Economic Reform, Rising Nationalism, and Japan’s Changing Role in the World

With an economy finally on the rebound, growing tensions with its Northeast Asian neighbors, and an imminent leadership transition, Japan was the focus of the plenary’s leadoff session, which featured assessments of current trends by three Japanese leaders and two non-Japanese commentators. Kakutaro Kitashiro, chair of the Japan Association of Corporate Executives, shared his optimism about Japan’s economic prospects; Yoichi Nishimura, a prominent journalist, drew a connection between rising income inequality and the regional emergence of nationalist tendencies; and Yasuhisa Shiozaki, a leading politician and senior vice minister of foreign affairs, described Japan’s new sense of confidence and its potential regional and global contributions. Meanwhile, Bill Emmott, former editor of The Economist, explained why Japan’s economy has moved from its “exceptional unhealthiness” to the “normal unhealthiness” that characterizes most of the world’s advanced economies, and Gerald Curtis, a leading political analyst, underscored how Japan stands on the threshold of a new era. Condensed versions of their presentations and a summary of the discussion session are below.

Kakutaro Kitashiro

Japan’s economy is clearly back. The sun also rises. From the business perspective, we have very healthy conditions. GDP is growing at a rate of around 3 percent, the exchange rate is favorable for manufacturing, and interest rates are very low.

The often-asked question is whether this is the accomplishment of the Koizumi government. I believe that this is the result of the Koizumi Cabinet’s structural reform. The prime minister’s five-year policy has had a significant impact on the recovery of business, particularly in wiping out nonperforming loans. As a result, financial institutions are much healthier today. His structural reform policies have been very important, in particular the deregulation of the economy, the shift from government-led sectors to
the private sector, and a particularly important initiative, the decision of the government not to increase public spending to stimulate the economy. In the past, our business community used to ask the government to spend more when the economy was bad. But Prime Minister Koizumi clearly said that, without reform, there will be no economic recovery and no economic growth. That message clearly drove significant changes in the business community, and businesses faced the tough issues of excess employment, excess capacity, and excess debt. With strong economies in China and the United States, these businesses could deliver significant returns, and with lower employment numbers, much stronger balance sheets, and much healthier capacity, there is a strong recovery. So, I give significant credit to the Koizumi Cabinet for the recovery of the Japanese economy.

The question is whether this recovery or this healthy economy is sustainable. In the short term, I am optimistic. There are a lot of risks: the risk of higher oil and resource prices, the sustainability of the U.S. economy, exchange rate stability, and rising interest rates. But all in all, considering the risks, I think it may well continue to grow in the short term.

The biggest risk for business today involves the successor of Prime Minister Koizumi. Koizumi clearly stated his policies in the form of a manifesto, such as privatization, no additional public spending for economic growth, and improving the fiscal situation of the government. He made a commitment to the people that he would follow these policies. But his successor will not have that political capacity because he has not publicly stated his policy and will have just succeeded the Koizumi government.

Mid- to long term, Japan has many issues. In addition to the issues that all nations have, such as the environment, energy, and the proliferation of nuclear weapons, Japan has its own difficulties. The biggest risk is the fiscal situation. As you know, the debt of our central and local governments is more than 150 percent of GDP—the highest amount among developed countries—and it is not clear whether this is sustainable. The government is taking actions to reduce fiscal deficits and, by 2011, it is hoping that the primary balance will be positive. We need to reduce government spending, particularly in the areas of social security, welfare, medical care, and elderly care, and it may be necessary to increase taxes.

The second difficulty we have is the declining population. The birth rate is less than 1.3 children per woman and it is declining. If the statistics are right, in 100 years, Japan’s population will be half of what it is today. This alone may not be a major issue, but a steep, significant decline in the short term coupled with the huge government deficit is a concern. With a falling population, we need to significantly increase productivity to drive
GDP growth so that the government’s fiscal situation can be maintained. And obviously, an aging population is a burden for the social welfare and elderly care systems.

Another area of concern is the vitality of the Japanese economy. People are discussing the gap between the haves and have-nots and whether structural reforms have caused this disparity. We need to continue to work on structural reform so that we can be more competitive, but the backlash from the have-nots may cause structural reform to stall. Education plays the most important role in addressing this disparity. If people have an equal opportunity to obtain quality education, the children of those who have not may be able to learn. But the education system has a lot of problems in terms of the quality at both the K–12 and university levels.

Turning briefly to international relations, in the late 1990s, about one-third of our exports went to Asia, but today about half do so. In the past we had a huge dependence on exports to the United States and Europe, but today our exports depend on Asia, including China. And maintaining good relations, particularly political relations with China, Korea, and South Asia, is a major issue. Our businesses are diversifying their investments so that we will not just rely on investment in China, but still relations with China, Korea, and other Asian countries are a major issue we need to address.

In the long term, I am cautiously optimistic that, once we recognize all of these issues, the Japanese people will take action. We are somewhat slow to recognize problems, but once we do, I am sure that we will take significant steps to improve the situation.

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Yoichi Nishimura

In Tokyo, predictions about the successor to Prime Minister Koizumi and the implications for domestic politics and diplomacy have begun to dominate the political agenda. I would like to talk about two big political issues today. The first is the widening gap between the haves and the have-nots,
or the disintegration of the middle class. And secondly, I would like to talk about Japan-China and Japan-ROK relations, in other words, Japan’s Asian diplomacy. Both are related to the topic of nationalism. If you go to bookstores in Tokyo, you can easily find the two bestsellers, which epitomize my point. One is entitled *Lower Class Society*, and the second is *Ken Kanryu*, which can be translated as “Hating the Korean Wave.”

When I was a correspondent in Moscow, I heard that an aide to Mr. Gorbachev once said, “The Japanese economy and society is the most successful socialist one in the world.” The Liberal Democratic Party (LDP) had been conducting a policy in which liberalism aimed at economic growth was harmonized with socialism in pursuit of egalitarianism. In fact, 70 to 80 percent of the Japanese public considered themselves as middle class.

Today, the poverty rate has nearly doubled, the number of households receiving welfare has reached 1 million, and the number of part-time and temporary workers is going up. Polls show that a significant number of people believe they have dropped out of the middle class. More than 30 books focusing on the widening income disparity between rich and poor have been published and their brisk sales reflect the public’s interest in this area.

Of course, we have been witnessing a strong economic recovery as a result of Mr. Koizumi’s policy of small government and deregulation. And Japan still has a long way to go before it shows the levels of income disparity found in the United States. But the debate on the widening gap as a dark side of Koizumi’s policy reforms is an emerging political issue and a constant topic in parliamentary discussions. Not only the opposition leader, Ichiro Ozawa, but also some of the candidates to succeed Koizumi are pointing this out.

In Japan, the formation of a middle class–focused society happened at a time of steady economic growth and played an important role in stabilizing the nation’s democracy. In contrast to Japan, where the disintegration of the middle class is occurring, in China the middle class is expanding—not in the style of 1960s national capitalism, which formed a huge Japanese middle class, but with the process of global neo-liberalist market capitalism, which tends to disintegrate the middle class in many industrially advanced countries. In Japan, Koizumi has been consistent in his commitment to break away from conventional LDP politics, which shaped a gigantic middle class–centered society by distributing the fruits of high economic growth to every corner of the country. But both restructuring and the end of the era of old pork barrel politics are placing a heavy burden on the younger
generation rather than on the baby boomers. The losers may be the younger generation, particularly “permanent temporary workers,” who will feel a keen sense of uncertainty. In China, it is also reported that wider gaps are opening up between the have and the have-nots, which is also changing what was once the world’s most equal country to one of the least equal.

This sense of uncertainty among the younger generation at a time of globalization may lead to emotional nationalism in both countries. Voters who no longer feel affiliated with the political system in terms of gaining benefits from politics could become increasingly influenced by emotional nationalism.

If nationalism and the disintegration of the middle class is a potential issue, nationalism and Japan-China and Japan-ROK relations is an urgent issue. We have three disputes with China and South Korea. The first is a dispute over territory, sovereignty, and resources; the second is over history; and the third is over security in the long term.

Politically, the biggest issue is Yasukuni Shrine. The Chinese president, Hu Jintao, set a clear precondition for dialogue between Japanese and Chinese leaders, and this is for Japanese leaders to stop their visits to Yasukuni Shrine, where 14 Japanese war criminals are enshrined. Many political leaders said that a decision not to pay homage at Yasukuni should not be made on the basis of external pressure, and it seems politically impossible for Japanese leaders to appear to have their action dictated by Beijing. Koizumi has described his visits to Yasukuni Shrine as a “matter of the heart” and found it beyond his “understanding” that foreign governments would “try to intervene in a matter of the heart and make Yasukuni into diplomatic issue”.

The Yasukuni issue is more damaging to Japanese regional influence than two or three years ago because, due to its growing political and economic clout, China is emerging as a skilled diplomatic player that can use the history card more effectively to marginalize Japan than previously. Many of my friends in the United States and Japan have said that it is almost tragic to see the Japanese political leadership responding to the “rise of China” with such a reactionary emotionalism. It has done great damage to Japan’s national interests, it has damaged Japan’s relationship with both China and South Korea, and it may hurt the U.S.-Japan relationship. Certainly China also has serious problems with “history issues.” But this situation has decreased Japan’s influence in Asia, which may not be in the U.S. interest either, and it has narrowed Japan’s policy options toward Asia.

Many politicians and regular people in Japan question China’s motives. They think stirring up historical tensions with Japan helps deflect attention
away from China’s own internal social problems and that China’s criticism of Japan has less to do with historical grievances and far more to do with a desire to stem Japan’s influence or marginalize Japan.

Both states are adopting confrontational stances partly because of rising popular involvement in politics and resurgent nationalism. According to polls by the Cabinet Office, in October 2005, 32 percent felt warmly towards China—down from 48 percent in 2001—and 63 percent had cool feelings.

Japan’s conservative postwar administrations have maintained a kind of balance between improving Asian relations and returning to old traditions. On the one hand, they advanced reconciliation based on the refutation of and reflection on Japan’s prewar conduct. On the other hand, there has been a trend to return to traditional ways that could lead to an affirmation of prewar Japan. The double face of postwar Japanese politics is symbolized by these two contradictory trends. Reconciliation and patriotism have been the specialty of LDP governments. But can the next prime minister maintain this balance?

Some specialists say that, given deepening economic relations, it is possible to avoid a crisis. But now that the political and economic dynamics are changing in Asia, it seems risky to think that deepening economic interdependence will automatically improve difficult relations. It is possible to face unintended conflicts if politically emotional and narrow nationalism rises.

In Beijing and Tokyo, post-Koizumi politics and the implications for Japan-China relations has begun to dominate the political agenda. Former Foreign Minister Tang said, “We no longer expect anything from Koizumi. There is little possibility that our relations will turn for the better while he is in office.” Looking ahead, Beijing moved to engage Japan’s political leaders, and Prime Minister Wen called for an expansion of economic ties and people-to-people exchanges to build mutual trust and cooperation for “win-win results.”

At the same time, many leaders including former Prime Minister Yasuhiro Nakasone, Foreign Minister Taro Aso, and LDP policy chief Hidenao Nakagawa began to point out the necessity of managing and controlling nationalism in East Asia. In this context, what interested me most were Nakagawa’s remarks. He said, “Japan’s GDP will be overtaken by China’s in the 2010s. Are you satisfied with the status of such a low-growth country? If Japan will be a 1 percent growth nation, in the future how can we help Asian nations at a time of financial crisis or a tsunami disaster? We have to have the political will to maintain our status as the world’s number
two economic power. There is no precedent in Asia for two big countries to have a strategic partnership based on equality. We want to establish a strategic partnership with China based on equality.”

What we see right now may be a struggle between a mature power and a rising power. If nationalism in China is the nationalism of a rising power, the nationalism of Japan can be called nationalism due to a sense of psychological helplessness at a time of shifting power. What Nakagawa meant was that it will be necessary for Japan to convert anti-China emotions into constructive energy to rebuild a strong economy in order to have a strategic partnership with China when it replaces Japan as an economic power.

Generally speaking, growth and new economic dynamism in Asia is resulting in a deepening economic interdependence, but with the byproducts of psychological friction, frustration, and emerging nationalism. The expansion of personal and business communications and the Internet culture has given us extensive, real-time knowledge of important issues, but easy, instantaneous access to detailed information often triggers widespread emotional reactions in each country, making it difficult for the respective leaders to control or contain public opinion. This may cause a spiraling escalation, which impedes easy political solutions.

In China, because of limited political freedom, people target Japan to vent their pent-up feelings. And in Japan, populist trends allow politicians to paint China, an easy emotional target, as the bad guy. As interdependence deepens, there is a built-in mechanism that strengthens short-term friction and confrontation.

This autumn, we will see the LDP’s post-Koizumi election, as well as intra-party elections in the opposition party and in Komeito, the coalition partner. Together with widening gaps in our society and Asian diplomacy, the management and control of narrow nationalism will potentially be a big issue in this political season, and this may be a common challenge throughout East Asia.

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Yasuhisa Shiozaki

Japan now finds itself standing at a new stage. After the difficult reforms during the last decade or so, Japan has finally emerged from the economic crisis and successfully revived its industries. This nation is beginning to regain confidence. Inspired by the rise of China and India, a sound competitive mind in this region is also beginning to arise. At this historical juncture, what is Japan trying to achieve and where are we headed?

Ever since the Meiji Restoration 150 years ago, one of the most important sources of Japan’s power has been the diligent nature of its people. In Japanese society, everybody—even the leaders of society—is careful about details and does his or her job by him or herself. This moral standard regarding diligence and self-discipline has enabled Japan to become a model for success. Many developing countries had taken Japan as an icon when they set out on their own paths toward prosperity. Japanese people well recognize the fact that it is not just a handful of entrepreneurs but rather the moral values shared by the common people on the street that serve as the driver for prosperity and democracy. I strongly hope that, based on our essential virtues, Japan will continue to serve as a global model in the 21st century.

We must keep improving our domestic structure of national governance in order for Japan to play a more active role in the international community. Needless to say, these efforts must be made by the next administration as well. Human resources in both the public and private sectors will have to be utilized for diplomatic purposes. While the younger generation now tends to choose careers with some flexibility, many people with tremendous potential still confine themselves within the domestic system, which is evidenced quite typically in the Japanese government. Political commitment is required to enhance the effectiveness of Japan’s capabilities in the international arena.

The Japan-U.S. Alliance and International Cooperation

You may then ask what are Japan’s specific capabilities? First, the Japan–United States Alliance ensures that Japan has the capability to support stability in Asia. Japan is located as the United States’ gateway to Asia. We are determined to keep the Asian Sea a sea of prosperity, safety, and freedom. In addition, Japan-U.S. Alliance cooperation has progressed to cover
global issues like Iraq, Afghanistan, North Korea, and parts of Africa, step by step, careful step by step. I hope this progress will continue.

Second, Japan will start active international cooperation in close collaboration with the United Nations and other players. We must enhance our role in international standard-setting bodies as well as in decision-making processes on global issues; the UN Security Council may be one example of the latter. We hope to be a frontrunner in the world community in the 21st century by committing ourselves to sharing these responsibilities.

A majority in Japan now feels that our constitution should be amended. An increasing number of Japanese look forward to Japan taking on positive roles on the international front. That said, the draft constitution formulated by the Liberal Democratic Party has maintained the current first clause of Article 9, which renounces war as a sovereign right of the nation and the threat or use of force as a means of settling international disputes. I believe that Japan’s commitment to peace, which was made after the traumatic experiences of the mid–20th century, will never change in the years to come.

Japan’s Relations with Neighboring Countries

In this century, I earnestly hope to see Japan continue to be a model in Asia. Obviously a bright future lies ahead for this region. But unfortunately more people are having concerns about Japan’s relations with neighboring countries. One could raise the issue that sovereign nations do not appreciate being guided by others, however well intentioned. And yet, by no means should we allow disputes about the past to negatively impact our future. Amazingly enough, 4 million people a year—more than 10,000 per day—travel between Japan and China and between Japan and Korea. We hope to engage in a future-oriented manner with these countries.

The rise of China and India might offer both dynamism and instability to the world. I believe that a medium- to long-term pursuit of democracy and sound economic growth in both China and India ensures significant opportunities for other Asian countries.

In this context, Japan could serve as an honest broker, paving the way for regional stability and prosperity. Japan is working toward the establishment of an open and transparent East Asian community, with the participation of Australia, New Zealand, and India, among others. I very much hope that the concept of East Asian community receives the positive interest of the United States and Europe, because the concept is one of an open and non-exclusionary Asia.
Japan's Relationship with Europe

As I am chair of the UK-Japan 21st Century Group, I have come to the conclusion that the trilateral nations indeed share common values, and we must work together to address global challenges. In the Iranian nuclear case, all members of the Trilateral Commission, both public and private, must take steps for an effective solution.

On the economic front, Japan wishes to maintain its sound and competitive links with Europe by keeping markets open for goods, services, and investment. Since we have much we can learn from each other, we must not take any actions to undermine our links by damaging Asia’s security balance. We may have to show an accurate picture of the regional security situation to our European counterparts.

The New Japan

In conclusion, a new spirit is now emerging in Japan, although it is still embryonic. Japan will provide a stable power base, which helps to improve the standard of living for people in the global community, though not in an intrusive or noisy way. In the field of human security, Japan has been active in providing support for refugees and community rebuilding. Japan can play an enhanced role in many areas of operations conducted by the UN or by nongovernmental organizations. Japan can also expand its role in global energy conservation. Its energy efficiency now stands at three times that of the United States and 10 times that of China. With advanced technology, we should be able to live comfortably without supply constraints.

Japan has shaped its own history for thousands of years, maintaining our independence and integrity through our unique model and power. In our history, there have been as many failures as successes. We have always been mindful of past errors, but it is time to build a successful future by overcoming the past.

A fourth-term member of the House of Representatives, Yasuhisa Shiozaki, was senior vice minister for foreign affairs at the time of the plenary. He was subsequently appointed chief cabinet secretary by Prime Minister Shinzo Abe.
BILL EMMOTT

Is Japan’s economy now healthy or is it still unhealthy? My answer is that it is now healthy in the sense that it is just as unhealthy as every other country in the world. In other words, Japan’s economy has moved from a time of exceptional unhealthiness, and now it just has normal unhealthiness like everyone else.

How has this happened? My first observation is about the importance of time in this process. It has taken almost 15 years. The great strength of Japan has been that it is a very stable society, and this provides the opportunity for implicit decisions. I think it was always implicit that Japan should change slowly rather than dramatically. Time really has healed many wounds, particularly the excess production capacity, the excess debt, and the resultant excess labor in many companies.

A second question is whether we should give Prime Minister Koizumi and his administration the credit for bringing this period to an end. My answer is that we should not give the Koizumi administration full credit. Actually, this has been a product of more than 10 years of reforms, and there has been striking continuity in those reforms. Deregulation began in the 1990s and efforts to deal with the banking systems began under the Hashimoto administration. The efforts to cut public spending and the abandonment of the great Keynesian public works schemes also began under the Hashimoto administration. So there is a lot of continuity.

However, we should give credit to the Koizumi administration for continuing and then reinforcing these reforms—particularly the clean-up of non-performing loans—and for reinforcing the trend toward a more limited state role in the economy by limiting public spending, public works projects, and most importantly the privatization and reform of state financial institutions. These have been big contributions.

The reform that is most important for international audiences to recognize is the labor market reform during the Koizumi administration. This has led to a two-tiered labor market through the creation of temporary contract workers and new opportunities for part-time workers, who now make up 30 percent of the labor force as compared to 17–18 percent around 12 years ago. That has produced a very successful outcome in Japan, namely the restructuring of many companies and the reduction of labor costs that lie behind what is now happening.

Another reform that we should mention is the reform of company law. There has been a fundamental overhaul of the commercial code, which
really took place in the Diet committees more than in the Koizumi administration itself.

So, how optimistic should we be about the future about this now healthily unhealthy economy? I think we can now be quite optimistic about the short term. In the short term, while the economy depends a lot on exports to China, there is also a revival of corporate investment, capital expenditure, and the beginnings of the revival in consumption. It is beginning to be an economy that is supported by domestic demand as well as export demand. And the reason that it is now being supported by consumption is that excess labor is being absorbed, wages are beginning to rise again, and full-time jobs are now being created more rapidly than part-time and temporary jobs.

What about the long term? Productivity is the key thing to look at in terms of the long term. Productivity growth is necessary if the declining labor force is to be overcome and the growth rate of the economy is to be above OECD projections, which are based on recent productivity growth rates and on labor force predictions that suggest a long-term growth rate for the economy of only 1.3 percent a year. If you can increase the productivity growth rate from the 1.7 percent a year that has been recently seen to American-style rates of 3–4 percent a year, then Japan can in fact have rapid economic growth despite the falling labor force. What matters is the continued reduction of the role of the state, which has been responsible for a lot of distortion in the economy. And secondly, there needs to be much better allocation of capital and more competition.

How important will the choice of the next prime minister in September be? The limits are set for future prime ministers in terms of the role of the state by the level of public debt. If the debt-GDP ratio is about 150 percent, there is not much freedom to maneuver in terms of reversing reforms, increasing public spending, or reestablishing a strong role for the state. This means the role of the state is likely to decline.

Allocation of capital really depends more on the reforms of the past than on those of the future. The bubble period of the late 1980s and then the huge Keynesian rescue of the 1990s saw a spectacular misuse of capital. Capital was often put to the least efficient uses, supporting bankrupt companies, building bridges to nowhere, and laying concrete on the bottom of rivers. That was a huge misallocation of capital. The question now is whether capital is going to be used more efficiently in the future. I think with the withdrawal of the state, the reform of company law, and the pressure from the labor shortage, there is a high possibility that capital allocation will be much better.
As a final point, in my view, the new prime minister will matter most in terms of politics, rather than economics, and particularly in terms of the politics of China-Japan relations. We now have a situation we never had before—a confident, strong Japan facing a confident, strong China—and this is what is going to shape the future.

*Bill Emmott served as editor of The Economist for thirteen years until March 2006.*

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**Gerald Curtis**

Three eras are simultaneously coming to a close in Japan: the end in September of five years of the Koizumi administration, the end of 15 years of economic stagnation, and the end of 50 years of timidity, or what the Japanese call a low posture on the international political stage. These simultaneous endings raise fundamental questions about the direction Japan will take in the new era that is now beginning.

The past five years have been a period of both political stability and impressive political and economic change. Koizumi has been a prime minister who has behaved like a president. He treated those in his party who opposed his policies as his enemies and went over their heads to secure support directly from the public. His charisma, his willingness to gamble, and his political instincts put him in a political league of his own. None of his possible successors will be able to duplicate his approach. Koizumi succeeded by flouting the rules; his successor will have to play by the rules and work with the party to succeed.

The next prime minister is going to be under great pressure to restore some of the traditional LDP ways of doing things, but he has to do so without giving the impression that the party is simply going backwards. It is going to be very difficult to do. And there is the danger that if his popularity starts to sink, he will resort to populist appeals, especially involving relations with China, to shore up public support.

The LDP is not as strong as it appears. Its recent success is due to the extraordinary popularity and electoral skill of Prime Minister Koizumi. The Democratic Party of Japan (DPJ) is not as weak as it seems. It lost
badly in the last parliamentary election, but its vote total was a little more than it was in the previous election. (It lost because the voting rate went up and the new voters voted for Koizumi’s handpicked candidates). If the LDP gets a weak leader and the DPJ a strong one, given the disintegration of the LDP’s traditional vote-gathering machine, party politics may become much more competitive than they are now. One should not assume that the political stability of the past five years will characterize the next five years.

Secondly, this is the end of a roughly 15-year period of economic stagnancy. The 1990s are regarded as a lost decade but it was more than that; it was a watershed decade in which values, behavior, assumptions about the future, and institutions changed. Wherever Japan goes in the future, it cannot go back to what it was before the 1990s.

The next government will have to deal with issues that Koizumi did not try to tackle. Koizumi focused on cutting government spending by slashing the public works budget, shrinking the government bureaucracy, and privatizing the postal savings system. The next government is going to have to face the question of what to do about reforms on the revenue side, and especially whether and when to raise the consumption tax.

Moreover, there is the now widespread perception in Japan that inequality is increasing. The situation is not as serious as some people make it out to be. And as the economy improves, inequality will decline. Already there is evidence that companies are increasing the hiring of lifetime employees and reducing the proportion of contract and part-time workers. Nonetheless, in politics perception is reality and the government will be pressed to address the issue of how to strike a balance between equality and competition. It has to do so in the context of a rapidly aging and now shrinking population.

It is a new era requiring new policies and new thinking, especially about education. The quality of public K–12 education in major urban centers has declined precipitously and the inadequacies of university-level education in meeting the needs of a globalized economy are issues of major and growing concern in Japan.

This year can also be seen as marking the end of a 50-year period of Japanese timidity in international politics. Japanese are tired of being told by others how they should manage their economy and society and how they should write their history textbooks and pay respects to those who died fighting for their country in past wars. Gaiatsu, the public use of outside pressure, has become counterproductive. The Bush administration deserves credit for recognizing that emphasizing respect and a strategic dialogue
work much better than insults and threats. Unfortunately, China has not gotten this message.

U.S.-Japan relations are excellent; the problems that exist can and will be managed. Military-to-military relations have never been better. American concerns about economic relations are focused on China. And there is now optimism in American business circles about the opportunities presented by Japan's economic recovery and future prospects.

But the relationship faces two major challenges and dangers. One is the danger of concluding that Japan is about to become a normal country. Too many Americans underestimate the continued power of constraints on Japanese military policy. The only proposal for the revision of Article 9 of the constitution that has any hope of being adopted would provide for a quite modest change, recognizing the legitimacy of Japan possessing a military and specifying that it is constitutionally permissible for the military to participate in UN peacekeeping operations. Unrealistic American expectations about Japan’s role in regional and global security run the danger of turning into anger that Japan is failing to live up to commitments it in fact has not made.

The second challenge is that posed by China. The United States wants China to act as a responsible stakeholder in the international system. It does not want relations between China and our ally Japan to deteriorate further.

The next prime minister will have to deal with the serious deterioration in Sino-Japanese relations. Resolving the controversy over prime ministerial visits to Yasukuni is not going to necessarily result in better Sino-Japanese relations. Yasukuni is not the fundamental reason for tensions in Sino-Japanese relations. The key problem is that East Asia has never known a time when both Japan and China were great powers and these two countries have not yet figured out whether and how to accommodate such a new reality.

Resolving the Yasukuni issue, however, is a necessary precondition for improving relations, or at the least for shifting the onus of responsibility onto China for a failure to make relations better. Koizumi got himself into an argument with China over Yasukuni without intending to do so. But the next prime minister knows full well that if he goes to Yasukuni, relations will only deteriorate further with China and Korea. Moreover, as long as China is successful in focusing world attention on the history issue, criticism of Japan will continue to grow in the United States and elsewhere. Japan has simply chosen the wrong issue on which to dig in its heels against Chinese pressure.
The United States should quietly urge politicians who have aspirations to succeed Koizumi as prime minister to exercise self-restraint. (And it should impress on the Chinese government that if it would like to see an anti-Chinese, hard-line government in Tokyo, it should continue to deal with Japan exactly as it is doing now; if it wants to normalize relations, it needs to change its tone and its tactics and seek a grand bargain with Japan.) The United States should also encourage the creation of a quadrilateral (U.S.-Japan-China-Korea) dialogue on Northeast Asian security issues. And the United States should encourage the formation of a track-two dialogue on territorial issues modeled on the track-two dialogue between China and ASEAN on the Spratly Islands dispute.

Relations between Japan and Korea also are strained by the history issue and by a territorial dispute, but these problems are encased within what is overall a strong and increasingly intimate relationship. Never has Japanese sentiment been as positive as it is today about Korea. Korean popular music and movie stars are the rage in Japan. Tourism is booming, and Japanese and Koreans no longer need visas to visit each other’s country. As long as Japanese and Korean political leaders remain cool-headed and resist the temptation to attempt to use bilateral disputes to mobilize nationalist support, the Korean-Japanese relationship is bound to grow closer.

Koizumi is in every sense a tough act to follow. The next prime minister cannot succeed by imitating his leadership style. He needs to adopt different economic priorities and social policies, and he needs a bold, imaginative, and courageous policy to deal with China. And in that regard, he needs, most of all, to take a positive approach to improve relations and avoid pushing the two countries further toward confrontation.

Japan is on the threshold of a new era in its domestic politics and foreign policy. It behooves the rest of us to pay attention.

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Two significant domestic issues, Japan’s growing income disparities and the September 2006 selection of a new prime minister, emerged as key topics of interest in the discussion period. A number of experts noted that the emerging income gap is not actually as serious as it is sometimes made out to be, but that it has gained political traction in the hands of politicians opposed to Prime Minister Junichiro Koizumi. They argued that in reality, the area where energy really needs to be invested is in Japan’s education system, which is failing to meet the needs of an increasingly globalized world.

Meanwhile, the race to succeed Koizumi was the topic of intense discussion, with a general agreement that he has been a transformational figure in domestic politics. One participant, a leading Japanese politician, remarked that the prime minister’s central achievement has been to overhaul Japanese political culture, partly by destroying the old system of factional politics. Other observers noted, though, that the intense attention on Koizumi and his LDP has obscured the fact that the opposition DPJ is much stronger than it appears and the LDP weaker, an observation with important implications for the course of post-Koizumi politics.

It was foreign policy, however, particularly Japan’s tenuous relations in Northeast Asia, that dominated the discussion. The continuing visits of Japanese leaders to Yasukuni Shrine despite the enshrinement of war criminals were interpreted by most of the non-Japanese participants as a troubling sign of emergent nationalism. One Japanese participant defended this nationalism as a healthy sign that Japanese are finally taking pride in their heritage, but others condemned it as narrow-minded and damaging to Japan’s long-term interests in the region.

While the Yasukuni Shrine visits were seen as detrimental to Japanese relations with Southeast Asia, South Korea, and other countries, the greatest amount of concern was expressed over the damage that has been done to Sino-Japanese relations. A number of Japanese and Western experts noted that even if the Yasukuni Shrine dispute were to vanish overnight, China-Japan relations would still be characterized by tension and a sense of competition. In fact, they asserted, just as Japanese nationalism is fueling Chinese resentment and being exploited by some Chinese leaders, China’s approach to Japan has been almost as if designed to stoke Japanese nationalism.

To change these dynamics, several participants called for a grand bargain between China and Japan, one which bundles mutual commitments not to politicize “history issues,” greater dialogue on security policy, and
cooperation on key issues such as economics and energy efficiency along with an agreement that the Japanese prime minister refrains from visiting Yasukuni. Going further, one current Japanese policymaker noted that, while China and Japan may not be able to settle on common goals and values in the bilateral context, perhaps they can build them together through the construction of some form of East Asia community.