub> eq/kWh. Gas-based plants produce 290-930 g CO<sub>2</sub> eq/kWh. In other words, natural gas emits the least greenhouse gases among fossil fuels. In order to continue its commitment to green energy, Japan will have to continue LNG imports. Under such urgent circumstances, Japanese internal politics have changed its energy policy significantly. While Japan has diversified LNG exporters fairly efficiently, there are two LNG suppliers that will be critical to Japan's energy security strategy: the U.S. and Russia. The next section highlights fundamental features of global gas market.

## **World Gas Market**

The world gas market is more geographically and geopolitically fixed than global oil market due to geological characteristics of natural gas. Unlike crude oil, natural gas is not liquid or a solidified substance. As a result, though it is also possible to transport natural gas through pipelines, shipment requires liquefaction and re-gasification. Liquefaction means to cool natural gas to  $-162\text{ }^{\circ}\text{C}$  ( $-260\text{ }^{\circ}\text{F}$ ) and to turn it into liquefied natural gas (LNG). Both extensive investment and installment of infrastructure are necessary for such processes. Plants for liquefied natural gas (LNG) tend to be site-specific and can range from \$100 million to more than \$2 billion to build the plants. Because of this relatively high fixed cost, gas market has faced issues related to allocation around the globe. Even though the high fixed cost has declined gradually, the high cost still discourages investment in LNG plants.

In fact, the quantity of natural gas traded internationally in 2009 accounted for only 30%, whereas that of oil was approximately 67%. There are only 18 LNG exporters in the world with approximately 100 re-gasification plants. The other 70% of natural gas was traded through pipelines, thus on a regional basis. In order to overcome geographic constraints, countries like the U.S., Russia and Canada have invested in LNG plants.

While these geographic constraints prevent the emergence of a global natural gas market, these issues also cause different regions to use different pricing methods. These regions include North America, Asia and Europe. The European market is the most complicated of the three regions for its domestic production and allocation through both LNG ports and pipelines from Russia, North Africa and beyond. The liberalization of the market had built spot markets in northwest Europe, such as the United Kingdom, Belgium and the Netherlands. Although Continental Europe bases its price on oil-indexation, Britain exceptionally applies market competition. The most referenced price in this market is the UK National Balancing Point (NBP).

The U.S. market prefers gas-to-gas market competition. The gas price in the U.S. is generally based on Henry Hub and its spot market. Due to its high liquidity in the market, Henry Hub has been used frequently in the Western Hemisphere. Since LNG is an added-value product of natural gas, most LNG sales in North America have to be linked to Henry Hub prices. Given this market structure, it is likely that the U.S. will link its LNG exports to Henry Hub prices.

The Asian market has oil-indexation. Since Japan is the most dominant LNG importer and imports 50% of Asia's LNG, those prices are linked to the Japan Custom Cleared price (JCC), the average price of crude oil imported into Japan monthly published by the Ministry of Finance. While overall market price can be influenced not only by the index price, but also by transportation costs and storage costs, the massive difference in pricing between North America and the Asia-Pacific has been the driving force for the U.S. and Canada to export LNG. The price in Asia is much higher than that in North America (Graph 4). It is also worth noting that the aforementioned fact about the Asian LNG market indicates that Japan is the hegemon of LNG trade in the Asia-Pacific and needs to utilize this position for price negotiation.

## **The United States and Its Domestic Affairs**

The U.S. will be ready to export LNG to Japan in the medium-term, but not in the short-term. Over the long-term, LNG exports may encounter opposition if legal constraints are imposed by

the Department of Energy (DOE) or if high domestic energy demand reduce the surplus gas available. At this juncture, however, DOE has given Japan a waiver to allow future exports of LNG to that country. And Japan once it is formally in the TPP will be eligible for LNG purchases without a waiver. So the long-term outlook for Japan may now be less foreboding than before.

### **Shale Gas Revolution**

The U.S. is the second largest energy consumer on earth. Despite its richness in natural resources, the U.S. consumes much more oil than it produces. As a result, the U.S. has been an oil importer since the late 1940s. Its richness in natural gas also slowed its investment in unconventional gas until the late 2000s even though the Section 29 Tax Credit provided a substantial tax credit for unconventional gas resources. The Natural Gas Policy Act (NGPA) and the Fuel Use Act in 1978 caused a substantial supply surplus along with low natural gas prices until around 2000. During this period of the so-called “Gas Bubble,” conventional gas production was dominant and discouraged the development of unconventional gas. While conventional gas played a pivotal role in the U.S. energy market, unconventional gas productive capacity grew steadily. The capacity increased from 50 billion m<sup>3</sup> in 1990 to 140 billion m<sup>3</sup> in 2000.

Since the early 2000s, the Gas Bubble faded away due to the decline of conventional gas production and the increase in natural gas consumption. Moreover, the U.S. installed more than 200 GW of new gas plant capacity with the assumption of continuing low gas price. Despite the continuing decline of conventional gas production in the early 2000s, the U.S. found a new method of drilling multiple wells from a single site. This method reduced both cost and environmental harm simultaneously and caused a substantial increase in U.S. production capacity in 2007. The main shale gas reserve includes Marcellus, Lower Huron, Haynesville, Barnett, Woodford and Fayetteville in the U.S. as well as Montney-Doig in Canada (Map 1).

This development also caused not only a substantial increase in gas production but also the shale gas price to be cheaper than that of conventional gas. The U.S. is no longer expected to import LNG to any substantial amount. The U.S. is on the threshold of being an LNG exporter, and Japan will be one of its first customers. The U.S. is planning to build 14 LNG plants (Map 2). How difficult will it be for the U.S. to export LNG to Japan? If so, how economically feasible would it be for Japan to import U.S. LNG? The next section discusses these challenges.

### **Challenges Facing the U.S.**

In order to extract and liquefy unconventional gas as LNG, the U.S. has encountered geological, demographic, legal and financial challenges. While the U.S. has gained this technology, it has not been fully aware of the location of reserves, their possible production capacity, and extracting costs. Some of the reserves can be located far away from present infrastructure, such as via pipelines. In this situation, firms have to build infrastructure to connect upstream and downstream. Some of these also reserves can be located near residential areas with high population density. In this case, firms have to obtain permission for extraction and installment of infrastructure by negotiating with residents and local authority. In addition, gas extraction can pollute the area around the drilling site and beyond with sulfur. Gas extraction can create a large

numbers of wells and require a large amount of water. Firms also have to acquire permission for such projects.

The U.S. is also confronted with the huge costs of installing LNG liquefaction plants for export. Since the U.S. has never exported natural gas abroad, no such plants exist; there are only re-gasification plants for LNG imports. Moreover, the aforementioned shale gas reserves are not located on the West Coast. Most of them are on the East Coast and in the Mid-West. Pipelines will have to be built to connect shale gas produced at the reserves and LNG liquefaction plants on the West Coast. It is also necessary to build LNG cargo ships to cross the Asia-Pacific. Given such financial constraints, investors have to plan their constructions carefully. Japanese investors are already hard at work, however, to finance LNG plant construction.

In terms of the actual price, shale gas in the U.S. costs approximately 3 dollars per BTU. This price is nearly 20% of the LNG price that Japan now pays from other sources. According to the Development Bank of Japan (DBJ), if development and trade of shale gas in the U.S. influences contracts with foreign firms positively, the gas price will experience the maximum of 15.2% decline in LNG price in Japan in 2020. This price change can also lower electricity prices in Japan. There is also risk of price increase due to eventual decrease in investment. In other words, though risk certainly exists in investment in shale gas and LNG export, Japan considers this investment worth an attempt. For this reason, Japanese firms already have begun investing in LNG trade. Mitsubishi and Mitsui plan to export 12 million tons of LNG annually from Cameron, Louisiana from 2017. Chubu Electric Power (CEPCO) and Osaka Gas also attempt to export 5 million tons annually from Free Port, Texas from 2017, while Sumitomo and Tokyo Gas plan to export 13 million tons annually from Cove Point, Maryland.

In addition to the aforementioned constraints, the U.S. Congress is on record of not being in favor of LNG exports, mainly because it would like to keep the gas price in the U.S. domestic market low. In terms of U.S. domestic demand, even though the U.S. energy consumption growth rate is projected to be smaller than that between 1950 and 2000 due to energy efficiency, its consumption is still projected to increase. In other words, the U.S. still has to sustain its high domestic needs while exporting its gas to Japan and other states. The new LNG export can undermine the intentions of the Congress. The fact that the current U.S. restriction on LNG exports is a violation of WTO rules, even though such exports could increase trade balances as well as employment in the U.S., makes no difference to lawmakers with a different agenda.

### **U.S.-Japan Trade and Its Constraints**

Despite its gigantic market, the U.S. has suffered from a chronic trade deficit. The U.S. also has had trade deficit with Japan for decades. Given the situation, one of the priorities in U.S. trade policy is to reduce that imbalance. Although the U.S. economy used to rely on raw material imports and value-added goods as exports, the U.S. now can export such raw materials as shale oil and gas. By exporting shale gas as LNG, the U.S. can reduce its trade deficit with Japan.

### **Russia as an Energy Superpower?**

Even though Russia has the reputation of being is an unreliable energy supplier, due to its disruption of gas shipments to the Ukraine in 2005-2006 and 2008-2009, in the Russian Far East, there is a different perspective. Russia's extensive investment in that region and its richness in

natural resources have attracted serious attention in Japan. Russia is ready to meet Japan's increased LNG demand not only in the short-run but also over the medium-to long-run as well. As long as Japan is financially capable of paying the spot price to Russia, Japan will not suffer from the economic harm that Ukraine and its neighboring states experienced after the famous dispute over gas prices. Until the U.S. presented itself on the horizon as another major supplier of LNG, Russia was starting to be seen as the supplier of choice for energy-hungry China, energy-lacking Japan, and energy-seeking Republic of Korea. This section initially discusses Foreign Direct Investment (FDI) in Russia. It later discusses gas prices in both Asia and Europe as well as investment in natural gas and LNG in Russia. At the end, this section discusses the Gas Exporting Country Forum (GECF) and the impact of shale gas to Russia.

### **Difficulty in Foreign Direct Investment (FDI)**

Russia has been well-known for its richness in natural resources and possessed approximately 33% of the natural gas reserves around the globe, at least until the Shale Gas Revolution. This geological fortune had given Russia leverage over other entities, such as the Ukraine. For instance, negotiations in 2005 over gas prices for 2006 between Russia and Ukraine led to a gas shortage in Europe. Russia also stopped its gas supply to Ukraine and other consumers in 2009 due to that country's failure to reach an agreement on gas prices and supplies. Even though Russia may be antagonized for suspending its supplies to Ukraine, the EU and their neighbors, Russia did so not only to display its political bargaining power. Ukraine at the time simply could not afford to pay the European market price.

In this regard, as long as Japan pays the requested price, Russia will not suspend its shipments of LNG to it. It is simply a cold business arrangement. In addition, Japan's LNG mix is fairly diversified. Even if Russia should suspend LNG shipments to Japan, it can still import enough from other suppliers, such as Qatar. In this regard, Japan will not suffer the same consequences that the Ukraine experienced in 2009. Given that fact, Russia uses its fossil fuels as leverage, and in order to protect that leverage, it has been extremely strict about allowing foreign investment in its oil and gas reserves.

Even though Russia lacks the technology to extract and refine fossil fuels, it still restricts operations by foreign firms. For instance, the Russian government protected its interests over the Sakhalin by suspending the Sakhalin-II project by Shell, Mitsubishi and Mitsui in 2006, charging them with environmental harm. This suspension forced Shell to invite Gazprom to become a partner, offering 50% equity of the project to it in December 2006. Mitsui and Mitsubishi also had to go along with Moscow and accept Gazprom as a partner. Shell saw its share drop from 55% to 27.5%, while Mitsui dropped from 25% to 12.5%; Mitsubishi went from 20% to 10%. Despite the actual cost of \$10-11 billion (50% of the entire \$20-22 billion project), Gazprom paid out only \$7.45-8.45 billion. As a result, Russia secured gas reserves in the Sakhalin. While Gazprom gained greatly, Shell, Mitsubishi and Mitsui had to share the burden of the remaining \$2.55- 3.55 billion. Under a 20-year bilateral contract, Japan imports 65% of natural gas from this project. In this regard, Russia is a challenging, cold-headed business partner for Japan.

### **Russia's Price Controls in Asian and European Markets**

Prior to 2009, Russian gas prices in the European market used to be higher than those in the Asian market. This price difference was present partially due to Soviet market tradition focusing

on the European gas market. However, the emergence of new petro-states in Eurasia, issues related to price negotiation with Ukraine, and the rise of energy demand in Northeast Asia reversed the price situation in the two markets after 2009 (Graph 4). Russia and its clients have negotiated over price unification. Although there has been no concrete outcome from these negotiations, Russia broke with its practice in 2011 by bringing down its natural gas offer to the Chinese in order to break a stalemate in negotiations for a 30-year export contract.

The price differential issue and Russia's stickiness is still relevant in Japan's energy trade with Russia. The price of LNG in the Asian market is combined with liquefaction costs and off-shore transportation costs. Russia plans to build pipelines and LNG plants in the Far East and elsewhere to strengthen its trade with Northeast Asia. This investment will affect gas prices in the Asian market in the near future.

### **LNG Plants and Trade in Russia**

Due to its massive energy development projects in the Far East, Russia will continue to increase its LNG exports to Japan, contributing to Japan's energy security. The investment dialogue extends back to Prime Minister Junichiro Koizumi's administration in the early 2002s. At the time, however, China was also competing for the same energy resources, and ultimately won out in the first round. Japan planned to build a 4,130 kilometer oil pipeline from Taishet in eastern Siberia to Nakhodka, a port city on Russia's Pacific coast across from Hokkaido. This pipeline was supposed to export 80 million tons of crude oil every year from Siberia to Japan. It would bypass China. Prime Minister Koizumi, in approving this project in 2003, promised that Japan would invest \$14 billion in the pipeline and \$8 billion in other fossil fuel-related projects in Russia. Since Japan consumed an estimated 4.5 million barrels per day (bbl/d) of oil in 2011, this pipeline could sustain Japan's oil demand for approximately 17-18 days per year or 4.87% of Japan's annual oil demand.

At that point, geopolitics came on the scene. Such bilateral cooperation was of great concern to China, which also wanted some of that oil. Although Moscow wanted the large capital investment from Japan, it also did not want to harm close political ties with China at the time. China, its high economic growth requiring increased supplies of energy, China competed vigorously against Japan and in 2005, won the oil pipeline contract with Russia. The oil would flow to China instead. The pipeline, running between Siberia and the northeastern Chinese city of Daqing, opened in 2011, allowing allow a rapid increase in oil exports between the two countries, previously shipped by rail.

Even though Japan never built that oil pipeline from Russia, it has since negotiated with Russia to build a natural gas pipeline to Japan. The two countries have discussed the possibility of increasing LNG supplies from Sakhalin and constructing a new LNG plant in Vladivostok. Russia now plans to build the Yakutia–Khabarovsk–Vladivostok pipeline to connect the Chayanda oil and gas field in Yakutia with Vladivostok with the investment of approximately 770 billion rubles. Russia also plans to connect Sakhalin and Vladivostok through the Sakhalin–Khabarovsk–Vladivostok pipeline. This pipeline is expected to carry 100 million cubic meters (m<sup>3</sup>) of gas a day (36.5bn a year). These two pipelines are expected to supply natural gas to Vladivostok, where Gazprom can liquefy it and ship LNG to the Asia-Pacific (Map 3).

In addition, Russia plans to start shipping along the Northern Sea Route, a shipping lane connecting the Atlantic Ocean to the Pacific Ocean. Until recent years, the entire route was frozen most of the year due to harsh cold weather in the North Sea. It was formerly impossible for Russia and other countries to ship goods through this route, but climate change has increased the temperature of the North Sea, and the Northeast Passage for most of the year is free of clogging ice. Shipping has begun in earnest.

Recently Gazprom has collaborate with Novatek, an independent gas producer, to install an LNG plant on the Yamal Peninsula of Siberia, the largest gas reserve on earth with nearly 38 trillion m<sup>3</sup> of natural gas. The capacity of this LNG facility is 16.5 million tons, and the project is in partnership with French multinational Total. Russia intends to export LNG from this facility to Northeast Asia including Japan.

Given Japan's urgent for new supplies of LNG, the Abe administration has embarked on a new diplomatic initiative toward Russia to foster more cordial and cooperative bilateral relations, which had been strained during the previous DPJ governments. In April, Prime Minister Abe and President Putin in a summit meeting discussed such bilateral issues as tackling the settlement of the northern islands territorial dispute and concluding a peace treaty. But at the top of the agenda was Japan's energy security.

Japan already has joint natural gas projects with Russia on Sakhalin Island to the north and in the Russian Far East, and is keen to expand such projects. In March 2013, Japan's Marubeni Corp signed a framework agreement with Russia's oil giant Rosneft to build a liquefied natural gas plant in the Russian Far East. And Russia's Gazprom had earlier that year announced talks with Japan about a project to build a new plant in the Russian city of Vladivostok. Increased Japanese demand could not have come at a better time for Russia. Huge supplies of shale gas from the U.S. have reduced demand for Russian gas exports, putting pressure on companies like Gazprom to find new customers.

The summit statement noted that Japan and Russia intend to "expand energy cooperation in the areas of oil and gas, under mutually beneficial conditions, including the provision of energy at competitive prices." For Japan, the meeting was an additional step toward diversification of LNG suppliers, and for Russia, an enhancement of its petro-power role in the Far East.

### **Gas Exporting Countries Forum (GECF) and Shale Gas**

Utilizing its gas reserves as leverage, Russia is organizing the Gas Exporting Countries Forum (GECF), an intergovernmental organization of 11 members controlling over 70% of the world's natural gas reserves, 38% of the pipeline trade and 85% of the LNG production. According to GECF's official website, the object of this forum is:

"To support the sovereign rights of member countries over their natural gas resources and their abilities to independently plan and manage the sustainable, efficient and environmentally conscious development, use and conservation of natural gas resources for the benefit of their peoples."

Given its control over the upstream and downstream of natural gas around the globe, it is appropriate to call GECF a Gas OPEC. Since Russia controls nearly half of the entire gas reserve



within GECF member states, it will have great influence in both the GECF and the global gas market.

But the technological innovation of shale gas drilling and fracking is taking away this leverage. Russia has had to rely on foreign firms, such as Exxon Mobile, to extract its own shale gas in Siberia, while the U.S. has invested in LNG facilities in Russia to export LNG. Japan, too, has a role to play in such investments.

### **Other LNG Trade with Japan**

While this paper has covered the U.S., the rising player in LNG, and Russia, Japan's neighboring exporter, these two are not the only main LNG exporters to Japan. Qatar, Australia, Malaysia and Indonesia also play important roles in supplying Japan with LNG. Canada has to be included as a future LNG supplier since the country, too, has experienced its own gas and oil revolution. This section briefly addresses these countries as compared to the U.S. and Russia as LNG suppliers. While Australia and Canada will rise in the Asia-Pacific LNG market in the medium- and long-term, Malaysia and Qatar will partially lose their market shares due to the rise of new competitors. Indonesia will recede over time as an LNG competitor due to its high domestic energy consumption.

### **Australia**

Over the long run, Australia will rise to become a main LNG exporter to Japan. Australia is one of the few members in the Organization for Economic Cooperation and Development (OECD) with the ability to export large amounts of fossil fuels. Australia was the world's fourth largest exporter of liquefied natural gas (LNG) in 2010, after Qatar, Indonesia, and Malaysia. In 2009, Australia shipped 11.9 million tons or 66% of its LNG exports to Japan. It is rapidly becoming an LNG competitor due to large gas reserves. Australia is expected to reach 76 m<sup>3</sup> LNG capacity and become the second largest LNG exporter after Qatar. Give its growth in LNG capacity, Australia is expected to become the second Qatar. In addition, the country enjoys political and economy stability to attract investment in its resource development. Since Australia is also geographically close to Northeast Asia and has served as a dominant coal supplier to Japan, Australia will be a strong LNG competitor in the Asia-Pacific in the near future.

Japan has started its own Hinomaru (national) project in Australia to produce conventional gas that will be in large part shipped to Japan as LNG. To launch the massive project, the Japan Bank for International Cooperation (JBIC; Governor: Hiroshi Okuda) signed on December 18, 2012, a loan agreement totaling up to 5 billion U.S. dollars (JBIC portion) with Ichthys LNG Pty Ltd (Ichthys LNG) in Australia. This is JBIC's largest loan (in U.S. dollars) for a single project.

In this Project, INPEX Corporation, TOTAL S.A., a French company, Osaka Gas Co., Ltd., Tokyo Gas Co., Ltd., TOHO GAS Co., Ltd. and Chubu Electric Power Co., Inc., all of which have indirect equity stakes in Ichthys LNG, will develop the Ichthys Gas and Condensate Field off the northwest coast of Western Australia; transport the produced gas through subsea gas pipelines to the onshore liquefaction plant to be built in Darwin, Northern Territory; and produce and sell LNG (annual production capacity: 8.4 million tons), liquefied petroleum gas (LPG), and condensate through Ichthys LNG. This loan is intended to finance the development of the gas

and condensate field and production of LNG and other petroleum products in this project.

This is the first project for INPEX as a state-run Japanese company to operate the complete process of the project: from development of the gas and condensate field to production of LNG and other petroleum products. INPEX and Japanese power and gas companies have approximately 70% interests in the project and are expected to take delivery of about 70% of LNG produced (about 5.67 million tons per year).

The \$34 billion project will bring gas from the Ichthys gas field off the coast of Western Australia for processing at a plant built in Darwin. Senior Trade Vice Minister Matsushita stated, “LNG procurement is becoming increasingly important. Once production starts at the Ichthys Project, close to 10% of Japan’s LNG demand is to be supplied from the project over the long term. It is therefore a significant project which is indispensable in securing a stable supply of energy for Japan.”

### **Canada**

Along with Australia, Canada will become a strong LNG competitor in the Asia-Pacific due to Shale Oil/Gas revolution. Canada holds unconventional gas deposits in Alberta and British Columbia. Canada has been the largest energy exporter to the U.S., supplying natural resources to the U.S. through pipelines. Coinciding with U.S. plans to export its LNG to the Asia-Pacific, Canada also plans the same and has attracted investors from other countries, such as Japan and Korea. There is, however, an internal debate over the environmental harm done by the construction of a pipeline across pristine wilderness and the extraction of shale gas and oil. The public’s desire for the additional jobs and economic benefits may not be enough to overcome the environmental issue. Canada's westernmost British Columbia province on Friday rejected a proposed pipeline to move crude from the oil sands of Alberta province to the Pacific coast, citing environmental concerns.

Moreover, Canada’s projects to develop gas pipelines and other infrastructure will have to traverse long stretches of wilderness, meaning that construction will take longer with high capital expenditure. Facilities to make LNG and export the product will have to be built from scratch. It is likely that Canada will become and play a role as a large LNG exporter in the Asia-Pacific but only over the medium to long run.

### **Indonesia**

Indonesia will lose its leverage as an LNG exporter over the long-run due to rising domestic energy needs. The country, as of January 2012, contained 141 trillion cubic feet of proven natural gas reserves, held the 14th largest proven natural gas reserves in the world, and the third largest in the Asia-Pacific region. In terms of LNG exports, Indonesia was the second largest supplier after Qatar in 2009. Japan imported 54% of Indonesia’s LNG in 2010. But Indonesia’s LNG exports have shrunk over time. Malaysia, *de facto*, surpassed Indonesia in 2011 and became the third largest exporter. Indonesia’s economic growth has caused a significant growth in energy demand; GDP growth from 2003 to 2011 averaged 5.62%. While Indonesia was initially an oil exporter, it has begun importing the commodity since 2004.

This shift in energy security applies also to natural gas production and LNG export. The government intends to construct new LNG receiving terminals and pipelines to sustain domestic

demand. Over the long run, Indonesia will cease to play a major role in LNG trade in the Asia-Pacific. This outlook indeed has forced Japan to look elsewhere for long-term supply needs.

### **Malaysia**

Malaysia will hold its ground in the future as a competitive LNG exporter to Japan. It was the third largest LNG exporter to Japan after Qatar and Indonesia in 2009. Malaysia holds 83 trillion cubic feet of proven natural gas or the fourth largest natural gas reserves in the Asia-Pacific region. Most of the country's natural gas reserves are in its eastern areas. In 2010, Malaysia exported over 1 trillion cubic feet of LNG or 10 % of total world LNG exports. Malaysia roughly exports 65% of its gas to Japan annually. With GDP growth now recovered since the Asian Financial Crisis, Malaysia, unlike other resource-rich states, has not been under the effect of Dutch disease -- the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector: 58.5% of its GDP in 2006 came from services.

Malaysia has experienced high economic growth for a decade, and its production and consumption in natural gas has been enormous. Malaysia plans to increase its gas/oil production capacity by 5% annually until 2020 to sustain both domestic energy demand and its exports to foreign markets. In other words, Malaysia will stay as a dominant LNG exporter around the globe for the long-run.

### **Qatar**

Qatar will experience a relative decline in its position as a major supplier to the Asia-Pacific LNG market due to the rise of new competitors, such as Australia, Canada and the U.S. For decades, though, energy exports have accounted for the country's high economic growth. The economy, though, lacks diversification and can be influenced easily from the spot price of natural gas and demand from foreign countries, such as Japan. Although Japan has been one of the largest LNG traders to Qatar (the fourth largest in 2010 with approximately 10 billion m<sup>3</sup> per year), Japan has negotiated with the U.S. to export cheaper LNG to Japan. In addition, Australia and Canada will do the same for Japan eventually. Some fear that over time, the country's overdependence on one set of products and eventual decline in competitiveness may bring about social instability and increase the political risk in Qatar.

### **Conclusion**

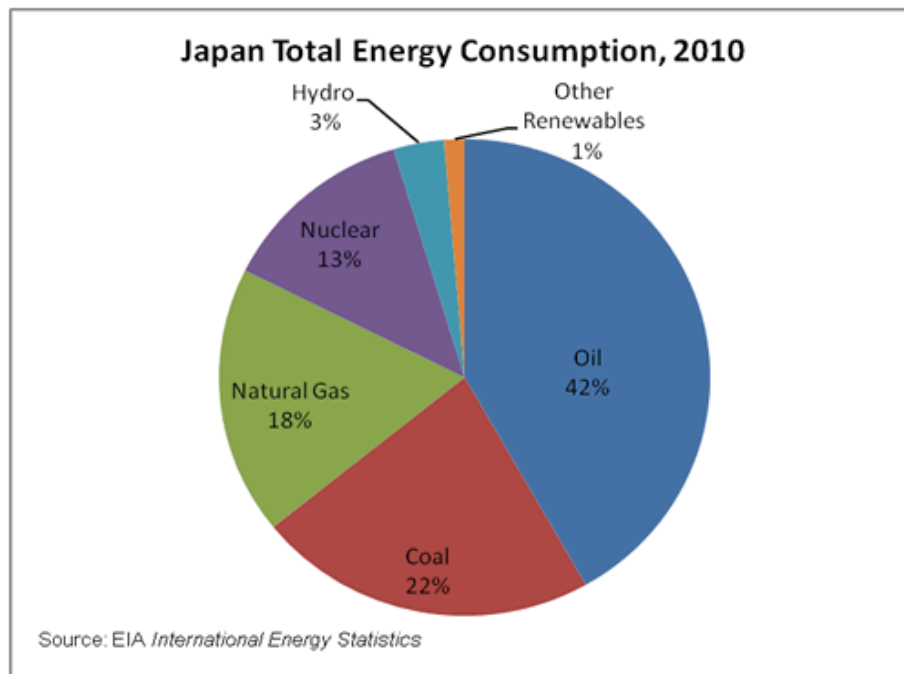
The U.S. is likely to become the LNG supplier of choice to Japan over time, but extensive investment in infrastructure related to LNG must be carried out first. Japan already has received a waiver from DOE to obtain LNG shipments, and its membership in the TPP will ensure it of continued shipments in the future to satisfy its tremendous energy demand that no longer can include significant nuclear energy supply. Significant Japanese investment in the LNG supply chain is also necessary. The U.S. will begin to export LNG to Japan in the medium-term. Over the long-term, however, the outlook could be clouded by moves inside the U.S. for energy independence or energy protectionism, which would mean curtailing energy exports.

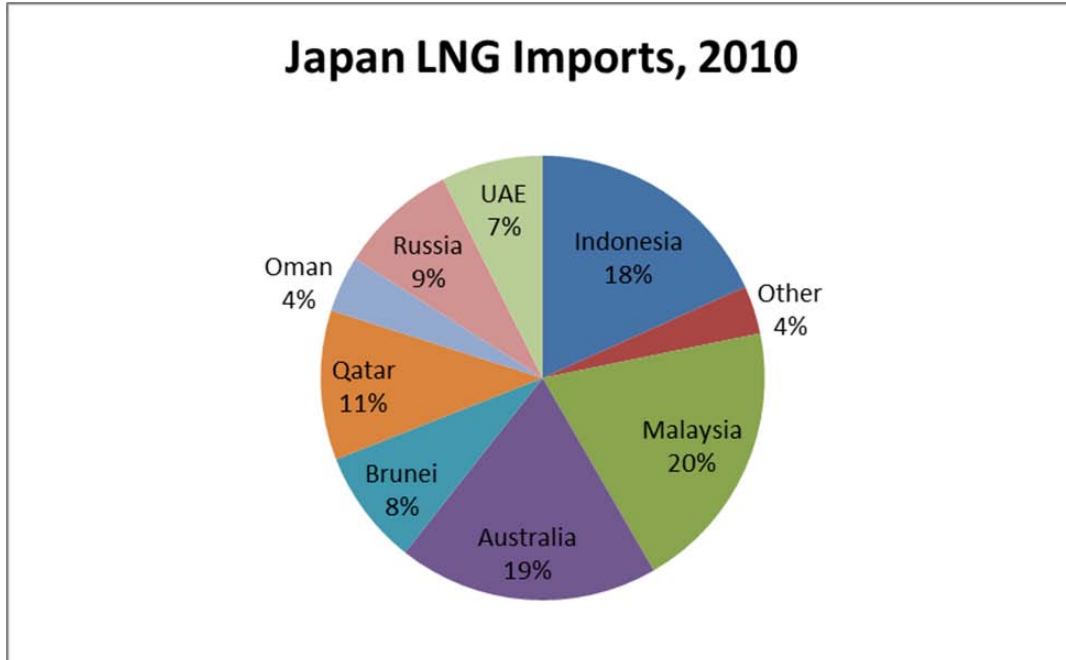
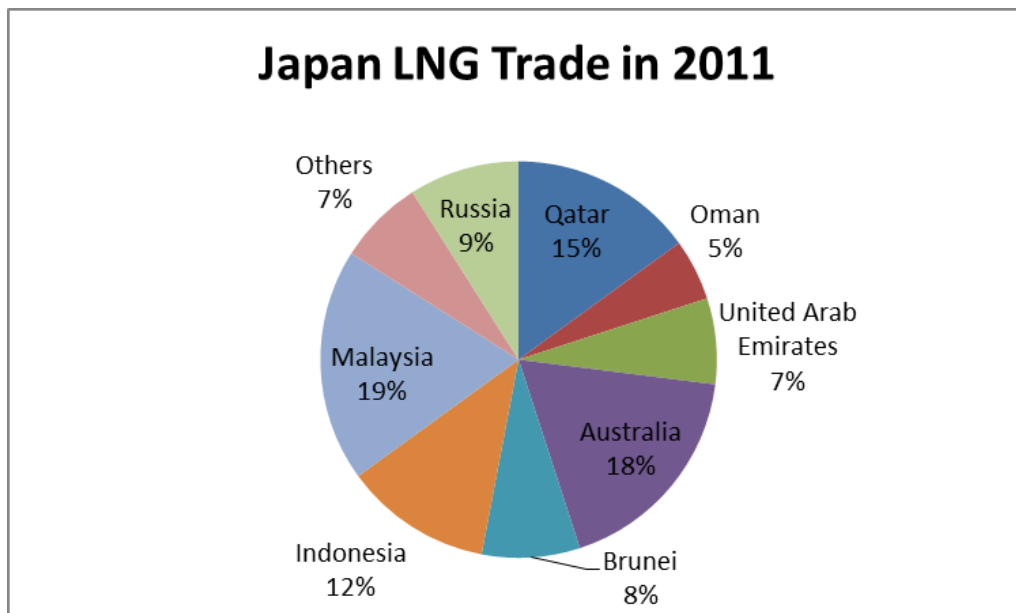
Russia is likely to become a good second-tier supplier of LNG to Japan, despite its reputation as an unreliable partner due to its previous gas disputes with the Ukraine. It could serve Japan well in terms of LNG trade from now to the foreseeable future due to its significant investment in the

Far East. Australia and Canada, however, will compete as LNG suppliers against the U.S. and Russia and increase market shares in the Asia-Pacific region over the medium to long term. Malaysia and Qatar will lose some of their market shares due to the rise of new players. Though Indonesia has been a main LNG exporter to Japan, it will lose its position over the medium to long run due to high domestic energy consumption.

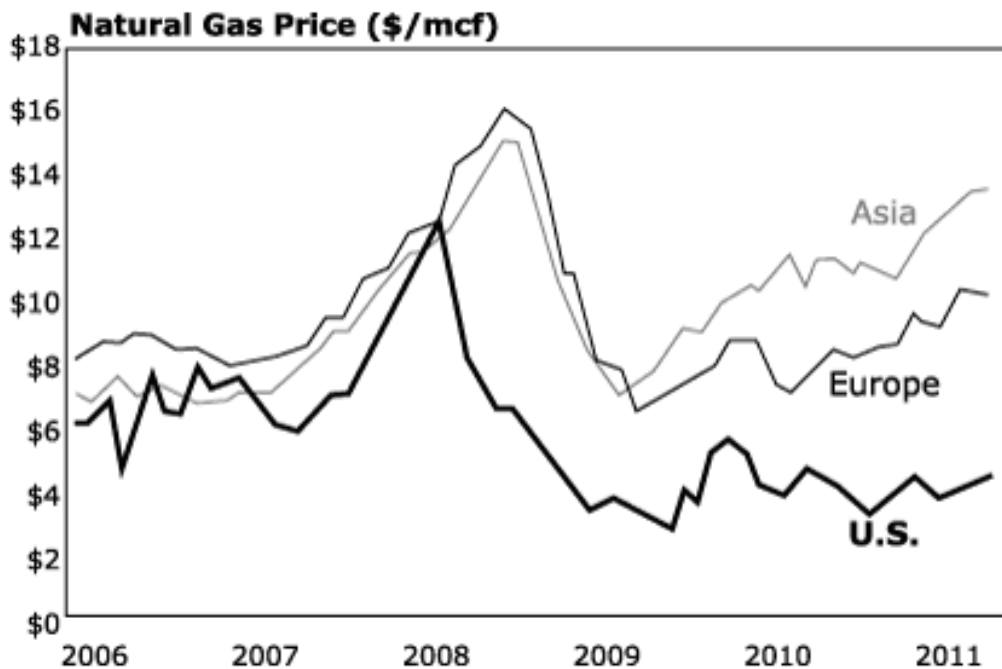
While diversifying LNG suppliers, Japan can maximize this position in negotiating price and terms in the Asian market. It may not be able to keep this advantage of being almost the only receiver of supply over the long-run due to the rise of energy demand in China, South Korea, Taiwan and others in the Asia-Pacific region. Since resources will become scarce under such pressure, suppliers have to keep up volume in shipments to consumers. Future competition for supplies of LNG will lead to price volatility. Japan must factor in such a reality in negotiating prices for the LNG and by further diversification.

**Graph 1: Japan's Total Energy Consumption in 2010**



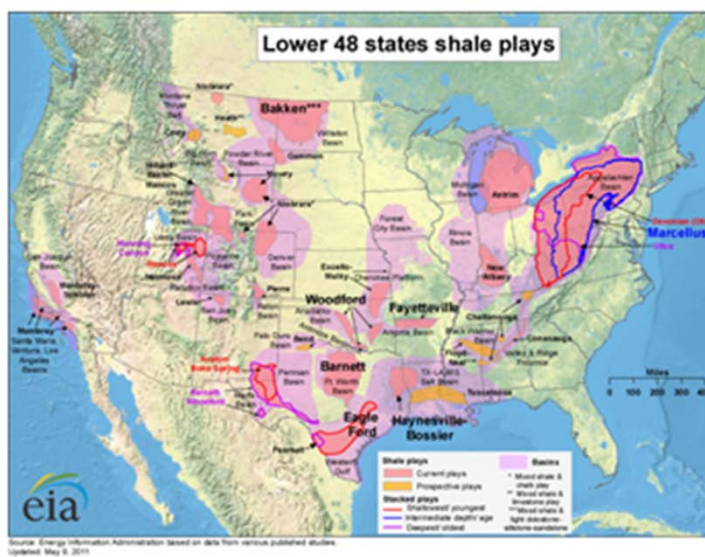
**Graph 2: Japan LNG Import (2010)****Graph 3: Japan LNG Import after Fukushima (2011)**

Graph 4: Gas Prices in the U.S., Europe and Asia



Map 1: Shale Gas in North America

US shale gas and shale oil plays



Source: EIA, <http://www.eia.gov/analysis/studies/usshalegas/>

Map 2: Proposed LNG Plants in the U.S.



Map 3: Planned Pipelines in the Far East



## References

- “Abe, Putin Agree to Revive Isle Talks.” *The Japan Times*. April 29, 2013  
<http://www.japantimes.co.jp/news/2013/04/29/national/abe-looking-to-revive-talks-on-russia-isle-row/#.UYwqBrW-2So>
- “Australia.” *U.S. Energy Information Administration*.  
<http://www.eia.gov/countries/cab.cfm?fips=AS>
- “Australia’s Offshore Petroleum Industry.” *Department of Resources, Energy and Tourism*.[http://www.ret.gov.au/Department/Documents/MIR/FS\\_1\\_AUSTRALIA'S-OFFSHORE-PETROLEUM-INDUSTRY.pdf](http://www.ret.gov.au/Department/Documents/MIR/FS_1_AUSTRALIA'S-OFFSHORE-PETROLEUM-INDUSTRY.pdf)
- Bamberger, Nowell David Beckett. "In the Wake of Sakhalin II: How Non-Governmental Administration of Natural Resources Could Strengthen Russia’s Energy Sector." *Pacific Rim Law & Policy Journal* 16, no. 3 (June 2007).
- Brooke, James. "Koizumi Visits Energy-Rich Russian Region, Seeking Oil." *The New York Times*, January 13, 2003.
- Chan, John. "Japan outbids China for Siberian pipeline." *World Socialist Web Site*, February 14, 2005. <http://www.wsws.org/en/articles/2005/02/pipe-f14.html> (accessed March 20, 2013).
- Clark, Jeff. "Take the Money: Royalty Trust Yields Look Good Here ." Stansberry & Associates Investment Research .  
<http://www.stansberryresearch.com/growth-stock-wire/2768/Take-the-Money-Royalty-Trust-Yields-Look-Good-Here>  
 (accessed March 25, 2013).
- Deming, Rust. "How Foreign Policy Is Made in Japan: The Structure and the Players." Japanese Politics and Foreign Policy. SAIS, Washington D.C. (October 2012). Lecture.
- Dietsch, Marcel. "The Next Global Energy Cartel". *Forbes*. December 12, 2009 (accessed April 23, 2010).
- "EIA - The Global Liquefied Natural Gas Market: Status and Outlook - LNG Industry Costs Declining." *Report #:DOE/EIA-0637*. US Energy Information Administration. (December 2003).
- Fesharaki, Shahriar (2013). “Implications of North American LNG Exports for Asia’s Pricing Regime.” Pacific Energy Summit.
- “Foreign Trade: Data." Census Bureau Homepage.  
<http://www.census.gov/indicator/www/ustrade.html>](accessed March 25, 2013).
- "Foreign Trade - U.S. Trade with Japan ." Census Bureau Homepage.  
<http://www.census.gov/foreign-trade/balance/c5880.html> (accessed March 25, 2013).
- Fukushima , Kawauchi,. "Abe may review zero-nuclear policy." Daily Yomiuri Online.  
<http://www.yomiuri.co.jp/dy/national/T121229002927.htm> (accessed March 25, 2013).
- "Gazprom and Novatek Set Up LNG Plant." *Natural Gas Europe*, January 11, 2013.  
<http://www.naturalgaseurope.com/gazprom-and-novatek-set-up-lng-plant> (accessed March 21, 2013).
- "Gazprom forecasts sharp rise in gas consumption in eastern Russia ." *Ros Business Consulting*, November 07, 2008.  
<http://www.rbcnews.com/free/20080711093536.shtml> (accessed April 13, 2013).



- “GDP Growth Rate” *The World Bank*.  
<http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/1W-ID?display=graph>
- GECF members include Algeria, Bolivia, Egypt, Equatorial Guinea, Iran, Libya, Nigeria, Qatar, Russia, Trinidad and Tobago and Venezuela.
- Gas Exporting Country Forum, Last modified 2013. Accessed March 21, 2013.  
<http://www.gecf.org/aboutus/gecf-objectives>.
- Goldman, Marshall I. (2010). *Petrostate: Putin, Power, and the New Russia*. Oxford: Oxford University Press.
- “Governmental Debt.” OECD Stat Extracts.  
[http://stats.oecd.org/Index.aspx?DatasetCode=GOV\\_DEBT](http://stats.oecd.org/Index.aspx?DatasetCode=GOV_DEBT)
- Hafner, Manfred. "Natural Gas Markets and Geopolitics." *Politics and Economics of International*. SAIS Bologna, Bologna. 16 Dec. 2011. Lecture
- Hafner, Manfred. "World LNG Market." *Politics and Economics of International Energy*. SAIS Bologna, Bologna. 1 Dec. 2011. Lecture.
- Harding, Luke. "Yamal peninsula: The world's biggest gas reserves." *The Guardian*, October 20, 2009 .  
<http://www.guardian.co.uk/environment/2009/oct/20/yamal-gas-reserves> (accessed March 21, 2013).
- Helmer, John. "China beats Japan in Russian pipeline race." *Asia Times*, April 29, 2005.  
[http://www.atimes.com/atimes/Central\\_Asia/GD29Ag01.html](http://www.atimes.com/atimes/Central_Asia/GD29Ag01.html)
- Ikenberry, John (2000). “After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order After Major Wars.” *Princeton University Press*.
- “Indonesia.” U.S. Energy Information Administration.  
<http://www.eia.gov/countries/cab.cfm?fips=ID>
- “Iran: Possible Implications of An Oil Embargo.” (2012). *Country Currents*,  
<http://www.countercurrents.org/mearns081211.htm>
- “Japan Press Highlights.” *American Embassy: Media Analysis and Translation Teams*. May 8, 2013.
- "Japan." *U.S. Energy Information Administration*.  
 <<http://www.eia.gov/countries/country-data.cfm?fips=JA>>.
- “Japan - Analysis.” *U.S. Energy Information Administration (EIA)*. (March 2011).
- "Japan." *U.S. Energy Information Administration (EIA)*. (June 4 2012).  
 <<http://www.eia.gov/cabs/japan/Full.html>>.  
 <<http://www.eia.gov/countries/cab.cfm?fips=JA>>.
- "Japan: Overview/Data." U.S. Energy Information Administration (EIA).  
<http://www.eia.gov/countries/country-data.cfm?fips=ja> (accessed March 25, 2012).
- “Malaysia.” U.S. Energy Information Administration  
<http://www.eia.gov/countries/cab.cfm?fips=MY>
- Moomaw, W., P. Burgherr, G. Heath, M. Lenzen, J. Nyboer, A. Verbuggen (2011):  
 Annex II: Methodology. In IPCC Special Report on Renewable Energy Sources and Climate Change Mitigation [O. Edenhofer, R. Pichs- Madruga, Y. Sokona, K. Seyboth, P. Matschoss, S. Kadner, T. Zwickel, P. Eickemeier, G. Hansen, S. Schlomer, C von

- Stechow (eds)], Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA. 982.  
[http://srren.ipcc-wg3.de/report/IPCC\\_SRREN\\_Annex\\_II.pdf](http://srren.ipcc-wg3.de/report/IPCC_SRREN_Annex_II.pdf)
- “Malaysia Facts & Figures.” *The United Nations Development Program*.  
<http://www.undp.org.my/page.php?pid=53&menu=sub&title=Malaysia>
- Nikkei Shinbun. 米、日本にシェールガス：来月にも輸出解禁。February 7, 2013.
- “North Sea cod 'could disappear' even if fishing outlawed.” *The Telegraph*, September 09, 2009.  
<http://www.telegraph.co.uk/earth/environment/globalwarming/6162167/North-Sea-cod-could-disappear-even-if-fishing-outlawed.html> (accessed March 21, 2013).
- "Russia, Japan in Building Gas Pipeline Talks." *RIA Novosti*, March 5, 2012.  
<http://en.rian.ru/world/20120503/173198752.html> (accessed March 20, 2013).
- “Obama Administration Notifies Congress of Intent to Include Japan in Trans-Pacific Partnership Negotiations.” *The Office of United States Trade Representative*.  
<http://www.ustr.gov/about-us/press-office/press-releases/2013/april/congressional-notification-japan-tpp>
- Science Council of Japan (2011), *About the Choice of Energy Mix – Toward the Development of Energy Mix for Citizens*.
- “Securing feedstock: Lining up supplies to fuel liquefied natural gas exports.” *Oxford Business Group*.  
<http://www.oxfordbusinessgroup.com/news/securing-feedstock-lining-supplies-fuel-liquefied-natural-gas-exports>
- Solís, Mireya. “Asia in Washington: The Evolution of the Trade Policy Debate”, The Reischauer Center for East Asian Studies February 6, 2013.
- Stansberry , Porter . " The Biggest Opportunity in Energy You'll See For Decades ." Stansberry & Associates Investment Research .  
<http://www.stansberryresearch.com/dailywealth/1795/the-biggest-opportunity-in-energy-you-ll-see-for-decades> (accessed March 25, 2013).
- The Growing Importance of Coal." *JBIC*.  
<http://www.jbic.go.jp/en/report/jbic-today/2011/201111/02/index.html> (accessed March 25, 2013).
- The Office of United States Trade Representative. “Free Trade Area.”  
<http://www.ustr.gov/trade-agreements/free-trade-agreements>
- The Institute of Energy Economics (2008), Japan Energy Brief. No.18. p. 4-5.  
<http://eneken.ieej.or.jp/en/jeb/1203.pdf>
- “U.S. Energy System” (2012), the University of Michigan, the Center for Sustainable Systems. [http://css.snre.umich.edu/css\\_doc/CSS03-11.pdf](http://css.snre.umich.edu/css_doc/CSS03-11.pdf)
- “U.S. International Trade Data.” *United States Census Bureau*. (Accessed May 10, 2013).<http://www.census.gov/foreign-trade/data/>
- 資源エネルギー庁 "エネルギー白書：第2部 エネルギー動向:4. 石油製品," (2005)  
<http://www.enecho.meti.go.jp/topics/hakusho/2005/html/17021440.html>.
- "米シェールガス:対日輸出「前向き」 燃料費抑制に期待." 毎日新聞.  
[headlines.yahoo.co.jp/hl?a=20130224-00000014-mai-bus\\_all](http://headlines.yahoo.co.jp/hl?a=20130224-00000014-mai-bus_all) (accessed February 24, 2013).
- "日米首脳会談(概要)." *Ministry of Foreign Affairs of Japan (MOFA)*.

<http://www.mofa.go.jp/mofaj/kinkyu/20/H302013022318425501A/> (accessed March 25, 2013).

"G8 ドーヴィル・サミット内外記者会見." 首相官邸.

<http://www.kantei.go.jp/jp/kan/statement/201105/27G8naigai.html> (accessed March 25, 2013).

“T P P 自動車業界 関税最大限維持など落胆.”

<http://www.sankeibiz.jp/business/news/130413/bsa1304130801002-n1.htm>

“農水省／世界の穀物価格 10年後 3割上昇 T P P 反対.”

<http://n-seikei.jp/2011/02/post-2087.html>

三井物産, "サハリンへの道が エネルギーの道になる."

<[http://www.mitsui.com/jp/ja/business/challenge/1190462\\_1589.html](http://www.mitsui.com/jp/ja/business/challenge/1190462_1589.html)>.

“Газопровод `Якутия - Хабаровск – Владивосток` получил название `Сила Сибири`" <http://news.ykt.ru/article/7679>

日経新聞 2012年9月20日7面

<http://grandpalais1975.blog104.fc2.com/blog-entry-548.html>

ガспロムのマルケロフ副社長「東シベリアからもガス」日露の局冬季知恵の供給、日本経済新聞 (December 25, 2012).

## **Crisis in U.S.-Japan Educational Exchanges**

By Zhe Liu

### **Introduction**

One of the success stories of postwar U.S.-Japan relations was the rich and rewarding experiences of Americans and Japanese who had studied in each others' country and then went on to become in many cases leaders in business, government, academia, politics and other professions. That historical pattern of young Japanese being attracted to America and vice versa, however, seems to be fading rapidly in recent years, and the past decade has witnessed, particularly from the Japanese side, a significant falling off of students coming to the United States. Between 1994 and 1997, young Japanese comprised the largest number of foreign students enrolled at American institutions of higher learning. At present, students from China hold that position. In fact, as of 2011, more than a quarter of the foreign student population in America is Chinese. And fewer than three percent of foreign students in the U.S. are from Japan, and the numbers are still dropping. What is going on and why?

The goal of this study is to identify factors that individually and collectively explain the decline in foreign students from Japan and what perhaps can be done about it. There needs to be a strategy laid out that would make America more enticing for Japanese students wanting to go abroad, and measures that would help young people to overcome some of the hurdles that impede them from leaving Japan and enrolling at an American college or university. The same goes for Americans wanting to study in Japan, and this paper below examines how Japan since 2008 has been trying to bring more foreign students into the country.

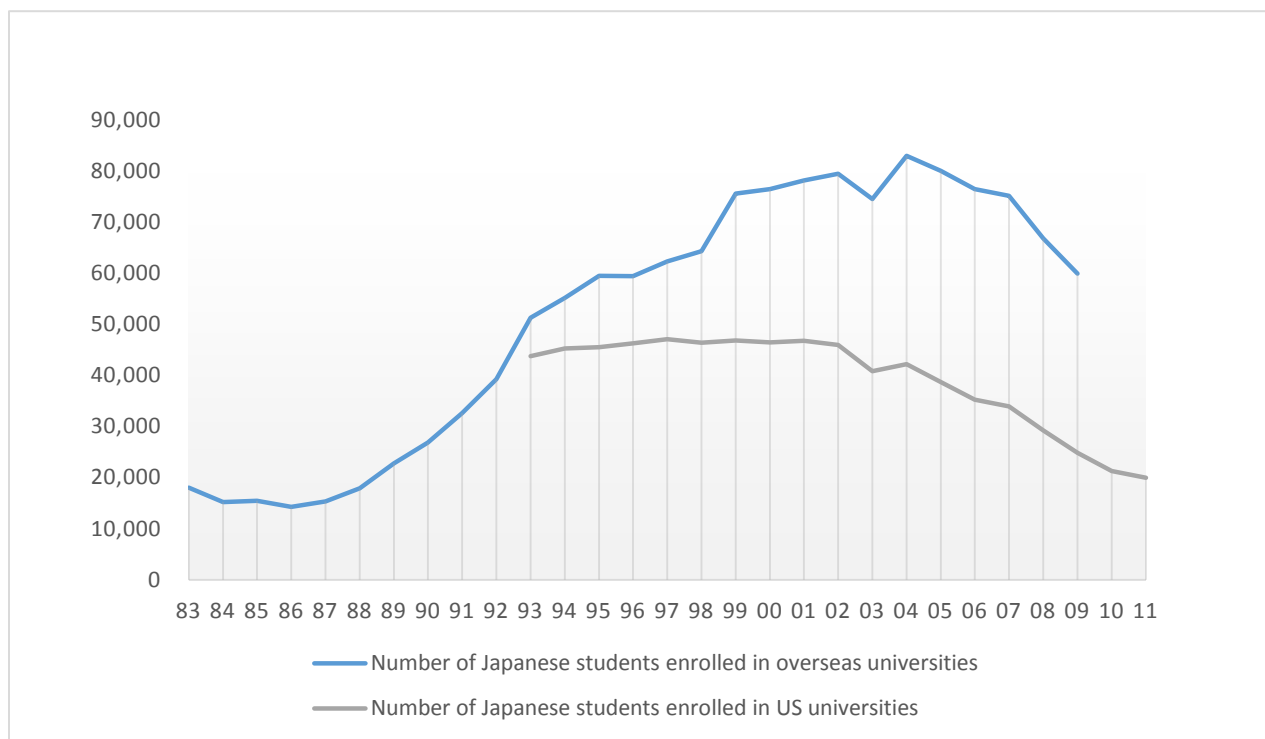
There is no shortage of reporting in the media about the decline in young Japanese studying abroad in general, let alone in the U.S., and their alleged lack of interest in the world around them. In fact, as this study will point out, much of the cause of the problem lies beyond the students' control, and interest among Japanese in overseas study remains strong. One factor, compared with their parents' generation, young Japanese today have to overcome more obstacles if they want to go abroad, especially to the U.S. It is also equally important to keep the issues in perspective, for there have been various efforts over the past several years to facilitate educational exchanges and signs that such may be gradually turning the tide.

This paper first analyzes current trends and the characteristics of Japanese students studying in the U.S. It then explores a broad range of factors simultaneously impacting and magnifying the overall trends. After evaluating the selected policies and ongoing programs in the public and private sectors in recent years, the paper concludes with additional policy recommendations and a summation.

### **Analysis of Current Trends**

Over the past decade or so, there has been a marked decline in Japanese students studying in the United States. In the 2011/12 academic year, 19,966 Japanese were studying in the United States at institutions of higher learning, a decrease of 6.2% from the previous year. The figure is in line

with an alarming trend of falling numbers since a peak in 1997/98. As shown in Figure 1, the number of Japanese students studying in the U.S. has decreased by almost 58% since then.



Source: Open Doors, Report on International Educational Exchange<sup>152</sup>

As of 2011, Japan is seventh among leading place of origin for students coming to the United States. From 1994/95 until 1998/99, Japan was the leading sender of students to the U.S. but has since fallen to seventh as students surge in from India, China, South Korea, and Saudi Arabia. (Table 1)

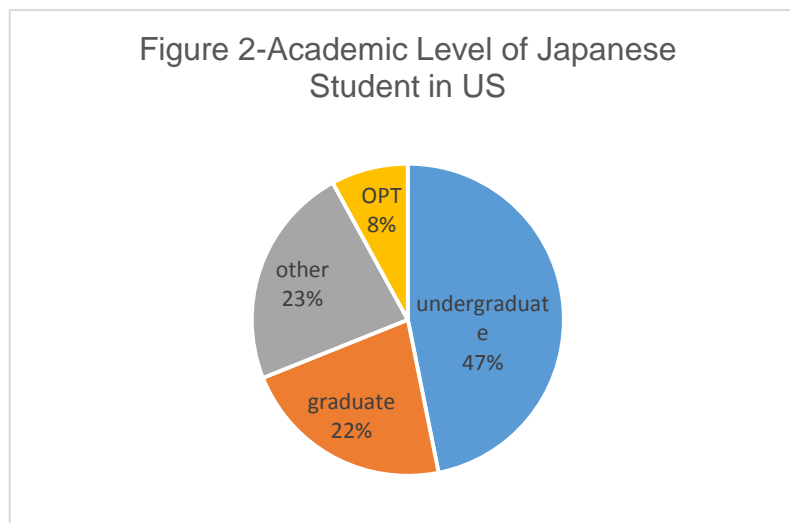
<sup>152</sup> Published annually by IIE with support from the U.S. Department of State's Bureau of Educational and Cultural Affairs. <http://www.iie.org/Research-and-Publications/Open-Doors>

**Table 1-Top 10 Places of Origin of International Students in US 2010/11 - 2011/12**

RANK	Place of Origin	11月-10	12月-11	2011/12 of Total	% % Change
	WORLD TOTAL	723,277	764,495	100	5.7
1	China	157,558	194,029	25.4	23.1
2	India	103,895	100,270	13.1	-3.5
3	South Korea	73,351	72,295	9.5	-1.4
4	Saudi Arabia	22,704	34,139	4.5	50.4
5	Canada	27,546	26,821	3.5	-2.6
6	Taiwan	24,818	23,250	3	-6.3
7	Japan	21,290	19,966	2.6	-6.2
8	Vietnam	14,888	15,572	2	4.6
9	Mexico	13,713	13,893	1.8	1.3
10	Turkey	12,184	11,973	1.6	-1.7

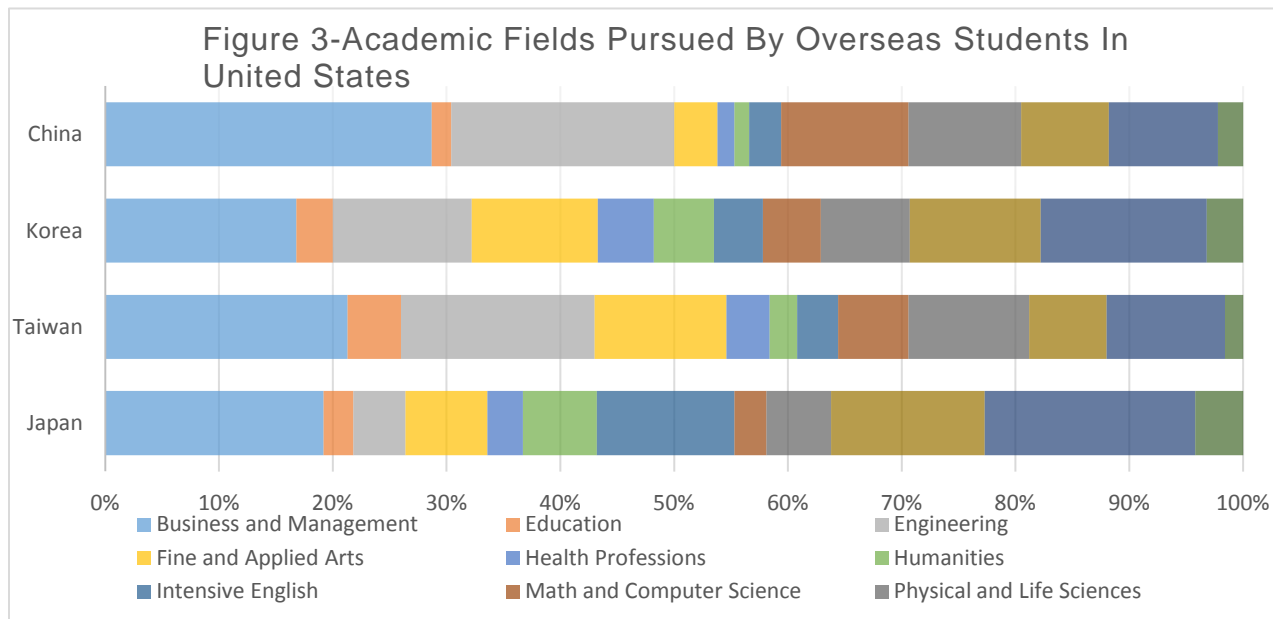
Source: Open Doors: Report on International Educational Exchange

In terms of academic level, the majority of Japanese students study at the undergraduate level (Figure2).



Source: Open Doors: Report on International Educational Exchange

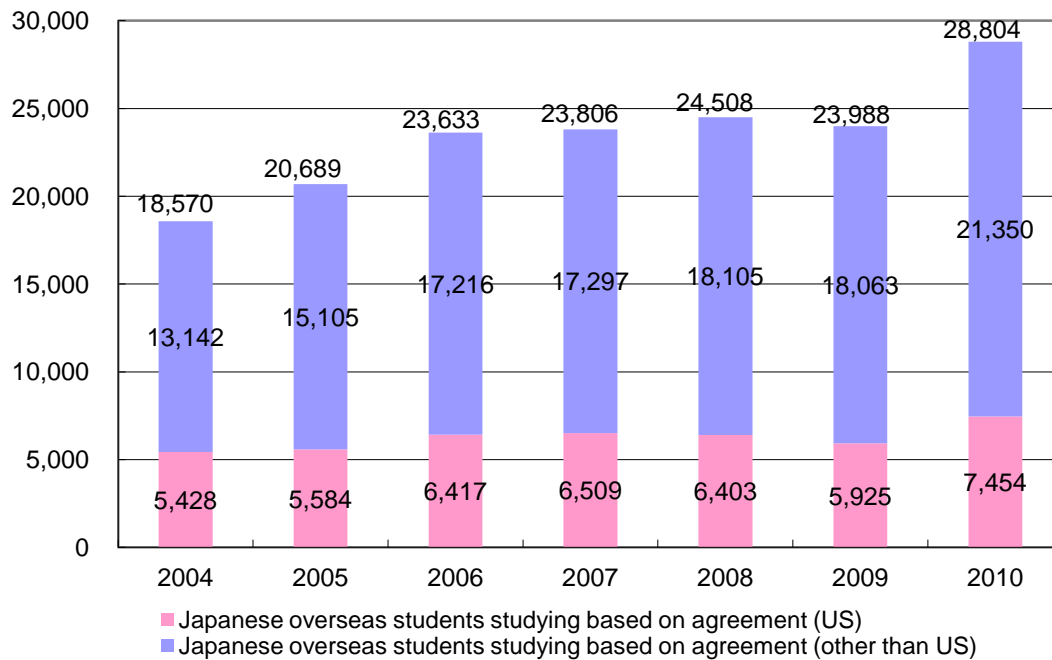
In terms of academic fields, 19.2% of Japanese students study business and management, and 18.5% choose humanities, with only 4.6% of them studying engineering. The percentage of Japanese students studying science or engineering is relatively small compared with other Asian countries. For instance, 19.6% of Chinese student study engineering in the U.S. (Figure 3)



Source: Open Door, International Students Fields of Study by Places of Origin, IIE

Regarding exchange type, figure 4 shows that there are growing numbers of short-term exchanges, instead of pursuit of degree. While the overall number of Japanese overseas students studying in the United States has been declining, the number studying under inter-university agreements is increasing.

Figure 4- Numbers of Japanese students studying abroad based on agreement



Source: “Report on Japanese Students Studying Abroad based on Agreements”, Japan Student Services Organization.

In relation to this, the number of Japan-U.S. inter-university agreements is increasing as well. We will return to this phenomenon in later sections of this paper.

### Reasons for the Decline

The mystery of the vanishing Japanese exchange students worries many. A variety of reasons have been advanced for the shrinking number of Japanese who choose to study abroad in the United States.

### Demographic Issues

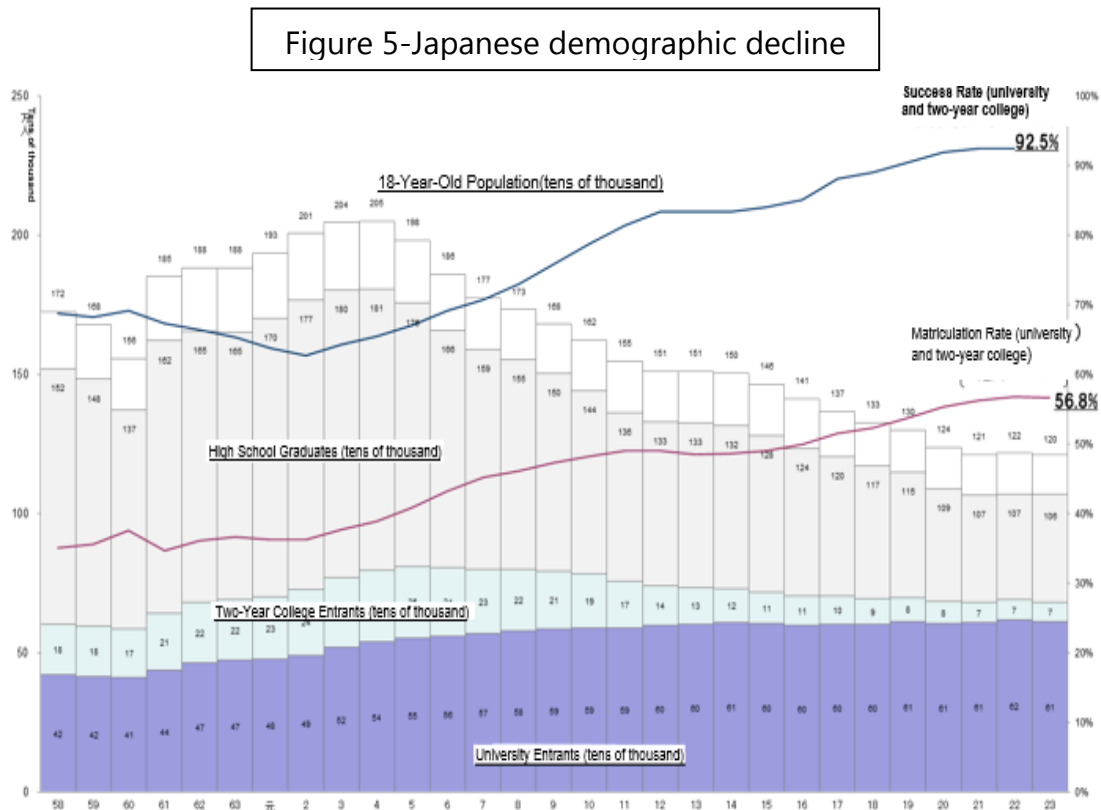
According to the Japanese government’s official census report,<sup>153</sup> the total population of Japan has stopped growing, peaking at just under 128 million. It has been reported that the total number of males has actually started to decline. Some total growth might still be possible because people, especially women, are living longer, and the number of long-term immigrants is actually growing (foreign nationals make up 1.5-2.3% of the population). Still, standard demographic indicators show that the birth rate is low (8.39 per 1000) and not much above the mortality rate (8.2 per 1000), and the fertility rate of 1.29 is low and declining further. It is little wonder, then, that the population is predicted to decline to around 115 million by 2030 and 100 million by 2050.<sup>154</sup> Most importantly for anticipating the impact of demographic trends on higher education is the decreasing size of the 18-year-old cohort. This group is now at 1.2 million, roughly half of

<sup>153</sup> Japan Statistical Yearbook 2012, Chapter 2 Population and Households. <http://www.stat.go.jp/english/data/nenkan/index.htm>

<sup>154</sup> United Nations 2010 World Population Prospects medium variant forecast. <http://esa.un.org/wpp/other-information/faq.htm>



what it was 15 years ago, but it is set for further gradual declines every year for the next decade or more, although much less drastic than the annual decreases in size from 1993-present.<sup>155</sup>



Source: Japan Statistical Yearbook 2012, Chapter 2 and Chapter 22.

Despite this decline in 18-year-olds, the number of those advancing to university remains flat. As shown in the figure 5, the number of 18-year-olds fell by 200,000 between 2004 and 2009 from 1.41 million to 1.21 million, while the number of those advancing to university rose by 10,000 during the same period from 600,000 to 610,000. This is mainly due to the quantitative expansion of universities in Japan.

### Quantitative Expansion of Universities

As for the 200,000 Chinese students at U.S. universities, the majority are studying abroad because China's 2,000 universities simply cannot accommodate 30 million young people (soon to be 40 million) vying to obtain degrees.<sup>156</sup> The conditions that force Chinese students to go abroad for their education are very different from anything experienced by Japanese students at the present time. The number of Japanese universities is increasing, from 373 in 1991 to 572 in 2011. As we can see from the above data, about 50% of high school graduates at the age of 18 enter universities or junior colleges. These institutions are run either by the public or private higher education sector. The public sector institutions consist of national and municipal institutions, but it is the private sector that has become the larger part of the system.

<sup>155</sup> Japan Statistical Yearbook 2012, 2- 7 Population by Age.

<sup>156</sup> China Statistical yearbook 2011

There are currently 86 national universities, 95 public universities and 599 private universities across the country in 2011.<sup>157</sup> More than 73% of students are studying at private universities, which is a huge proportion compared to the 20% of American students enrolled at private universities in the United States. National universities have for a long time been under the control of the Ministry of Education because they have been parts of government agencies. Private universities too, despite their autonomous status, are still under the strict supervision and control of the Ministry. One of the concrete means by which the Ministry exerts its control over the private universities is the legislation “Standard for the Establishment of Universities”,<sup>158</sup> which specifies the many rules that universities must abide by when seeking Ministry approval to establish or expand a university. The legislation stipulates the standard that university must meet, for example, in terms of the number of students, degree requirements of academic staff, number of teachers, number of books in the library, square footage of the campus building per student, and so forth. In order to satisfy these requirements, such as the number of student’s quota, some universities have to lower their admission standard.

All universities, whether national or private, select their entering students by an entrance examination conducted by a national agency and by its own, which are generally achievement tests of Japanese language, foreign languages, social studies, math, and sciences at the high school graduate level. The process of selection differs among universities and fields of study: the most selective is the University of Tokyo, and the other national flagship universities follow. Some traditional private universities are also highly selective in their choice of enrollees. At the other end of the scale, however, even the least competitive students can now enroll without difficulty in the current climate of increasing supply and decreasing demand in higher education. Thus, there is no fundamental shortage of space or capacity in Japanese institutions of post-compulsory education. Sufficient opportunities are offered to students who wish to go to a university in Japan. As a result, studying abroad is not a very attractive option.

### **Low level of Internationalization of Japanese Universities**

This can be reflected in two dimensions: admission season and foreign faculty members. Unlike the fall admission for most of the universities worldwide, the admission season for Japanese school has been spring since the 1920s, which is matched with the Japanese fiscal year. Admission in April is standard elementary/junior high schools and universities, as well. Not until 2008 did the government revise the system so that universities may freely select a timing of commencement and end of academic year at the rector’s own discretion, which was intended to allow for reception of diversified students, including returnees and international students. Since April 2011, the University of Tokyo and 11 other universities have mulled shifting admissions season to autumn, including Hokkaido University, Tohoku University, Tsukuba University, Tokyo Institute of Technology, Hitotsubashi University, Keio University, Waseda University, Nagoya University, Kyoto University, Osaka University, Kyushu University<sup>159</sup>. Moreover, the percentage of foreign faculty members in Japanese universities is also relatively low compared with famous universities in the U.S. and Europe. According to Times Higher Education ranking report<sup>160</sup>, the overall foreign teacher percentage in Japanese universities is around 5%, however,

<sup>157</sup> Japan Statistical Yearbook 2012, 22-13 Universities and Graduate School

<sup>158</sup> <http://www.mext.go.jp/english/highered/1307524.htm>

<sup>159</sup> Presentation by Dr. Teiichi Sato, former ambassador to UNESCO, at the joint plenary meeting of the United-States-Japan Conference on Cultural and Educational Interchange. Jan, 2013.

<sup>160</sup> <http://www.topuniversities.com/university-rankings/world-university-rankings/2009>

it is about 30% at Harvard and UC Berkeley and even higher at Oxford and Cambridge, reaching 40%.

### **Labor Market Recruitment in Japan**

One compelling reason for the decline in Japanese students studying overseas is the increasingly early onset of job recruitment season. With the stagnant economic situation, job searching has preoccupied a lot of college juniors. Usually, junior year in college is the best time to participate in overseas exchanges. But Japanese companies often go to the universities at this time to hold career fairs. In this case, the job search can only be conducted in Japan and facing a tight job market, many students feel they have to forgo the idea of a “junior year abroad.” At the same time, given the less stringent entry requirements for universities and the shrinking labor pool, companies see an incentive to start recruiting early in a bid to get the top graduates. This ratcheting up of competition for top graduates means that the starting date is gradually pushed further and further into the students’ university career. Corporations now recruit heavily amongst third year students, and students are under enormous pressure to secure their employment prior to the fourth year, and the universities are also eager to show successful job-placement statistics as part of their marketing efforts to attract more students.

Secondly, oversea experience is not properly valued in the recruitment standard or treated as a “value-add”. The Japanese system of recruitment and job placement differs from that of the West in that it is highly structured and strictly organized. Large companies in Japan screen potential employees through exams and interviews while they are still at the university. Besides, starting in the 1960s, a period of rapid economic growth, long-term relationships between employers and employees became the norm in most Japanese firms. This “lifetime employment system” reflects the tendency of Japanese companies to make considerable investments in the skills of their employees through in-house training in order to adapt more quickly to changing economic situations and technological development.<sup>161</sup> At big Japanese companies, many bosses don't like what they see as the sometimes uppity and overly independent ways of American-educated young Japanese. Many employers prefer the "harmony" that comes from hiring the locally educated, who they believe work longer hours, complain less and request fewer vacations.<sup>162</sup>

According to a survey conducted in 2012 by Disco, a Tokyo-based consulting firm, most (60%) companies make no special effort to hire Japanese returning from studying abroad<sup>163</sup>. Also, studying abroad offers no clear advantage in terms of finding a job. Over the past nine years, Japanese companies have made little progress in tackling the hiring of Japanese returning from studying abroad year-round. However, the downward trend is reversing in Japan, partly because of demands by major employers seeking to globalize. The numbers of companies recruiting new graduates year-round have been steadily increasing since 2010, which is in line with the growing demand for global human resources for companies that are establishing overseas bases. A questionnaire survey on Development of Global Human Resources by METI in 2010 shows that

---

<sup>161</sup> “The Labor Situation in Japan and its analysis 2011/12,” Japan Institute of Labor.  
<http://www.jil.go.jp/english/laborsituation/general/2011-2012.html>

<sup>162</sup> Interview with Ms. Yukako Uchinaga, director and executive vice president of Benesse Holdings, Inc, which focuses on correspondence education and publishing.

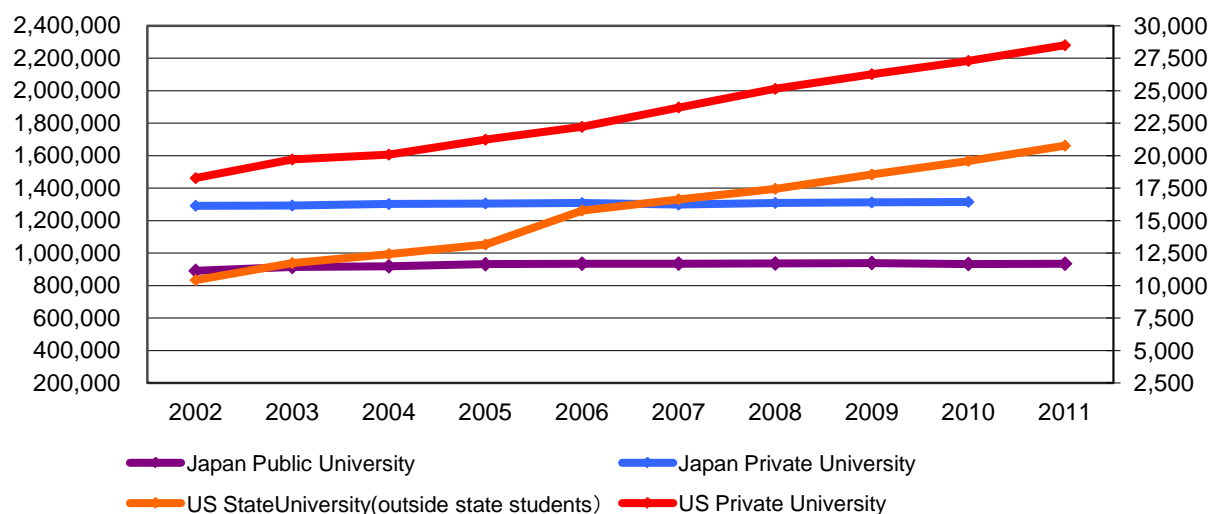
<sup>163</sup> <http://www.japantimes.co.jp/news/2013/02/26/reference/firms-go-abroad-by-hiring-foreign-students-here/#.UY2N2LWG1y4>

74.1% of companies feel they have problems in securing and developing domestic human resources who can promote their globalization<sup>164</sup>.

### Financial Situation

Figure 6 shows that U.S. college tuition and fees has continued to climb for the past decade, and they are increasing more rapidly than those of Japanese universities even taking the strong yen into account.

Figure 6-Comparison of university tuitions in US and Japan



Source: US, the College Board; Japan, MEXT

Meanwhile Japanese household income has been decreasing, making it difficult to afford high college tuition and fees. In this regard, bottom-line considerations are steering many young Japanese away from U.S. colleges. This is not a time in Japan for intellectual curiosity, and people have to think about investment and return<sup>165</sup>.

In the 1970s and 80s, when Japan's economy was booming, the bottom line did not matter for many young Japanese. It was fashionable, stimulating and affordable for them to travel the world, study English in foreign settings, and attend college in the United States. Their parents had money, and jobs were plentiful when they came home. The collapse of the bubble economy in the 1990s changed those calculations. And the construction inside Japan of more than 200 new universities has made it easy to find an affordable education without enduring jet lag and having to learn English.

### Competitiveness of Japanese Students

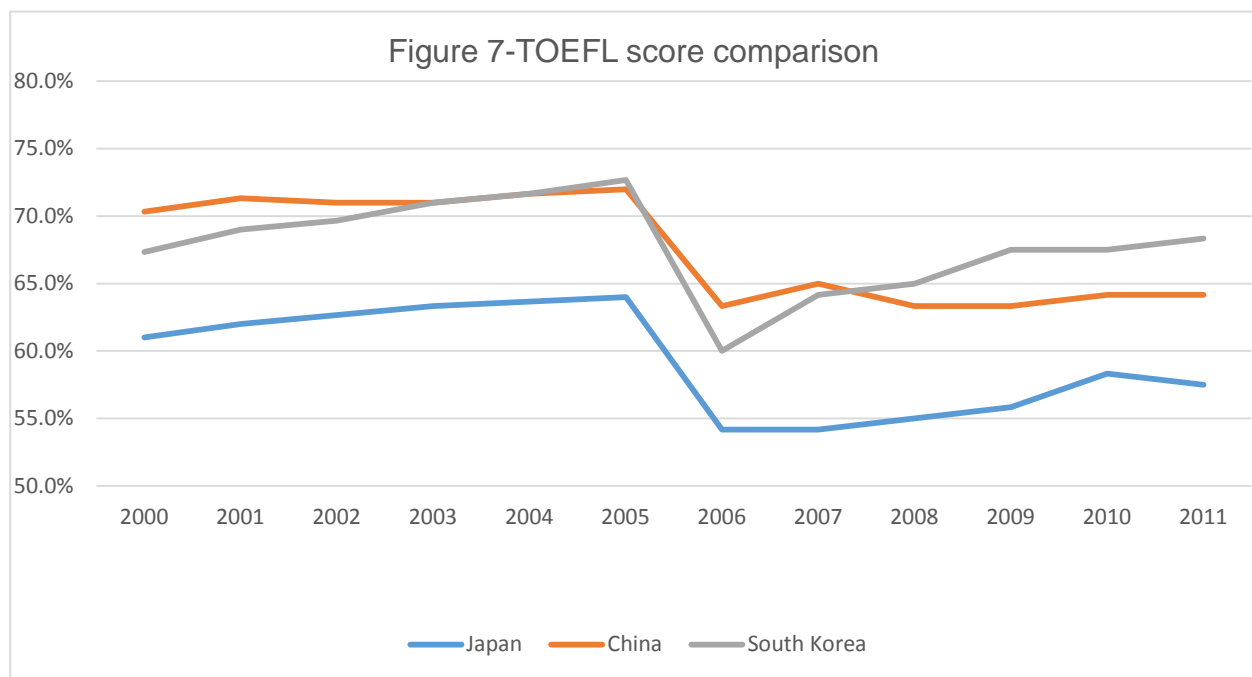
During the 1990s, when the number of Japanese students in the U.S. reached its peak, they did not have students from other Asian countries as competitors when they applied for admission to U.S. colleges or universities. For the universities in the U.S. desiring to internationalize, they had no other choice but to accept Japanese students, who were almost the only representatives of Asia at the time. Nowadays, the situation has greatly changed. With increasing numbers of

<sup>164</sup> [http://www.meti.go.jp/english/press/data/pdf/Human\\_Resource.pdf](http://www.meti.go.jp/english/press/data/pdf/Human_Resource.pdf)

<sup>165</sup> Interview with Ms. Chizuru Sasada, senior advisor of Fulbright Japan office.

Chinese, South Korean and Indian students submitting applications, the competition has become fierce. Indian students have the advantage of the English language. Education system reform in South Korea has made its higher education similar to that in the U.S., which effectively helps the students prepare better for further study in the U.S..

Using English ability as an indicator, out of the 33 countries in Asia, Japan ranks the third from the bottom in English proficiency. TOEFL has been widely utilized at American universities as an examination that aptly measures linguistic ability. As shown in Figure 7, Japan's TOEFL score is lower than its neighbors, including competitors China and South Korea. Especially after the examination system was changed to be Internet based in 2005, it has become much harder to get a good score, making it disadvantageous for Japanese wanting to study abroad at an American university.

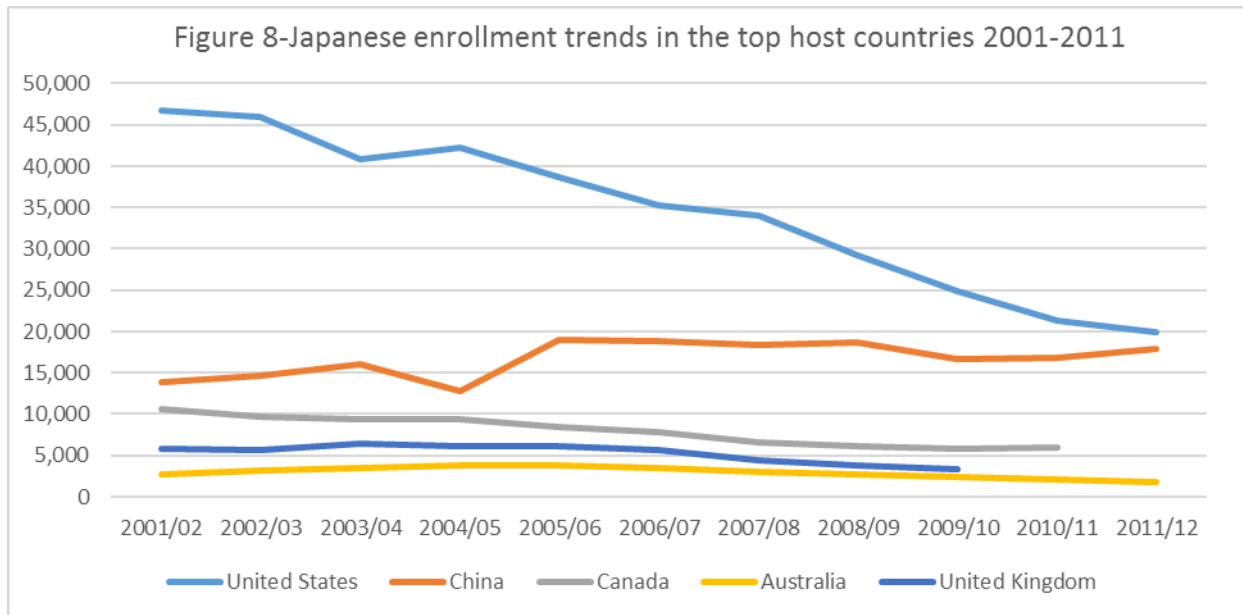


Source: 1. ETS, Test and Score Data Summary in 2011

2. "Test scores" indicate the average percentage score for each country out of a possible 300 points for CBT and 120 for iBT.

### The Possible Shift of Destination

To assume that Japanese youth are lazy couch potatoes just because they are not heading for U.S. colleges fails to take into account the increasing diversity of overseas studies opportunities available for Japanese students at institutions outside the United States. Whereas in 1994, 78 percent of Japanese choosing a foreign school went to a U.S. college, by 2010, that percentage had dropped to 46 percent, according to Japanese government figures. Today students from Japan are enrolled at universities in China, Britain, Australia, Germany, Taiwan, Canada, France, South Korea, and New Zealand in that order.(Figure 8) In fact, when the number of Japanese students at these destinations is tallied, the combined total is greater than at US universities. Especially the proportion of those heading for Chinese universities climbed from 9 percent to 24 percent – more than 18,000 students.

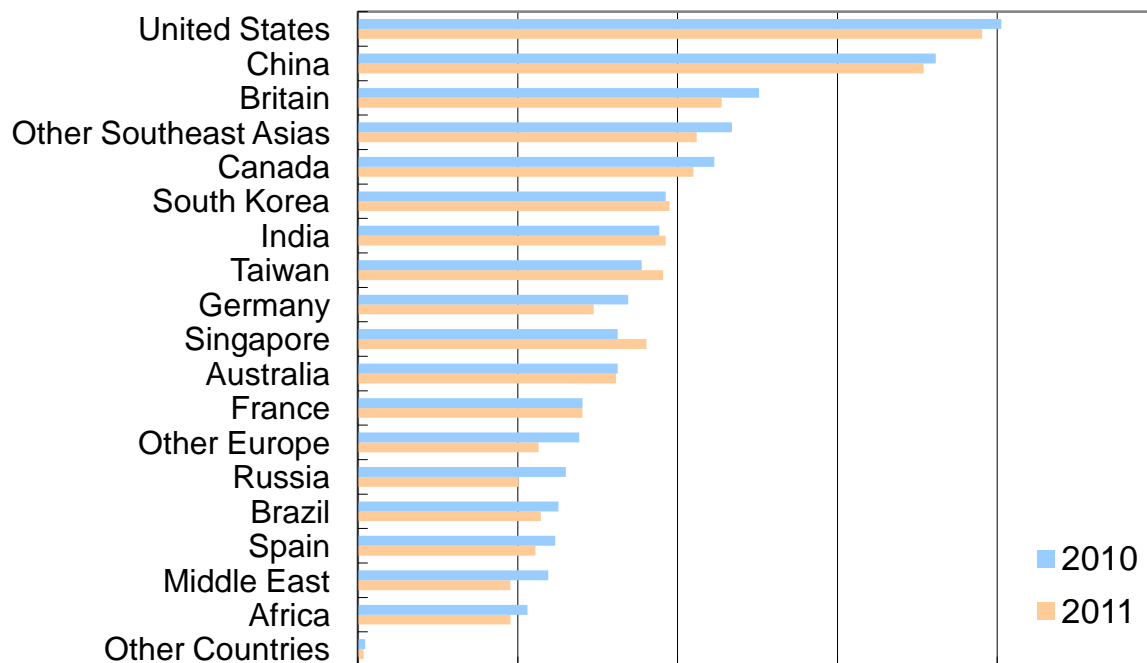


Source: MEXT, Japan, Statistics on International education 2012.

Why as there been such a shift? Most significantly, it is because of the sudden steep rise in tuition costs in the U.S. Another factor is the demand side of the labor market. In 2012, China has overtaken the U.S. and became Japan's largest trading partner. In recent years, an increasing percentage of companies want to hire Japanese students who had studied in Asian countries. The destination countries for Japanese overseas students most sought after by companies are, in order of ranking, the United States, China, and Britain (Figure 9). While more Japanese students still go to the United States and China, Canada has emerged as a new popular destination. According to the Canadian Embassy in Tokyo<sup>166</sup>, the number of student participants in study-abroad fairs at the embassy jumped to 3,643 in 2012, from 2,375 in 2010. One reason for the increased popularity of study in Australia, Canada, New Zealand, and Britain is the work holiday visa available to Japanese young people heading for those countries.

<sup>166</sup> <http://www.educationau-incanada.ca/educationau-incanada/study-etudes/index.aspx>

Figure 9-Number of Employees in Japanese Companies



Source: Survey on Corporate Employment Activities; Aggregate Results by Number of Employees by Disco.<sup>167</sup>

### Current Program Evaluation

In the white paper on education for 2008, issued by the Ministry of Education, Culture, Sports, Science and Technology (hereafter referred to as MEXT), for the first time the Japanese government proposed a plan for “Internationalization of Universities”<sup>168</sup>. In the report, the significance of “Internationalization of Universities” is addressed as following:

“As globalization proceeds, enhancing functions of education and research at universities by gathering researchers and students from both within the country and abroad results in meeting domestic expectation toward universities which conduct high-level education and research, and education for cultivating qualities and personalities required by the times we live in. At the same time, such effort leads to contributions to the world by using knowledge of universities to resolve the issues which international society faces. That is one of the directions which universities in Japan in the 21st century should aim at.”

Many projects then followed to support the internationalization of universities initiated by both the public sectors and private sectors.

### Framework of the “300,000 International Students Plan”

As of May 2008, the number of foreign students in Japan numbered 123,829. But the ratio of international students remained at 3.5% of all students enrolled in higher education institutions

<sup>167</sup> Respondents: 15,445 major companies nationwide; Survey method: by Internet; Survey period: February 20-29, 2012; Number of responding companies: 1,245

<sup>168</sup> [http://www.mext.go.jp/b\\_menu/hakusho/html/hpab200801/1292564.htm](http://www.mext.go.jp/b_menu/hakusho/html/hpab200801/1292564.htm)

in Japan, which is low compared to the situation in advanced countries. For example, Britain had 376,000 or 25.1% of all higher-education students; France had 263,000 or 11.8% of the total, and the United States had 583,000 or 5.5% of all higher-education students.

Against this background, in July 2008, in order to open Japan more to the world for the sake of social development, MEXT and other ministries and agencies concerned settled upon the Framework of the “300,000 International Students Plan”, which sets the longer-term goal of accepting that number of foreign students annually by 2020. Measures have been introduced to make Japan attractive to foreign students, including making their initial steps, such as entrance examinations, enrollment, and entry into Japan uncomplicated. Other measures include helping students smoothly integrate into university life and society, and active post-graduation support in finding employment in Japan, if the students so wish.

### **Global 30 Project -Establishing University Network for Internationalization**

The project for “Promotion of Global Human Resource Development (Global 30)” is a Japanese initiative founded in 2009 under MEXT with the aim of nurturing internationally competent individuals in an academic environment where foreign and Japanese students can learn from one another and create lasting international bonds that will help them in the future. Global 30’s main goal is to standardize the rules for accepting foreign university credits at Japanese academic institutions. The selected 13 core universities have been implementing a variety of approaches to internationalize academic systems and campuses such as developing degree programs conducted in English and enriching international student support, while they are expected to enhance inter-university network for sharing educational resource and other outputs including establishment of overseas office which can be jointly used by all Japanese universities.

The thirteen universities that are part of the Global 30 program are Tohoku University, Keio University, Sophia University, University of Tsukuba, University of Tokyo, Meiji University, Nagoya University, Waseda University, Kyoto University, Doshisha University, Osaka University, Ritsumeikan University and Kyushu University<sup>169</sup>. As of 2011, 21,500 out of 138,000 international students in Japan are studying under the Global 30 project<sup>170</sup>. The exchange program has been geared towards China and South Korea. Along with this drive to promote student exchange in East Asia, eight cities- Tunis, Cairo, Bonn, Moscow, New Delhi, Hyderabad, Tashkent and Hanoi- were selected to help boost study abroad for Japanese students. As can be seen from the cities listed above, no U.S. cities were selected for this endeavor.

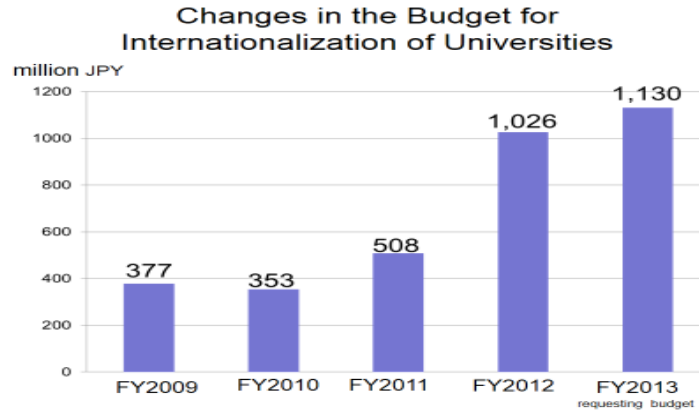
However, the effectiveness of such projects is questionable. First, in the beginning two years after the “Internationalization of Universities” plan was proposed in 2008, the government budget for this program was declining. We can sense this from the titles used in the government white paper<sup>171</sup>, both in 2009 and 2010. Now the program was called, “Enhancement of International Exchange”. Finally, in 2011, the title was changed to “Expanding International Exchange,” marking a turning point for government strategy.

<sup>169</sup> <http://www.mext.go.jp/english/highered/1326725.htm>

<sup>170</sup> <http://www.uni.international.mext.go.jp/>

<sup>171</sup> <http://www.mext.go.jp/english/whitepaper/index.htm>

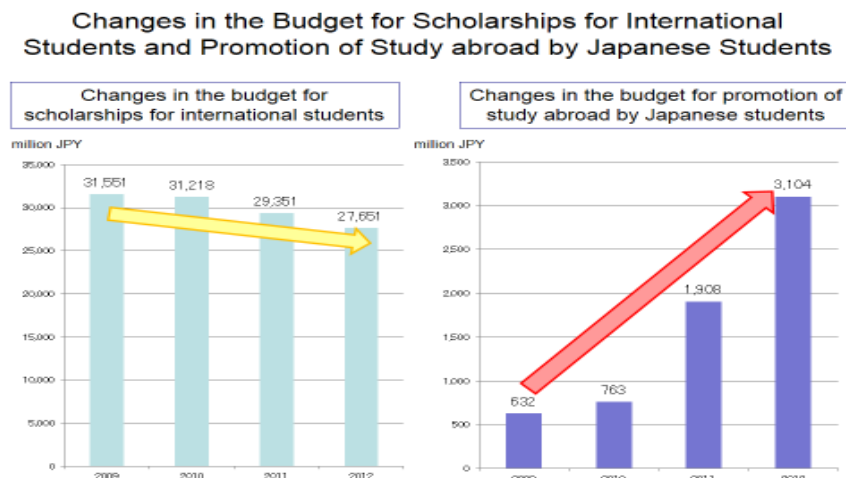




Source: Presentation by Shigeharu Kato, Deputy Director-General at MEXT, at CULCON in Jan,2013

Secondly, before 2011, the strategy for the Japanese government to achieve the goal of the internationalization plan was to attract more foreign students by providing abundant scholarships. However, these foreign students have little access to the local labor market after graduation, so majority of them had to leave Japan in pursuit of their careers after graduation. In practice, this inbound-only promotion of exchange did not bring much benefit to the Japanese society.<sup>172</sup>

In 2011, the government started to pivot to a two-way exchange model, by increasing the budget for the overall “Internationalization of Universities” project. In addition, the program began to provide scholarships to Japanese students studying abroad.



Source: Presentation by Shigeharu Kato, Deputy Director-General at MEXT, at CULCON in Jan,2013

In addition to government programs, Japan’s two most influential big business associations, Keidanren and Keizai Doyukai each have set up committees to address the issue of the declining numbers of Japanese studying in the U.S. These reports call for the need to foster new globalized leaders and to foster diversity in Japan.<sup>173</sup>

<sup>172</sup> Interview with Dr. Bruce Stronach, Dean of Temple University, Japan Campus.

<sup>173</sup> <http://www.keidanren.or.jp/english/policy/2010/114.html>

### **Keidanren Scholarship for Global-minded Human Resources**

In order to foster global human resources, Keidanren initiated a scholarship program (“Keidanren scholarship for global-minded human resources”) in June 2011. Under this program, 30 students per year who study abroad using a student exchange program are entitled to receive a healthy stipend. Keidanren will also support their efforts to find jobs after they return home.

### **Joint curriculum of global business**

In order to nurture young people who will be active on the international stage, and make a strong contribution to the global business of Japanese corporations, Keidanren worked with the 13 universities selected under the "Global 30" project to develop a curriculum of credit courses. In the course, top corporate executives as well as corporate administrators and experts will give lectures.

In cooperation with Sophia University, one of the 13 universities selected under the "Global 30" project, Keidanren presented a course, "Issues in the Global Business and Career Development," from October 2012 to February 2013. The number of students in the course is set at 36 in order to ensure two-way communication in the classroom. Twelve member corporations of Keidanren participated in the course, with representatives giving lectures on the current situation in their respective global business, the challenges they are facing, and ways to overcome them. The purpose of the lectures was to convey to students the skills they will need to acquire to become future global leaders.

### **Boston Career Forum in the U.S.**

The Boston Career Forum organized by Disco Corp. is the world's largest Japanese-English bilingual job fair. For over 25 years, students and job seekers alike have launched their careers at the Boston Career Forum. The fair is aimed at students who are bilingual in English and Japanese or ability to conduct business in English and Japanese and graduated or will be graduating from an undergraduate/graduate program outside of Japan.

The job fair focuses on providing information on companies and carries out recruitment. Participating companies have increased year by year, from 132 in 2010 to 190 companies in 2012, including many well known institutions, such as the Bank of Japan, Boston Consulting Group, Fuji Television Network, Panasonic, and Tokyo Gas. New participants included leading mobile gaming companies, and the discount clothing chain Uniqlo. These companies are very active in conducting recruitment internationally.<sup>174</sup>

### **Policy Recommendations**

There are two conclusions to be drawn before making policy recommendations addressing the educational exchange crisis. First, considering Japan’s demographics, with fewer babies being born and the population shrinking, a decline of Japanese students overseas, including the U.S., is not surprising. Second, the United States remains the top first choice for young Japanese who want to have an overseas educational experience, but, compared with their parents’ generation, they have to overcome more obstacles in fulfilling that dream, many of which are institutional barriers outside of their control, as discussed above. Policy recommendations, thus, should be

<sup>174</sup> <http://www.careerforum.net/event/bos/comlist.asp?lang=E&eventid=121001>

oriented toward breaking those barriers. If not addressed head-on through pro-active and strategic policy measures, the decline will result in further “Japan passing” -- as younger generations of other countries benefit from overseas studies while young Japanese stay isolated at home -- and ultimately, the loss of Japan’s competitiveness on the global stage. What can Japan and the United States do individually and collaboratively to improve the quantity and quality of bilateral educational exchanges?

### **Japan**

The Japanese government should first focus on improving the country’s higher education system so that it embraces internationalization in a comprehensive way. Japan must put in greater efforts to proactively promote such an initiative due to the country’s geographical isolation and the still formidable language barrier.

First, it is critical to have an agenda that includes priority setting and a timeline with concrete outcomes so that the progress of efforts can be evaluated. Such priorities should enjoy strong governmental support.

The reform can start from expanding courses conducted in English. Until 2009, the number of universities that permit graduation solely from “classed in English” is only 1% for undergraduate level and 14% for graduate level<sup>175</sup>. By expanding the courses conducted in English will not only attract more international students, but also prepare Japanese students better in their future pursuit of oversea study. Secondly, university should also actively recruiting foreign faculty and professors with overseas experience. At leading universities abroad, it is not rare that 30% to 40 % of all teachers have foreign nationalities. In Japan, the percentage of foreign teachers at domestic universities is extremely low in comparison. Japan is not carrying out its responsibility to its own citizens as well as to the international society by isolating its academic world in this way. Japan should enhance the international competitiveness of its universities by globalizing the educational and research experiences of students and teachers both inside the country and abroad. Further steps toward that goal could include changing from spring to autumn admissions in line with the international standard. Those high school students who have completed their high-school courses in March may utilize a period of about half a year from April to the admission season to accumulate social experience, such as a short term study abroad, volunteer activity or the like.

Further improvement of the linguistic ability of Japanese students is essential. Historically, English was viewed as a means of acquiring knowledge, rather than as a means for facilitating dialogue or cross-cultural communication. Consequently, English-language pedagogy historically focused on grammar and translation rather than on developing communication competencies, intercultural awareness and a global perspective. The Japan Exchange and Teaching Program (JET Program) began in 1987 as a bold plan to bring native English speakers from a variety of English speaking countries to Japan, where they would serve as assistant language teachers (ALTs) in Japanese public junior and senior high schools.

---

<sup>175</sup> Presentation by Tomohiro Yamano, advisor at MEXT, in Jan 2013.

The JET Program has played an important role in improving English education in Japan, but adjunct foreign English-language teachers (AFELT) may be considered exploitable because of their status as adjunct staff. Communicative English-language programs and native teachers are not taken seriously by students, Japanese academics, and administrators of higher education.

While many Japanese universities appear to offer well-coordinated English-language programs, whether they relate to international understanding and intercultural awareness and communication is questionable. There has to be a smooth integration of such goals into the purpose and function of higher education in Japan. In this regard, the government and the media need to play a proactive role in promoting English in the education system as an effective means for facilitating cross-cultural dialogue and understanding. In addition, the JET program should be made an even more substantial part of lower education in Japan.

Further, the high school years of Japanese youth should be targeted for educational exchange promotion. Those years can be a stepping-stone toward further participation in higher educational exchange. To encourage more high school students to study abroad, the International Baccalaureate should be offered in more Japanese schools. The International Baccalaureate (IB) is a non-profit educational foundation, motivated by its mission, focused on the student. Founded in 1968, they currently work with 3,570 schools in 145 countries to develop and offer four challenging programs to over 1,095,000 students aged 3 to 19, which help students develop the intellectual, personal, emotional and social skills to live, learn and work in a rapidly globalizing world. Currently, there are 787 schools in the U.S. and 57 schools in China that offer this degree, while only 16 schools in Japan<sup>176</sup>.

Aside from academic institutions, businesses and other segments of the private sector should be encouraged to introduce programs and activities that encourage internationalization at the corporate level. For example, a young person should be able to receive a clear and positive evaluation for the experience of studying abroad, and not be impeded from promotions or other career enhancements because of time spent abroad. There should be a shift in corporate priorities and recruitment efforts to require proficiency in English and or other languages used internationally. Employment quotas for those who have experienced foreign study are another possibility. Some institutions might provide corporate scholarships for overseas study. Business associations like Keidanren should encourage year-round hiring and preferential treatment to companies that hire Japanese returning from study abroad.

### **United States**

American universities eager to have more Japanese students might offer more incentives such as tuition waivers and conditional admission. There should be efforts like tuition waivers to reduce the financial burden of talented young people unable to afford studying in the U.S. Conditional admission could be made to Japanese students who are considered to be academically qualified, but lack the English proficiency required for regular admission. The students can demonstrate a specified level of English proficiency later by taking the TOEFL or IELTS again or completing level 112 of the English as Second Language (ESL) for Academic Purposes Program. Such a measure has great appeal to international students who plan to study in the U.S.

---

<sup>176</sup> <http://www.ibo.org/general/who.cfm>

For Japanese students, the U.S. remains a gateway to the world. Making use of the Internet can powerfully assist in the dissemination of information promoting the rebranding of U.S.-Japan educational exchange. For instance, Education USA is a global network of more than 400 advising centers supported by the Bureau of Educational and Cultural Affairs at the U.S. Department of State. Six of these Education USA centers are located in Japan: three in Tokyo; one in Fukuoka; one in Osaka; and one in Sapporo.<sup>177</sup> The Education USA centers in Japan have been under-utilized by MEXT and U.S. agencies in terms of promoting Japanese students to study abroad in the United States. They have many connections, not only with well-known U.S. universities and colleges, but with secondary and community colleges as well. Education USA could be an extremely helpful means to get more students interested in the U.S.

The flexibility of the U.S. visa system should be enhanced. Currently, international students in the U.S. are under the F-1 visa, which does not allow students to work outside university until they study there more than a year. After one year, only Curricular Practical Training (CPT) allows overseas student to work under the F-1 status. However, approval for CPT usually takes a long time. Therefore, Japanese universities have difficulty in arranging a program which contains internship, volunteer and other kinds of practical activities, in addition to study. In contrast, Australia, Canada, New Zealand, and Britain have holiday working visas available to Japanese young people that allow study and travel. For instance, Japanese students can stay, study and travel in Canada without a visa for as long as six months or they may opt for a holiday working visa that is good for a year. According to the Canadian government, 3,546 Japanese students obtained study visas in 2011, up from 3,238 in 2010<sup>178</sup>. As work opportunity has become a major determinant when students are planning to study abroad, F-1 status should allow oversea students to join various programs which include internship and other kinds of practical activities. Under the current visa status, U.S. universities could also coordinate more programs which contain various kinds of practical activities that would enhance the attraction for Japanese to study in the U.S.

### **Jointly**

There is much room for strengthening inter-university collaboration between Japan and the U.S. Japanese universities are making a shift to short-term dispatches and student exchanges based on inter-university agreements, as problems associated with overseas study are relatively easy to address and resolve in such programs. Here, short-term is defined as less than a year of study abroad. This kind of program is popular because it is more affordable and in general does not interfere with a student's pursuance of a degree. While the total number of Japanese students studying in the U.S. has been decreasing, the number of Japanese students studying in the U.S. based on the inter-university exchange agreements has not been decreasing. In fact, the number of inter-university exchange agreements between US and Japanese universities is steadily growing. Studies have shown that there are no significant differences based on the length of study abroad in relation to global awareness gained. Instead, the study emphasizes the profound increase initial cultural immersion has on views of global engagement when compared to views before the study abroad program. Such short-term exchanges can act as a springboard for longer study abroad.

---

<sup>177</sup> <http://www.educationusa.info/Japan>

<sup>178</sup> <http://www.nytimes.com/2013/03/25/world/asia/25iht-educside25.html?pagewanted=all>

Unfortunately, recent cuts on both the Japanese side in Japan Foundation funding and the U.S. side on Fulbright funding<sup>179</sup> are alarming. Both nations should do their utmost to maintain the core institutions of bilateral educational exchange, which have long played a critical infrastructural role for maintaining educational, cultural and intellectual ties between the two nations.

### **“The Science without Borders” Model**

The Science without Borders Initiative is a good potential model for increasing the number of Japanese students studying in the United States. The “Science without Borders Initiative”, known also as the 101,000 Strong Initiative, was introduced by Brazilian President Rousseff. The program aims to send 101,000 Brazilians abroad to study science, technology, engineering and math over the next four years. Half of these students and researchers are expected to study within the U.S.

The Science without Borders Initiative has already made partnerships with community colleges, public and private colleges and universities, states, and other consortia to promote this education program. Education USA has been involved in brokering these partnerships. A total of 75,000 Brazilian students and researchers will be funded by the Brazilian government itself, while the other 26,000 will be funded by the private sector through scholarships. The process in selecting students is straightforward: Brazilian universities nominate candidates for the program, the Agency for the Support and Evaluation of Graduate Education (CAPES) and National Council for Scientific and Technological Development approve the students and takes care of their placement, tuition, and fees, and finally the hosting institutions makes the final decision of acceptance. The first cohort under the initiative has already been sent to more than a hundred U.S. universities in forty two states.<sup>180</sup>

There are six Education USA centers in Japan that can facilitate connections with U.S. universities and colleges, as well as offer advice and supplemental materials on these U.S. academic institutions to Japanese students.

There are many policy options open to encourage and assist Japanese students to go abroad especially to the United States. With growing global interdependence, this endeavor to promote educational exchange, is a win-win situation. The U.S. and Japan will be different players on the global stage in coming decades, and each will experience increased demand for global human resources. The promotion of pragmatic pathways toward developing and cultivating global citizenship and global leadership is a critical priority. Also, the bilateral cooperation of the two countries for knowledge generation has a great potential for solving global issues.

---

<sup>179</sup> Joint statement by CULCON in April,2012

<sup>180</sup> <https://www.scientistswithoutborders.org/>

## References

- Beltramello, A. (2011). Opening Japan: Comparisons with Other G20 countries and Lessons learned from International experience. OECD Science, Technology and Industry Working papers.
- Craig Whitsed, Peter Wright. (2011). Perspectives from within: Adjunct, foreign, English-language teachers in the internationalization of Japanese universities. *Journal of Research in International Education*.
- Keidanren, N. (2010). Sunrise Report.
- Kevin Kehl, Jason Morris. (2007). Differences in Global-Mindedness between Short-Term and Semester-Long Study Abroad Participants at Selected Private Universities. *The Interdisciplinary Journal of Study Abroad*.
- Matthew, R. (2002). The bear and the honeycomb: a history of Japanese English language policy. *Nagoya University journal of language culture and communication*, 41-52. Retrieved from <http://www.nucba.ac.jp/cic/pdf/njlcc041/05REESOR.PDF>
- METI, T. G. (2010). Develop Global Human Resources through Industry-Academia-Government Collaborations.
- S. Poole, G. (2005). Reform of the University English Language Teaching Curriculum in Japan: A Case Study. In *The 'Big Bang' in Japanese Higher Education: The 2004 Reforms and the Dynamics of Change* (pp. 242-273). Tokyo: Trans Pacific Press.

## **Waning Cultural Influence of Japan on the U.S.: Case Study of Video Games**

By Curtis Yibing Che

### **Introduction**

Video games, since the golden age for this popular entertainment in 1980s, have been regarded as one the most influential of Japanese brand industries. Japan's strengths in video games had to do not only with consistent technological innovations, but also the unique concepts instilled in the virtual world by generations of Japanese video game producers. As a result, Japanese video games reaped tremendous success beyond the domestic gamers and expanded into overseas markets, with the U.S. providing the most fertile ground.

Nowadays, the international video game industry, following decades of rapid developments and marketing strategies, has changed dramatically. Competition in the U.S. market alone has become ferocious: With new games produced by the rising European and American developers, Japanese games gradually forfeited their once solid monopoly. The market share of Japanese games in the U.S. has been on the decline for the past decade or so, an observation often interpreted as symbolic of a "dying" industry.

If the question of dying versus prospering comes down to the sheer size of the market share, the answer is clear for Japanese firms. Yet, if we are to consider the impact of Japanese culture in the U.S. through the medium of video games, the picture gets somewhat murky as more decisive factors can be included.

Game culture per se, is a tricky term whose definition receives constant updating. The game industry is propelled by active dynamics and non-stop innovations. The video game technology is a contributing factor in the shaping of game culture, let alone the unpredictable preferences or individual tastes that determines the nature of new games every year.

Thus, is it a valid claim to argue that the cultural values associated with Japanese video are also waning in the U.S. as the percentage of sales decrease there over the years? In other words, can cultural impact or cultural differences explain the loss of American gamers' appetite in Japanese video games? If so, does it provide any insights to Japanese game producers for a likely comeback in the future? And more broadly, are the cultural interests of Americans and Japanese at the popular level – games, movies, and other entertainment contents – drifting apart?

To provide a comprehensive answer, this paper will take on the questions above from the perspective of both American and Japanese gamers. The comparative study approach serves to lay out some of the major differences between U.S. and Japanese games before reaching the conclusion on the cultural impact of Japanese video games in the United States.



## The Role of the Government in Japan's Video Game Industry

It is important to note that Japanese video game sector is a free market determined solely by market forces. There is no regulatory authority exercising top-down guidance in the industry. Nor does the government provide subsidies or support of other forms to game companies.

That being said, Japan does have a self-regulating system in place. CERO, abbreviated for Computer Entertainment Rating Organization, is the sole rating agency for video games released in Japan, similar in functions to Entertainment Software Rating Board (ESRB) in the U.S.<sup>181</sup>. Established in 2002, CSA is a non-profit entity that scrutinizes the content of video games and notifies consumers by assigning advised parental guidance ratings. Apart from rating video games, CERO is also specialized in the research on video games environment, disseminating age-appropriateness rating system and cooperating with individuals and organizations on upholding code of ethics, etc.<sup>182</sup>. Although the rating system is voluntary, due to the reputation of CERO as well as the information guidance that CERO is known for providing, most game companies choose to obtain CERO membership.<sup>183</sup>

Although the Japanese government does not intervene directly in the market, various government affiliates indeed do keep a close watch over moves in the industry. The Ministry of Economy, Trade and Industry (METI) and Japan External Trade Organization (JETRO) are among those agencies that probe into issues such as the employment in the game industry, the viability of Japanese game developers, and the social behavior aspects of video games.

The reasoning for paying close attention to the video game industry is that it does not run as a stand-alone sector in the Japanese economy. Rather, a lot of synergies exist between video games and surrounding industries such as anime (animated) video and manga comics. The implications of video game sales and production are therefore far-reaching. In the broader context of culture exchange, video games have provided a platform of communicating the ideals and values of Japanese culture to the outside world since the industry's birth in the 1970s. This began a process referred to by some scholars as the globalization of Japanese culture production.<sup>184</sup>

Moreover, given its early dominance over the global market, the Japanese video game industry now finds itself in deep decline, and its once monopoly overtaken by European and U.S. game creators. Reportedly, Japan's market share of video game sales globally has fallen to a nadir of merely 9%, down from over 50% in the 1980s.<sup>185</sup> The origin of such decline is something that both the Japanese government and game makers are keen on discovering.

## Market Overview

Both the U.S. and Japan boast huge markets for game software, being the first and second largest in the world. In 2011, the U.S. game software market amounted to an astounding 719.1 billion

<sup>181</sup> Rating guide for ESRB, please refer to: [http://www.esrb.org/ratings/ratings\\_guide.jsp](http://www.esrb.org/ratings/ratings_guide.jsp)

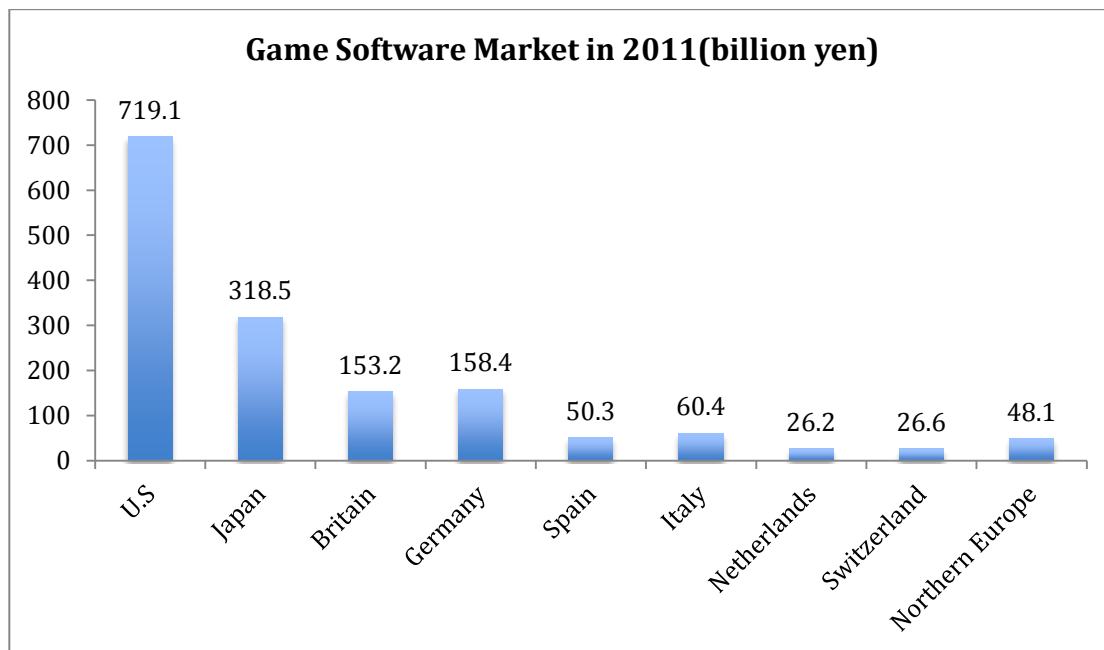
<sup>182</sup> According to the website of CERO, available at: <http://www.cero.gr.jp/e/outline.html>

<sup>183</sup> Gifford, Kevin, All about Japan's Anti-Violence Game Rating System: Why getting a Z is the kiss of death over there, Iup.com, available at: <http://www.iup.com/news/japan-anti-violence-game-rating-system>

<sup>184</sup> Please refer to: *Manga, Anime and Video Games: Globalizing Japanese Cultural Production* (2007) by Dr. Minako Oohagon, published in *Perspectives: Studies in Translatology*

<sup>185</sup> *Main Players in Video Game Industry*, Duke University, available at: <http://sites.duke.edu/soc142-videogames/international-trade-patterns/main-players/>

yen, followed by 318.5 billion yen in Japan (see chart below; dollar equivalents not available). Consider the difference in total populations; the American and Japanese markets are about the same size in relative terms.



(Source: CESA Game Report, 2011)

Japanese games used to enjoy dominant influence in the U.S., boasting name brand game series including the Mario Bros, Pokemon, Legend of Zelda, and Final Fantasy. Characters originating from classic games earned wide acclaim in America and became cultural icons of Japanese gaming industry. The characters, by and large, were seen as representations of Japanese popular culture. Americans, just like gamers anywhere else in the world, recognize the games they play, the consoles that run the majority of popular games, as well as the characters in many games as cultural artifacts of Japan.<sup>186</sup>

The sweeping success in early years earned Japanese game producers fortune and reputation that nurtured a group of outstanding performers into multinational enterprises. Among them, Nintendo and Sega were under an extra spotlight as the two companies did not only specialize in producing video games but were also developers of game consoles that revolutionized video game philosophy on a consistent basis.<sup>187</sup>

Over the past decade, however, overseas markets, the U.S. in particular, has oddly seen almost no new popular hits by Japanese companies with characters of equivalent charm. Certainly, popular games like the Mario Bros endure the test of time as old series continue to develop new games over the years. Yet, the decrease in the number of popular Japanese games is an undeniable fact. A popular claim voiced by many is that the “Japanese gaming industry is dead”

<sup>186</sup> Japanese Media in the U.S., available at: <http://www.freewebs.com/qube808/>

<sup>187</sup> For more detailed descriptions on the similar path Nintendo and Sega take, please refer to: *Is Nintendo Following the Path of Sega?* IGN.com, <http://www.ign.com/blogs/logicallydashing/2013/01/21/is-nintendo-following-the-path-of-sega>

Moreover, even the old brand names are losing charisma as gamers began to get fed up with the repetitions of similar characters stories.<sup>188</sup>

In the meantime, U.S. and European games, significantly outperformed Japanese games in sales and critics, claimed grand victory in the U.S. In 2011, among the top 10 bestselling video games in the U.S., 6 games are made by American developers and 4 by European developers. The most popular Japanese games, two new Pokemon games, are ranked 11th and 15th on the chart<sup>189</sup>.

#### 2011 Best Sold Game Software in Japan (all domestic)

	Title	Maker	Genre
1	Mario Kart 7	Nintendo	Racing
2	Super Mario 3d	Nintendo	Action
3	Monster Hunter	Capcom	Action
4	Monster Hunter	Capcom	Action
5	Final Fantasy 13-2	Square Enix	RPG
6	Final Fantasy Zero	Square Enix	RPG
7	Rhythm Heaven	Nintendo)	Music
8	Tale of Xillia	Namco Bandai	RPG
9	Wii Sports Resort	Nintendo	Sports
10	Wii Party	Nintendo	Other

<sup>188</sup> Stuart, Keith, *Is Japan 'finished' in the games industry?* Available at <http://www.guardian.co.uk/technology/gamesblog/2009/sep/30/games-gameculture>

<sup>189</sup> *2011 video game industry report*, METI, 2012

<b>2011 Best Sold Game Software in the U.S. (no Japanese brands)</b>			
--	--	--	--

	Title	Maker	Genre
1	Call of Duty: Modern Warfare 3	Activision (US)	Racing
2	Just Dance 3	Ubisoft Entertainment(Fra)	Action
3	Madden NFL 12	EA (US)	Action
4	Elder Scrolls V: Skyrim	Bethesda (US)	Action
5	Battlefield 3	EA (US)	RPG
6	Call of Duty: Black Ops	Activision (US)	RPG
7	Batman: Arkham City	Eidos (UK)	Music
8	Gears of War 3	MS (US)	RPG
9	Just Dance 2	Ubisoft Entertainment(Fra)	Sports
10	Assassin's Creed: Revelations	Ubisoft Entertainment(Fra)	Other

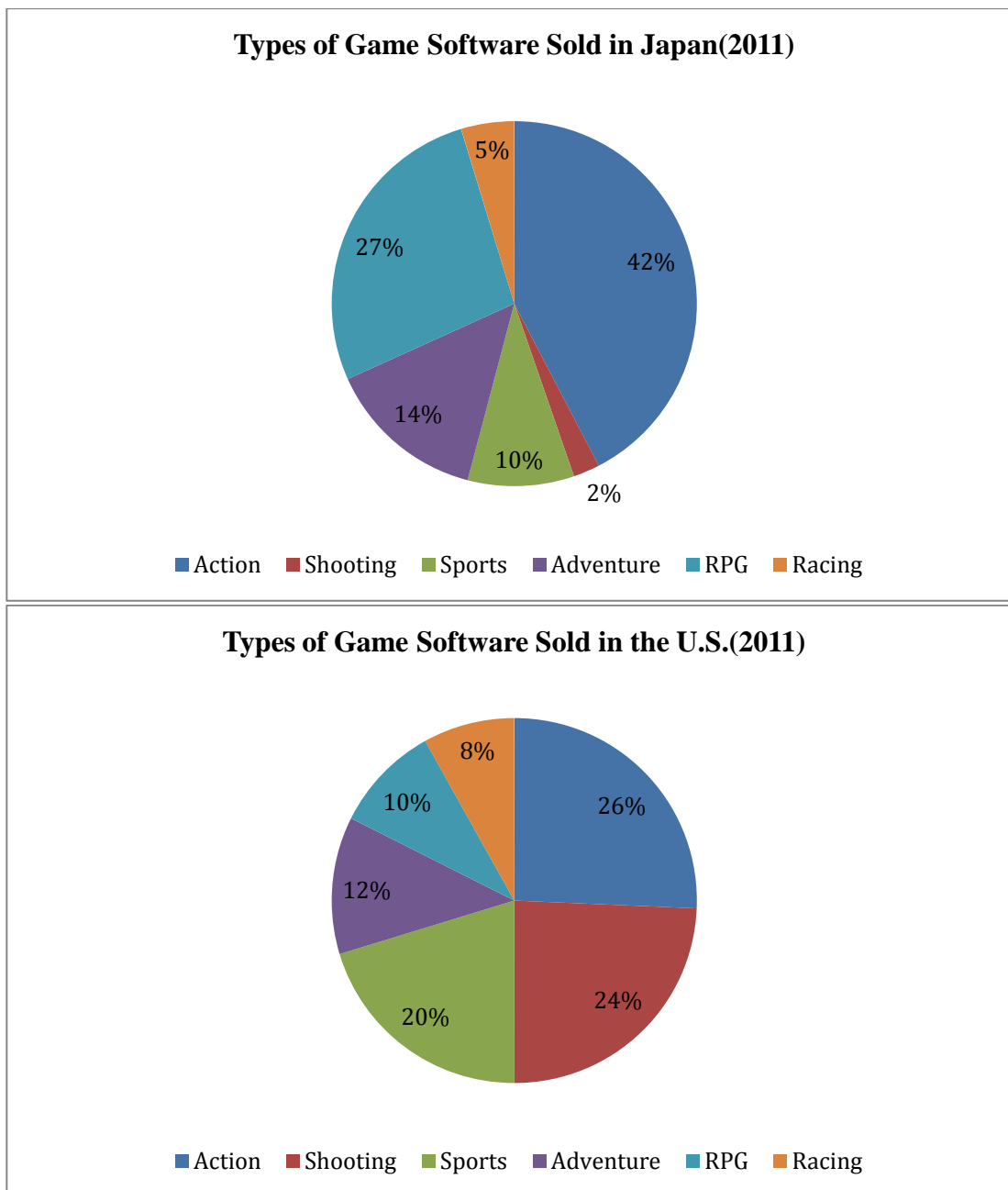
(Source: CESA Game Report, 2011)

### Definition of Gaming Culture

Defining game culture is the starting point for observing the trends of cultural influences of video games. Today's game culture encompasses a variety of interest parties that play distinct roles in the shaping of game culture: Who plays (gamers), what they play (content, protagonists, storyline, picture and other elements of the games, design strategies) and how they play (social behavior of video gaming). The following sections lay out the landscape of gaming culture in the States and Japan in order to find out the similarities and differences between the two, which serves as the structure of arguments for this study.

## Who Is Playing?

### Japanese and U.S. Gamer Demographics



(Source: Gaming Industry Report 2011, Ministry of Economy, Trade and Industry)

Statistics show that in the U.S., average gamers are 30 years old with 12 years of gaming experience<sup>190</sup>. In Japan, the largest gamer group is 9 to 14 years old and 35-39 years old, with the overall average age at 26.5.<sup>191</sup> The preferences of games are different in the U.S. and in Japan as

<sup>190</sup> Video Game Market, Entertainment Software Association, available at: <http://www.theesa.com/facts/>

<sup>191</sup> 2011 Japan, Korea Game User and Non-user Report, Computer Entertainment Supplier's Association, 2012

well: While shooting take up big portions in U.S. markets, Japanese gamers favor role playing games (RPG).

Preferences of games are also reflected elsewhere. Even in the same category of video games, Japan and America differ dramatically. For example, action games in Japan, with high popularity, include chart hits such as Mario Brothers and Monster Hunter, which are modestly intense and have little to no game restricting content. In the U.S., action games characterize a lot more mature content and violent actions like God of War. The majority of action games cater to adult video gamers. One is tempted to draw inferences from this of linkage to America's gun culture and addiction to violence in movies and other entertainment.

Another observation is Japanese gamers' obsession with role playing games. Three of the top 10 best sellers in 2010 are RPG, namely Final Fantasy 13, Final Fantasy Type-O and Tales of Xillia. In 2011, RPG accounts for 23% of the games sold in Japan, comparing to merely 7% and not a single RPG in the top ten titles in the U.S. In fact, the popularity of RPG has been a fashion with longstanding history in Japan. Here, one is tempted to infer that Japanese tend to opt for escapist entertainment in literature, games, and movies.

In addition, sizable gap exists between the popularity of shooting games. While games like Call of Duty swept across the U.S. market, Japanese gamers seem to care little about such violent scenarios. In 2011, shooting games make up 18% and 2% of overall sales in the U.S. and Japan, respectively. The flourishing of shooting games follows the adoption of advanced physics and picture engine by video game production.<sup>192</sup> Japanese gamers however, did not shift their preferences to shooting games as Americans did. In fact, none of the top 10 best sellers in Japan are of this category in the same year.

### **Changing Preferences**

Changing tastes for video games have revamped the U.S. market. In recent years, games that build on a virtual world with many options have gained huge popularity. GTA series by Rockstar studio for example, was a sensational hit that earned wide acclaim among US gamers. The game is based on a virtual American city in which gamers are allowed to pursue various routes and different options without the need to follow preset storylines, or so called linear format.

Another category of games that surged in the past decade was point of view (POV) and over-the-shoulder shooting games. In recent years, more and more shooting games such as Call of Duty and Battlefield rely on cutting-edge graphics, vivid animation system, motion capture mechanisms and other advanced gaming technologies, which provide the real world experience that U.S. gamers increasing demand.<sup>193</sup> The lack of advanced technologies and difference in design strategies are two key factors that put Japanese firms at disadvantage, as will be discussed in later sections.

---

<sup>192</sup> *In Japan, game makers struggle to instill taste for Western shooters*, wired.com, available at: <http://www.wired.com/gamelifelife/2010/09/western-games-japan/>

<sup>193</sup> Please refer to an article by Martin Robinson on Eurogamer. Net: The truth about Japan: a postcard from the Japanese games industry, available at: <http://www.eurogamer.net/articles/2012-10-10-tokyo-story-a-postcard-from-the-japanese-games-industry>

Developing game series with several installments and popular characters are what made the greatest fortune for Japanese game creators. Past lessons such as Resident Evil and Final Fantasy seem to serve this principle well and become the bible for the majority of game companies in Japan. Indeed, faithful followers for long-life Japanese games still exist in America, but more people are growing tired of the seeming never ending series. Ranked 12<sup>th</sup> in 2011, Pokemon (Pocket Monsters) is the best sold new game of old Japanese brand name in the U.S.

Along the lines of game developing strategies is the difference between supply and demand market orientations. In Japan, game developers are mostly dedicated game players themselves. With strong personal perspectives to start, Japanese developers create games that fit their tastes. Japanese gamers are presented with a wide range of isolated games to choose from. The result is the survival and flourishing of the fittest games with unique features that few others measures up. On the downside, the supply driven market slows down staff and technology upgrade as incentives are lacking.<sup>194</sup>

In the U.S., with massive resources poured on market research and marketing campaigns, companies track closely the needs of gamers. Games are typically reflective of mainstream tastes and views to accommodate a high volume of market demand. Consequently, games created that sell well in the U.S. are those that conform to mainstream tastes and homogenization of game culture. In recent years, popular games in the U.S. sold well in Asia, Europe and other areas but almost never in Japan. Japanese games seem to be successful mostly in the domestic market. American gamers complain that Japanese games have to try harder to regain the favor of foreign players as not many of them are interested in the 2D manga character-based games that Japanese love.<sup>195</sup>

It seems that split preferences in the U.S. and Japan explain the difficulties for Japanese firms to survive overseas. However, challenges are equal for U.S. firms. For example, Electronic Arts, the gaming giant that enjoyed tremendous success in America and Europe, has not made even a minor breakthrough in Japan thus far. According to analysts, failing to address game types that Japanese prefer remains a tough hurdle to leap over<sup>196</sup>. In this sense, if Japanese game culture has passed its prime in the U.S., American game culture hardly ever made a dent in Japan. Consumer preferences, therefore, are only a partial answer to the struggle of Japanese game developers in the U.S. Nor does that factor lend any validity to the argument that the cultural impact of Japanese video games is shrinking across the Pacific.

### **Nationalism**

Some researchers argue that Japanese are somewhat nationalistic when it comes to purchasing video game consoles. One example is the disappointing sales of Xbox 360, a game console produced by Microsoft: Six years after it was available in Japan, Xbox 360 totaled 1.5 million units of sales<sup>197</sup>, as opposed to the 6.3 millions for PS3. In the U.S. however, gamers rarely base

<sup>194</sup> According to Martin Robinson in *The truth about Japan: a postcard from the Japanese games industry*

<sup>195</sup> Please refer to the article by Ryan Winterhalter: Why Japanese Games are Breaking Up With the West, available online at 1Up.com, <http://www.1up.com/features/japanese-games-breaking-west>

<sup>196</sup> According to *Japan-U.S. divide splits video game industry* by Daisuke Wakabayashi and Ben Berkowitz, released by Reuters, available at [http://www.ddrfreak.com/newpress/Japan-U\\_S\\_%20divide%20splits%20video%20game%20industry.htm](http://www.ddrfreak.com/newpress/Japan-U_S_%20divide%20splits%20video%20game%20industry.htm)

<sup>197</sup> Leigh Alexander (March 31, 2011). *GameStop Details Europe, U.S. Installed Base For Consoles*, Gamasutra.

their purchases on whether the game was made in the U.S. or not. Japanese game consoles, PlayStation 3, sold 13.5 million units in the U.S. as of November 2010<sup>198</sup> compared to 24 million for Xbox 360 as of March 2011. Consider that Xbox 360 was released one year before PlayStation 3, the actual gap in sales can be much lower.<sup>199</sup> Researchers believe that in Japan, it is natural for one to support products from his or her own country, especially when presented with two products of similar functions and prices.<sup>200</sup> Whether Japanese gamers prefer Japanese games for the same reason is unknown, but almost certain that American gamers tend to get swayed less by nationalism, as European and Japanese games at various points dominated the U.S. market.

## What They Play

### Strategies of Game Design

Japanese games are usually made based on a so-called “from the core out” pattern, meaning that the main characters are built before the creation of supporting cast and the surroundings.<sup>201</sup> The main characters are usually the very center of most traditional Japanese games, with details carefully delineated and personality meticulously crafted by the designers. Pokemon and Mario Brothers characters are cases in point.

In fact, Japanese games are remembered for their strong characters. In RPGs for example, game developers personify protagonists in many ways so as to set the stage for series or lineage by tracing the biographies of the characters. Some virtual characters have their biography or family tree outlined as the series go on. For example, in Capcom’s Resident Evil, which started in mid 1990s and released its sixth game in 2012, is built around lives of a few protagonists following a virus outbreak.<sup>202</sup> Prioritizing characters also open the gate for marketing campaigns of related products. For instances, making use of the brand name of Mario Bros series, Nintendo sold books, clothes, plush toys, or hardware equipment to loyal gamers. Movie production is another lucrative area of extension, which has adapted stories of Tekken<sup>203</sup> and Silent Hill<sup>204</sup>, among others, into Hollywood blockbusters.

On the other hand, American and European games were created based on an out-to-core strategy. Opposite to the character-first Japanese game making process, constructing a virtual environment is the very first step in American and European game design. With the advent of 3D and other cutting edge technologies, the quest for surroundings and objects that highly resemble the real world picked up the pace. In the meantime, characters of the games are assigned less importance, as the ultimate goal of the game developers is to mimic the gaming experience as if it was “yours” rather than telling the life stories of imaginary figures.

<sup>198</sup> Gamasutra, *Gamasutra – News – Fils-Aime: Holidays More Important To Nintendo Than Rivals*, 2010.

<sup>199</sup> Microsoft Corporation, *Bill Gates Declares 10 Million-Unit Head Start for Xbox 360 and Outlines Future of Interactive Entertainment*. Microsoft Corporation. 2006.

<sup>200</sup> Moriarty, Colin, *Why Did Xbox 360 Fail in Japan?* IGN.com, available at: <http://www.ign.com/articles/2013/04/01/why-did-xbox-360-fail-in-japan>

<sup>201</sup> Please refer to a direct quote of Alex Jones, producer of Devil May Cry and a conduit between Cambridge-based developers Ninja Theory and Capcom Japan, available at: <http://www.eurogamer.net/articles/2012-10-10-tokyo-story-a-postcard-from-the-japanese-games-industry>

<sup>202</sup> For a more detailed introduction of Resident Evil series, please refer to Resident Evil Wikia, available at: [http://residentevil.wikia.com/Resident\\_Evil\\_series](http://residentevil.wikia.com/Resident_Evil_series)

<sup>203</sup> Review of the movie Tekken is available at IMDb: <http://www.imdb.com/title/tt0411951/>

<sup>204</sup> IMDb review of Silent Hill: [http://www.imdb.com/title/tt0384537/?ref\\_=sr\\_2](http://www.imdb.com/title/tt0384537/?ref_=sr_2)



The in-out and out-in strategy presents a sharp contrast of the Japanese versus Western cultural norms, which translates into differing perceptions of games by U.S. gamers. U.S. gamers appreciate video games more along the lines of realism of experience whilst Japanese treasure the charisma of fictitious characters.

### **Domestic versus International Focus**

A lot of Japanese firms nowadays devote most resources to domestic gamers, lacking the will power to carve up greater market share overseas. Few Japanese made games impressed people to the similar extent as those in 1980s and 1990s. In the meantime, the successful series are gradually losing their pull among U.S. gamers, revolving around different stories yet the similar virtual characters. Some Japanese firms like Capcom were aware of the importance of refreshing storylines and updating game features in efforts to conform to Western tastes yet received lukewarm reaction from the market. The flop of Resident Evil 6 serves a great case for this argument.

On the other hand, the majority of Japanese game companies target Japan as the sole end-markets and rarely make any efforts to compete internationally. After all, Japanese gamers have specific needs for video games that only Japanese companies seem to meet. Numbers have suggested that just as popular games in the U.S. are dominated by American and European developers, the Japanese video game industry, too, is monopolized by domestic game producers. METI's ranking of the top ten popular games in Japan shows all to be made by Japanese firms, a clear sign that the Japanese gaming market is highly insulated from outsiders.<sup>205</sup>

Why did Japanese gamers not become fans of American and European games, disregarding their popularity outside Japan? The uniqueness of Japanese games however, has to a great extent hurt its competitiveness in the U.S. Japanese games are too different from the rest of the world that few non-Japanese seem to appreciate them.

While Japanese game creators were retreating to home base, European and American game companies committed to serving wider ranges of gamers. Indeed, U.S. gamers are buying into the European and American game ideologies: The split up between European and American games in the top 10 most popular game chart is evident of such market trend. American games like Call of Duty for example, has achieved tremendous success both in and outside of U.S. U.S. game companies aim to rake in as much revenue as they can by conquering overseas markets. Anecdotally, the latest installment of Activision, Call of Duty: Black Ops 2, hit a record high 1.5 billion world sales in U.S. dollars within 15 days since the day of release.<sup>206</sup>

### **Technology**

Back when video game industry was at a nascent stage, producers made do with rough graphics and raw pictures with little advanced technology employed. Most games were presented in dots, lines and blobs that resemble the landscape or characters created. It was this very era of next to

<sup>205</sup> 2011 Video Game Industry Report, METI, 2012

<sup>206</sup> LeJacq, Yannick, *Activision Breaks Own Sales Record With 'Call of Duty: Black Ops 2,' Grossing \$1B In 15 Days*, International Business Times, Dec. 5<sup>th</sup>, 2012, available at: <http://www.ibtimes.com/activision-breaks-own-sales-record-call-duty-black-ops-2-grossing-1b-15-days-921473#>

zero technology that Japanese earned its kudos in the market. With its simple yet compelling picture design that inspired gamers' imagination, Japanese games like Namco's Pac-man blasted into the U.S. market. Later on in the 1980s, Pokemon and Legend of Zelda again attracted U.S. gamers for similar reasons: Arresting storyline with rough pictures. Some studies were done to probe into the secret of creating Legend of Zelda and found a connection between the garden settings most often seen in the game and Japanese concept of "hakoniwa", the idea of expressing the world within a limited space as seen in traditional Japanese style gardens.<sup>207</sup>



---

<sup>207</sup> Kiyoshi, Tane, *Decoding the Charm of Japanese Video Games (Part One): A History of Combining Technical Prowess and Creativity*, Nippon.com, translated version available at: <http://www.nippon.com/en/views/b00101/>



(Snapshots of Pac-Man and Legend of Zelda, source: Nippon.com)

With the advent of new game consoles that made 3D and high definition technology a common place for video games, Japanese games started to fall behind firms in America and Europe. While a growing portion of popular games in the U.S. employed high quality animation and audio technologies to mimic the real world, Japanese developers seem to be apathetic about a ubiquitous market trend that has gradually become the mainstream fashion. Some say that Japanese game developers refuse to infuse too much new picture technology into their game design most likely for two reasons: The exclusiveness of the Japanese market as described in previous section, and more importantly, the Japanese approach of game perception. The 2D characterization used most often in manga based games and RPG, is still held dear to by the majority of both Japanese game makers and players, which plays down the need for technology upgrade.<sup>208</sup>

Another explanation for the technological gap between Japanese and Western game companies traces back to the origin of massive technological breakthroughs when PC game technologies were transplanted to game consoles. Researchers argue that due to the lack of PC game sector, Japan was in a natural disadvantageous position to catch up with Europe and U.S., where knowledge sharing with personal computer entertainment software gave the industry a critical boost in technology upgrade.<sup>209</sup>

<sup>208</sup> From a speech made by Hideo Kojima, famous Japanese game producer, available at: <http://www.eurogamer.net/articles/2012-03-16-kojima-japanese-developers-lack-global-outlook-technological-skills>

<sup>209</sup> According to Brian Ashcraft in his article *Why Japanese Developers Should Have Played More PC Games*, available at Kotaku.com: <http://kotaku.com/5844588/why-japanese-developers-should-have-played-more-pc-games>

Whatever the reasons, nowadays European and American game firms boast cutting edge physics and picture engine, along with other key technologies in game development. Japanese producers on the other hand are lagged behind due to lack of investment and research over time.

### **The Growing Mobile Gaming and Handheld Game Sector**

Although the share of Japan's games designed for televisions ( "*terebi geimu*" ) in the video game industry (games on television, or games played on TV-connected dedicated game consoles such as PS3, Wii, Gamecube and Xbox, etc.) have been shrinking relative to the entire video game market, mobile gaming is flourishing at a rapid pace. Mobile games have met the needs of suburban population in Japan, which lacks choices for entertainment as people live in cities. Another feature of mobile games in Japan is the simplicity. Most mobile gamers in Japan are those who need a time killer during a commute. Making easy-to-play games that end in minutes is more important than creating astounding graphics or arresting storylines with high complexity of controlling, which may appeal to hardcore gamers but not salaried workers on trains.

Japanese mobile game companies are expanding at a rapid pace amidst the inclement market climate for Japanese game companies in the U.S. Developers such as GREE and DeNA, often referred to as social application providers, produced popular hits that have resonated both in Japan and foreign markets<sup>210</sup>. Because a growing portion of mobile games typically run on smart-phones, tablets and other non-dedicated game consoles, the ongoing revolution of mobile devices lends expectations to exploiting the huge market potential of mobile games in the near future.<sup>211</sup>

The market for mobile games designed for traditional game consoles is also growing steadily in Japan. As a matter of fact, among the top 10 most popular game software in Japan of 2011, 3 are handheld games that operate on either Nintendo 3DS or PlayStation Portable (PSP). In U.S., this number is zero.

### **How They Play: Cultural Identity**

#### **Groupism versus Individualism**

In Japan, games that allow cooperation between friends and family have boomed to becoming a major market presence. With family entertainment feature led by Nintendo Wii, Japanese have grown fond of games that allow shared joyful gaming experience among a group of people in a single room. This is different from the online gaming feature of most American games, which still separates games in their individual console systems and enables communication through headsets. The lack of face-to-face communication and lesser importance of individual roles – elements of high group orientation – sets Japan apart from the U.S, according to a social dimension theory devised by Dutch social psychologist Geert Hofstede.

According to Hofstede, "groupism" is an overarching characteristic of the Japanese, whereas individual performance is usually prioritized over group coordination in the U.S. Group-oriented

---

<sup>210</sup> *The market activity of online games*, METI, 2011

<sup>211</sup> For projections on the growth of mobile games, please refer to the article *Mobile to be "primary hardware" for gaming by 2016*, available on Gameindustry International, at: <http://www.gamesindustry.biz/articles/2013-04-30-mobile-to-be-primary-hardware-for-gaming-by-2016>

societies value sharing and the commonality of interests over individuality.<sup>212</sup> Playing the family entertainment games by inviting friends over and enjoying the games seem to fit the typical pattern of a group-oriented society.

Such observations, however, are not necessarily conclusive. For one thing, Americans are just about as crazy as the Japanese for family entertainment game-play. In 2011, two multiplayer Wii games (Just Dance 2 and Just Dance 3) were among the top 10 best sellers.<sup>213</sup> One year earlier, half of the top 10 best sellers were Wii sports or family games.

Another finding casts more doubt to the groupism argument. In recent years, online gaming has emerged to be a strong selling point. Online gaming enables multiplayer participation and enables inter-player communication during the game. Because of this, online gaming communities on most game consoles such as PlayStation 3 and Xbox 360 have expanded very fast. To go along with the growing desire for online gaming, more games developed each year support multiplayer mode by creating live network online through the internet connection of game consoles, replacing the old fashion multiplayer game of two or more players sharing the device and screen (James, 10). Actually, in the U.S., online gaming feature is a major reason of success in popular hits such as Call of Duty and Halo.

The ultimate question is: If Americans are indeed individualistic as Hofstede demonstrated, how can the popularity of multiplayer games in the U.S. be explained?

To give a valid explanation, scholars introduced another concept of group orientation: group permeability. Japanese groups are believed to be exclusive to close friends and family members. The boundaries between insiders and outsiders are clearly marked and hard to cross. A representation of the low group permeability in Japan is the high walls surrounding Japanese houses that block views of the house from the outside as opposed to the low fences and high visibility of American homes. When visiting Japanese houses, guests are typically treated with formal reception by the hosts. The U.S. notion of a casual “drop by” does not exist in Japan.

Add group permeability to the original analysis, scholars made a more thorough understanding of multiplayer games in Japan and the States. Japanese gamers, dictated by high degree in groupism and low group permeation, show interest in playing console multiplayer games that entertain a small number of identified group members, either friends with close ties or family members. As for U.S. game players, tastes for both online and console multiplayer games are nearly equal because of low group identity and high group permeation. In a nutshell, U.S. gamers are much more comfortable sharing game-play experience with more people.

### **Originality of Characters**

Another finding of Japanese gamers is the preference for preserving the originality of characters. Taking anime inspired games for example. Japanese game producers build games around the same manga characters that reflect the traits of the characters, including appearance, personality, temperament, habits and so on. Japanese gamers also like seeing the same characters leading

---

<sup>212</sup> For the full analysis of Japanese and American social dimensions, please refer to Hofstede’s official website: <http://geert-hofstede.com/japan.html>

<sup>213</sup> *CESA Game Report*, 2011

different stories, which might provide an explanation to why successful Japanese games come in long series. According to an informed Japanese official, the French gaming giant Ubisoft Entertainment making a video game for the famous Manga series Naruto, seemed to dissent constantly with the Japanese side over whether the originality of characters should be preserved or be changed in adapting the stories into the games.

It is challenging to find out the underlying causes of Japanese gamers' obsession with originality, it could be that the deep-rooted dislike of deviation from old path that dictate such mentality. According to the social dimension theory, Japan scored over 80 on uncertainty avoidance, a finding that seems to explain this peculiar phenomenon.<sup>214</sup> In the U.S., game players on average care much less about characters in video games. On top of that, sensitive to what the market needs, U.S. and European game makers are prompt at making adjustments to meet the demand.

### **Silver Lining for Japanese Games**

Numerous challenges lie in the way of Japanese game industry. Despite that, success stories exist that may make the future for the game companies brighter. In recent years, the number of popular Japanese video games in the U.S. has been few, but they do exist. To name a few, Bayonetta, Dark Souls and Tokyo Jungle received excellent reviews in the U.S., and all were believed to exemplify essence of Japanese game culture. Thus, discovering the secrets of those sporadic successes may brighten the road ahead for the Japanese game industry.



(Source: ToTheGame.com, StrategyInformer.com)

Dark Souls by Namco Bandai Games Co. is one example. Dark Souls is a role-playing action game based on a fantasized dark world and clashes with monsters and ogres. Merits of the Dark Soul were numerous. First of all, the environment design was acclaimed by IGN as “incomparable, confidently spanning the extremes between disgusting, horrific, majestic and

<sup>214</sup> *Social Dimensions Japan*, Hofstede's official website, available at: <http://geert-hofstede.com/japan.html>

desolately beautiful.”<sup>215</sup> Also, the puzzle solving nature of putting pieces of limited information together was extremely intriguing for gamers. As the icing on the cake, Dark Souls enabled online feature for gamers to seek camaraderie and support with other players. Gamers applauded Dark Souls. The financial report of Namco Bandai stated that the game sold 1.19 million units in the U.S. and Europe by March 2012 and 2.37 million units worldwide in April 2013.<sup>216</sup>



(Source: fruitlesspursuits.com)

Another example is Tokyo Jungle, a 2012 PS3 game jointly developed by PlayStation C.A.M.P., Crispy's and SCE Japan Studio based on a fictional battle of survival in Tokyo. Gamers play the role of animals in different echelons of food chain and test the ability of survival in abandoned Tokyo city after the extinction of mankind. Critics praised Tokyo Jungle for several reasons: The excessive violence, the freedom of exploring that resembled Grand Theft Auto series and the creative storyline.<sup>217</sup>

In other words, the integration of peculiar imagination, a key advantage for Japanese game companies, with popular action game features led to the success of Tokyo Jungle and Dark Souls in the U.S. Similar lessons can be drawn from other popular hits such as Bayonetta and Devil May Cry. As past records repeatedly show, neither mere imitation of U.S. and European game features nor producing games of pure Japanese attributes promise success for Japanese games. The rule of thumb is to merge the comparative advantages of Japanese games with those of American games. As of now, Japanese game makers remain phenomenal at crafting game characters, writing sophisticated storylines and operating complex yet fun combat system for particular types of games like RPG. Admittedly, Japan has fallen behind Western rivals on many fronts, but situation can be overturned if leveraging those strengths sensibly.

<sup>215</sup> *Dark Souls Review* by Keza MacDonald is available online at: <http://www.ign.com/articles/2011/09/30/dark-souls-review?page=2>

<sup>216</sup> *Namco Bandai Touts Dark Souls Sales, Over 1.19 Million in US and Europe*, Playstationlifestyle.net.

<sup>217</sup> *Tokyo Jungle Review* by Colin Moriarty is available on IGN.com at: <http://www.ign.com/articles/2012/09/13/tokyo-jungle-review>

Lastly, although Japanese games are not sold well in the U.S., Japanese companies, Nintendo and Sony in particular are still producing game consoles, both large and hand-held ones that enjoy wide acclaim in the U.S. The strength in hardware production is an indispensable legacy in Japanese game culture, which is likely to propel the nonstop evolution of the industry.<sup>218</sup>

### **Japanese Games Moving Forward**

Japanese game designers attempt to convey complex situations in their games. And they have not given up on reasserting their game concepts in the U.S. market. The picture is not as clear-cut when viewed through the lens of Japanese designers. Some Japanese companies are actively searching for new labeling of their products that redefine Japanese gaming culture as being unique and unmarketable in the U.S.

Approaches to understanding the game culture differ greatly based on a variety of factors, such as the size of the firm, vision and mission, and field of concentration. For example, bigger firms now employ a merger and acquisition strategy with overseas studios, trying to combine the skill sets of U.S. and European game companies with that of Japanese firms. One standout in this category is Japanese video game giant Capcom, which managed to cooperate with U.K. based Ninja Theory studio in the production of chart-hitting title *Devil May Cry*.

Smaller firms, lacking resources to exercise collaborative efforts with other firms, are moving in the direction of designing new games with unique features. So far the market has responded positively. Companies including GREE and DeNA have done particularly well on creating mobile games.

In general however, Japanese firms lack the incentive to gain footholds overseas. Too many Japanese game developers are satisfied with their success in Japan and reluctant to learn from the lessons of foreign competitors. After all, Japan has the second largest market of video gaming, the annual profits made in gaming industry is enormous.<sup>219</sup> If old tricks still work in Japan, why do Japanese producers ever want to step out of their comfort zone and explore the market across the Pacific?

As explained in the first section of this study, the video game industry is not an isolated sector. Its intricate connections with anime industry, for example, provide employment opportunities and technological support. A reviving Japanese video game industry will bring about a profound effect on Japan. It would generate positive synergies to the anime and manga industries, and likely to resonate in broader cultural context, as seen in game based movies.

### **Conclusion**

In sum, Japan's cultural influence in the U.S. is waning, as the declining market share of video games reveals. The causes of decline are complex, but the Japanese game culture nowadays has evolved into a whole new concept that differentiates itself greatly from that of America.

---

<sup>218</sup> Stuart, Keith, *Is Japan 'finished' in the games industry?* Available at <http://www.guardian.co.uk/technology/gamesblog/2009/sep/30/games-gameculture>

<sup>219</sup> *2011 Video Game Industry Report*, METI, 2012



More specifically, on the production side, Japanese game developers are dedicated to serving domestic gamers, which deepens the exclusiveness of the Japanese video game industry. On the demand side, the Japanese gamers' tastes for video games are considerably different from Americans' preferences. This factor further isolates the game market from outside world as the majority of games produced in Japan are popular only domestically and do not meet the expectations of foreign gamers. To make matters worse, the prolonged period of exclusion during which Japan consistently underinvested in video game technology development has witnessed the most rapid technological upgrade by European and U.S. firms that propelled the revolutionary changes of the industry. Facing numerous challenges ahead and continuously declining U.S. market share, Japanese companies are gradually losing interest in venturing new paths to reclaim the lost territory overseas and instead shifted more focus towards Japan, drawing a vicious circle that paints a bleak picture for the future of the industry. The brutal yet undeniable reality that Japanese game creators are witnessing is that Americans are forgetting "Japanese games", and whatever that represents.

That being said, Japanese games should not give up hope of regaining a U.S. market presence for several reasons. Japan's advantages are still obvious compared to its international rivals. Technological gaps, although sizable, can be bridged or bypassed with efficient strategic planning as proposed in previous section. Moreover, despite the setbacks that Japanese games encountered, Nintendo and Sony, in the hardware business, have retained firm footholds in the U.S. market. Nintendo, which continuously innovates and pioneers new products, has the capability of driving game-play trends. In addition, in spite of the social-dimension differences, multiplayer games are enjoying high popularity in the U.S. This is a relatively new subsector in which Japanese firms like Nintendo are best at. Last but not least, Japan still has the edge over foreign competitors in hardware production, in both large and handheld consoles. For Japanese firms, venturing into new gaming sectors with less saturation might put revival of the industry on fast track, with the possibility of repeating the global dominance it enjoyed decades ago.

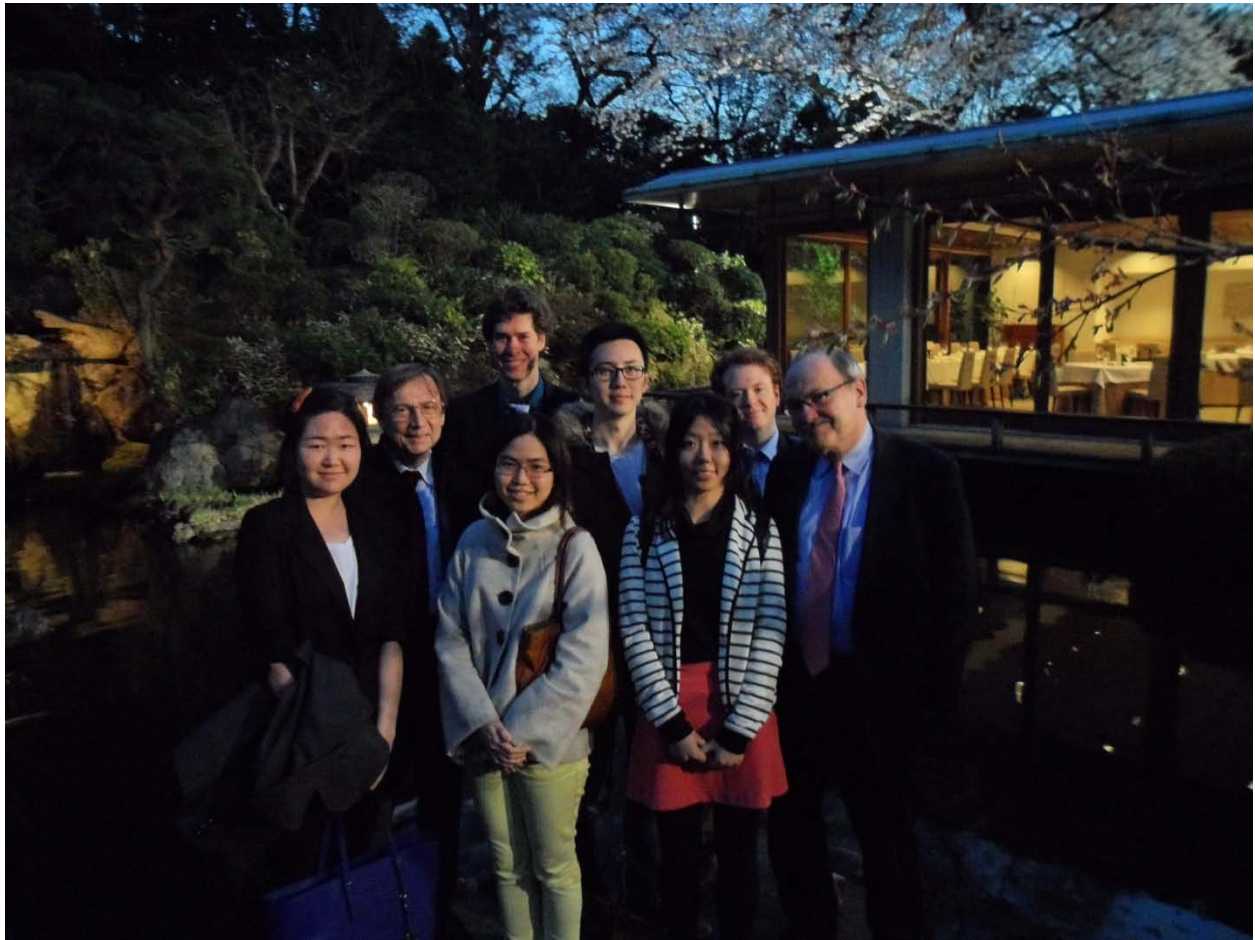
The one decisive component missing is incentive. In spite of the enormous potential for gaining a strong presence in the U.S. gaming market, Japanese game developers do not show adequate interest or confidence as they once did. The relative large domestic market is a major disincentive, blocking an outward looking movement. The divided preferences between domestic and U.S. gamers also are affecting game creators. Moreover, the huge cost associated with investing in the U.S. is a problem, given that few Japanese games were successful in recent years. Without a prod in the back and insurance against contingencies that may arise, it is unlikely that Japanese firms will be willing to take on the massive risk related to overseas expansion. The Japanese game industry has historically been free of direct intervention by regulatory authorities, so the likelihood of government support to game producers is almost out of question. The cultural drift between Japan and the U.S., as symbolized by the trends in the video game industry, seems likely to continue.

## References

- Alexander, Leigh, *GameStop Details Europe, U.S. Installed Base For Consoles*, Gamasutra, 2011.
- Ashcraft, Brian, *Why Japanese Developers Should Have Played More PC Games*, Kotaku.com, available at: <http://kotaku.com/5844588/why-japanese-developers-should-have-played-more-pc-games>
- Bill Gates Declares 10 Million-Unit Head Start for Xbox 360 and Outlines future of Interactive Entertainment*. Microsoft Corporation. 2006
- Computer Entertainment Supplier's Association, *2011 Japan, Korea Game User and Non-user Report*, 2012
- Dutton, Fred, *Kojima: Japanese developers lack global outlook, technological skills: Plus, explains why Kojima Productions is like the Starship Enterprise*, Eurogamer.com, available at: <http://www.eurogamer.net/articles/2012-03-16-kojima-japanese-developers-lack-global-outlook-technological-skills>
- Gamasutra, *Gamasutra – News – Fils-Aime: Holidays More Important To Nintendo Than Rivals*, 2010.
- Gifford, Kevin, *All about Japan's Anti-Violence Game Rating System: Why getting a Z is the kiss of death over there*, lup.com, available at: <http://www.lup.com/news/japan-anti-violence-game-rating-system>
- In Japan, game makers struggle to instill taste for Western shooters*, wired.com, available at: <http://www.wired.com/gamelifelife/2010/09/western-games-japan/>
- Interview with Mami Toyonaga, research and communications officer at Japan External Trade Organization, 2013
- Interview with Mia Consalvo, professor of communications at Concordia University, 2013
- Interview with Paul Tassi, columnist on video game industry, 2013
- Interview with Yushi Mariko, research officer at Media and Content Industry Division, METI, 2013
- Is Nintendo Following the Path of Sega?* IGN.com, available at: <http://www.ign.com/blogs/logicallydashing/2013/01/21/is-nintendo-following-the-path-of-sega>
- Japanese Media in the U.S.*, Freewebs.com, available at: <http://www.freewebs.com/qube808/>
- Kiyoshi, Tane, *Decoding the Charm of Japanese Video Games (Part One): A History of Combining Technical Prowess and Creativity*, Nippon.com, translated version available at: <http://www.nippon.com/en/views/b00101/>
- LeJacq, Yannick, *Activision Breaks Own Sales Record With 'Call of Duty: Black Ops 2,' Grossing \$1B In 15 Days*, International Business Times, Dec. 5<sup>th</sup>, 2012, available at: <http://www.ibtimes.com/activision-breaks-own-sales-record-call-duty-black-ops-2-grossing-1b-15-days-921473#>
- MacDonald, Keza, *Dark Souls Review*, IGN.com, available at: <http://www.ign.com/articles/2011/09/30/dark-souls-review?page=2>
- Main Players in Video Game Industry*, Duke University, available at: <http://sites.duke.edu/soc142-videogames/international-trade-patterns/main-players/>
- METI, *2011 Video Game Industry Report*, 2012
- Mobile to be "primary hardware" for gaming by 2016*, Gameindustry International, available at:

- <http://www.gamesindustry.biz/articles/2013-04-30-mobile-to-be-primary-hardware-for-gaming-by-2016>
- Moriarty, Colin, *Tokyo Jungle Review*, IGN.com, available at:  
<http://www.ign.com/articles/2012/09/13/tokyo-jungle-review>
- Moriarty, Colin, *Why Did Xbox 360 Fail in Japan? IGN.com*, available at:  
<http://www.ign.com/articles/2013/04/01/why-did-xbox-360-fail-in-japan>
- Namco Bandai Touts Dark Souls Sales, Over 1.19 Million in US and Europe*,  
Playstationlifestyle.net.
- Resident Evil Series*, Resident Evil Wikia, available at:  
[http://residentevil.wikia.com/Resident\\_Evil\\_series](http://residentevil.wikia.com/Resident_Evil_series)
- Oohagon, Minako, *Manga, Anime and Video Games: Globalizing Japanese Cultural Production*,  
2007, Perspectives: Studies in Translatology
- Outline, CERO, available at: <http://www.cero.gr.jp/e/outline.html>
- Rating guide*, Entertainment Software Ratings Board, available at:  
[http://www.esrb.org/ratings/ratings\\_guide.jsp](http://www.esrb.org/ratings/ratings_guide.jsp)
- Robinson, Martin, *The truth about Japan: a postcard from the Japanese games industry*,  
Eurogamer. Net, available at: <http://www.eurogamer.net/articles/2012-10-10-tokyo-story-a-postcard-from-the-japanese-games-industry>
- Shaw, Adrienne, *What Is Video Game Culture? Cultural Studies and Game Studies*, Games and  
Culture, 2010, Sagepub, available at: <http://gac.sagepub.com/content/5/4/403.full.pdf>
- Silent Hill*, IMDb, available at: [http://www.imdb.com/title/tt0384537/?ref\\_=sr\\_2](http://www.imdb.com/title/tt0384537/?ref_=sr_2)
- Social Dimensions Japan*, Hofstede's official website, available at: <http://geert-hofstede.com/japan.html>
- Stuart, Keith, *Is Japan 'finished' in the games industry?*, Guardian Co., Available at  
<http://www.guardian.co.uk/technology/gamesblog/2009/sep/30/games-gameculture>
- Tekken*, IMDb, available at: <http://www.imdb.com/title/tt0411951/>
- Video Game Market*, Entertainment Software Association, available at:  
<http://www.theesa.com/facts/>
- Wakabayashi, Daisuke and Berkowitz, Ben, *Japan-U.S. divide splits video game industry*,  
Reuters, available at: [http://www.ddrfreak.com/newpress/Japan-U\\_S\\_%20divide%20splits%20video%20game%20industry.htm](http://www.ddrfreak.com/newpress/Japan-U_S_%20divide%20splits%20video%20game%20industry.htm)
- Winterhalter, Ryan, *Why Japanese Games are Breaking Up With the West*, 1Up.com,  
<http://www.1up.com/features/japanese-games-breaking-west>

## Class Research Trip to Tokyo, March 2013: Photo Album







## **The Reischauer Center in 2012-2013: Expanding Global Horizons**

By Kent E. Calder  
Director, Reischauer Center  
Washington, D.C.  
July 13, 2013

Approaching its thirtieth anniversary in 2014, the Reischauer Center steadily expanded its horizons this past academic year. Internationally, it co-sponsored three major conferences—two in Tokyo, and a third in Hanoi, Vietnam. At home in Washington, the Center hosted a historic team of thirteen Visiting Fellows from three nations, and convened a record 32 events of unprecedented variety. Center affiliates also lectured in varied locations overseas, and the alumni network expanded steadily to new corners of the globe.

The Reischauer Center’s activities began in deep summer, with a conference in Tokyo, dealing with “Afghanistan Post-2014: The United States, Japan, and Future Prospects for South-Central Asian Cooperation”, on July 9-10, 2012. Co-sponsored with the Tokyo Foundation, and generously supported by the United Nations Development Program, this conference involved key policymakers concerned with Afghan issues, including Afghan Deputy Foreign Minister Jawed Ludin; US Principal Deputy Assistant Secretary of State for South and Central Asian Affairs Geoffrey Pyatt; and Masafumi Ishii of Japan’s Foreign Policy Bureau. Central Asia-Caucasus Institute Chairman Frederick Starr and Reischauer Center Director Kent Calder also spoke.



*“Afghanistan Post-2014: The United States, Japan, and Future Prospects for South-Central Asian Cooperation”  
Kent E. Calder, Director, Reischauer Center; Fredrick Starr, Chairman, Central Asia-Caucasus Institute;  
and Jawed Ludin, Deputy Foreign Minister, Afghanistan. Image courtesy of The Tokyo Foundation.*

Another early element of the Reischauer Center’s global program for the year was a conference in Hanoi, Vietnam, held on July 17, 2012, dealing with “Trans-Pacific Relations and a Changing Washington, D.C.” Keynoted by US Ambassador to Vietnam David Shear, the conference was cosponsored by the Japan Foundation, and involved officials of both the U.S. and Japanese Embassies in Vietnam, as well as representatives of JETRO, Vietnamese think tanks, and private firms. Dr. James McGann, Director of the Think Tanks and Civil Societies Program at the University of Pennsylvania, and Junichi Chano of the Reischauer Center and the Japan Foundation also spoke, together with Reischauer Center Director Kent Calder.



*“Trans-Pacific Relations and a Changing Washington, D.C.”  
Clockwise from the background middle: Junichi Chano and Kent Calder of the Reischauer Center;  
Ambassador David Shear; James G. McGann; and other participants*

Following the 2012 US Presidential election, the Reischauer Center joined forces with the Keizai Koho Center of Keidanren to hold a mini-conference on “The 2012 U.S. Presidential Election: Implications for the U.S.-Japan Relationship”. Held in Tokyo on November 14, 2012, this event considered prospects for pending issues in the bilateral relationship including Okinawa basing. Dr. Kent Calder noted that the coming two years would likely be important both in determining the historical legacy of President Barack Obama and in resolving pending base issues.



*“The 2012 U.S. Presidential Election: Implications for the U.S.-Japan Relationship”  
Kent E. Calder, Director, Reischauer Center. Image courtesy of Keizai Koho Center.*



In early fall, an unprecedented group of Visiting Fellows assembled at the Reischauer Center for the academic year. They included representatives from Japan's Ministries of Finance, Defense, and METI, as well as the U.S. Air Force Academy, and other prominent universities, together with major private-sector firms. The Fellows both participated in academic seminars and presented their own research at informal brownbag luncheons initiated this year. These luncheons and related receptions also provided opportunity for informal dialogue with current and former officials in Washington, D.C., including US State Department officials James Zumwalt and Marc Knapper, as well as Suzanne Basalla, formerly Special Assistant to US Ambassador to Japan, John Roos.



*Reischauer Center Visiting Scholars*

Extra-curricular seminars were a key element of this year's program, and were more numerous and broad-gauge than ever before. Among the central themes explored were energy security; US-Japan relations; and Washington's role as a "global political city." The appearance of several outside speakers was generously supported by the Japan Foundation Center for Global Partnership, under the "Washington's Ideas Industry" first-year grant. Among the major speakers in this category were Professors Stephen Walt of Harvard University and Saskia Sassen of Columbia University.

Reischauer Center affiliated faculty also played active roles in global intellectual life beyond the university. Center Director Kent Calder lectured at Tokyo, Oxford, Beijing, Seoul National, and Sheffield Universities during the year, and spoke at China's Boao Forum for Asia, as well as the Asan Plenary in Korea. His latest book, *The New Continentalism* (Yale University Press, 2012) was translated into both Japanese and Korean, and published in both Japan and Korea during the spring of 2013. Professors William Brooks, Rust Deming, and Arthur Alexander also published and lectured widely as well.

An important concluding event for the academic year was formal establishment of the new Reischauer Policy Research Fellowship Program in May 2013. Chosen through a nationwide search, future Fellows will both participate actively in major research projects of the Reischauer Center and engage more broadly with the Washington policy community. The first two Fellows to be selected, pictured below, are Narae Choi, a Johns Hopkins University graduate who has

recently completed her MA at SAIS; and Megan Dick, a former National Merit Scholar and recent graduate of Pomona College.



*Inaugural Reischauer Policy Research Fellows, Narae Choi and Megan Dick*

Approaching its thirtieth anniversary year, the Reischauer Center continues to emphasize student education and research as it has since its foundation. This yearbook is the epitome of that work, and the Center is proud to present its fruits to the broader world. The yearbook's editor, Professor William Brooks, symbolizes the combination of academic rigor and policy sensitivity that we always strive to maintain. Together with the yearbook, and hopefully synergistic with it, the Reischauer Center is actively coming to terms with an emerging global world, as chronicled in this short report, and will intensify that effort in the years to come.

## Reischauer Center 2012-2013 Events

June 27th, 2013

**The Road Forward: Interpreting Mongolia's Presidential Election of June 26th**

Dr. Alicia Campi, President of the Mongolia Society, Reischauer Center Visiting Scholar

May 29th, 2013

**Japanese Strategic Culture and the Senkaku Crisis**

Colonel Thomas Drohan, Air Force Academy, Reischauer Center Visiting Scholar

May 28th, 2013

**The Unique Organization of the U.S Forces in Japan**

Yasuyuki Kimura, Defense Facilities Administration Agency, Reischauer Center Visiting Scholar

May 9th, 2013

**The India-U.S-Japan Triangle**

Professor K.V Kesavan, Distinguished Fellow, Observer Research Foundation

May 9th, 2013

**Singapore Public Policy Seminar**

Kai Jiun Wong, MIPP, SAIS

May 2nd, 2013

**An Emerging Urban Global Geopolitics: Will Global Cities Matter More Than Their Countries?**

Saskia Sassen, Professor of Sociology, Columbia University

April 25th, 2013

**The Liao-Takasaki Agreement: High Point of Sino-Japanese Cooperation?**

Mayumi Itoh, Professor, University of Nevada Las Vegas

April 23rd, 2013

**Okinawa: The Defiant Island**

Gavan McCormack, Professor, Australian National University

April 18th, 2013

**The Tomodachi Initiative and Post-Tsunami US-Japan Relations**

Suzanne Basalla, Executive Vice President, U.S-Japan Council

April 17th, 2013

**Shale Gas and the U.S-Japan Relationship**

Shinichiro Ichiyama, Reischauer Center Visiting Scholar

April 17th, 2013

**Transforming Gender Politics: Japan and Korea in Comparative Perspective**

Narae Choi, Researcher, Reischauer Center

April 11th, 2013

**Abenomics and China-Japan Tensions – A Report from Tokyo**

Richard Katz, the Oriental Economist

April 11th, 2013

**The End of the East Asian Miracle**

Dr. Michiko Kitaba, Kansai University, Reischauer Center Visiting Scholar

April 4th, 2013

**Changing the Security Environment in Asia and the Pacific: Perspectives of International Law**

Shinya Murase, Professor, Sophia University

April 3rd, 2013

**Japanese Health and Welfare Policies: What the World Can Learn**

Kent Calder, Director, Reischauer Center - Moderator

March 28th, 2013

**How the Media Environment Shapes Political Activism in Japan and South Korea**

Celeste Arrington, Professor, George Washington University

March 27th, 2013

**Current and Future Prospects of Japan's Eurasia Policy Under the Abe Administration**

Dr. Takeshi Yuasa, Institute of Defense Studies, Central Asia

March 14th, 2013

**Japan's Distinctive Energy Policy Tools**

Nobuhiko Watanabe, METI, Reischauer Center Visiting Scholar

March 14th, 2013

**The Logic of Making Okinawa the 'Linchpin' Island and the Role of Okinawan Politics**

Nanae Yamashiro, Tsukuba University, Reischauer Center Visiting Scholar

March 13th, 2013

**Economic Policy – Singapore Style**

Alpana Roy, Deputy Director of Singapore Ministry of Trade and Industry

March 8th, 2013

**Japan-Korea Brownbag Series – Is There An East Asian Model of Immigrant Incorporation?**

Professor Erin Chung, Johns Hopkins University

March 7th, 2013

**Think Tanks and the Trans-Pacific Relationship**

Professor James McGann, Director of the University of Pennsylvania Global Think Tank Program

February 28th, 2013

**Why American Foreign Policy Keeps Failing**

Stephen Walt, Robert and Renee Belfer Professor of International Affairs, Harvard Kennedy School

February 22nd, 2013

**Challenges in the Japanese Economy – 'Abenomics'**

Takashi Hara, Japanese Ministry of Finance, Reischauer Center Visiting Scholar

February 21st, 2013

**Mongolia's View of its Rising Role in the Northeast Asian Political Economy**

Dr. Alicia Campi, President, The Mongolia Society

February 19th, 2013

**America, Russia, and Asia**

Paul Saunders, Executive Director, Center for the National Interest

February 13th, 2013

**Abe Administration Defense Strategy and its Implications**

Kenkichi Ishiyama, NHK, Reischauer Center Visiting Scholar

February 6th, 2013

**Asia in Washington: The Evolution of the Trade Policy Debate**

Dr. Mireya Solis, The Brookings Institution

December 6th, 2012

The US-Japan-China Triangle

**Quansheng Zhou, Director, Asian Studies Program, American University**

November 30th, 2012

**Reischauer Center Christmas Reception at the Chastleton**

Remarks by Marc Knapper, Director, Department of Japan Affairs

November 29th, 2012

**Changing Minds, Changing Course? The Evolution and Education of American Think Tanks**

Donald Abelson, Professor of Political Science, Western University

November 15th, 2012

**What Does It Take to be a Naval Power**

Jakub Grygiel, Professor, SAIS

November 15th, 2012

**The Obama Administration and US Foreign Policy**

James Mann, Foreign Policy Research Institute, SAIS

November 8th, 2012

**Prospects for US-Japan Relations in 2013**

Kent Calder, Director, Reischauer Center – Moderator

October 25th, 2012

**Crises in the Asian Littoral: Case Studies of Successes and Failures in Strategy**

Colonel Thomas Drohan, Air Force Academy, Reischauer Center Visiting Scholar

October 18th, 2012

**Sino-Russian Oil and Gas Cooperation: The Reality and Implications**

Keunwook Paik, Oxford University Energy Research Center

October 10th, 2012

**Japan's Post-Earthquake Energy Crisis and Policy Options**

Nobuhiko Watanabe, Visiting Scholar, Reischauer Center

September 27th, 2012

**Stress Test for the Alliance Under the Democratic Party of Japan**

William Brooks, Professor, SAIS

September 20th, 2012

**Reischauer Center Fall Reception at the Chastleton**

September 19th, 2012

**Japan-Korea Brownbag Series – the Japanese and Korean Political Economies in Comparative Context**

Kent Calder, Director, Reischauer Center

September 13th, 2012

**SAIS Faculty Colloquium – The New Continentalism: Energy and Twenty-First Century Eurasian Geopolitics**

Kent Calder, Director, Reischauer Center

September 7th, 2012

**Trilateral Cooperation: Ushering in a New Era of Cooperation in Northeast Asia**

Ambassador Shin Bong-Kil

September 5th, 2012

**Visiting Fellows Welcome Luncheon**