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# The U.S.-Japan Trading Relationship and Its Effects

RICHARD ROSECRANCE\*

The historical relationship between the United States and Japan since 1945 has always been one-sided. Since World War II Japan has tended to assume that it was (at least in security terms) a dependent partner of the United States. From that standpoint, Japan could be a "free rider" on U.S. security and foreign policy protection and largesse. Equally and oppositely, the United States has generally believed that because Japan was dependent, it did not need to be consulted about matters of global security and high policy. It could be asked to participate in U.S. and United Nations peacekeeping and peacemaking endeavors after the fact. The United States could concert with other nations, Russia and the European allies, and then ask Japan to help pay for the operations that had been agreed upon.

Both of these assumptions obviously represent inappropriate responses to the changed relationship between the two countries. The future success of the U.S.-Japan relationship requires mutuality and reciprocity of interests and symmetry of behavior that have not yet been fully understood, and certainly not acted upon, by either partner. Can these outdated policies be changed?

## I. THE GROWTH OF THE TRADING RIVALRY

The origins of the U.S.-Japan tension over trade are relatively recent in character. The essential problem that the Japanese economy presents to the world trading system is that the economy operates with too high a level of national savings.<sup>1</sup> This means that Japan cannot consume the produce of its own industry, and consequently, this produce has to be sent abroad as exports. This was not a major problem in the 1960s and early 1970s, because during those times, high Japanese private investment absorbed national savings. Private corporations bought investment goods, new capital,

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1. See generally EDWARD J. LINCOLN, JAPAN: FACING ECONOMIC MATURITY (1988).

and equipment, and the failure of private and government consumption did not matter. Japanese productive capacity was fully utilized in making new machines. There was, as a result, no significant Japanese trade surplus.

The situation changed in the mid- to late 1970s and early 1980s. At that time, private investment spending declined, but it was replaced by high government spending. Government purchases absorbed Japanese savings. Low consumer spending (high savings) presented no problem because the government purchased large amounts of goods. Again, there was no large Japanese trade surplus.

The problem grew greatly in 1984, however, when the Japanese government reduced its deficit spending, and business did not take up the slack by increasing investment, as it had done in the 1960s and early 1970s. From the mid-1980s on, therefore, Japan no longer consumed the produce of its own industry, and this produce then had to be sent abroad as exports. At that point, the high level of Japanese savings (and the correlatively low level of Japanese consumption) created problems for the nation's trading partners. This was the beginning of the problem of persistent imbalances in the Japanese trading account with the United States and other countries.

The problem worsened as a result of the United States' opposite tendency to consume too much and save too little. Under President Reagan's administration, the United States embarked on a major military spending plan, while at the same time reducing revenues by cutting taxes. As a result, government deficits reached unparalleled heights, and U.S. government indebtedness rose from one trillion under President Carter to four trillion under the Reagan and Bush administrations.<sup>2</sup> To reduce the great fiscal pressure in the Reagan administration, the Federal Reserve Board maintained a policy of high interest rates, but this had the associated disadvantage of increasing the value of the dollar, which then rose to 260 yen, ten French francs, or three Deutschmarks.<sup>3</sup> The high valued dollar also stimulated imports and depressed U.S. exports, worsening the trade deficit,

2. BENJAMIN FRIEDMAN, *A DAY OF RECKONING 90-91* (1988). Friedman shows the debt as of Dec. 1987 at \$2.4 trillion. *Id.* at 91. It has since risen to \$4.0 trillion. *ECONOMIC REPORT OF THE PRESIDENT* 246 (1993).

3. Selected values in dollars for the three currencies in 1985 are as follows:

	Yen	Deutschmark	French Franc
February	264.5	3.43	10.45
June	248.4	3.02	9.19
September	216.8	2.68	8.15

WORLD CURRENCY Y.B., 1986-87, at 453, 589, 607 (1989).

which then reached \$160 billion. The rise in the value of the dollar was stopped in 1985, as a result of the September Plaza Hotel agreement in New York City,<sup>4</sup> in which G-7 finance ministers agreed to lower the value of the U.S. dollar, but the U.S. trade position did not immediately improve. Not until 1991 did the trade deficit fall to \$73.4 billion, but that was reversed in 1992 when it rose again to \$96.3 billion.<sup>5</sup>

During this period Japan used its surpluses to purchase U.S. government bonds. This foreign help allowed interest rates to fall in the United States. In the absence of those purchases, U.S. government refinancing would have "crowded out" private investment, raised interest rates, and weakened the economic recovery following the 1980-82 recession. U.S. interest rates remained low, and the recovery continued until 1989, when a new recession began. Thus, the Japanese trade surplus was useful in the short term, because it provided Japan with funds to reinvest in the United States. In the long term, however, the Japanese surplus created major new world imbalances which had to be corrected.

## II. "SHARKS AND FISHES"?

The problem that the United States currently faces is to turn around the trading deficit. The overall Japanese merchandise trade deficit may reach \$160 billion in 1993-94.<sup>6</sup> This will present problems for other countries, as well as for the United States. The situation is analogous to that depicted in the "Sharks and Fishes" computer game.<sup>7</sup> In that game, the objective is to maintain ecological balance between populations of sharks and fish. It is assumed that fish live on abundant plankton and sharks live on the fish. Players are then asked, at the outset of the game, to choose the number of sharks and fish, the life spans of the two species, and the breeding and feeding times of the sharks and fish. With these selected, the computer begins its iterations, with the populations of sharks and fish oscillating over time. Frequently after about 4,000 iterations, the sharks consume all the

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4. Peter T. Kilborn, *U.S. and 4 Allies Plan to Cut Value of Dollar*, N.Y. TIMES, Sept. 23, 1985, at A1.

5. *Trade Deficit Widened in '92*, N.Y. TIMES, March 2, 1993, at D2.

6. THE ECONOMIST cited one estimate of \$200 billion "if the yen stays at current levels." *Japan Says No*, THE ECONOMIST, May 15, 1993, at 77.

7. See A.K. Dewdney, *Computer Recreations: Sharks and Fish Wage an Ecological War on the Toroidal Planet Wa-Tor*, SCI. AM., Dec. 1984, at 14.

fish, but then, as a result, the sharks also die, and the game comes to an end. This game presents a morality tale for the United States and Japan. It makes it clear that if the U.S. market is going to serve as the continued sustenance for Japanese industry, it must be allowed to grow rapidly enough to regenerate itself. If U.S. industry does not sell enough, either domestically or abroad, U.S. incomes will fall to levels that will not sustain large Japanese exports to the United States. Then Japan and the United States will both lose.

### III. THE U.S. AGENDA

Of course, there is much the United States must do to redress its part of the trade imbalance. Obviously, it must cut its government deficit (which was over \$290 billion in 1992),<sup>8</sup> and it should seek to increase its household savings rate, which has been hovering between three and five percent of the gross national product (GNP). If household savings rose, the pool of investible funds would increase and the government deficit (which trenches upon these funds) would be less worrisome. For example, in the late 1970s, even though Japanese government deficits reached five percent of the GNP (about the same percentage as the current U.S. figure), there was no huge trade deficit because Japanese *private* savings more than made up for the shortfall in *public* funds. Japanese consumers restrained consumption even when the government failed to do so.

Absent a growth in the U.S. private savings rate (which is increasing very slowly), the U.S. government deficit must be cut to reduce the trade deficit over the long period. A reduction in the deficit, or even the achievement of a surplus, would dramatically increase the overall U.S. savings rate. If achieved, this would reduce the U.S. proclivity to buy, and thus enhance government savings. To achieve this result, one needs both cuts in government expenditures and increases in taxes. It is only on this basis that long term interest rates can fall and subsequently stay down. The Clinton budget began, but did not complete this onerous process.

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8. ECONOMIC REPORT OF THE PRESIDENT, *supra* note 2, at 244.

## IV. THE JAPANESE AGENDA

A solution to the trade imbalance would also require Japan to recirculate the surpluses it has gained. Axiomatically, Japanese exports are balanced by short term borrowing in the United States and foreign money markets. In a schedule sense, equilibrium could be maintained by Japan cutting its borrowing abroad, but this would not solve the long term problem. A solution to this more fundamental imbalance involves recirculating the surpluses in a more permanent way.

A major systemic balancing issue is involved here, and all past financial hegemony have faced it. In the nineteenth century, Britain recirculated the surpluses it had gained in trade by investing and loaning money to trading partners. But these investments had to be financed, and the loans had to be repaid. By 1910, Britain had enabled all its debtors, except India, to repay loans by running a trade surplus in the British home market. One after another, Germany, the United States, Canada, Australia, New Zealand, and South Africa gained surpluses in trading with Britain.<sup>9</sup>

Though the United States failed to recycle its surpluses when it gained the status of a financial hegemon in the 1920s, it did behave more responsibly after the Second World War. The Marshall Plan, foreign and military aid, and then investment abroad, set the stage for foreign import surpluses in the U.S. home market after 1970. To achieve greater security and rehabilitation of allied economies, the United States allowed, and even encouraged its trading partners to finance U.S. investments by running trade surpluses in the U.S. economy.

If Japan is to ease the payments imbalance, it must follow a similar policy today. If its political system cannot produce this result, there will be a major trading conflict with both the United States and Europe. Even the rapidly developing countries in the Far East wish to reduce Japanese surpluses.<sup>10</sup> The world does not want to create another "1932 situation," in which critical, large nations default on their debts. The need to avoid such a disastrous outcome has not yet been felt strongly enough in Tokyo.

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9. See Richard Rosecrance & Jennifer Taw, *Japan and the Theory of International Leadership*, 42 *WORLD POL.* 184, 202-03 (1990).

10. In 1991, for instance, the deficits with Japan were, respectively: South Korea, \$8 billion; Singapore, \$9 billion; Taiwan, \$9 billion; Thailand, \$4 billion. *DIRECTION OF TRADE STAT. Y.B.* 241.

As on many other issues, the world will need more *gaiatsu* (foreign pressure) to change Japanese policy.

This will not be easy. The Japanese political system has been mired in stagnation, however strong its economic system. The multimember district system and the single nontransferable vote have made huge Liberal Democratic Party (LDP) expenditures necessary to win elections and to differentiate individual LDP members competing in the same constituency.<sup>11</sup> The large amounts paid to win elections siphon off domestic resources that could be used for other purposes. They also contribute to political corruption, and to the influence of the *yakuza* (underworld) in Japanese politics. The new Hosokawa coalition is pledged to change this situation with a mixture of "first past the post" (plurality) and proportional representation systems. The first would benefit the LDP, the second the minority parties. Some combination of these two electoral elements is likely to emerge from the Diet in 1994.<sup>12</sup>

For a variety of reasons, however, even if this system is changed, major alterations in Japanese policy are unlikely in the short run. The Hosokawa government is a refractory amalgam of disparate and conflicting elements that are unlikely to cohere for a long period of time. In the short term at least, the Japanese political system may not be strong enough to take the actions needed to resolve its international problems. It will need foreign pressure, as well as further domestic change, to achieve salutary results.

Enter the Clinton Administration. The President and his advisors resolved to do something about the trade problem and also pushed strongly for an alteration in the relationship with Japan. At the same time, the Japanese were highly vulnerable, in macroeconomic terms, for their own citizens protested against high prices, low employment, and the continuing shortage of housing and land.

Japan's 1992 trade surplus reached \$116 billion, nearly fifty billion of it with the United States. In addition, alone among major Organization for Economic Cooperation and Development nations, Japan attained a government surplus in its domestic spending. This was difficult to

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11. See generally J. MARK RAMSEYER & FRANCES ROSENBLUTH, *JAPAN'S POLITICAL MARKETPLACE* (1993).

12. The Hosokawa Government proposal is for 250 members of the Diet to be elected by plurality in single member districts, and 250 by proportional representation. David E. Sanger, *New Japan Premier Offers Political Reform Plan*, N.Y. TIMES, Sept. 18, 1993 (National Edition), at 2.

understand because, at the same time, Japanese economic growth had slowed to two percent or less per year, and unemployment had significantly risen. For the first time since World War II, major Japanese companies had to breach their compacts with labor and their own white collar staffs by firing workers and managers.

These conditions cried out for a domestic stimulus strategy, for both internal and external reasons. Domestic pump priming would create more employment and increase consumption. It would also bring in imports, which would begin the process of redressing the trade imbalance. Domestic stimulus was not immediately agreed to, however. The Ministry of Finance initially opposed a pump-priming strategy. The Ministry was not sure that the property bubble had been deflated to a manageable size, and it was opposed to any reduction of interest rates, at least in the short term. But the pressure from Japan's population, as well as its foreign partners, was overwhelming. New public works projects had to be initiated.

But Japan's problems did not end at home. In the General Agreement on Tariffs and Trade (GATT) negotiations (the Uruguay Round), the Japanese hid behind the Europeans on agriculture, hoping that there would be disagreement between the United States and Europe over export subsidies for grain produced under the European Common Agricultural Policy. In such a situation, Japan could not be accused of causing the breakdown. Japanese intransigence on rice was just as great, however, as European obstinacy on grain and oils. If the GATT agreement were to be resuscitated, Japan would have to open its rice market—and more than a crack.

Finally, in the political realm, Japan was again hiding behind the four islands issue to avoid taking a share of investment in Russia and the Ukraine.<sup>13</sup> It was very convenient that the Russians did not meet the Japanese demands (for the simple and immediate return of the islands). Failing agreement, Japan could argue that it did not have to do anything. But again, the pressure rose to put this dispute on the back burner and get Japan economically involved in the future of the countries composing the Commonwealth of Independent States (CIS).

It is, therefore, easy to forecast a major interruption of close relations between the United States and Japan over economic issues. This relates not

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13. Japanese leaders argued that Japan could not give major economic assistance to Russia until four islands in the southern Kuriles were returned to Japan. Craig A. Whitney, *Summit in Munich: Leaders in Munich Warn Rival Forces in Bosnian Strife*, N.Y. TIMES, July 8, 1992, at A1.



only to trade issues, but also to investment. The United States is seeking to ensure that Japanese direct investment in automotive plants in the United States not be shifted to Mexico after the completion of the North American Free Trade Agreement (NAFTA), causing a loss of U.S. jobs to Mexico. There is an assumption that Japanese firms producing within the United States which jump to Mexico would *not* be allowed to re-export freely into the U.S. market.<sup>14</sup> There will also be pressure for domestic content legislation in the United States. Japanese automotive manufacturing plants now in the U.S. market are essentially assembly plants. Such plants would not be tolerated in the European Community, where the content standard for qualification of full and free trade circulation in the European market will be approximately sixty percent of the finished product.<sup>15</sup> Nissan found out, after French objections, that it could not expect to build assembly plants in Britain and still send its British-assembled automobiles to continental Europe without penalty. NAFTA's local content standard will apparently be sixty percent. Following the EC's example, the United States may well establish progressively higher standards in its domestic market.

Thus, in the short-term future, there is likely to be a looming crisis in economic relations between the United States and Japan. The trade deficit, the failure of Japan to reduce its savings rate and of the United States to increase its savings and reduce consumption as a share of the gross domestic product (GDP), together with political-economic differences in regard to Russia, China, and other issues could produce the highest U.S.-Japan friction since the Second World War.

#### V. LONG TERM HARMONY BETWEEN THE UNITED STATES AND JAPAN?

But the long term looks much more harmonious, for political-military as well as trading reasons. From a traditional balance of power standpoint, the tension between the United States and Japan will ebb as China becomes a more significant world actor. The pressure on two feuding countries to compromise their differences because of a rising third power did not occur between 1910 and 1914. Germany and Britain were not brought together by the rise of either Russia or the United States. The United States turned

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14. For further discussion see GARY HUFBAUER & JEFFREY SCHOTT, *NAFTA: AN ASSESSMENT* 18 (1993).

15. GARY HUFBAUER, *EUROPE 1992: AN AMERICAN PERSPECTIVE* 39-40 (1990).

out to be at best an episodic participant in world and European politics, and Russia, after the 1917 revolution, was isolated. Given the United States' preoccupation with hemispheric affairs in 1914 and its return to "normalcy" in 1920, foreigners recognized that U.S. power could not be used as a threat to bring cooperation between Germany and England. Nor, despite Chamberlain's wish for an anti-Soviet group, did Soviet Russia serve as a catalyst to bring feuding Europeans together.

In the next century, however, the rise of China will have a very significant effect. It will moderate any lingering U.S.-Japan discord. China will be a major player in world politics, and its growth rates (even in the absence of further political modernization and democratization) will quickly move it into a position to challenge Japan. The U.S.-Japan-China triangle will make it difficult for any single conflict to become the central focus of trilateral attention. If anything, China will probably continue to improve its relations with Washington as an antidote to its regional neighbor, Japan. The United States will not rebuff these ties. The result will likely be a further improvement in U.S.-Japan relations as China moves into the position of both an economic and a political-military world player.

But balance of power factors will probably not be the most important feature of the new economic environment. Power factors will check both China and Japan, but economic ones will keep them highly interrelated with the United States in the world marketplace. Trade between the United States and Japan will not decrease, even as Japan strives to carve out a niche in East Asia for its exports. East Asian populations will not be able to afford the high end of Japanese production. As we know, trade alone does not create a mutuality of interest, especially if there are other markets for one's goods. It is necessary also to have strong and well developed stakes in the economic success of a trading partner. This tends to emerge when a country deposits a large amount of direct investment within the confines of another's economy. If this sum is very large and also illiquid in the sense that it cannot easily be withdrawn or sold off on the local market, the stake which each country acquires in the economic success of the other greatly increases. The 2.3 trillion dollars that Japan has invested in the United States includes a very large foreign direct investment share, now reckoned in the hundreds of billions. The stake that the United States possesses in Europe is also very great, as is the reciprocal European stake in the U.S. economy.

This reciprocal investment is very significant. Two studies done by Cornell researchers have shown that there is a correlation between cooperation between nations and the amount of direct investment a country has placed within the confines of another state.<sup>16</sup> The higher the stake one nation has in the economic success of another, the greater the cooperation offered to it. It is not surprising that the United States has been a strong partisan of European economic growth, for its own financial stake in European economic success is a very substantial one. In recent years the movement of very large amounts of European direct investment into the United States has also increased the European stake in the success of the U.S. economy. Now Japan has established a similar stake in the U.S. economic system. Of the major powers, only Japan has still refused to accord a major foreign direct investment stake to others in its home industry. In the Cornell studies, this had a not surprising result: Japan received markedly less cooperation than powers which had already conceded a large stake in their economies to foreign partners.

This mutual interpenetration of direct investment is relatively permanent and is unlikely to be changed by the movement toward trading blocs. The common European tariff may well rise in the future, and even if it does not, quantitative restrictions may inhibit trade between Europe and the United States and between Europe and Japan. But such changes will not reduce the U.S. or Japanese stake in the success of the integrated European market. Even a collapse of the GATT negotiations—though halting trade liberalization—would greatly stimulate foreign direct investment as a substitute for trade. New investment in Europe by the United States and Japan might actually increase their stake in the continuing prosperity of Europe.

There will be no common North American Tariff if NAFTA is accepted by Congress, but foreign direct investment will pour into the new region of free exchange and trade to escape the national tariffs that now exist. Production within the North American market will begin to substitute for

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16. *See generally* Brian Healy, *Economic Power Transition in the International System: The Translation of Economic Power into Political Leverage in the International Monetary System* (unpublished Ph.D. dissertation, Cornell University, 1973) (on file with author); William Gutowitz, *The Interrelationship of Economic Factors and Political Relations among Nations—A Quantitative Analysis* (unpublished honors thesis, Cornell University, 1978) (on file with author).

imports. With local content requirements in place, component manufacturers will also move their production to the new free trade area.

It is another matter, of course, to try to specify the security effects of these new trading blocs upon the world economic and political system. From this vantage point, it seems clear that economic ties among nations will help to chart the pattern of their military relations and responses. In the 19th and early 20th centuries, economic and trading ties did not proscribe war between erstwhile trading partners. There were few ties close enough (involving significant direct investment stakes in each others' economies) to dictate common responses to security threats.

This began to change after 1945. The military response to the hostile Soviet bloc took place among countries whose common economic interests were already well recognized. NATO became as much an alliance of economic partners as of security brethren. In the Pacific and Asia, economic ties also duplicated security links. Nuclear balancing after 1945 was fostered by a growing identity of economic interests among adherents of the Western pole. It is perhaps significant that in the 19th century, economic interests did not similarly unite balancing partners confronting international threats.

Even more significant today is the possibility that the typical balance of power mechanisms of the past may actually reverse gears. As long as the centralization of the world economic system was neither desired nor feasible, the decentralization implicit in the balance of power was both a foreordained and healthy development. Today and in the future, however, greater coordination and centralization of international politics is extremely important if the world economic system is to be managed effectively. World prosperity cannot be achieved unless laggard partners are assisted in joining their more prosperous neighbors. Unless world markets are relatively open and capital can flow easily from one place to another, low-wage countries cannot benefit from new investment, which leads to new exports. With higher barriers to trade, economic growth for one group does not help achieve development for another.

The greater consolidation of economic interests—increasingly expressed through reciprocal direct investment—will have powerful security effects. In the 19th century, it was always possible to create a “balance” against a disruptive power, even though this was infrequently done. No single power or combination could overawe the rest. In the future, however, a dynamic economic and political power complex centered on Europe and North

America would likely have centripetal not centrifugal effects.<sup>17</sup> One factor contributing to the end of the Cold War was the benefits that the erstwhile Soviet Union could gain from an association with the Western economic system and in particular with the European Community. The consolidating economic power of Europe did not, perhaps surprisingly, lead to Russian attempts to balance against it. Rather, the beacon of an integrating Europe and the prospect of a wider association with the United States drew the Soviet Union and its successor states into the network of trading states.<sup>18</sup> Paradoxically, power did not repel; it served to attract.

Nor has Japan stood aside from this enlarging and centralizing market. The price of Japan's admission to the Western trading system has been a common security orientation. If a reliable economic combination of Europe, a reforming Russia, the United States, and Japan is forged, no set of countries could hope to stand against it. As the new industrializing countries (NICs) found out, nations cannot prosper using a "decoupling" strategy.<sup>19</sup> Thus, even theoretically, it is ludicrous to imagine a Chinese or a Sino-Indian policy of balancing against this economic colossus, or staying out of its market. The very economic interpenetration of developed economies has made it impossible for poorer states to seek to secure prosperity in isolation. In this way, the balance of power may well reverse itself into a healthy imbalance.

In fact, historically, there have always been two different strategies of conflict management. The first, the most successful and general method, was to seek to "co-opt" the potential adversary and secure his adherence to the existing pattern of world relationships.<sup>20</sup> A second, and more adventurous strategy, was to "balance" against an opponent who could not be "co-opted." The second was a risky strategy because it raised all the complications of the "public goods problem" and provided incentives for others to "free ride." For most of the 19th century "co-optation," with some "compensation" for disadvantaged powers, was the primary method of

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17. See Richard Rosecrance, *A New Concert of Powers*, 71 FOREIGN AFF., Spring 1992 at 64.

18. See generally RICHARD ROSECRANCE, *THE RISE OF THE TRADING STATE: COMMERCE AND CONQUEST IN THE MODERN WORLD* (1986).

19. Despite Third World attempts to achieve economic growth without connection to the Western economy, all such attempts have failed, most recently that of Burma (denominated "Myanmar" by the current military regime).

20. For evidence and argument, see particularly Paul W. Schroeder, *The Nineteenth Century System: Balance of Power or Political Equilibrium?*, 15 REV. OF INT'L STUD., April 1989 at 135.

conflict resolution in the European international system.<sup>21</sup> Co-optation worked particularly well when a European Concert of Nations was already in existence. The latter could provide a heavy dose of restraint if the miscreant power did not agree to being co-opted.

The Concert did not endure for long, however; co-optation did not fully succeed, and nations faced the difficult task of engaging in military balancing against one another. If the adversary was a weaker power like Russia, this was not too difficult, as the outcome in 1856 and 1878 clearly showed.<sup>22</sup> But if the disturber was a stronger state like France or Prussia-Germany, much less could be done. In the end, despite a gradual systemic movement toward balancing against the Triple Alliance (Germany, Austro-Hungary, and Italy), the Triple Entente (France, Britain, and Russia) did not succeed. The second combination was forced to wage war against the first to enforce a balance of power. The Triple Entente was not so powerful that it could attract most other states to its side. Thus, the uniqueness of the world of the 1990s is that a potential Concert combination, buttressed by a strong and integrating world marketplace, does not have to "balance" against others; it can "attract" them through co-optation strategies.

## VI. GLOBALIZATION, COMMERCE, AND DEMOCRATIZATION

This does not mean that the world does not have myriad problems ahead of it in the short term. The G-7 has been a failure. GATT negotiations have been derailed and may not get on track again. French opposition to an agricultural agreement to reduce surpluses remains strong. Economic conflict among the major trading partners is rising. Economic imbalances are increasing, not diminishing. It is still uncertain whether either the Japanese or U.S. political systems will be strong enough to make the necessary but tough decisions to reform, economically and politically. Japan will be asked to change its policies in major ways and a government in Washington that no longer is dominated by either free market or "security comes first" advocates will have to press Congress and the people of the United States to achieve reforms at home.

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21. See generally Paul Schroeder, *Did the Vienna Settlement Rest on a Balance of Power?*, 97 AM. HIST. REV. 683 (1992).

22. See generally A.J.P. TAYLOR, *STRUGGLE FOR MASTERY IN EUROPE: 1848-1918* (Alan Bullock et al. eds., 1965).

It is not possible to forecast precisely the ways in which current vexing conflicts will be overcome. Undoubtedly some compromise between U.S. positions—which lay the onus of change on Japan—and Japanese positions—which put the responsibility squarely on the United States—will be fashioned.<sup>23</sup> The short-term tension, however, will include new legislation in the United States in the fields of industrial and technological policy which will make the United States a more effective trading competitor. While perhaps deploring the direct impact on Japan, most thoughtful Japanese will favor these changes. The development of new political ties among great trading units—Europe, the United States, Japan, Russia, and China—will make the world economy and polity operate more smoothly in the long term. The smoothness will largely stem from the mutual need to plumb major northern markets. Even if tariff or quantitative restrictions rise, they will not offset the flow of direct investment. There is a kind of co-optation at work in the international system today. It failed at the end of the 19th century because economic links did not coincide with security tasks. After the year 2000, security tasks are most likely to be determined by a consolidating grouping of commonly oriented economies.

What does this process of economic globalization have to do with democracy? There is evidence that economic progress can be made in relations between countries before democracy has taken root domestically. Indeed, premature attempts at democracy may be abortive. The economic attractions of state capitalism beckoned to Russia, South Korea, Indonesia, Brazil, and Taiwan long before the democratic plant had borne fruit. It is tempting to think that democracy provides the universal answer to international problems. But democracy in Canada and the United States did not obviate isolationism in the 1920s. At least in the short term, a more fundamental answer is the globalization of economic relationships. Russia and China are not now more amicable participants in the international system because of the establishment of democracy in either country. As repressive regimes they were drawn to participate more in the network of economic relationships because of the failures which ensued from isolation—in the Russian case, military autarchy, in the Chinese case, the “Cultural Revolution.” The incentive to rejoin the Western industrial and capitalist states did not wait on the prior establishment of democracy; nor,

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23. See generally ROSECRANCE & TAW, *supra* note 9.

despite what is commonly said, would the final dismantling of Chinese political repression add decisively to the strong, free market incentives which already exist. More than fifty percent of the Chinese GDP is already earned in the private sector. It is of course true that the final transition to a market economy cannot take place so long as authoritarianism reigns. But this impediment existed in Brazil, to some degree in Mexico, and in the four Asian Tigers without preventing them from joining a Western-oriented capitalist world economy.

In fact, countries can become "trading states" without yet being fully democratic, but democracy helps to seal the ultimate economic orientation. As the United States and Japan have shown, countries can have substantial economic friction while being fully representative democracies. A world economic mechanism comprised of fully liberal and democratic states can collapse in a worldwide depression. Democratic countries can still remain in isolated economic compartments. Historically, there did not appear to be a fundamental disadvantage in separating one's economy from the world system as the United States strove to do in the 19th century, and as Soviet Russia managed to do for an extended period after 1917. Following the example of others, Japan and Germany sought to annex large territories to emancipate themselves from rising economic interdependence in the 1930s. They failed. Today the task is even more formidable, and rising participants in the world trading system will not face a realistic choice between autarchy and interdependence. Democratic or not, they will be forced to choose interdependence. It is this indefeasible interdependence which will ultimately make it impossible for Japan and the United States to follow entirely separate paths. In time, the consolidation and centralization of the world economic system will ultimately fashion stronger political ties among nations.



