Clash of the Titans: Hashimoto, Ozawa, and U.S.-Japanese Relations

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When I first came to Washington, in 1981, the trade deficit with Japan was about $8 billion. I asked Secretary Malcolm Baldridge, who was then Secretary of Commerce, what my task would be if I joined the Commerce Department, and he said my job would be to reduce the trade deficit. Then I asked him how much I would get paid, and he gave me a figure. I've forgotten what it was, but I remember it was a lot less than my wife and kids had become accustomed to. I mentioned this to Baldridge and he said not to worry, he understood, he was a businessman himself, and he'd make me a deal. The Commerce Department would pay me a bonus, ten percent of the amount by which I reduced the trade deficit. Five years later, I owed him $15 billion. I'm really glad to see today's numbers, showing that the trade deficit has been reduced somewhat, which means I'm gaining on my debt.

There has been a long-running question in U.S.-Japan relations about change in Japan. Is Japan changing? Is it not changing? Can Japan change and, if so, what does change mean? Does change mean that Japan is adopting more U.S.-style policies and business practices, or does change mean something different from the past but not necessarily a U.S.-style approach? This question has been bounced back and forth over the past twenty-odd years, without resolution, and I'm not sure we can resolve it today, but I want to address it.

I think the political developments that have occurred recently in Japan provide the perfect takeoff point to address the question. We have a new prime minister. We have a new party alignment in Japan. There has been much talk, both in the United States and in the Japanese press, of reform, even of revolution, in Japan. I think the questions are: What is the significance of some of the political changes? To what are they related? and What is the significance of those developments that have given rise to some of these political changes?

For a long time, while this question was debated, I think it is fair to say that, at least in a political sense, there was no change in Japan. Think about it. Think about the long list of Japanese prime ministers who have succeeded one another over the past twenty years. Does anyone remember Prime Minister Suzuki, and was he different from Prime Minister Uno? Was he different from Prime Minister Miyazawa or Prime Minister Kaifu or fifteen or sixteen other names? In fact, for a very long time the political scene in Japan was dominated by one party, the Liberal Democratic Party (LDP), and, although there was a succession of prime ministers, they were essentially different masks on the same person. That may be a bit of an overstatement, but there really wasn't going to be much of a change in policy because of a change in prime ministers.
Today, I think that situation has certainly changed, in the sense of the dominance of the Liberal Democratic Party. A political realignment is clearly taking place in Japan. The LDP is the dominant party in the governing coalition, but not the only party. There have been very substantial splits in the Liberal Democratic Party, giving rise to the New Frontier Party and other smaller parties and coalitions.

The new prime minister, Ryutaro Hashimoto, in my judgment, represents a great deal of continuity in the liberal democratic tradition. He grew up in the Liberal Democratic Party, he now has gained control over it and leads it, and his policy pronouncements, his appointments, in my opinion, are very much in keeping with the long-running conservative tradition of that party. He has spoken about reform, but he has not sketched out a very clear, concrete plan of exactly what that reform would be.

Nevertheless, I do see Hashimoto as something new in Japan. I first got to know him back in the early 1980s. At that time, the United States and Japan were locked in difficult negotiations over telecommunications. Japan was rewriting its basic law for telecommunications, and the United States was trying to influence the direction of that new law in order to provide a more open market for equipment and telecom services in Japan. It won't surprise you to hear that we were deadlocked in those negotiations. They were going nowhere, and I received an invitation from Mr. Hashimoto to meet him secretly in the basement of the New Otani Hotel to discuss this telecommunications issue.

I duly showed up in the bowels of the New Otani Hotel, and Hashimoto-san entered, accompanied by some of his aides. I was immediately struck by the fact that this is a different kind of person from the kind of gray, faceless politicians I had come to know so well in Japan. Hashimoto showed up in a green leather suit. His hair was slicked back in movie-star style. He, of course, had his trademark cigarette holder and his whole manner was one of assertion, confidence, and a bit of flamboyance. At the same time, I have to say he proved a quite positive negotiating partner. He wasn't a pushover. He strongly defended Japan's interests and he clearly had a nationalistic flavor. At the same time, however, I found him to be a practical negotiator, a practical politician, who in the end was searching for an acceptable solution, and we indeed found such a solution.

Personally, I don't feel that the rise of Hashimoto to the prime ministry poses any particular danger to the U.S.-Japan relationship. There has been some commentary to the effect that Hashimoto is anti-American, highly nationalistic, or a tough guy. Although I don't mean to imply that he is a marshmallow, I think he represents a great deal of continuity in Japan, and I don't see him as any particular threat. I don't think the United States and Japan are going to be in any
more of a tense situation because of his prime ministry than they would have been if anyone else had been prime minister.

At the same time, it is not clear that Hashimoto represents real change in Japan. He has been closely aligned with the Japanese bureaucracy, he essentially inherited his following from his father, so he is, in my view, very much in keeping with the old LDP.

Now, Ichiro Ozawa also comes out of the old LDP and shares, at least originally, many of the same characteristics as Hashimoto, and yet, Ozawa has sketched a view of a new Japan. He has gone to the trouble to put down in writing, in a book, a concrete plan for turning Japan into what he calls a "normal" country. Of course, there has been great discussion about what the word "normal" means. However, if one reads through Ozawa's blueprint, it is clear that what he means is a Japan that is more decentralized, less controlled by the bureaucracy. It is a Japan that is more transparent, more open to small, new businesses, and a Japan that plays a fuller role on the world scene, both diplomatically and in terms of security. This, indeed, represents a very new program in the context of Japanese politics.

At the moment these two are paired up. Hashimoto is prime minister, Ozawa is leading the opposition and, for the first time in a very long time in Japan, we have what loosely resembles a two-party competition or, let's say, a two-coalition competition. There will have to be an election in Japan within the next fifteen or sixteen months, so these two are going to compete in Japan for political power. In my view, this will be the first real election in Japan in quite some time. When I say "real" election, I mean in the sense that there are substantive issues at stake and the vote could offer the possibility of significant political change in concrete, substantive terms. Now, that doesn't mean it's going to happen. That just means for the first time in a very long time the possibility exists that it could happen.

Let's suppose that there is a significant change in Japanese politics. Either Ozawa eventually gains power or Hashimoto co-opts Ozawa's program and he gains power, but he does it with a new program. One way or the other, let's suppose that there is a new political alignment in Japan. What does that mean? Does that mean real change in Japanese society? Does it imply significant change in Japanese relations with the United States and with other countries? I think the big question mark here has to do with the relationship between Japanese political leaders and Japanese bureaucracy.

One of the important aspects of the last forty years of Japanese history has been, in my view, the fact that the Japanese bureaucracy has ruled Japan to a much greater extent than its political leaders have. One reason that there could be a
succession of faceless political leaders is because it didn't matter very much. The real control was in the hands of the bureaucracy. In a way, that's even more true today, because of the transition in the Japanese political scene and the fact that the old political alignments are shifting. This has diluted what little power the political leaders had, so that, in the last couple of years, the bureaucratic leaders have been even stronger, relatively speaking.

If whatever new political leadership in Japan fails to gain control of the Japanese bureaucracy, then I suggest that not much is really going to change. If the leadership can gain control of the Japanese bureaucracy; if it becomes possible for political leaders to install their people, their appointees, in significant positions in the bureaucracy; if it becomes possible for Japan's political leaders to establish independent sources of information; if it becomes possible for Diet members actually to write legislation and introduce it, and to hold real hearings in which they can put the bureaucracy under a microscope; then, it seems to me, the potential exists for change, significant change, both domestically and internationally.

Now, there is something very important that lies behind these movements, and that is that the old Japan isn't working very well. The days of 10-percent growth are over. The Japanese miracle is looking less robust. Japan has been mired in recession for the past three-and-a-half years. There is concern in Japanese business, political and academic circles about the future. The confidence about the future that used to exist in Japan does not exist in the same way, at the moment. This has come about because of a change in Japan's circumstances.

For the period ranging from about 1952 until about 1992, I think we could characterize the situation in the following way. The Japanese yen was undervalued, the Japanese market was relatively closed, and the cost of capital to major Japanese industry -- not to small businesses, but to major manufacturers -- was low and was kept at a relatively low rate. Foreign markets, particularly the U.S. market, were relatively open to Japanese exporters, and Japan didn't really have to worry about its diplomatic or security problems. The United States took care of Japan's security and the United States essentially paved the way for Japan diplomatically. A Japanese prime minister never got called in the middle of the night to be told by his foreign office that a Japanese fighter airplane had just shot down a civilian airliner over Iraq or Iran. They didn't have to worry about those things. The whole system only had to focus on the economic equation.

Now, in the last several years, I think those circumstances have changed significantly. Obviously, the yen is no longer undervalued. Japanese industry's cost of capital has risen significantly, partly as a result of partial liberalization of Japanese financial funds and greater integration into the global financial markets,
and partly as a result of the collapse of the bubble and the distress of the Japanese financial system. Further, the Japanese market, while I would not characterize it as "open", is more open than it was ten, fifteen, twenty years ago, and that has created some foreign competition in Japan for domestic Japanese producers. At the same time, foreign markets are, in some ways, less open to the Japanese than they were fifteen or twenty years ago.

Finally, although Japan still doesn't really have to take care of its own security and diplomatic problems, it is beginning to see the possibility that it might. The United States has continued to insist that it will maintain as many troops as are needed in the Pacific, indefinitely. We continue to insist that the security situation remains the same, but the Cold War is over, and there are many in Asia and in the United States who question the continued viability of the old relationships. So, many in Japan are looking at the possibility of having to deal with the revision of status quo.

I think all of these issues lie behind the political changes in Japan, and they also lie behind some of the recent economic shifts we've been seeing. For the first time in a long time, the Japanese trade surplus is coming down.

Now, I think it's important to put this in context. It's good news for everybody, I think, that the Japanese trade surplus is diminishing, but we have to remember that, while falling from $120 billion to $110 billion is in the right direction, it's still a huge imbalance and still a major distortion in the world economy. Also, I think we are seeing, and we are going to see, continued Japanese investment in Southeast Asia and elsewhere as Japanese manufacturers move some of their production to lower-cost locations, and of course, there has been an expansion of Japanese manufacturing capacity in the United States, so the numbers may begin to look a bit better.

I think we have to look at several sides of this issue. On the one hand, the forces are there to push the numbers in a more positive direction. On the other hand, there are also forces acting to counteract them. In terms of how the forces are operating for change, it's clear that there is pressure on Japanese manufacturers because of the rising cost of investment. There is pressure because the strong yen makes it more difficult to export. There are also concerns in foreign countries about nonreciprocity with Japan that give rise to greater pressure on Japanese manufacturers to produce abroad. All of these pressures are moving in this particular direction.

On the other hand, some things haven't changed and, interestingly, the United States is currently operating in a mode that, in some ways, retards forces for reform. For example, let me mention one thing that is on the front burner. Everybody knows that the Japanese financial system is under great strain because of the so-called jusen, the home mortgage lending situation. Proposals
have been made by the Ministry of Finance in Japan to bail out the lenders with taxpayer money.

The Bank of Japan has been buying dollars like crazy -- Japanese dollar-denominated reserves more than doubled in 1995. The Bank of Japan was buying $10 billion a month as part of its effort to manage the yen-dollar exchange rate. Parenthetically, I find this ironic because, in much of the debate over the past ten or fifteen years, we've talked about the desirability or nondesirability of managed trade. The Japanese have vehemently insisted that they oppose managed trade and that they want free trade, but in the most important commodity of all -- money -- trade is being managed. The money is being managed to keep the yen high in order to improve profitability for Japanese companies, to enable the interest rates in Japan to remain low, and to take pressure off the banks.

What is very interesting is that the Japanese banks are all major shareholders in corporate Japan. This is the essence of the keiretsu system. The Japanese banks all hold 10, 15, 20 percent of major companies like Toyota, or Fuji, or Fujitsu. These companies typically don't pay dividends. They pay nominal dividends, but not much in the way of dividends. The stress on the financial system in Japan could be easily alleviated by dint of enabling, or demanding -- the banks demanding -- that the companies in which they hold shares pay some dividends. Tap their reserves. Come to the support of the major banking institutions. This is not being done. To me, this is an indication that the essence of the keiretsu system and the essence of the bureaucratic system is still operating pretty well.

The second thing we see is that the nature of Japan's negotiations with the United States, it seems to me, has not really changed very much. We had an agreement with Japan, about a year ago, on insurance. The Japanese insurance market was supposed to be liberalized in stages. It appears that agreement is now a troubled one. Both sides have different interpretations of the agreement. It's not clear that the American expectations are going to be met and, of course, the Japanese argue that the American expectations are false because the Americans don't understand the agreement. We've been here before. We've had this same experience with the semiconductor agreement and other agreements with Japan, so this looks a little bit like déjà vu.

If we look at other negotiations, we find the Japanese are really reluctant to enter into discussion with U.S. authorities. In the Kodak-Fuji case, in the semiconductor case, at the moment, the position on Japan's side is essentially,
"We're not going to talk about that." This seems to me to be a somewhat distressing position, given that we have a relationship with Japan in which we still have an enormous trade deficit, in which we unilaterally provide Japan security, and in which our financial authorities have cooperated with Japanese financial authorities to strengthen the dollar and devalue the yen as a way of cooperating to help the Japanese solve their difficult financial problem. There are many aspects here where one could look and conclude that not much change has occurred.

I think it is also important -- particularly in the context of discussions about exchange rates -- given that the United States has become a more competitive economy compared to five or ten years ago, to consider the question asked by Jack Welch, chairman of General Electric, in a recent Wall Street Journal editorial: "How competitive would we be with the yen at 125?"

To ask the question is to answer it. Much of the U.S. resurgence is tied to the fact that we have cut our prices and, effectively, have made Americans relatively poorer by dint of devaluing the currency. Again, I think, in terms of looking at the future, at what's changed and what hasn't changed, it is important to ask Welch's question. If we are looking at relative productivity and relative competitiveness, those ought to be reflected in the marketplace without manipulating the exchange rates.

What the United States and other countries need in their relationship with Japan, in order to achieve significant change, is control of the Japanese bureaucracy. The United States needs the same thing that Japan's political leaders need. The difficulty that one runs up against, either as a business or as a government in dealing with Japan, is the ability of the Japanese bureaucracy to use discretionary power and authority to control significant aspects of Japanese economic and political life. If that authority can be made truly transparent, and if Japan can truly decentralize power, I would expect there would be continued movement in a positive direction, from the U.S. point of view.

Interestingly, at the moment, the interests of Japan's political leaders, Japan's taxpayers, Japan's consumers, U.S. negotiators, and U.S. business are aligned. I believe, therefore, the big questions over the next eighteen months are: Can Japan's political leaders gain control of their own bureaucracy? and Can the United States encourage that kind of movement?

Let me just close by saying that there's a story of a climber who was scaling a sheer cliff. Just as he was about to put his hand over the top, he slipped and began to fall. It was a thousand feet straight down into the rushing rocks and water, and the climber, flailing around, managed with one hand to grab a
protruding root. It was a precarious perch. The climber knew he couldn't hold on for very long.

He wasn't particularly religious, but in this dire situation he looked to the heavens and he shouted, "Is there anyone up there?" To his utter amazement a huge voice boomed out, "Yeah. Whaddya want?"

And the climber said, "Whadda I do now?"

And the voice said, "Jump."

The climber looked down. It was a thousand feet into the rocks and the water, and he looked back up and he said, "Is there anyone ELSE up there?"

That's the question I think we have before us in the U.S.-Japan debate.

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