

Introductory Remarks

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Washington DC no doubt has the greatest concentration of expertise on Japan of any city in the United States and probably any city in the world outside Japan. We have government officials both active and retired, think tanks, academics, and a host of nonprofits and associations. This is a city of experts, not just on Japan but on almost anything. But it is not just a city of experts and of ideas and opinions. Because we are the nation's capital, we are also a city of doers. This is where the government is. This is where the people who conduct our official relationship with Japan are, and also many of the people who try to influence how we conduct that relationship.

For many years, we at the Japan-America Society have had the idea of hosting an annual gathering of all of that expertise, kind of an intellectual *shinnenkai*, where we all could come together at the beginning of the year, exchange our New Year's greetings, and talk about what might be coming down the road for Japan and our relationship in the year ahead. This year, thanks to the Sasakawa Peace Foundation USA and the National Association of Japan-America Societies, we are able to do that. We sincerely hope that this will become an annual event and that we will see everyone again at "Japan in 2014."

2013 is the year of the snake. When I looked at the description of the animals on the Japanese zodiac, it was very interesting and appropriate for today's gathering. It says that according to popular belief, people who were born in the year of the snake possess tremendous wisdom. They're intelligent, they're wise, and they are regarded as great thinkers. Complex problems stimulate them. Snakes are very creative and extremely diligent, it says. They're excellent problem-solvers.

This morning we will focus on what is likely to happen in Japan's political and economic world over the next year. Then in the afternoon we will turn to Japan's external role, Asia, and its relationship with the United States.

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Note: This transcript has been edited for clarity,
but not for content.

Morning Keynote **by Professor Gerald L. Curtis** **Columbia University**

John Malott: Our first speaker this morning was not born in the year of the snake, even though he is one of the wisest people whom we know. He was born in the year of the dragon. Gerry Curtis is Burgess Professor of Political Science at Columbia University, director of the Toyota Research Program, and a senior research fellow at the Tokyo Foundation, among numerous other things. He's a recipient of many awards. The award that we are most proud that he possesses is the Marshall Green Award, which our Society created in 2011, and which we give to someone who has made a sustained and significant contribution to increasing American understanding of Japan. Gerry was the first recipient.

I think what we all like about Gerry, whether you studied under him at Columbia or not, is his openness and his willingness to share his knowledge, his thoughts, his ideas, and his advice with all of us. I relied on Gerry a lot when I was in the government, and I'm sure that people in the government today still rely on Gerry. One website described Gerry this way. "Gerald Curtis is widely regarded by Japanese and foreigners alike as the world's preeminent expert on Japan." If Gerry is not the world's preeminent expert on Japan, I would be hard-pressed to think who it is. So please join me in welcoming Gerry Curtis.

Gerald Curtis: Good morning, everyone. I want to thank John for that very, very generous warm introduction. I'm quite touched. As he said, this is a room of experts, so I'm trying to figure out now what I'm going to do here for the next 30, 40 minutes. Well, I know what I'm going to do. I'm going to tell you what I think is going on in Japan, and then I want to hear where I'm wrong from the way you see things or where you agree with me.

I think the way the day is going to go, is I'll talk about the domestic political situation, and then there'll be a panel the rest of the morning. Then, Yukio Okamoto will give a talk in the afternoon about foreign policy, and there'll be a panel on that, and then I think there's time for you to ask questions. So we'll get going on this cold morning in Washington with the domestic scene.

Japan's New Political Situation

Needless to say, Japan faces a very new political situation in many respects. The DPJ came to power a little more than three years ago. It had a stunning victory -- and then an even more stunning defeat in December (2012). Its very existence is, I think, at peril. Public opinion polls showed DPJ support to be five or six percent, less than that for the Restoration Party, in a number of polls. Whether this party can pull itself together and remain the leading opposition party or whether it gives that position up to the Ishin no Kai, the Restoration Party, is very uncertain.

The LDP is dominated by right-of-center leaders led by Prime Minister Abe. As I just said, the Restoration Party of Mr. (Toru) Hashimoto, and former Governor Ishihara may well replace the DPJ as the number one opposition party as a result of the coming Upper House elections.

Since Prime Minister Koizumi resigned in 2006, there's been a prime minister a year. That's likely to change. Now I think we're going to probably not have that (kind of turnover). As long as Prime Minister Abe's health stays good and he doesn't do something really unwise, he's going to be prime minister and there won't be an election for three or four years.

The LDP did so well. So the last thing it wants to do is have an election any sooner than it has to. But in Japanese politics, as in politics in lots of places, nothing is certain. The public support for the LDP is tentative. It's tenuous. The Komeito, which is the LDP's coalition partner, may find it increasingly uncomfortable being in a coalition with a party that is considerably to its right on many key issues. And Prime Minister Abe is enjoying a honeymoon - actually for Japanese politics a rather extended honeymoon. But honeymoons end, and this one can end rather suddenly.

Japan's Last Election

Let me just step back and say a few words about the election and then about what Abe's strategy is and how it is coming along.

This election, as you're well aware, was not really so much a victory for the LDP. In terms of voter motivation, it was a massive defeat for the DPJ. (It had) 308 seats in the previous election, and 57 in this election - a huge swing. The LDP went from 118 to 295. This is an indication of the problems created by the single member districting system that Japan adopted in 1993, a predominantly single member districting system. As a result, we've seen wild swings from one election to the next. Without getting into a political science lecture about electoral systems, the fact is electoral systems have something to do with the social structure of the countries in which they take place. In the U.S., where each party rests on a different social coalition, a two-party system and a single member districting system works, I won't say effectively, but it works. In Japan, the distinctiveness of each party is very hard to identify, so when they get dissatisfied, voters all swing from one to the other. There were more first-term Diet members elected in this election than at any previous election in post-war Japan. That's not a healthy thing. It's not healthy when incumbents or many incumbents are being defeated and you constantly have a group of freshmen.

When Koizumi was prime minister, we had the so-called "Koizumi children." Then when the DPJ won, there were the "Ozawa children." Now there is a whole group of new first-term members in this election. No matter what, the result of the election was that the LDP ended up with a solid majority. And with the Komeito, they have two-thirds of the seats in the Lower House, so they can override any Upper House rejection of Lower House bills.

People ask, what were the issues that led people to vote against the DPJ and for the LDP? It's interesting to note that it wasn't issues -- it's very tough to identify key issues. It really wasn't the consumption tax, because the LDP supported the increase in the consumption tax. It wasn't any sort of foreign policy issues, because there's been a basic convergence on the views of their defense minister, Mr. Morimoto, the adviser to Prime Minister Aso. So I don't think this was an election that the LDP won or the DPJ lost based on issues. It was an election they lost based on competence, or the sense that they didn't know how to govern and you couldn't figure out what they stood for.

The Return of Shinzo Abe

The result is that Prime Minister Abe, to a lot of people's surprise including my own, is back in the saddle, six years after having had an unhappy experience as prime minister. He's back in the saddle galloping forward in a way that is very dramatic. He came in clearly with a strategy this time, unlike when he was elected the first time as prime minister. Remember when he was elected the first time, it was all about *Utsukishi Kuni*, beautiful Japan, constitutional revision, and a lot of things that were long-term goals that you couldn't do very much about in the short run. That's not Prime Minister Abe now. Abe's strategy is to focus on the economy and win the Upper House election, and to win at least a majority with the Komeito so they don't have to override Upper House rejection of bills and avoid the so-called twisted Diet, and - not easily but not impossibly - possibly win a majority on its own or at least get close enough that if the relationship with the Komeito becomes too difficult, they can switch horses and tie up with the Restoration Party.

I think what Abe is focused on, and what his economic policies are most focused on right now, is to win the Upper House election by getting the markets excited about change and getting the public hopeful about a new direction for Japan. So far, you have to give him credit for having done very well. The Nikkei goes up, the yen goes down, and it's all on the basis of talk. It's all on the basis of the expectations that have been created by what Minister Abe has said, rather than anything that he has done, although he's just about to do it.

So clearly to me at least, he's focused on economic issues, at least until the Upper House election. And then if the LDP wins the Upper House election, I think he will turn his attention to the issues that he's really passionate about, which are not the economy but issues of constitutional reform, of a more activist foreign policy, and questions about how to teach children in Japanese schools about history, including the history of the wartime period and the like.

"Abenomics"

Now, what is the economic policy of this administration? It has two major anchors. One is a huge fiscal stimulus. This is still the year 2012 in Japanese budgeting years, until the end of March, so the supplemental budget of 10.3 trillion yen is a supplement to the regular 2012 budget. That brings the total (amount of) Japanese government spending for the year 2012 that is funded by borrowing, by issuing bonds, to 51 percent of the total, about 52 trillion yen in borrowing to fund the national government. The supplemental budget, which will pass within the next month, will only increase the ratio of the Japanese government debt to GDP ratio from the current 230 or 240 percent and make it even higher. A little bit more than half of this supplemental budget is for public works spending.

This is good, old-fashioned LDP politics. There's nothing new here. This is pre-Koizumi LDP politics: feed a lot of money to the construction industry, get it out in a hurry, stimulate growth, and it works. It always has worked. It will work this time. The economy will grow. That's what happens. Whether it will be money consumers spend or the government spends, you are spending money, a lot of it, including money you don't have. By borrowing and spending it, you'll get growth.

The question is what happens when the spending ends? What we know from LDP policies in the past is that when the spending ends, growth ends. So this is a way to buy time. You're going to get some growth, and you buy time to adopt measures that will lead to sustained growth. The big question about Abe's fiscal policy is - will it be connected to the kinds of reforms that are needed to get sustained growth? I'll come back to that in a minute.

Now, you know, public works spending has had a bad name in Japan. Koizumi reduced it tremendously, but a lot of public works spending is very important. We could use some of what the Japanese are going to be doing in public works spending right here (in the U.S.), like fixing tunnels that collapsed and killed people, and fixing bridges that fall down. Decrepit infrastructure, which is a big problem in the United States, is increasingly a problem for Japan as well. So some of this public works spending is for a very socially useful purpose, which is to repair and improve the infrastructure, but a lot of it is simply good, old-fashioned pork barrel spending to buy the support of a lot of vested interests that will provide the votes to win the Upper House election. That's what the motivation is.

The question about the fiscal spending is really twofold: one, can they spend all this money as quickly as Abe needs to spend it to get the demonstrated economic payoff? That's a question, because there's still money in the pipeline in Tohoku that hasn't been spent yet, because it's not easy to spend trillions of yen especially at a place where there isn't a lot of young labor available and so forth. The second is this: we talk about a fiscal cliff in the United States. Well, there is a fiscal cliff that sits on top of Mt. Fuji. If Japan falls off this cliff, it has a very long way to fall if it cannot convert this government spending into some sort of a sustained economic growth policy.

Here's the other piece of this. One important date this year politically is July, when the Upper House election is going to be held, but the other important month is October when Prime Minister Abe and his cabinet have to decide whether to go forward with the consumption tax increase. Clearly, the hope is to get enough growth, which is what the supplemental budget is supposed to do, to get three percent growth. He has said three percent nominal growth is what is needed to justify going ahead with the consumption tax. If they don't reach that, I think the chances are good that he will not raise the consumption tax to 8 percent next year and to 10 percent the following, in which case the fiscal situation will become much worse.

There's a lot of enthusiasm in the markets particularly, although not as much among the Japanese public, but there's enthusiasm there as well that Abe is doing things. At least somebody is trying to do something. But reality will soon set in that this is a risky strategy. I think of it as Abe's "Hail Mary pass" economic strategy. You throw the ball out there; you pray that your team won't fumble it, that it'll catch it, and you will score a touchdown. If it doesn't, you're in deep, deep trouble. But that's what he is up to. The companion piece to the fiscal program is strong-arming the BOJ, the Bank of Japan, to adopt a two-percent inflation target. And he's been successful, at least successful to the extent that the bank has signed a joint statement with the government committing both to achieving this two-percent inflation target and to making constant asset purchases, purchases of government bonds, to try to get there.

Clearly, Mr. Shirakawa, the head of the bank, doesn't, I think, have his heart in this policy. He really didn't have much choice because of Abe's threat, real threat to revise the BOJ law, to reduce the Bank's independence if they didn't go along. Come April, another

important month in this political calendar, he will have the chance to replace Mr. Shirakawa with somebody who is committed to the kinds of reflationary policies that Mr. Abe wants to see the bank support. One of the big guessing games is who that is likely to be. There's no point going into names here, but it's clear, I think, that it will be someone who will swear on a stack of Bibles that he will support the kinds of policies that will commit the bank to try to achieve this goal.

Looking at it from a political point of view, rather than getting into the arguments economists get into about whether this is the right way to go or not, the questions are whether this is an achievable goal within a reasonable timeframe and what the political consequences are. I'm very dubious. Mr. Shirakawa, the governor, in announcing the bank's support for this policy, also said - or the bank projected - that this year the consumer price index would rise by 0.4 percent, and next year, fiscal 2014, by 0.9 percent.

But [Abe] is talking about 2 percent. So at the earliest, in 2015, this projection would suggest it will be a little later, 2016, and then it's already getting close to election time and the bank has not achieved the 2 percent inflation target in three years, four years. Is this a successful policy? Six months from now, will the markets be as excited about Abe's policy when it sees the CPI crawling up 0.3 or 0.4 percent? No. I think that right now you have very high and unrealistic expectations. The question for Abe is, can them alive until July and win the Upper House? I think that's what this is largely about.

Also, let's say this inflation target policy begins to have a payoff and you see real inflation, modest inflation, but still inflation. But if the inflation is mainly in the form of higher energy prices and higher food prices because a depreciating yen makes imports more expensive, is the public going to say, wow, this is a wonderful policy? We have inflation and we're out of deflation. My energy bill has gone up. My food bill has gone up. My wages are stagnant. Is that a recipe for political success? I don't think so, but that's a very likely outcome.

Rengo, the labor union federation, had a very modest request this year. The request for a "base up" or general increase in wages was for one percent, to which Keidanren's response was, "that is impossible. Not only will it be zero but we have to reconsider the custom of increasing wages according to seniority." So Keidanren hasn't changed their tune, at least not yet. The business community doesn't look as though it's very enthusiastic about raising wages.

So you may have some inflation. It's going to be largely because of the increased cost of imports, and especially of energy.

Now, Mr. Abe wants to restart nuclear reactors, partly so that this import energy bill doesn't keep on getting larger. But it is not going to happen. There is simply too much opposition among the public. One of the things that the Noda government did manage to do was to restructure the regulation of the nuclear power industry. There is now a more independent Nuclear Regulatory Commission, which, as you know, has stopped the reopening of one nuclear power plant because they discovered that it sits on an active fault line, and it may reach the same conclusion about another. Nuclear energy is not coming back that quickly, no matter what this government would like to see.

So all I'm suggesting here is be a little cautious and skeptical. First of all, about how new this economic policy is. A lot of it is old LDP. And how successful it's likely to be, as for example, this two-percent inflation target, and whether it's good or not. Right now, there's

very little in the way of criticism. I don't mean to criticize the policy yet. All I'm suggesting, all I'm doing is waving a warning flag.

Now, the question is - you do this fiscal stimulus, you have this reflation, but what is happening about trying to create sustained economic growth, and things like agricultural reform? I think Abe will decide to have Japan join the TPP negotiations, but whether this results in major agricultural reform is uncertain at best.

Since Mr. Abe has become prime minister, or even before for that matter, have you heard the word "immigration" spoken by anybody in this government? No, but here's a country with a declining population, a declining labor force. How do you get growth if you don't increase the labor force and raise productivity, with no talk of immigration? Is there much talk about making it easier for mothers, working women to carry fulltime and mainstream jobs? Is there a lot of talk about creating the kind of daycare centers and other child services that are necessary, so women can work and be paid equivalent wages to men? I don't hear it. What about social security and health care reform? In the supplemental budget, I think there's 2 trillion yen to subsidize the healthcare system so the co-pay that elderly people pay doesn't have to increase. That's good. The older you get, the more you think that's really great. But is this part of the kind of structural reform necessary to make the Japanese economy more dynamic? I don't think so.

So this is the reverse of the Koizumi policies. It's not small government. It's not deregulation. It's not agricultural reform. It's not immigration. It's not more women in the workplace. It's good, old-fashioned LDP pork barrel politics.

But it's early in the game and we'll just have to see how things play out. I mean, Prime Minister Abe has brought in excellent advisers. He's reestablished the Council on Economic and Fiscal Policy. There are four outsiders or private sector people -- two academics: Ito Motoshige, who's a liberal international economist at Todai; and Takahashi Susumu who heads a think tank, the Sumitomo Mitsui Bank think tank at Japan Research Institute; and there are two CEOs from the business community. He didn't bring in Mr. Yonekura, the head of Keidanren. He brought in two active ones, two active and interesting businessmen: one, the head of Mitsubishi Chemical, Kobayashi Yoshimitsu; and the other the president of Toshiba, Mr. Sasaki Norio. And there's an economic revitalization headquarters with the best of younger generation of entrepreneurs and economic thinkers - Mikitani of Rakuten, Hasegawa of Takeda Pharmaceutical, Sakakibara of Toray, Takenaka Heizo, and Niinami of LAWSON - very interesting people.

At the moment, both the liberals and the old style LDP fellows are all behind Abe. At some point, he's got to make some tough decisions about which way to turn. So I think that before much more time goes by, we'll start hearing murmurs of discontent from the liberals that things aren't happening in the way of structural reform. I have my doubts about the viability and likely success of this economic strategy, but I think as a political strategy, so far, it's working like a charm. He's changed the mood. There was a sense with the DPJ that they just accepted [the idea] that Japan is going to drag along the bottom. Noda typed himself as this bottom-feeding fish, and I think that was unfortunately the impression the voters got. This was a bottom-feeding fish group that couldn't get off the bottom and get the country moving again.

I actually think Noda was a good prime minister in many respects. I admire the fact that he stuck to his guns. But he never could connect with the public, and that's an

important part of politicians. But I've been watching Abe for a long time. He's a very different kind of leader now than he was six years, so he did learn some lessons. He learned that as for constitutional reform and all those issues that could take a long time to bring in, you talk about them, and you build public support; but in the meantime, you do things that the public can relate to. After all, "It's the economy, stupid" works as a slogan in Japan as well as elsewhere.

He has a savvy media strategy. I think probably that Mr. Iijima, who was Koizumi's man to deal with the media, has gone to work for Mr. Abe. Clearly, his footprints, his handprints are all over the media strategy. He's appointed some high profile women to key positions, leading positions in the party so they're constantly in the public eye. He's on track to doing very well in the July Upper House election.

Abe's Foreign Policy

So that leads me to the next big subject area. What is Abe likely to do about the issues of foreign policy, of constitutional revision, of history revision? Now, Abe Shinzo is one of the most ideological of Japan's post-war prime ministers. When you think about who else sort of sits on the right where Abe is, the name that comes most to mind is his grandfather, Prime Minister [Nobusuke] Kishi. They're very much alike. Much of Abe's long-term agenda is to achieve the goals that his grandfather had 50 years ago and was unable to achieve, like constitutional revision, building up the Japanese military and so on.

So Abe is a lot like his grandfather, but a lot like his grandfather in another important respect. I think he's a pragmatist. Kishi was a pragmatist. He always distinguished between what was desirable and what was possible, and he went for what was possible. I think that's what we're going to see with Mr. Abe -- that pragmatism trumps ideology.

The things that Abe has said about moving beyond or getting rid of the post-war regime -- for example, about revising or taking a new look at the Kono Statement about comfort women and the Murayama Statement about apologizing for Japan's wartime atrocities committed during the war and so on -- these are very troubling. The "*Sengo rejimu no dakkyaku*," getting beyond the post-war regime, that's a very odd expression, a curious and a troubling expression for me. The post-war regime is a regime of democracy and a regime of largely one party dominance. So do you want to reject that regime? He must mean something different, like I'm not going to choose the BOJ governor from a former official or from the BOJ. That's okay. But to talk in these general terms about getting rid of the post-war regime creates a lot of nervousness, I think, abroad, not only in Asian countries but also in the United States.

It is the same with, and even more so, for this issue of history. I gather, although I have no direct knowledge, but my impression is that the U.S. has made it clear to Prime Minister Abe that rejecting the Kono Statement about Japanese government complicity in the forcible recruitment of women and young girls 15, 16, and 17 years old to provide sex for servicemen during the war would not only lead to a crisis in relations with South Korea, it would create a very adverse reaction in the United States. I think that's very true. But my impression is that Abe gets the message. He sent an envoy to Seoul almost as soon as he became prime minister, Mr. Nukaga. He cancelled plans to have the government sponsor the so-called Takeshima Day celebration that was supposed to be held in February. He's saying

all the right things about the importance of relations with South Korea, and so I don't think we're going to see this historical revisionism.

On the constitution, I think he has a long-term goal. I mean he'd like to serve these three years, win the Upper House election, do better in the next Lower House election, better in the next Upper House election, and get two-thirds of the seats in each house of the Diet with the Ishin no Kai and possibly other parties that are more on the right, in order to support constitutional reform. He has a strategy for revising the constitution, which is very clever, which is not to talk about Article 9 but about Article 96, the article about how you amend the constitution. [His strategy is] to change that article about how to amend the constitution, which now requires a two-third vote of all the members of both houses, not only those voting but all members of both houses of the Diet, and then requires a majority in a referendum. [He would] reduce that two-thirds maybe to a majority and make it easier.

So the first step will be to amend the constitution, to make it easier to amend the constitution; and then to focus on issues like Article 9 and other issues that he's concerned about; strengthening articles about social responsibility rather than just freedoms and other things that other people have commented about. But this is not going to happen soon. And the U.S. position, it seems to me, is not unambiguous on Japanese constitutional reform and revision. Will Americans welcome the major revision of the Japanese constitution including Article 9? I have my serious doubts.

On foreign and defense policy, which we'll get into more this afternoon, I'll just make a few points and then I'm going to conclude. Some things have already changed. For the past 11 years, the defense budget has gone down year on year. Every year, it's been reduced, but now it's going to go up. Not a huge increase, but it's going up. There's money in the supplemental budget for the acquisition of defense material.

Mr. Abe, I think, wanted to come to Washington this month. We had other things to do like the inauguration and a lot going on, and there may have been other reasons that it was postponed until February. So he went to Southeast Asia and quite overtly made the point that Japan wants to develop its relations with the countries that sit on China's periphery. He stressed Japan's concern about freedom of navigation and the like.

But I think that at the end of the day, Mr. Abe is and will continue to be a cautious hawk. Pragmatism will trump his ideology. Various pressures will work to keep him, and to keep Japan from veering far away from its current course. Right now a coalition member, the head of the Komeito, is in China. Mr. Yamaguchi went there basically saying we should return to Deng Xiaoping's advice about the Senkaku Islands - shelve it, and leave it for further generations to figure out how to solve. That's the message, I think, he's taken with him to China.

On the Senkaku Islands, I just want to say a word and then, again, this is something we'll get into later today. This recent flare up over the Senkaku Islands unfortunately was precipitated, not by something the Chinese did but by the actions of the former governor of Tokyo, Mr. Ishihara. I think, very unfortunately, that things are playing out pretty much according to Ishihara's playbook: have a crisis with China; test the American commitment to defend Japan; and get the Japanese to understand that the China threat is real and that Japan has to do more in its own defense.

I don't think Noda had much of a choice but to buy those three islands from the person who owned them, in order to prevent Tokyo from doing so. There really wasn't much

of an option. He could have just said no, but given the realities of Japanese politics at that time, that wouldn't have solved the issue. Ishihara had raised a lot of money, \$14 million or more, to buy those islands. He could have sold them to a private right-wing group. In any case, I think Noda tried to convey the message to the Chinese that by buying those islands, he was trying to preserve the status quo. The government had been leasing the islands. Nothing changed in terms of the government's authority over how they're used. But as you know, the Chinese would have none of it, and they ratcheted up the controversy and the confrontation, and they continue to do so.

So in my view, the way to deal with the Senkaku issue is first to recognize one reality. There is no way to resolve this territorial issue. You have to accept that this issue cannot be resolved. It can only be shelved and pushed away. I think there's only one way to do that and that is for the Japanese government to accept and give up the fiction that there's no dispute with China over the Senkaku Islands. There is a dispute. Mr. Noda wanted and was prepared to say that, except I think he felt a lot of pressure from the right not to. But one of the most curious things in the Ishin no Kai Restoration Party manifesto is that the manifesto calls for the Senkaku Islands dispute to be adjudicated by the International Court of Justice. This is in the Ishin no Kai manifesto. Well, you can't ask the international court to adjudicate something if there is no dispute. By saying that you want the ICJ to adjudicate it, even the right has accepted the fact that there is a dispute. And, of course, that's the American position. The U.S. government has said the question of sovereignty over these islands is an issue that should be resolved by negotiations between Japan and China. I think the Japanese are going to have to accept that reality, and I think there's reason to hope.

I think there's reason to believe there's a very good chance that that is really what those rational-thinking people in Chinese policy circles want. That is, if the Japanese recognize a dispute and it's on the bilateral agenda, you can talk about it. If you talk about it, you can remove your ships from the 12-mile zone around the islands and talk about it this year, next year, 5 years, 10 years, as long as it takes to calm this issue down. I think that once the Japanese make this move, if they make this move, then the U.S. position is very clear. We support Japan. We recognize Japanese administrative control over the islands and understand our obligations in the security treaty to support Japan, and now it's up to Japan and China to figure out what to do about it.

Summing Up

This is where I end up. I end up finding myself skeptical about the Abe government's economic policies and cautiously optimistic about its foreign policy, just about the opposite of the way I think most people look at the situation. I'm skeptical that his economic policy is going to work. I think it probably will work well enough to get the LDP to win the Upper House election. But long term, the problems of the Japanese economy are not on the way to solution by these policies.

On foreign policy, pragmatism will win out. The hawks will remain cautious. Great changes, for better or for worse, are not likely to happen.

The election in December didn't change Japanese politics as we know it. There's a unique system of checks and balances in the Japanese system. They continue to function,

and they will keep the country from veering sharply away from its current course on either domestic or foreign policy.

So what do we have at the end of the day? Japan will continue to be one of the world's major economies. It will be a country that will continue to limit its military's roles and missions in ways that are unique, and it will continue to be a model of democratic civility and social order.

I think this last point is a really important one. We saw it in Tohoku in the response to the earthquake, and you see it just by living in Tokyo or anywhere. This is a country in which civility, good manners, cleanliness, caring for your neighbors when there isn't enough, when there's no more nuclear power plants producing energy, and cutting back on your consumption. There's a lot about Japan that is very admirable and will continue to be so.

I think there's a lot of scare talk right now about Japan's right-wing shift. I don't think it's happening. Thank you.

Morning Panel Discussion

Domestic Political and Economic Prospects

John Malott: Our first panel session this morning is on domestic matters and will be chaired by Dr. Michael Auslin of AEI. It will consist of Glen Fukushima, who's back in Washington as a senior fellow for the Center for American Progress. Glen, as you know, is past president of the American Chamber of Commerce in Japan. Also James Schoff, senior associate from Carnegie Endowment for International Peace; and Yuki Tatsumi, who is a senior associate at the Stimson Center.

Michael Auslin: Good morning. I'm Michael Auslin, resident scholar at the American Enterprise Institute. I'm joined here by three people who really need no introduction, so I won't really do one. I'll just very quickly mention who they are. To my immediate left, Glen Fukushima - as John mentioned - recently returned to D.C. after two decades. Every one who's been to Japan at any time since 1990 knows Glen very well. It's nice to have him back and adding to our Japan expertise in town. James Schoff is now a permanent D.C. resident after having been seconded to the Department of Defense for a couple of years and joining the Carnegie Endowment. It is outstanding to have another new Japan expert in town so that we're building the stack. Jim is just coming off working in the government but now is looking at some of the more domestic issues. And, of course, Yuki Tatsumi, whom everyone knows, has been in town for a while and has been a regular commentator particularly on defense and military issues. But obviously John is trying to get us to spread our wings a little today. So with no further ado, I'm going to turn it over to Glen and then we'll go through the panel. I look forward to a discussion with you. Thank you.

Glen Fukushima: Thank you, Misha. It's good to be back in Washington. As Misha mentioned, I was here 22 years ago working at USTR. But after 22 years working in Japan, I returned to D.C. last fall, and it's great to be back and to be joining activities such as this with the Japan-America Society of Washington, D.C.

This panel is supposed to talk about domestic issues. Following Gerry Curtis's comments, I'm going to say that I don't have too much to disagree with what Gerry has already said. But since the topic is for us to talk about the political, economic, and social issues in Japan for 2013, I'll try to pick up on each of these three in sequence.

Japan's Political Splintering

In the first arena, that is politics, clearly for this coming year the big event is the Upper House election. As Gerry mentioned, much of the focus now by Mr. Abe and the electorate as well is what can we expect with the Upper House election and what will actually be produced by the time of the Upper House election as to effect the outcome.

The expectation at the time of the Lower House elections back in 2009 was that there would be over a period of time a development of roughly two parties that would compete with each other. At that time, it was thought that it would be the LDP on the one hand, and the Democratic Party of Japan on the other. The LDP, which had been in power for 54 years, lost to the Democratic Party of Japan, and the thought was that this would create basically two major parties. There would be other parties as well, but primarily two major parties that would be able to over time to compete not only on personal relations but on real policies and issues.

One of the issues I think that has been surprising and one of the major disappointments out of the 2012 election is that it has in fact gone in the other direction, at least for the time being, and that there's a splintering of political parties. At one point, before the election last December, there were something like 15 political parties that were vying with each other, and it was hard to keep track just of what the policies were, as well as which people were in which party. So I think one issue that merits attention this year is to what extent this fragmentation of the political parties is going to continue, and to what extent is there going to be more of a convergence on the major issues over the next several months leading up to the Upper House election.

Also, as Gerry mentioned, most people speculate that the prime minister is focusing on the economic side so as to try to produce results and get a good result out of the Upper House election. And then after the Upper House election to have a freer hand to do what Mr. Abe holds dear to his heart, which are the security and history and other issues.

I guess one question really is to what extent is this going to be true? That is, even if Mr. Abe does well in the Upper House election, how much of a change is there going to be in the government's policy direction after the Upper House election? Obviously, this will depend on a large part of what the results of the election are, but I think that's an issue that merits some serious scrutiny.

The Business Mood

On the economic side, I was in Japan for 22 years in business. In addition to being the president of the American Chamber of Commerce in Japan, I was quite active in a number of Japanese business organizations, including in particular Keizai Doyukai. I think from the business perspective, as Gerry mentioned, there is a real change in mood in Japan since last October and November.

I was in Japan then and also in January of this year. Just going to the *shinnenkai*, the annual New Year's parties in the first two weeks of January held by the major economic organizations - the Keizai Doyukai, Keidanren, Japan Chamber of Commerce, the Japan Productivity Center - as well as other new year's parties where all the senior executives of the Japanese companies got together, it was quite palpable how the mood had changed. There was an expectation that with the new government, we would have professionals back in control who could work with the bureaucracy to have effective economic policies.

Even among those Japanese business leaders who welcomed the change of regime in 2009, I think many of them ended up disappointed that the Democratic Party of Japan, although well intentioned, had not produced the kind of results that they had hoped for. So, as Gerry mentioned, even though there really is no substantive basis of change in economic policy, stock prices and the Nikkei have gone up, the yen has weakened, and there's a general mood of optimism. In talking with various Japanese business leaders the last two months, I think there's a sense that what's really needed is competence in economic leadership. And whether or not Mr. Abe has a certain ideological orientation, it's not that important a subject [to them], at least as long as it doesn't get Japan into trouble right now.

Now, Gerry mentioned the economic strategy. I think Mr. Abe himself would explain there are three parts, the "three arrows": the monetary side, the fiscal side, and the growth side. I think that there has been a lot of controversy and discussion about the monetary issues, the two-percent inflation target for the Bank of Japan, and the huge fiscal stimulus, and to what extent that's going to produce sustained growth, and to what extent it's going to be productive growth as opposed to the old pork barrel politics. I think the third leg of this, the third arrow of industrial growth, is the one that requires considerable scrutiny.

There are some, like Mikitani, who have even gone as far as to say that it is not effective for the Japanese government to go back to the old industrial policy of the '60s, '70s, and '80s. But I think we're going to find in the Industrial Competitiveness Council enough diversity among the business and economic leaders who are involved to have some real discussion and debate about what makes sense for Japan. So I find this to be one of the more interesting aspects of the economic strategy, the third leg of the Industrial Competitiveness Council.

On the social side, I think that one of the major areas of focus that we need to watch is the general subject of globalization. This refers to the youth of Japan and the issue of universities and education, to what extent Japan is turning inward versus outward, and to what extent Japanese universities are accepting students and faculty from abroad. I was on a number of university boards and advisory councils in Japan, and I was really astounded by the extent to which some of them were so insular.

In addition, I think that there's a renewed focus just within the last year or so on the role of women in the workplace. I think that Keizai Doyukai has been playing a very active

role, especially under Mr. Hasegawa, the chairman, in trying to promote women in the workplace into managerial positions. Although, as Gerry mentioned, you can be skeptical because the Japanese government itself is not taking that strong of a leadership position. In fact, I think Japanese companies are realizing that they can't really wait for the government to take the leadership. So Japanese companies themselves, many of them, are being much more aggressive and proactive in terms of trying to make it possible for women to work, including things like incorporating daycare centers so women can work and also raise children.

Also, I think the globalization of the workforce in Japanese companies and also trying to get non-Japanese to work effectively in Japanese organizations is another social aspect of change this year which requires scrutiny. I think that regardless of what Mr. Abe does or doesn't do on the economic policy side, the fundamental direction of Japanese society is going to be forced to go in more of a global direction whether it's at the university or school level or in corporations. Frankly, even if Mr. Abe is successful in eventually getting around to trying to inculcate more patriotism in the schools, I think that the importance and influence of globalization is overwhelming, and Japan will be required to educate its citizenry to deal more effectively with the international environment.

In summary, this year is going to be a very interesting year because of the Upper House election, because of the return of the LDP after three years, and because there's a great expectation by people within Japan as well as outside about how successful Japan's economic policies and globalization are going to be, and to what extent that's going to be accelerated or hindered by this new government. Thank you.

Michael Auslin: Thank you. James Schoff.

James Schoff: It's great to be here. I don't know what I was thinking trying to follow Gerry Curtis and talk about politics today. What I want to look at a little bit is what I would not normally try to talk about, and that is the next election, right after an election [has just been held]. I usually hate it when people try to do that. But given the LDP's campaign mode that they're in right now and the fact that this 150-day session of the Diet that we're about to begin is going to be dominated by the fact that we have this Upper House election in July, it's hard to avoid, and I think it's going to be meshed in the dialogue in the coming year quite strongly.

The Coming Upper House Election

I want to look at the Upper House election, the legislative agenda that's on the table right now, and how it might impact the region and the alliance in 2013. I've been pretty impressed so far, as Gerry was discussing, by the focus and the energy of the LDP and its discipline. Frankly, early on, they've really come out with a tremendous amount of focus on securing an Upper House majority. If you look at Abe's press conferences, they seem almost like campaign events. I don't know if that's Iijima's influence, but he'll be very careful to keep including contrasts and comparisons to the DPJ and reminding people about the failures of the DPJ. I suppose we will continue to see some of this. I think the focus on the

economy in Tohoku reconstruction is a very good strategy politically, but it is also, I think, what Japan needs right now. I think there is some substance to it.

The LDP is very disciplined at the moment because they are focused on the election. I wonder in the second half of the year if we'll see that same kind of discipline. I don't think that Abe commands the kind of control or loyalty within the LDP that will allow him to keep everyone in line once the election is over. We'll see how some of these issues and more sensitive issues play out over time. Abe is starting out with relatively high support rates, about 64 percent, but I think the LDP is also aware that it lacked a mandate coming out of the December election. I'd note that of Japan's last nine prime ministers since 1998, all but one saw their support rate drop below 50 percent within three months and below 30 percent within 10 months. Koizumi was the only exception to that. So public support can drop pretty quickly, as Gerry alluded to.

The big question is, how will the LDP's agenda change potentially after the July election? I think that's part of what the Democratic Party really wants to focus on. They want to try to push the LDP now on where it wants to take the country in the next two or three years and try to force them to talk about that issue. But I think the LDP will be reluctant to get into that.

Just looking at past history, in 2009 the DPJ succeeded beyond expectations. It really highlights the drop off for the DPJ, I think, in 2012 in terms of the number of votes received. Obviously, the LDP's decline in vote totals since 2009 is also interesting, and it underscores the fragility of the support for the LDP. The Restoration Party, which is the next [after the LDP in the 2012 elections], had a pretty impressive result for a very short notice. Part of the strategy was to snuff out any big showing by the Restoration Party, but they still put up pretty good numbers.

In terms of seats won, this really highlights part of what Gerry was talking about in terms of how the system challenges third parties especially. In this regard, the big disparity in votes was for seats in the single-seat districts. The LDP, for example, won 79 percent of the seats in the single-seat districts with only 43 percent of the vote. The DPJ took 9 percent of the seats with about 23 percent of the vote. Now, if you put it all together, the LDP overall had about 32 percent of the vote, and yet they won 61 percent of the seats. The DPJ and the Restoration Party each had about 20 percent of the vote and received about 10 or 12 percent of the seats. There's some discussion about trying to reform this, but I don't see any movement on this in the near term.

So we have a weakened opposition and also a diluted opposition, if you look at the DPJ numbers and where the Restoration Party is. The "Your Party" is consistently trying to resist merging with the Restoration Party. You could see the appeal of trying to put these parties together for the sake of elections, but it's hard to do so and still maintain your sense of identity and policy.

In the Upper House, you have a pretty similar dynamic. The LDP wins two to three times more seats in the prefectural districts than they do in the proportional representation. In 2010, the LDP won 28.7 percent of the votes but got 42.1 percent of the seats. The DPJ had about 35 percent of votes, and 36 percent of seats, so it was about equal. And "Your Party" has 12 percent of the vote, and 8 percent of the seats. Your Party picked up a pretty good vote in 2010. It's kind of an interesting dynamic as we head into the Upper House election later this year.

I'm going to make a few more points, but I don't want to go on too much longer. But in terms of Upper House seats won, there is a very similar dynamic in terms of votes received and seats won. If you look at the LDP and the Komeito together, their best performance was in 2001, when together they secured 77 seats. This time around, in July they will need 65 seats for a majority, and they will need 103 seats for supermajority that would give them the ability to have a two-thirds majority for constitutional revision or for other purposes. I would say certainly the LDP right now is well poised to secure a majority coming up. Chances are pretty good they'll pick up close to 60 seats at the current rate, if not a little bit more.

The Restoration Party could pull in about 10 seats, maybe 20 seats or so, but that would only put them about equal probably with where the Your Party might be. Your Party is only losing one seat this time around. They still have 10 who are not up for reelection in July. They could easily pull another eight or nine seats maybe this time around. As for the DPJ, because they still have about 45 seats or so that are safe, even if they win only 8 or 10 seats which is possible, they'll still have about 50, and they'll still be the second largest party in the Upper House. But again, it will be a very diluted opposition that is split among the different parties, and you could also notice the collapse of the left in this dynamic. The Social Democrats and the Communist Party are just off the map. To me, it suggests the opposition will be very weak on certain policies and very issue-based. It's hard to see that the Democratic Party will team up with the Restoration Party or with the Your Party every time to oppose some particular policy proposal.

A Look at the Policy Issues

Let's look at what some of these policy proposals are likely to be in the coming session. As Gerry talked about, I think the LDP is going to focus on very safe issues. They're going to stay away from controversial issues, and focus on economic stimulus and trying to get the economy going. Tax policy is certainly one part of what will be put forward. There's already been some discussions between the Komeito and the LDP on how they will shape tax policy on this regard. There's going to be some cutbacks in livelihood assistance expenses, higher top tax rates for the inheritance tax, and corporate tax cut adjustments in preparation for the consumption tax increase in 2014. I would anticipate fiscal stimulus actually being reined back a little bit as the year unfolds and after the Upper House election. I'm not sure if that fiscal stimulus leg of the three arrows is going to continue, but monetary easing will certainly continue to be promoted.

I would expect to see free trade discussions, the TPP, et cetera, more in the second half of the year as opposed to the first half of the year. The same for energy policy as Gerry suggested. I think that will take some time, but certainly after the Upper House election, I think you'll see a big push on trying to get movement there. Political reform is still outstanding. You have this promise to deal with the vote-value disparity and perhaps reduce the number of lower house members by a few. That will probably be addressed early on.

The Self-Defense Forces Law reform is almost certain to be brought up if not in this current session, then in the second session later on in the year. I would kind of hope that they actually wait to deal with this issue, given the Algerian crisis that has recently happened, which bared some of the shortcomings of the Self-Defense Forces' ability to

deploy and assist Japanese nationals abroad. The LDP wants to fix some of that. At the same time, they want to address some other issues. But if there is going to be a discussion on changing the collective self-defense interpretation, loosening some of the rules of engagement, participating in regional security cooperation activities and having some discussion with the United States on revising or reviewing the defense guidelines, all of that will require changes to the Self-Defense Forces Law anyway. Hopefully, they'll try to do it all at once later in the year, but we'll see, because after the Algerian crisis there is pressure right now to try to deal with it.

And then there is education reform, which I think they'll wait on a little bit because it can be somewhat controversial. It's not clear if the focus on educational reform is going to be systematic, for example, how many instruction periods, Saturday classes, pedagogical adjustments -- or is it going to be more content-focused, on moral education and teaching respect for history and culture. As [Osaka Mayor] Hashimoto has talked about, we've got to get away from the self-deprecating view of history in our schools. I suspect this latter content-focused education reform will be a part of the agenda. Then, when you have that [discussion] going on, at the same time you have reform of the SDF law, and that combination looks bad from a South Korean or Chinese perspective, unfortunately. That will create some tension there, but it certainly is manageable. Some of the self-defense reform activities are perfectly reasonable and have the support of the United States, so I think there will be movement on that front.

In terms of the impact on the region and on the alliance, there is some concern on the economic policy side that Japan is engaging in a little beggar-thy-neighbor approach in terms of driving down the value of the yen. There is concern in South Korea and China about what the impact will be. Automobile manufacturers in South Korea are more worried than electronics manufacturers because some of the Japanese electronic components [they import] will actually become cheaper as a result. So it's not clear exactly what the impact will be, but certainly the region will be watching how Japan's economy bounces back. Japan just had a record trade deficit in 2012, so it is absolutely critical that Japan addresses the economic and trade issues.

As for political stability in Japan, I think everyone wants to see that, and we should get some of that after the Upper House election. Then we'll have to keep our eye on the issues of education reform, some of the history issues, and Self-Defense Forces Law reform and how that's managed and explained in the region to minimize the downsides.

I agree with Glen. I have a strong interest in this third component [of the economic strategy], the competitiveness component of the Economic Revitalization Committee in Japan. I think it's very limited what the government can do from a fiscal point of view, and very limited what it can do from a monetary easing point of view. It's really the private sector in Japan that, I think, holds the key to revitalizing Japan's economy and opening up new markets and increasing the benefits for all. We'll have to keep our eye on how that dynamism is harnessed and utilized within the new government.

Michael Auslin: Thanks. Yuki?

Yuki Tatsumi: Since Jim and Mr. Fukushima have already laid out pretty eloquently what you can look for in terms of the Japanese political and economic agenda, my homework for

this panel was to discuss what is not directly related to those issues but other issues that still very much exist in Japanese society.

Growing Interest in Security Issues

One of the changes that we are seeing in Japan for the last 10 to 15 years is the distinct increased visibility and also seeming increase in public interest in the foreign policy and security policy agendas and how the government manages those issues. This morning, what I would like to do is to talk a little bit about where I think those trends are coming from, and what they mean for the new government under Mr. Abe as they face the foreign policy and security policy challenges from hereon out in 2013.

Just to start off, just because the public seems to be more interested in the foreign policy and security policy doesn't mean that it's an election-decisive issue. It certainly was not the case in last month's election. I will cite a poll that was conducted by *Asahi Shimbun* on December 11th and 12th of 2012. Let me remind you that this was in the middle of a time when Japan was really anxious about when North Korea might launch a satellite/missile; the poll was taken during that rather unsettling time. Even so, only 15 to 16 percent allocated the highest priority to that for voting decision or priority in the election. But at the same time, though, one of the major fallouts of the DPJ over the past three years was the very tangible visible mismanagement of national security issues, crisis management, and foreign policy. That certainly contributed to the increased level of public interest in those issues.

And also, not to minimize recent developments in East Asia, you only have to go back to a couple of years ago to remember the Chinese fishing trawler's collision with the Japanese Coast Guard ship, ongoing tensions between Japan and China over the Senkaku issue, and also diplomatic tension between Japan and Korea over Takeshima. Just the most recent example is the Algerian hostage crisis. There also was a huge national crisis management issue for all Japanese two years ago, when Japan was hit by a triple disaster.

All these issues, coming together, seem to be lead to a trend or dynamic that the public is more interested in foreign policy and security policy issues. Whether appropriate or not, this will probably impact the government's ability to manage certain policy issues as Japan moves forward. Let me just spend a minute or two to talk about where I think it's coming from.

Politicians Becoming More Involved in Policy-Making - *Seiji Shudo*

I see this as a confluence of two important trends. One is the greater desire of politicians to be more involved in the policymaking process, which is described as *seiji shudo* in Japan. The other is recent security developments in the region. Let me focus just on the first part. The DPJ really made a big issue of *seiji shudo*, but, in fact, it had existed long before then. It started off a long time ago, as Prime Minister Nakasone sought to enhance the prime minister's capacity to have more input into the policymaking process; also Prime Minister Hashimoto, for the administrative reform that he implemented under his watch; and Prime Minister Koizumi, who is the first prime minister who actually benefited enormously from *seiji shudo* but who also actually knew how to make the most out of it. So

there is this general trend towards *seiji shudo* dating back to Nakasone, although the DPJ really made it into their own issue.

What the DPJ did in addition was to raise awareness about government accountability and transparency in decision-making. You certainly saw that playing out in the area of foreign ministry's so-called secret nuclear agreements with the United States. They went into the archives and disclosed the documents, but it didn't always work to their benefit either. Sometimes, more often than not this led to a very messy decision-making process for the DPJ, where the prime minister or a party leader would say one thing in the morning, and someone else in the cabinet would say something completely different in the afternoon, minimizing the impact of any policy statement that came from the leadership. So *seiji shudo* was a mixed blessing for the DPJ.

One thing for sure is that the public is definitely more interested in the government's ability to manage foreign policy and security policy. While they won't vote on it as a decisive factor, it certainly is one of the very important gauges through which the Japanese voters see and make judgments on the government's capacity to govern. So there's no doubt that the government's management of foreign and security policy will continue to be under much closer scrutiny by the public than it was before. For the government, that comes with both pros and cons.

[Political control of foreign and security policy] depends on the leadership of the prime minister and his advisers and their ability to galvanize the bureaucracy to their marching orders, as well as their ability to do a good job in strategic communications, explaining their policy options and rationale more eloquently to the public in the words that they can understand. If they can do so, they will have a more willing audience to listen to their words, and whatever the policy outcome is will have deeper roots and greater public support. But on the other hand, if political leaders do not do so and continue to make decisions the way they have been doing all along, in kind of a closed circle of the foreign policy and national security policy elites, then it will definitely backfire, and public sentiment could actually constrain the government's hands. This is very much the case the closer to home those security policy issues are.

I will raise two examples where the Japanese government may find it challenging to manage this policy. One is its relations with China. Weariness, I don't call it anti-China but just weariness about Chinese aggressiveness, is very, very prevalent in the Japanese public among the average people. Without a clear explanation of what Prime Minister Abe intends to do in Japan's relations with China, including how the government is managing the Senkaku issue, there will be very emotional reactions to whatever the government does. It will be very hard for the government to control or manage those emotions.

The other is the North Korean issue. Prime Minister Abe became a national political figure by championing the abduction issue. North Korea seems to be ready for perhaps another nuclear test, and this is a serious national security concern for Japan. How to manage and frame the abduction issue within the context of Japan's overall policy toward North Korea is another big challenge for Prime Minister Abe and his advisers.

Michael Auslin: Thank you to the panel for three very insightful takes on what's happening today in politics in Japan. Before I open it up to the floor for questions, I'd like to take the moderator's prerogative and ask the first question.

I'd like to go back to something that's been referenced a few times, and which Gerry talked about a little bit. This is the devaluation issue, and the monetary issue, one of the legs of Prime Minister Abe's economic reform. What's been surprising or interesting to me is the amount of attention it's actually received. I mean, it's relatively front-page news. It's in the *FT*. It's in the *Wall Street Journal*. It's everywhere. You have the former head of Bundesbank weighing in. You have China weighing in. You have Taiwan weighing in.

So the question is, if it's not particularly significant, why is it causing such a reaction? What does that then say about the overall strength or underlying strengths of the Japanese export sector that we haven't seen in recent years? I mean, if I have the figures right, exports to China dropped by 15 percent last year and to the EU by 11 percent. And somebody called it a beggar-thy-neighbor policy. That's one approach to talking about devaluing the currency, but the government stance is that it's a natural rebalancing that's happening. So I'd like to sort of open it up and get your reaction. Is this really something that can spark a global currency war, which is how it's being portrayed, or what exactly is going on? Glen, you're probably well-suited for that.

Possibility of a Currency War

Glen Fukushima: Well, let me start off by saying that I don't think that it's something that's going to spark some kind of a major trade or a currency war. However, I do think that the amount of attention it's getting reflects two things. One is that it is very important for Japan domestically what the strength of the yen is. At least for those in the export sector in Japan, every yen makes a difference. Among the six or so challenges or disadvantages that Japanese companies are said to face in global competition right now, I think the strength of the yen is always pointed out as one of the most important. I think that within Japan, the fact that the yen would change even one or two yen in a day is a subject that merits attention among the Japanese. Internationally, I think, it's also the case for Japan's competitors that the strength of the yen is an important determinant of competitiveness, and the extent to which the Japanese government, whether through currency intervention or whether it's through just talking or trying to create the environment to make the yen weaker, is something that makes a difference as far as South Korea and China are concerned, but maybe not so much in the United States these days or among the Europeans. But I'm not surprised that it's getting the kind of attention that it's getting, because I think it does deserve that level of attention.

Now, to what extent this will be sustained is another question. If for instance we see a situation where the yen really gets back to the level of 100 yen or 110 yen or 120 yen then I think that it could precipitate some real concern among some of these other countries. But at this point, if it's in the 80s, 90s range, I don't anticipate it's going to create huge problems.

James Schoff: Can I just add something, since I threw the term out there before? I would definitely agree that at around 90 yen, even 95 or so, it's not a beggar-thy-neighbor approach necessarily. It is important to the exporters and to microeconomic decisions, but it shouldn't necessarily change the game in the region. But sometimes perceptions are very important. And if it's in the context of confrontation or competition in the region that China or South Korea or others can blame some of their own domestic failings on a stronger yen or

policies that Japan is taking, in the same way that we blame sometimes the undervalued Chinese Yuan for our own troubles, then that's something I'm worried about in the context of how it plays out in the region. So we need to consider the actual economic impact versus the perception and how it's used politically.

Yuki Tatsumi: What also matters, I think, perception-wise is whether Japan can really make a decision on TPP later this year. So everything probably should be looked at as a package. In terms of whether Japan will move forward to the TPP, what are they doing domestically to really strengthen their resilience of the economy?

Michael Auslin: Thank you. Just to chime in with Jim, I mean today there was a report on South Korea's economy slowing dramatically down. If that's a cycle that continues, China is attempting to deal with what is a slowdown for them, compared to what they had before, and so this adds on to it. You do have this potential for a lot of tension in a region that already has distrust and not a lot of cooperative relations anyway, other than what happens in the invisible hand of trade.

James Schoff: Unless there's outreach to talk with South Korea and China on free trade, and to have their own free-trade discussion. It can be counterbalanced, but you have to make that choice.

Michael Auslin: Right. Why don't we open it up for questions?

Japanese Competitiveness

Shihoko Goto: I'm Shihoko Goto with the Wilson Center. Continuing with the question about the economy going beyond spending itself out of a recession, it wasn't too long ago that Sony was producing all these hip products. These days, Sony is being overrun by Apple and Samsung and many other electronic manufacturers. Are the days of Japanese consumer electronic dominance in the global market over? Are there policies that the government can introduce to private sector growth that you're discussing, or are there specific industries that Japan should really focus on that has traditionally not been looked at?

Glen Fukushima: I think it's probably accurate to say that the days of the hardware mass consumer products that Japan was so successful in producing in the 1960s, '70s, '80s and into the '90s are over. I think that one of Japan's major shortcomings has been to focus perhaps a bit too much on the hardware and less on the software and the solutions that can bring more high value-added.

To answer your question about the role that the government can play, I think, yes, the government can provide tax incentives, investment incentives, and perhaps some consortium for encouraging research and development. There are things that government can do, but I think that especially in the technology area, things have become so global that it's basically up to the companies themselves to be able to enhance their international competitiveness. I mean, my own view is that the role that the government can play, if it's China I think it's probably a little bit different, but for a country in the global trading

environment the way that Japan has integrated into the global trading system, I think what the government can do is relatively limited.

Now, with regard to your question about areas Japan can develop where it hasn't really focused on as much as it might, I think it is in certain areas of services and high value-added services. The whole area, for instance, of healthcare is something that Japan probably has some of the leading edge learning in the world because of the aging population in Japan. The healthcare sector could enlarge, including not only the services part but also medical equipment and pharmaceuticals. That's a whole area, I think, where Japan can develop much more effectively than it has up to now.

I think education is another area where Japan has lots of potential resources, but it hasn't really deployed those resources very effectively from a global perspective. I also think there are some areas of infrastructure. That's an area where Japan has some real strengths, but it has to be infrastructure that has forward-looking high technology, high value-added infrastructure as opposed to some of the backward looking old-style infrastructure. I think that these are some of the areas where Japan really has some potential strengths. I think that in the medium and long run, I'm quite optimistic about the ability of the Japanese economy to compete, but it's not going to be by following the old model of focusing on hardware.

Michael Auslin: I have been trying to pull up some statistics on R&D in Japan. Japan devoted 3.5 percent of GDP to R&D across the board according to the World Bank, in 2008. Whether that's gone down because of the recession, I don't know. But I think that's one of the leading indicators. People also have been comparing Japan versus China on patent filings, for example. A number of researchers say that looking at the amount of R&D, Japan remains near the top. But I don't have the most recent statistics. I think that's one of the indicators that would get to your question about how Japan is going to make the leap back and when people will look to Sony or Panasonic or whatever for leadership in electronics again.

Demography and Immigration

Peter Tatian: Good morning. My name is Peter Tatian from the Urban Institute. I was wondering if the panel could talk a little bit about the Japanese labor force and how that might help or hinder the future of Japan's economic development. I think the demographics aren't really going in a positive direction. You've got a smaller working age population relative to an older population. I would just be interested to hear more thoughts about that. Thank you.

Glen Fukushima: I think with regard to the labor force, there isn't too much to be optimistic about in Japan for now. I think that this issue of the labor force is something that's been discussed for ages now. I remember going to Japan in 1979 and spending a summer at Dentsu as a business school intern from Harvard Business School. At that time in 1979, they were already talking about the aging workforce and about what areas Japanese companies can focus on for the aging population, so this has been around for like 30, 40 years.

I think just within the last year or two, there is a really serious realization in the Japanese companies. Not yet, I think, in the Japanese government but in the Japanese companies that they really have to do something in order to be able to sustain their competitiveness with regard to the labor force in particular. I think in terms of the quality of the labor force, the composition, the number of people available, I mean, they are very concerned. Just within the last couple of years, I think there has been hiring more and more of non-Japanese, especially Chinese, who have studied and graduated from Japanese universities. There is, as I mentioned before, for the first time in quite a while a serious relook at the role of women and trying to promote women in managerial positions in the workforce, and then also Japanese companies sending young Japanese who've been hired to spend six months to two years abroad to get international experience. I think that all of these are attempts by the Japanese companies to deal with this issue of the labor force.

Now, as Gerry alluded to in his comments, one big issue which nobody has really confronted yet is the issue of immigration. I actually believe that - well, I don't know with Mr. Abe himself if he stays for three or four years - that under his government there will be a discussion. But at some point within the next four to six years, I'd say, there will have to be a real serious discussion in Japan about immigration and how immigration can be used effectively in order to enhance Japan's economic position. There are already various study groups that have gone to Singapore, to France, and to a number of countries to look into how to bring in especially high-skilled labor and to use that effectively. It is a major issue that it hasn't yet gotten headlines, but I expect within the next few years it will.

James Schoff: Can I just add something quickly? I totally agree on tapping the potential of women in the workforce. I think that's one option that will be looked at because that reservoir is there, but it needs accompanying policies to facilitate it.

We'll probably see nibbling on the margins in terms of enhanced labor mobility down the line, that would provide some benefit perhaps in regard to being able to move from company to company or even industry to industry as trends change. We have seen compensation for the lack of immigration in the form of overseas direct investment, which essentially takes some of the production and utilizes a foreign workforce - but in the countries that they live in - and we'll see that continue.

Especially on the healthcare side, there has been an effort to bring in more nursing staff and others from the Philippines and Vietnam, but to try to do it in a way that is regulated and which teaches Japanese language skills. It is a very typical Japanese approach to try to manage things in that way, which I think is quite constructive. It doesn't change the numbers drastically in a short term, but over the long term it does improve the situation and helps mitigate some of the potentially adverse effects.

Women in the Workforce

Yuki Tatsumi: Let me focus on women's participation in the workforce. Often, it has some similarities to this country. But when you talk about women in a company, a woman should be able to work throughout her career. Yes, daycare centers are important. But in the Japanese case, there are so many other things that prevent women from maintaining a career. For example, when your child is an infant, there's a three-month checkup, a six-

month checkup, and all those medical checkups with the set of shots that your child needs to go through. Those are setup unilaterally by the local government's health department, and they basically notify you in a letter saying you're supposed to bring your child to this checkup. And usually the date and hours are setup with the assumption that there should be a stay-at-home mom, so it is scheduled right in the middle of the work week, say at 2:00 pm or so. If you work, what are you going to do? You have to take leave from your work. Here [in America], you can try to fit it into your schedule, and checkup dates are not unilaterally set.

There are things like that in Japan that are based on the assumption that there should be a stay-at-home mom. If Japan is really serious about tapping into the female population as a workforce, then more of an overall societal debate is necessary, which I haven't seen happening.

AFTERNOON KEYNOTE

Yukio Okamoto

John Malott: This afternoon we're going to turn to foreign policy and defense matters. But of course, domestic politics in Japan still has a major role to play in all that.

I'm very, very pleased to welcome Yukio Okamoto. I think all of us who worked with Yukio in the old days when he was in the Foreign Ministry expected him to rise to the top in the traditional Gaimusho pattern, which is you eventually become director-general of North American Affairs and then political deputy minister, vice minister, and then ambassador to the United States. But in 1991, Yukio surprised us all when he chose to take a different path and left the Foreign Ministry. But that path also, I think, has brought him great success. We always appreciated Yukio because he was forthright. He was willing to speak his mind. He would tell you exactly what he thought was happening. He was always very, very cooperative, and he always understood the importance of the relationship with the United States.

He left the Gaimusho in 1991 and established his own consultancy. He sits on the boards of a number of Japanese corporations, but he still has his hand in foreign policy matters. He's been an adviser to Prime Minister Hashimoto and Prime Minister Koizumi. He also was a member of Prime Minister Fukuda's Study Group on Diplomacy. He appears regularly on NHK, and makes speeches here and there. He is an adjunct professor at Ritsumeikan. He is in the United States now because he is a fellow at MIT's Center for International Studies. So would you please join me and welcome Yukio Okamoto.

Yukio Okamoto: Thank you very much, John, for those very kind remarks. Of course, no one can refute what you just said that I was to become a rising star, because there is no way to prove whether it would have been true or not. Thank you very much, my friends. I am, as John just introduced me, a senior fellow at MIT spending approximately a week to 10 days in Boston and 20 days in Tokyo every month. I'm shuttling back and forth.

Today I would like to talk about the Japanese election results, Japanese economy, Japanese territorial disputes, Japan-China relationship, Senkaku, Futenma, Japanese energy policy, and the earthquake. But obviously there is no time to explain all of them. At the risk of repeating what Gerry Curtis and James Schoff have already said, I'll give you my own insight -- which is actually identical to Gerry's -- and then talk to you about the Japan-China relationship in the Senkaku and the internal dynamics of China. That will pretty much use up all my time.

Japan's New Government

First the election results. James Schoff has shown a similar chart about the dramatic defeat of the DPJ and the dramatic victory of the LDP. Now, why did this happen? Of course, there is the unpopularity of the DPJ. When the DPJ won a landslide victory in 2009, I made a mistake in predicting the future of their government. I even wrote in my periodical newsletter that the DPJ would win the next election four years later, so we should have to brace ourselves to have the DPJ in power for the coming eight years. I was grossly wrong, but little had I known that their Prime Ministers, especially two of them, would have such a problem with their competence - to say the least - which made the Japanese public quickly turn away and create the unpopularity of the DPJ.

[When you look at] the total number of votes, I always focus on how many votes did each party get in the proportional block. In this proportional block election, you just write in the name of the political party. So you can see voter preferences for the parties and not for an individual candidate, and whether he is young and good-looking or will come to your funeral. [In 2005] the DPJ got 21 million votes altogether, [in 2009] this shot up to 29.8 million votes in the proportional districts, and then [in 2012 it was] down to a mere 9.6 million votes. You can see that people even preferred the Restoration Party more, which received 12 million votes altogether.

Now, is this a big victory for LDP? No. The LDP's votes actually decreased from 25.9 million in 2005 to 18.8 in 2009 to 16.6 million votes in the most recent election. Yes, people are disillusioned with the DPJ. But they are not supporting the LDP, either.

The voting rate also is very, very low. I mean, historically low. In 2009 you had a so-called theatrical election which excited people. They all went to the balloting booth and looked for an alternative, so they voted for the DPJ. Now in 2012 they were disillusioned with the DPJ, but they remained disillusioned with the LDP as well. So they simply didn't go to the balloting booth. It is incumbent on the LDP to know where they stand, and that they really have to renovate themselves to win back the support of the voters.

Mr. Abe has formed a new cabinet. I can spend hours talking about why he picked this particular person and so forth, but I'm going to stay away from doing that except for saying a few things. His priority is the economy. He has a powerful line-up with Mr. Aso, the former prime minister, sitting as the vice premier and the minister of finance. And then you have Amari as the minister for reconstruction. With Abe, they're called the "Triple A's" and they get along with each other quite well. There will be some power-sharing. I think this is going to be an effective group.

Whereas in foreign policy and defense, you have relatively junior ministers, Kishida and Onodera. Onodera is a very good friend of mine, so I have high respect for him. But, of

course, he doesn't yet have the political muscle to push things through. What this means is that Mr. Abe intends to run his own foreign policy directly. He has safely cornered his opponents in to difficult positions like Hayashi to agriculture, who has to make a hard decision on the TPP. And Ishihara, in-charge of atomic energy, who has to be in charge in the aftermath of Fukushima. They won't be able to make revolutionary movements within the cabinet.

So it is a very well-thought out cabinet, and Abe successfully isolated his formidable opponent, Mr. Ishiba, to the party's secretary-general post with two weaker political figures, both of whom are women, to the other two important party posts. So you can see that this time the strong politicians will be in the government, while the weaker ones will have party positions. So Ishiba will be responsible for the next House of Councillors election. If he wins, that means a victory for Mr. Abe. So, Mr. Abe will stay on. If he loses, Mr. Ishiba will have to take the responsibility and step down and not be an anointed heir of Mr. Abe anymore. So much for the political dynamics of Japan.

Will Japan move right? I agree completely with Gerry that this is not going to happen. If it happens, it will be to a moderate degree, and it will be late to appear. Gerry and Mr. Schoff talked about the House of Councillors election. Today the LDP and Komeito put together, that's a majority. They have to win 64 seats [in the July elections] to come to this level, as James Schoff said. But already, because of Mr. Abe's quite decisive announcements on the economic recovery, there are good signs showing up. This is a cartoon from *The Economist*. It says, "At last, Japan is flying again." The only bad news is that this cartoon is from 2004. Here is another one - "Japan's amazing ability to disappoint." This was in 1998.

Economic Implications

Gerry said that he's skeptical of Japanese economic future. Of course, he was referring to the mounting amount of government debt. I share his concern totally. Japan's governmental financial liabilities short-term and long-term put together now reach some 210 percent of the GDP. At the worst historical moment for Japan, during the Pacific War, Japan's debt was even lower than what we have today as a percentage of GDP. So unless something really drastic is done, we will be soon heading towards a cliff.

But, so far, there's a welcoming mood within the Japanese, especially in business circles. As Glen explained to you, stock prices have soared since Mr. Abe became prime minister. When he started talking very aggressively about the economy, stock prices went up. The yen, at last, began to depreciate a bit. You know, we are facing Korean competition everywhere we go. But it is no wonder. The won has depreciated against the dollar by 65 percent compared to three years ago, whereas the yen appreciated by 24 percent. Put it together, and it's a 90 percent disparity. How can we compete with the Koreans in such a situation? But, at last, the gap is closing. We still have 40 percent disparity compared to five years ago, but I think we can manage.

When Mr. Shirakawa took the Office of President of Bank of Japan, it was four years ago when the yen was 103 yen to a dollar. He did absolutely nothing to redress the situation. I shouldn't be too critical about him here, but in my newsletter I always write critical things about him. He let the yen appreciate to 75 yen, a 39 percent appreciation against the dollar.

How can Japan's export industry compete with such an almost artificial currency rate? Now, because the gap is closing, there's a lot of confidence restored among Japanese companies. Japan is a country where the atmosphere or the mood matters very much. The money is there, all in the hands of senior citizens, tightly clasped. So if you give them some amount of optimism, the money will be liberated and the economy will get started.

So while I am, of course, very mindful of Japan's long-term debt situation, I'm not as skeptical as Gerry, who has made an excellent analysis. I agree with all that he had said regarding the present scenario, but I would like to put more optimism emotionally into the future, with one condition. We have to do something about the increase of our social security costs. No wonder our financial situation is deteriorating, because under our present social security structure, everyone gets pensions and everyone is covered with medical insurance. It was designed and started in 1961, 52 years ago, and we are still working under the same architecture.

In 1961, the average life expectancy of men was 65 years. For women, it was 70. Fifty-two years later, the figure is 79 years for men and 85 years for women. How can we, with the same design architecture, cover this astronomical increase in the number and age of recipients? We are coming to a point we can no longer cover the cost by simply raising the consumption tax. We have to cut into the vested interests of senior citizens - which is, of course, politically very, very difficult.

That is the number one task of Mr. Abe's cabinet if he is serious about reconstructing the Japanese economy. He will have to make a hard decision on TPP, which is way overdue now. But because he wants to secure victory in the House of Councillors, he's not going to do that before the summer. Japan won't be able to join the negotiation until the end of this year, by which time all the rules will have been agreed to by all the countries except Japan.

Territorial Disputes

Mr. Abe, of course, has a very serious territorial issue with Korea. I won't mention it today. But in short, I think the preservation of the status quo is the only thing we can do on the Takeshima issue, what the Koreans call Dokdo.

There's an opening of the window for negotiating on the Northern Territories. Mr. Putin has proposed to go for a negotiation that guarantees neither side victory. Let's make it a draw. I won't go into this because of the time limit. But of all the three territorial issues, I think the Northern Territorial issue is the only issue where we have some room to advance and hopefully come into an agreement, because there are four islands and there are many formulations that you can play with: the duration of time, the mode of administration, how long a probation period one should place, and so forth. I think it is not impossible to come to an interim solution on this issue, with the remaining issues to be solved later, and then we can conclude a peace treaty with Russia. I think this is the greatest frontier for the Abe cabinet if he is decisive about moving forward. Of course, he will have to bear attacks from the rightists for relinquishing some Japanese territories. But it is virtually impossible to get four islands back at the same time, and there has to be a compromise somewhere.

Now, a much more serious issue is the Senkaku Islands. I will have to discuss this with Gerry more, because what Gerry has said is correct, but I am more pessimistic about this issue. It is not going to be easy. As you know, in September last year there was an

eruption, large-scale anti-Japan demonstrations in China in August and September, partly because the Chinese government wanted to deflect some of the internal frustrations these people have towards the diplomatic issue. The crowd was very well controlled. According to a Japanese witness who is a businessman, he saw buses bringing police forces to protect a Japanese Consulate General - and then the bus went away and the same bus brought the demonstrators in.

Now the Chinese banners are still about Senkaku, but you see Mao Tse-tung everywhere. Mao Tse-tung had nothing to do with Senkaku, so this is a very distinct sign that these youngsters are demonstrating against something else. China, the Chinese government, had to quickly put a stop to the demonstrations. They must fear that the same level of demonstration may erupt against the government, so they will be very cautious to allow anti-Japan demonstrations in the future. So, I'm not so worried about the mass protests against Japan. My worry is somewhere else.

As you know, China unilaterally declared that all islands in the South China Sea are their indigenous territory. Everything. From the southern tip of Chinese territory, Hainan Island, to the Spratlys, a course of 1,000 miles. It still is all theirs, they say. They have beefed up their coast guard. They started violating Japanese territorial waters and the adjacent waters of Senkaku almost everyday. Japan has only the Maritime Safety Agency, only one agency, but China has many different agencies. Chinese military expenditures are growing. If you make the defense budget, in the year 2000, 100, then today China is 484, a growth of almost five times. Japan is the only country among major powers to have actually reduced its defense budget. This was not the work of the DPJ; it was the responsibility of past LDP governments. So it is a very good sign that Mr. Abe, at long last, is turning this trend back.

Why am I afraid that the Senkaku issue can become even more serious? It has more to do with the evolution of Chinese military maritime strategy than its relationship with Japan, and what Japan does or doesn't do. Gerry's right. This case, this time, I think Mr. Noda made an impetuous move to acquire these islands, especially three days after he met with Mr. Hu Jintao. Hu Jintao reminded him not to take abrupt actions, but Mr. Noda ignored it. So, we are to be blamed a bit. But with or without that incident, China would have been aggressive anyway. Why?

Chinese maritime strategy was decided in the mid-1980s by Mr. Deng Xiaoping when he was the chairman of party military committee and by the famous Admiral Liu Shing Hwa. They made a two-phase strategy. In the first phase, by the year 2010 or around, they would have the complete military control of the waters within the first island chain, i.e., the South China Sea and the East China Sea. While they were in that phase one, Senkaku would be left alone. They would do nothing about it because it is located at the northern edge of their target waters. Yes, China did some provocative things in order to deal with Japan and shake up the Japanese political system, or to deflect internal dissatisfaction. But in my view, they were not serious about coming to actually seize the island. But now they have completed phase one. With a mighty Chinese fleet with more than 60 modern submarines, an aircraft carrier, more than 700 surface ships and so forth, they are overwhelmingly the dominant power in these waters.

So as Mr. Deng Xiaoping decided in 1980's, now they are coming into their second phase, which is to acquire what we call A2/AD capability, Anti-Access/Area-Denial

capability. In short, it is to acquire a capability to destroy an American fleet when it comes to these waters, especially to help Taiwan. For that, they first have to cross an island chain into the wide Pacific Ocean. Now, Senkaku is here. It sits in the gateway of their advance route. Maybe it's only me who is saying this, but now they are serious in trying to either seize or at least neutralize Senkaku Islands because the strategic importance of the location has changed.

So do we see improving signs of reconciliation between Japan and China over this issue? No. It's going to be more serious. Why do they keep trespassing territorial waters? I think it is to announce to the world, especially to the United States, that Senkaku is no longer under the effective control of Japan. The famous Article 5 of Japan in Security Treaty says "Armed attack against either party in the territories under the administration of Japan would be dangerous to both countries."

So if Senkaku is believed to be no longer under the administration or effective control of Japan, they must be hoping that the United States government, which has been very staunchly supporting the Japanese position and upholding Article 5, will come to believe that Article 5 is no longer applicable to these islands. I don't know. I have no grounds, but if I were them, that's the strategy I would take.

Future of Sino-Japanese Relations

So what will happen between Japan and China? This is my only very personal view, but nothing much can be expected out of this leadership, who belong to the fifth generation to rule China. The quick conclusion is that we have to wait to the sixth generation to come to power in China. People like Hu Chunhua or Sun Zhengcai. Hu Chunhua is now the first secretary of Guangdong Province. Sun Zhengcai is now the first secretary of the great of City of Chongqing. They belong to the sixth generation, and there are others.

Why am I saying this? Because how the Chinese look at Japan or fear Japan depends very much on the education they received. Until 1978, people learned under an almost suffocating communist education -- very stern and dogmatic. That's when the generations up to the fifth generation, including Mr. Xi Jinping, went to school. And then in 1978, Deng Xiao Ping brought the air of liberation, and education was greatly reformed. An air of freedom, free thinking, and more objective education began to take place. For the Japan-China relationship, it was a honeymoon during this period, with Mr. Hu Yaobang and Mr. Nakasone, and Mr. Hu Yaobang and Mr. Takeshita. So the generation who was educated in this time span has the most liberal and objective attitude to Japan.

And then came 1989 and Tiananmen Square, where the people tried to topple their government. The leadership got a shock out of it, and they really tried to wind back the system of education. Freshmen in universities were put into military training and so forth. So education after that became very nationalistic, and that was emphasized further by Mr. Jiang Zemin bringing anti-Japan education in 1994. This is actually patriotic education, but in essence, it was anti-Japan education. So the generation after this has been quite nationalistic, and the generation after 1994 education became quite anti-Japan. In Chinese, they are called fenqing, angry youth, and they are the generation who attacked the American embassy in 1999 and held anti-Japan demonstrations in 2005, 2010, and 2012.

So we have this narrow window of 10 years where the sixth generation was educated

and they will come to power two Party Congresses from now, which is the 20th Party Congress to be held in 2022. We have to wait 10 years more until the sixth generation begins to infiltrate the level of the Central Committee members, which has more than 200 members. So it is going to change and we will see real progress then between Japan and China. I'm giving you just a hypothetical scenario.

Of course, when the sixth generation takes power in 2022, they would not have consolidated their political power base strong enough to turn the trend of Japan-Sino relationship. So probably it's the next Party Congress of 2027 when they will have the real power. Then they will have the power, hopefully, to change Chinese education.

Unless education in China changes, the sentiment will not change against Japan. Kids are taught that Japan killed and wounded 30 million Chinese. That's the figure Mr. Jiang Zemin repeatedly used. Of course, I deny that. I mean, Japan thinks the number is much fewer. But, no, we cannot be proud of what we did. We committed atrocities which are inexcusable under any ethical standard. But Chinese inflation of the figures and the level of atrocities are making young kids hate Japan. So, hopefully let's expect more moderate textbooks to begin in the year 2027 and to affect kids 16 years old at that time.

When these kids come into their mid-20s, that will be another 10 years after that. When they come to a decision-making level, that's another 20 or 30 years, so we are talking about a time span of 30 to 50 years before Japan and China really become friends again. It may be a long time. But 20 years -- it took 20 years for the relationship to deteriorate that far and we have to expect for, at least, a long time before the Chinese sentiment against Japan really changes.

In my Japanese university classes, I teach kids that it's not only the fault of China. It's really the lack of accurate understanding of past history on the part of the Japanese. We have not really thought through what we did in China. The whole memory of the Japanese people starts from December 1941 and Pearl Harbor. Japan started the wrong war, and we were duly punished. More than duly punished, some people say. Our land was completely destroyed with 3.4 million people dead. And so the Japanese common perception is that we were wrong, but we have been punished. So let's forget about the war. We think we've paid for our guilt, so let's think nothing about the past. Let's move ahead.

But this does not apply to the Japanese relationship with China or Korea because we acted unilaterally and we were the victimizer. China and Korea had no chance to strike back at us the way the United States did to Japan. They were the victims, and the Japanese forget that the war started in 1931. What happened from 1941 afterwards is only an extension of the war that started in 1931. So it is the period between 1931 and 1941 that the Japanese have forgotten, while the Chinese are reinforcing their losses during that period. So it cuts both ways.

It will take a long time, but in the meanwhile what do we do? The only thing for Japan in the interim period is to beef up our alliance with the United States. No Japanese would expect the United States to go to war with China for the Senkaku Islands, for deserted and uninhabited islands in the East China Sea. No. But if Chinese knows that there is a staunch Japan-U.S. alliance and that perhaps under Article 5 you would provide us with information about Chinese moves, that would be a very strong deterrent to China doing something more adventurous.

Thank you very much.

Afternoon Panel Discussion

National Security and International Economics

John Malott: We're going to go into the second panel discussion now which will be moderated by our Chairman, Ambassador Rust Deming. Panel members are Marc Knapper, Country Director for Japan at the Department of State; Dr. Sheila Smith, senior fellow at our Council on Foreign Relations; and Dr. Mireya Solis, who is the chair in Japan studies at Brookings and also a professor at American University.

Rust Deming: We've had two tremendous presentations by Gerry Curtis and Yukio Okamoto, and an excellent panel presentation this morning. This panel will turn more to the foreign policy, U.S.-Japan relations side of things. Without further ado, let me introduce Marc Knapper, who will speak first primarily about U.S.-Japan relations. Marc, of course, is the Director for Japanese Affairs at the State Department. Sheila Smith, from the Council of Foreign Relations, will talk more broadly about Japanese foreign policy. Mireya Solis, from the American University and Brookings, will focus more on the economic, trade, and TPP elements. So, Marc, would you lead us off?

Marc Knapper: Thank you. I guess I'd like to start on a bit of a somber note and just begin by offering the condolences of the State Department for the loss that the country of Japan suffered recently in Algeria at the hands of the terrorists there. That tragedy, on the one hand, really, I think served to highlight the fact that U.S. and Japanese businessmen, engineers, aid workers, diplomats, you name it, we're working often together side-by-side in various corners of the world and often under dangerous circumstances. More than anything else, this event just showed how closely we are engaged together around the world and at the same time, I think, it really underscored the amount of -- the necessity of our two countries working with the international community to cooperate together on counter-terrorism and information sharing.

US-Japan Relations

My task for this panel is to talk a little bit about U.S.-Japan relations over the coming year. A good enough starting point is the visit last week of Foreign Minister Kishida. He met with Secretary Clinton last Friday, January 18th. I commend to all of you the joint press remarks that both made after the meeting. I think it really did a good job of covering the full range of issues that the two of them -- discussing the full range of issues on our bilateral agenda for the next year.

I think Dr. George Packard said this properly during the luncheon. I think he's left already, but I couldn't agree with him more, and I certainly couldn't agree with him more about channeling Marshall Green on the necessity of our leaders really looking at the relationship, the bilateral relationship from 30,000 feet, and the need to really have a strategic view of things. In fact, that was one of the goals in last year's April 2+2 statement

in which, some of you may recall, we decided to delink the issue of the move to Guam of our U.S. Marines from Okinawa, from the transfer of forces from Futenma to Camp Schwab in Henoko. The reason for that was to allow our leadership the space to be able to have this kind of important strategic conversation and not always be worried about landfill permits and things like environmental impact assessments.

So with that spirit, our two countries just this month, in fact last week, launched the first of what will be I think many conversations over many months on the issue of the U.S.-Japan defense guidelines. The last time we went through this was in '97. I know Ambassador Deming was intimately involved in that process, but really the goal is to take a look at our relationship, you know, 15-20 years from now, and what do we want the U.S.-Japan alliance to look like. What's our vision? What do we aspire to? And then sort of walk back from there. What steps, what do we need to do now and over the next couple of years to get to the kind of relationship we aspire to, in let's say, 2030.

I was fortunate to be a part of these talks last week and I think both sides are committed. But at the same time we realized this isn't something that's going to happen overnight. It's going to be a drawn-out process, I think. I don't know. Ambassador Deming, do you recall how long it took in '97? It was a couple of years, I think, from when President Clinton met with Prime Minister Hashimoto in April of '96. They commissioned basically the two sides to begin work on this which finally ended in the '97 guidelines.

But, unfortunately, even though we are thinking big thoughts bilaterally, for those of you who hope in 2013 never to hear again about Henoko or Futenma or any of those things, I'm afraid I've got some bad news. These issues do remain on the front burner with the U.S. government, and we are fully committed to the plan to realign our U.S. forces, including moving Marines from Futenma to Camp Schwab. We're confident that we'll see some real progress this year. This is something that Secretary Clinton and Foreign Minister Kishida discussed. Our goal remains to not only mitigate or rather shrink the footprint of U.S. forces on Okinawa and be good neighbors, but at the same time to ensure we are continuing to maintain our deterrence capability to preserve peace and stability in the region.

Just going back to the guidelines, one thing I would note is that if you look back at the '97 guidelines, they were really remarkable. It was a remarkable document. For the first time we gave our alliance the space to address the issues really beyond the defense of Japan. What we were talking then was the Korean Peninsula and how that figured into the role of U.S.-Japan security alliance. But a lot has happened since then, and so one of the driving forces behind this decision to take a look at the guidelines is we've had Japanese Self-Defense Forces in Iraq. We've had them in Kuwait. We've had Maritime Self-Defense Forces in the Indian Ocean participating in Operation Enduring Freedom, refueling coalition partners' vessels. I mean, Japan has gone way beyond anything that we would have dreamed of when we put the '97 guidelines together. So the goal now is to really just look where we want to be, as I said, 20 years from now and create the alliance that we aspire to.

Obviously, one issue on the front burner is, as we've already heard, Japan's relations with its immediate neighbors. I don't need to belabor the points, but North Korea remains a huge issue for us. The response to the recent missile launch and our coordination in New York and our ongoing cooperation among the U.S., Japan, and South Korea I think have been exemplary. It's obvious that as this trilateral relationship continues to develop while the U.S. has extremely close relations with Japan and with the Republic of Korea, we want to

ensure that the third leg of this tripod - that is the relationship between Japan and South Korea, is productive and healthy. I think it's safe to say we've been encouraged by the new leaders in both countries and the steps they've taken to try and lead the way and to continue to have a very strong and increasingly valuable Japan-ROK relationship.

About the Senkakus and Japan's relationship with China, I think Okamoto-san already gave us a great deal of good background on that. My goal here in talking about the Senkakus is not to make news. Suffice it to say that my boss, Kurt Campbell, is always keen to say Japan and China and Northeast Asia, this is the cockpit of the global economy. This is an area in which we don't want to see instability. We want to ensure that all parties involved address their differences in a peaceful manner through dialogue.

This is something that Secretary Clinton said last Friday, namely that our position remains unchanged on the sovereignty question, but that at the same time, as she said, we oppose any unilateral actions to challenge Japan's administration of the islands. Clearly, the concern is about the impact on the regional and global economy and also the concern - and this is something we in the United States are well familiar with - but mishaps, accidents, miscalculations, untoward events, they happen, and our goal is to ensure that both sides takes steps to avoid anything that can increase tensions.

One thing I expect we will continue to discuss and hear a lot about in the coming year is the strategic rebalance to Asia. Although we'll have a new Secretary of State in a few days, I fully expect that our strategic rebalance will remain one of the primary focuses, foci, of the State Department and our foreign policy establishment. Against this backdrop, the U.S.-Japan relationship remains an alliance that looks beyond the region and really is a global alliance. I mean, the things we do together in Burma and Afghanistan and Syria, these are all areas in which we're working very closely together to advance our mutual goals and support our mutual interests.

I think the issue of Indo-Pacific connectivity is going to increase in prominence. This is the idea of trying to break down this historic and bureaucratic, and really cartographic, barriers between the Indian and Pacific Oceans and to try and draw India more into the Pacific Ocean, to leverage their Look East policy to make them more a part of the Asia-Pacific region. Part of this involves really a lot of just infrastructure work in Bangladesh, in Burma, but it's a goal that we share with Japan, and we'll continue to pursue it. I think our commitment to multilateral institutions in coordinating our goals will remain another important focus of U.S.-Japan efforts this year, looking ahead to the ASEAN Regional Forum, the East Asia Summit, and APEC. These are three regional fora that the United States is fully committed to and ones in which we find that we and our Japanese friends have a great deal in common and ones where we find joint cooperation bears a great deal of fruit.

TPP is another area in which I want to be a little careful, so I'll leave all the hard work to Mireya. Suffice it to say this is something that Secretary Clinton and Foreign Minister Kishida discussed. I think it's self-evident that this is, as we believe, this is an initiative, a partnership that will yield tremendous benefits to its participants. It's an area in which we'll continue our close consultations with Japan. But as Okamoto-san said, the clock is indeed ticking. But we do have - I mean, aside from the TPP, when you talk about trade right now between the U.S. and Japan, we do talk a lot about TPP, but there are a lot of other things going on that I think tend to get less attention but which I think are equally important.

Energy issues, I think, this year are going to prove to be a tremendous area of

bilateral conversations and cooperation. Whether it's the ongoing review in Japan about its zero-nuclear policy or whether it's our own discussions here in the United States about what to do with liquid natural gas, these are areas in which I think our two countries have a tremendous amount to discuss. In clean energy and renewables, we have an excellent bilateral program in which we are doing joint research on these new frontiers of energy. I would expect that over the next 12 months we'll see plenty of opportunities for our two countries to really get down and then have a comprehensive discussion about energy because I think, this is my opinion, but I think energy security really is going to emerge as one of the pillars of our bilateral relationship.

Science and technology cooperation, space, cyberspace, these are all areas which are also new frontiers in our bilateral relationship. Unfortunately, bureaucratically for cyberspace and space, these are issues which cut across agency lines in both countries, and it's been tough to get our arms around some of these things because various actors in both Washington and Tokyo have their own positions. But at the same time, I think it's critical that our two countries have important discussions about cyber security, about the use of space, about these new domains in which we have so much at stake. The U.S. and Japan, for example, are the number one and two internet economies in the world. Last year, in September, we had our fourth internet economy dialogue, which really sought to get people from both government and industry together to talk about the implications of the increasing connectivity between our two internet economies. So these discussions will continue and are going to be increasingly critical to economic well-being in both countries.

Finally, I'll just put in a plug for people-to-people ties. I think we, government-to-government, we talk a lot about Futenma. We talk a lot about TPP. We talk about all sorts of things. But, really, our bilateral relationship rests on the shoulders of our people-to-people ties. It's exchanges between our young people. It's professional exchanges. It's programs run by whether it's Tomodachi, whether it's Kizuna run by the Japanese government, whether it's JET, whether it's CFR-Hitachi Fellows, or Mansfield. I saw Gordon [Flake] out there earlier. All these things, I mean these are really the life blood of our relationship. I think, at least here in Washington, it's one of our goals this year. We're really trying to ramp up our people-to-people ties and get more young people especially going back and forth between our two countries.

I'll just close here. As the secretary announced last week, we have Prime Minister Abe coming in the third week, in February. We're looking forward to that and looking really to that as a great opportunity to advance, I think, some of the things that I talked about. Thank you very much.

Rust Deming: Thank you, Mark.

Sheila Smith: Thank you very much. I'm delighted to be here today. My assignment today, as Rust discussed, is to talk a little bit about the security side of the relationship, to talk about Japan, the new government relations with Asia and some of the challenges, I think, the U.S.-Japan policy community are going to have to deal with in 2013.

I got a phone call soon after the December 16th election from a policymaker in Washington who said, "Okay, Sheila. So I've seen the picture. I've seen the cabinet. I know there's a new prime minister and I know it's important. But how many more of these

transitions are we going to go through and how long is he going to last?" I don't say that to be disrespectful to the Abe Cabinet. But I do think in the policy community, there is a desire for continuity in leadership in Japan. And so I think that there's going to be a great deal of receptivity to thinking through how to ensure that the bilateral relationship remains on steady footing. The consultative mechanisms, our goals, and our ambitions are going to be on a fairly steady footing as much as we can.

Marc has already outlined the official agenda, I think, and especially the summit coming up in February. There was a lot of media attention, especially in the Japanese press, to the notion that Mr. Abe really wanted to come in January but it is going to happen in February. I think that was much ado about nothing, frankly. That was more a media story than a reality. I think our two governments are very anxious to have the meeting and to have it be a successful one.

Transitions in Northeast Asia

Because I'm going to talk a little bit about Northeast Asia specifically, let me talk a little bit from where we are today in Washington, of course. There are challenges for both Japanese and American policymakers in the year ahead not only about how to manage this bilateral relationship but also to how to manage the region, specifically some of the challenges in Northeast Asia. I think that navigating the region with Japan is going to be a very crucial task in 2013 for our partnership. Here in Washington, President Obama has nominated his new foreign policy team for confirmation.

They will, hopefully, be approved. But we do have a transition in leadership here in terms of foreign policy formulation and execution.

I think, especially when it comes to the rebalancing or the pivot or whatever term you like to use to describe Obama's Asia strategy, he will need a pretty powerful Asia team to implement the goals that he has set out, and to follow in the footsteps of Secretary Clinton, Kurt Campbell, and others in the White House who have proceeded to lay the foundations of that thinking about Asia. So I think that for most of us close to Washington and Tokyo, there's a very kind of quiet conversation going on about who's coming next here in Washington as much as there is about the transitions afoot in Northeast Asia.

You had a very full conversation, and I always hate to talk after Gerry. So I say forgive me if I disagree, but I will talk a little bit about my interpretation thus far of what I think the Abe Cabinet means for some of these issues, but I won't really focus too much on the elections since you've had a full discussion. But I think it's important to put Japan's political leadership transition in the context of other Northeast Asian transitions. It's pretty important for U.S. policymakers or for Japanese policymakers to understand that we have tremendous transitions underfoot, I think, in China. I think Yukio did a very nice job of introducing us to some of those dynamics.

We also have, I think, a very dynamic leadership transition in Seoul. I wouldn't be able to predict how it's going to unfold, but there is a great deal of excitement in South Korea about that transition. We have had a transition in North Korea which doesn't come about the same way, but nonetheless it's making the new princeling in Pyongyang -- and it is continuing to keep us very busy. There's a lot of speculation. I'm not a North Korea watcher, so I listen to them very closely here in Washington and in Tokyo. Everybody is

trying to figure out what size elephant this is, and I don't think we know yet. There are some aspects of the Kim Jong-un government that are deeply troubling. The response to the UN sanctions, of course, is a pretty steady state North Korean response to United Nations sanctions. But that being said, I think there's significant preparations underway for another nuclear test. So we're going to have to get ready for crisis management with a new leadership in Pyongyang - and an untested leadership at that.

So let's talk a little bit about Northeast Asia and specifically some of the challenges for Japan and, by extension, for our relationship. I heard a lot of Japanese diplomats and strategic thinkers talk about the "threesome" of Japan's territorial disputes. I think just positioning them on the map helps you understand a little bit. I believe that the narratives for each of these bilateral differences over territory are very different and, therefore, the policy approach to managing them is very different. I think Yukio's comment about the opportunity in the relationship between Japan and Russia over the Northern Territories is, I think, very optimistic, so I hope that that is true. I'm not going to talk about that today, so I'm very glad you did.

I do think that there's a broad recognition in Japan that the status quo in Takeshima/Dokdo is going to remain and that there is not going to be a negotiated resolution of that, but there is a bilateral effort to improve or to restore the close Japan-South Korean relationships. That will be one of the issues that will need to be made part of that package of reconciliation. Senkaku/Diaoyu, of course, we've learned a lot about today, but we spent a lot of time thinking about it here in Washington I'm sure. But I think it's one piece of the puzzle.

I've just finished writing a book, it's hopefully going to come out soon, in which the Senkaku, the history of this issue is one of the case studies. If you go down to Ishigaki Island and you try to get to Senkaku, first of all you can't get there legally. You can get close to it, but you can't get there because the Japanese government since the early 2000s has rented those islands from the private owner and, therefore, has regulations in place that make it impossible to land on those islands. That has been the steady state management technique, keeping activists, whether they're Japanese, Chinese, Taiwanese away from the islands. It has, I think, weathered a pretty difficult bilateral Japan-China relationship over the last decade, but it is no longer the status quo, I think. I think there is an effort to try and get it back to that position, but I'm not sure I'm very optimistic.

The one piece of the geography, of course it's very important here, is how far away those islands are from Okinawa, from other islands in Okinawa, from the coast of China and even from Taiwan. So where you have interactions between coast guards and marine surveillance agencies and potentially militaries, it's important to remember that nobody is very close to land. They're very far away, and it's not an easy task to try to monitor. Everybody knows now. It's in the newspaper all the time, but I thought it will be useful just to remind everybody of these islands and what they look like.

I'm going to talk a little bit about Chinese patrolling and, I think, I'll use the word contiguous waters. It matters. If you look at where the Senkakus are, if you go in between those islands you are in territorial waters according to Japan. If you go in and around, you are in the contiguous waters which is acceptable. Not a happy occurrence, but it is not a territorial intrusion. I think that's part of the game where the dance is being played here with the Chinese.

So let me talk a little bit about interactions, Chinese activities near the Senkakus. [My] information comes from public source material that relies on the Japanese coast guard reporting, but it's all in the media. You know in September, October, November, the territorial intrusions, the numbers were pretty low. Many times there's four or five ships together, six ships together so the incidence of intrusion is much lower than the number of ships. On the contiguous zone, it's much higher. So the Chinese have been able to sustain a pretty extensive presence in the waters around the Senkaku/Diaoyu islands. But at the height, there were 120 ships, not all at once, of course. But that number is coming down, which I think is a positive sign.

The patrols are there. China is capable of them, but they are not continuing them at the same high levels. What I think people today are much more nervous about, and I think it probably deserves much more concern and attention, is the airspace. Since December, we've had some rather rattling reports of a Chinese intrusion on December 13th of a small reconnaissance plane but, nonetheless, a territorial intrusion. What we've had since then is not territorial intrusions, but intrusions into what is known as the ADIZ - Japan air defense zone. But what you have is scrambling on both sides of fighter jets and, therefore, you've got interactions in the sky in pretty close proximity to the Senkaku Islands of Japan and Chinese air forces. As we all know, the air force has to respond fast. If there's an incident it's not easy to recover and, therefore, I think the potential for loss of life is pretty significant.

So I think on the government side there has been a much, much more heightened sense of this is a situation that can't be continued and ought not to be allowed to continue. I think there's a lot of conversations here to be had between Beijing and Tokyo over the rules of the road, which is the term Mr. Yachi, who is Prime Minister Abe's adviser, has used in reaching out to Beijing.

I think Yukio is right that it's not just about a territorial dispute. It is also about a rising Chinese navy and its blue water ambitions. Where I would probably disagree a little bit, Yukio, is I don't see this as necessarily as hostile or targeted against Japan. China will have a large navy, and there's no doubt about it in my mind and, therefore, Japan's territorial waters or contiguous waters will be a point of transit for this Chinese navy and its going to have to be something that everybody gets more comfortable with. It's just going to happen. So the question then becomes how do we interpret intent? How do we find ways to work with China to understand Chinese maritime engagement practices and patterns?

The United States, of course, had the EP-3 incident. Not a very comfortable thing for the air force. We've also had the Impeccable incident. I think there are a lot of people in the Department of Defense, Naval War College and other places who are trying to discern rules of engagement practices of the Chinese in order to better predict the way in which the Chinese naval and maritime behavior is evolving. But I think this really obviously leads us to a military-to-military exchange between the United States and China. It's imperative and, perhaps, it ought to be a trilateral, Japan-China-United States, dialogue on how to ensure maritime, if not a maritime exclusion of the Chinese, at least a stability in the interactions.

So China – again, I'm happy to talk more about Senkaku specifics, but clearly you've had a long discussion of this and I'll just move on to what I think is clearly the second major security strategic challenge of 2013 for Japan, for the United States and also, obviously, for South Korea, and potentially for China. The North Korea missile test last April was a great failure. I went to Seoul a week before the test. Everybody was convinced it was going to be a

success. It was a massive failure in April, but the success that everybody expected in April clearly happened in December. The interesting part for me is that obviously the trajectory of the launch is different from the initial test of the intermediate-range missile.

You now have - in addition to Chinese maritime expansion - lots of traffic, civilian and otherwise, in the East China Sea. You now have the trajectory of the North Korean missile and, therefore, ballistic missile defense deployments in response all happening in the same region, all happening in this East China Sea area. It's an awful lot of activity, both military and otherwise. It's not a small area of sea, but it's a considerably dense and highly populated area of Asia.

We've forgotten a little bit, in giving our attention so much to some of the disputes in the South China Sea, that there are several treaty allies. I'm sure we haven't forgotten. Marc, don't look at me like that. He's going "No, we haven't." We haven't forgotten, but I want you to appreciate the density of the interaction that is happening in this part. It's not a small matter that there is a territorial dispute. There is a bad Seoul-Tokyo relationship at the moment. There is ballistic missile defenses required, and there is a rising China. It's a pretty difficult situation to manage.

For those of you who have been paying attention to UN sanctions and to the North Korean announcement that they are going to respond to those sanctions in a physical way, lots of headline news running around trying to figure out whether or not a nuclear test is about to happen or not, it could happen. It could happen within days. Many people are looking to see whether or not North Korea is going to do more missile tests and are going to aim them differently in a different direction. So I think I'll just -- I always throw this graph up here. It's an old graph, but it's an important one because it is easy to misunderstand that it's not just the nuclear ambitions of North Korea but it's the proliferation of delivery vehicles, the proliferation of missiles that really is the key to understanding the defense concerns of Japan and other countries in the region.

Okinawa

The last challenge - and I think Marc has already foreshadowed this one for 2013 in the bilateral relationship - of course, is Okinawa. I've spoken many times on this, so I won't go on at great length about Okinawa and what I think ought to happen, but we have a marine air station in Futenma that is surrounded by a residential area. Whatever, whoever we want to point a finger at, that is not relevant to me. But it is a densely populated region, and it needs to be closed. We also have a president and a prime minister, 17 years ago now was it -- how many years ago, who promised that we would close Futenma. So it's a problem that needs to conclude. It's a problem that needs to be resolved. I think it's going to take considerable political leadership to make that happen. I get lots of questions and I don't have any insights into the new Abe cabinet's approach to managing the Okinawa base issue. I haven't heard anything from the new government specifically on this issue that would indicate a specific approach.

I do think though that it is entirely conceivable that the prime minister will attempt to put the decision in front of the governor of Okinawa as soon as possible, and then Governor Nakaima will have to give a thumbs up or a thumbs down to whether or not he wants to build the replacement facility in Okinawa. I think moving that process forward is a

positive thing. I think we need to conclude this conversation on whether or not the FRF is doable or not. If it is not, we need to find an alternative. If it is, we need to proceed. My own personal sense is with the politics of Okinawa, I don't see how this is going to materialize. But at the very least, the governor has to say yes or no, and then the U.S. and Japanese governments will have to decide how to move forward in view of that decision. That will be a large part of the alliance this year, and I don't expect that this going to be easy, that it's going to be easy for Prime Minister Abe or for President Obama. It's going to be hard, and it will require political leadership, I think, on both sides.

Let me conclude. I had a couple of points here that were really relevant to our government, but let me conclude with a couple of remarks that really build off Yukio's presentation and what he shared with me, a little bit, of the conversation this morning. I think one of the great challenges for Japan and for the prime minister and this cabinet as well is not just continuity, not just winning the next election, but building a policy foundation so that when the next government of Japan comes, whether it's a LDP, DPJ or some coalition, that they have a significant amount of consensus on some basic fundamental issues. I think I would put the alliance at the top of that priority list but, perhaps, I'm a little biased since I sit in Washington. But I do think in the short run, we can't do anything until the next election. It's creating a great deal of frustration especially today in Washington when so many of these issues need strong Japanese participation.

I think just to put aside, to play devil's advocate on the issue of reconciliation, Yukio, because you mentioned the difficulty of Japan-China reconciliation. I think the same is true with Japan and South Korea. It requires leadership, of course, but it also -- I don't see the alliance as an alternative to reconciliation and, I think, that's an important piece of the puzzle for the United States and Japan as we move forward not just this year, but in the years to come. We can't have the alliance be something that gets in the way of reconciliation, but nor do we want the alliance to be a platform for not addressing key issues of reconciliation in Northeast Asia. That balancing act needs to be sophisticated, but it needs to be pretty serious. We don't win anything in the alliance by ignoring the fact that there's some serious issues of reconciliation that need to be addressed in the region. Thank you very much.

Mireya Solis: Good afternoon everybody and thank you so much to the Japan-America Society for the invitation to be part of this panel. I think that the discussions so far had been fascinating, and I'm very glad that I was asked. The division of labor in this panel is that I was going to talk more about trade issues and economic issues, foreign economic issues. I want to start actually with a very positive note, because I think that there are very interesting possibilities when we think about Japan's trade policy this year.

I want to highlight what are the potential opportunities that make this a very interesting year to be watching. But also, as I move along, I want to talk about potential pitfalls. So I'm going to then end perhaps with a much more pessimistic note, but I want to start with the big news why this actually would be perhaps a big, big year for Japanese trade policy. This is something that I do not say often.

Four Trade Negotiations on the Table

So why am I so excited when I think about what's in the horizon? What could Japan do in its trade policy this year? Basically, the fact that there are four major trade negotiations on the table, and this actually would bring Japan's trade visibility to a different level. We're talking about the trilateral China-Japan-Korea FTA. We're talking about the Regional Comprehensive Economic Partnership in East Asia. We're talking about the FTA, the Free Trade Agreement, with Europe. And we're talking about the Trans-Pacific Partnership initiative.

Now, three of these initiatives have already received the green light, so these are negotiations that will be launched very soon. Three of them - the RCEP, the trilateral, and the one with Europe - were approved to move forward just last November. So we all in the trade field are very excited trying to understand what this portends for Japan. The one big trade negotiation that has not been decided is, of course, the TPP.

First of all, I want to highlight why I believe that these trade initiatives are so interesting. I call them the big four. And then also talk about the challenges that each of these negotiations poses for Japan, and then talk in more detail about the most controversial of those trade initiatives and that is the Trans-Pacific Partnership initiative. What can we expect the Abe administration to do on that front?

So in thinking about trade policy in 2013, the big four, what is different? Well, clearly we're talking about a completely different order of magnitude as to what these trade negotiations could do, because for the past decade, the Japanese government has been very busy negotiating free trade agreements. Until the end of 2012, Japan had 13 free trade agreements. This actually, in terms of numbers, sounds like a great deal. But the sad reality is that for the most part these had been free trade agreements of small ambition. So you had a very busy negotiation strategy, but very little to show for. This is where the difference with the big four becomes very apparent.

There is a contrast between the first 13 FTAs. The thirteen FTAs combined only covered 19 percent of Japanese exports. And now look at the other FTAs that are now on the table, or perhaps on the table in the case of TPP. Each one of these trade agreements would deliver more in terms of the actual share of exports covered. I mean, Japan gets them all, this is obviously incredibly ambitious. But if Japan had it all, you could actually have an FTA policy that is so significant that 77 percent of Japanese exports would be covered under this preferential trade network. So that's why in the trade field we actually get excited about what's going on.

Another way to think about why these are initiatives of great significance is to think about how they would contribute to the Japanese economy. We have been hearing a lot about the need to find a new way to grow the Japanese economy, to deregulate and so forth. Well, some of these initiatives of the big four could get at that, but not all of it. But look at the [potential] contribution to GDP. I think that the contrast between the first 13, and the big four, is very, very eloquent. This is a different game altogether. So there's a lot to be gained this year. The question is, can Japan negotiate in the big leagues? Can this be done? Can these trade agreements be accomplished?

I started with a very optimistic note. This is where the realist in me begins to seep through, and then you will see how I actually become a little more skeptical. What I want to

do in my time here is to basically go over all of these four FTAs that I've discussed and talk very briefly about the challenges. Because there are specific challenges to each one in terms of what would need to be solved or addressed for these free trade agreements to really deliver their potential and, therefore, become a very important tool for Japanese trade policy as part of a growth strategy.

So let me just start with this overview as to what are the potential challenges in each of these trade agreements. I want to start by talking about the Regional Comprehensive Economic Partnership. This is a trade grouping that would cover 16 nations with a combined GDP of \$19 trillion and a share of world trade of 40 percent. So we're talking about a very substantial trade grouping. The economic stakes are high therefore, and I think that the RCEP - the Regional Comprehensive Economic Partnership - does good things for many of the major players and that's why it's moving forward. They think that they can accomplish important things through this trade initiative.

For ASEAN, it really is about the perennial question of trying to maintain centrality in the process of East Asian regional integration, to try to keep ASEAN focus, the ASEAN identity in a way in which the region defines its approach to trade liberalization, to economic integration. For China, this actually becomes a good counterpoint to what they perceive as a U.S.-led Trans-Pacific Partnership initiative. From the point of view of Japan, the fact is that the membership configuration of the RCEP dovetails perfectly with the long-standing Japanese proposal of an ASEAN plus 6. In that sense, it very much validates that Japanese proposal that you should have a more expansive definition of East Asia and that you should bring on board Australia, New Zealand, and India.

Now the RCEP, the Regional Comprehensive Economic Partnership, has a very ambitious agenda. It talks about wide scope of issues that would be covered, not only liberalization in goods and services but also intellectual property, competition, dispute settlement, and so forth. There is a clear statement that they intend to go beyond what the ASEAN plus 1 FTAs have done. So that there's real value added to the exercise, it is that they will go further than what has been negotiated in the past. They also make the case that they'll pay special consideration to the development gaps in the region and, therefore, the notion of special and differential treatment is a core element of this trade exercise. They also make the case that by moving forward in the RCEP, they will be able to address the so-called noodle bowl of free trade agreements, the bilateral agreements that crisscross the area.

Is Japan's Trade Agenda Achievable?

Now, this all sounds wonderful. But the big question in my mind is whether it is achievable. When you actually look at and read the negotiation objectives of the official document about what is the blueprint for RCEP, there is one word that's sprinkled very liberally everywhere - and that is flexibility. This might be very good. You might think in the sense then, well, it's a very realistic approach. We know that it's difficult sometimes for many governments to undertake painful reforms domestically to satisfy the requirements of liberalization and so forth. We also know from the long trajectory of negotiating free trade agreements that too much flexibility can actually undermine the quality of the trade agreement because it provides safe cover for many governments precisely to avoid those issues that are politically difficult at home, but that would actually generate very significant

economic gains in terms of liberalization.

So the question in my mind when I look at RCEP is, will it really accomplish all that it said it will? Can we really think about deep integration when we have such a diverse group of countries that are coming together in this negotiation? I'm actually quite skeptical that RCEP can solve the noodle bowl phenomenon because, again, in the official list of objectives, it's very clearly stated that the existing five ASEAN plus 1 FTAs will stay intact. It's not going to be that you dissolve the existing smaller agreements in favor of a larger, more cohesive one, but that you will only have an overlay over the already existing ASEAN plus 1 FTAs. To be fair, this criticism that RCEP will not be able to tackle the noodle bowl phenomenon also applies to the TPP because, again, no country in the TPP is going to eliminate the existing FTAs for the sake of aiming for an Asia Pacific-wide single trade agreement.

Now, let me move on to the trilateral, the China-Japan-Korean FTA. For a long time many people have lamented the fact that we know that we're talking about the three largest economies in the region and that there hadn't been a substantial effort to really bring them together through a free trade agreement. Trade specialists would always look at world maps to see how different FTAs were connecting all these countries. Before East Asia joined the FTA bandwagon, there was always one empty area in this world map, and that was East Asia. That eventually became a very crowded area except for one subsection, and that was Northeast Asia. That was the one trade initiative that everybody thought could yield substantial economic benefits, but the one that was not materializing because of defensive economic interest, and also because of the very complex political dynamics in the region.

The fact is that these three countries decided to launch studies to figure out what would be the benefits of doing this. They studied this possible trilateral FTA for years, which basically means that they benched these FTA for years until things began to pick up in late 2001, when there was an explicit decision to rush to finish that joint study, and to try to then launch negotiations. I think it's a great, great accomplishment. Even though we know that this fall China-Japan, Korea-Japan relations were rather difficult, they were rocky, it was a period of crisis, that this trilateral FTA was not a casualty to that climate of deteriorating diplomatic relations - but still, these countries managed to announce the launch of these talks last November. But this doesn't mean that we should just rest assured that because they said we will do this, we will sit down to negotiate, that they can do this smoothly.

I think that there are important defensive economic interests. You only have to read, for example, the joint study report. They identified those sensitive sectors and they very explicitly say that there will be some room for sheltering those sensitive sectors. So, again, it's not going to be as ambitious in the sense that there is already an implicit signal or explicit signal, that the most difficult areas can be negotiated out. But more importantly, I think the question in my mind is: can these free-trade agreement negotiations between China, Japan, and Korea prosper despite the very difficult climate in diplomatic relations? I know that very frequently we think about China-Japan economic exchange and we think that there is a compartmentalization between the hot economics and the cold politics. We think that, therefore, they will not be affected, that the economic side of things will not suffer from difficult political issues.

People have studied what happened in 2005, and what happened in 2010. The idea was, indeed, that economic exchange was not derailed at that time. The question is, are we facing now a different scenario where there will be a larger economic cost to be paid from the

political instability? The Japan Bank for International Cooperation just released their annual survey of multinational corporations, and there are some really interesting findings. That's because they went out of their way with specific questions as to what is the impact of the Senkaku dispute on their investment plans in China. They make specific comparison to what happened in 2010. There's a dramatic shift in terms of what seems to be the attitude of many of these companies.

Now, we don't know if this would be a long-term phenomenon. The fact is that this difficult situation continues, as we heard from Sheila's presentation, so it's not that we can think that this has been shelved and, therefore, economic exchange will resume. But my point is that free trade agreements are more vulnerable to the deterioration of diplomatic relations that are just the trade and investment flows. This is for two very, very obvious reasons. One is that when we talk about free trade agreements, we're talking about formal intergovernmental initiatives. Clearly, it's very hard to sustain them if these two countries have a major diplomatic difficulty.

But there's one other way in which having this worsening political climate can affect the prospects of this trade negotiation, and that is that every trade negotiator knows that when they sit down at the table there will be areas of difference that cannot be breached at that level. They need to bring it up to the political level. When there is this worsening of diplomatic relations, it's very difficult to find the political will to make that kind of investment, to solve those differences at the negotiation table. There's one case. We know from a fact that something like this happened already in Northeast Asia.

A few years ago, I wrote a case study on the failed South Korea-Japan trade negotiation, and this is precisely what happened. There was a major disagreement on market access, and it was impossible to bring it up to the political level because 2005 was also a very difficult year between Japan and Korea. So I guess the question mark in my mind when I think about this very interesting trade negotiation is, can it remain immune, isolated from the broader issues that we discussed in this panel? Will it be a casualty to those broader issues on territorial disputes and so forth, or not?

Now, let me move on to the Japan-EU trade negotiation. I think this is going to be a fascinating exercise. I'm actually quite surprised that the press has not emphasized as much as it should the significance of this trade negotiation. We're always mostly focusing on what's going on in East Asia, on Asia Pacific, but I think we're missing one really, really significant negotiation, and that is the Japan-EU negotiation. Why do I say this? Because, I think, there are two very interesting asymmetries at work regarding the level of interest and the main focus of the negotiation. What I mean by this is that Japan wants this agreement more than the European Union does. Japan has been keener in trying to get this agreement to move forward, and the European Union has been much more coy in deciding whether they wanted to join or not. Also, because what each party is trying to achieve in this trade agreement is very different. For Japan, this is mostly about eliminating tariffs in two specific industries: automobiles and electronics. They're interested because they feel that their rivals have a much better situation in the European market because of the Korea-EU FTA. So, really, this is about countering the trade diversion effects.

For the Europeans -- and this is why it gets really interesting, this is a negotiation we should really watch. They're really not talking about tariffs. They don't care about Japanese tariffs in the industrial sector. They're very low for the most part. This is about the

ubiquitous, the difficult, the vexing, the non-transparent, non-tariff measures. This is the all-in of Europe in coming to negotiate with Japan and they have done their homework.

I cannot tell you how many joint studies I've read over the years for these 13 FTAs, because that's what you have to do. That's where you identify where the issues are in terms of what a country is trying to achieve in a trade negotiation. I have never read a document like the ones that the Europeans have produced regarding the scoping exercise and the impact assessment exercise. I think it's a fascinating document. I was glued to my computer. Maybe I'm a weirdo by being so enthusiastic about reading documents of this nature, but basically you have a catalogue. They identified 194 non-tariff barriers sector-by-sector that are blocking European exports [to Japan]. So if you want to understand where should you deregulate in Japan, what areas you want to reform, you go there. They also have baseline scenarios, a conservative result when many of these non-tariff measures would remain in place to a very substantial scenario where you actually have substantial elimination and they are able to estimate how much these non-tariff barriers are actually blocking European products and what's in the realm of possibility.

Now, this is also very interesting, of course, because they negotiate. The European Commission came up with two directives in how they're going to approach the negotiation with Japan. One of them is we're not going to wait forever. If there is no significant progress in tackling those non-tariff barriers within one year of starting negotiations, we get out. Now this is, of course, a negotiation position. We don't know if Europeans really will back away from the whole exercise. But I think if this whole frame of this conference is to think about what lies in the year ahead, this is an actually very interesting calendar to watch for not only because Europeans have identified very systematically the non-tariff barriers, but also because they've given us a calendar. And third, because there could be a demonstration effect when we think about Japan's talks with the United States. The position of the U.S. automobile industries, of course, is that the non-tariff barriers in Japan are so significant that you cannot do it. You cannot open that market through a free trade agreement. I think it's really interesting to note that the whole exercise in Europe uses the view that they're solvable. We could actually tackle some of them. They can actually produce results.

Now I don't know how much time I have, but I have to talk about TPP very briefly, about five minutes or less. No other trade agreement has generated as much controversy as this one. This one is one that's really important to Japan. I already highlighted it. The other three are major trade initiatives, but this one should not be missed. Why? Because this is also a trade agreement that's very ambitious, a trade agreement that will help Japan achieve its goals of deregulation, strengthen its competitiveness, and be seen as a major player in defining new rules of trade and investment for the Asia Pacific-wide region. But also - and this is very, very important to understand - because it gives tremendous leverage to Japan in its other trade negotiations.

You see, the fact that Japan has so many possibilities before it in the trade agenda has a lot to do with the TPP. Why did China decide to speed up the trilateral joint study and move forward with this trade agreement? It was a reaction to Japan's possible membership in the TPP. This is also why ASEAN decided to roll out the RCEP after years of debating whether this would be an ASEAN plus 3 or an ASEAN plus 6. I think it's important to understand that all these trade negotiations are interconnected and that you gain more

leverage by being seen as a very active player in all these fronts.

What are the chances then that Japan can join? What will the Abe administration do this year? These are difficult questions to answer because I feel that the opponents and the supporters of TPP look at the Abe administration, their initial measures and so forth, and they see both things that they like -- that is they're seeing encouraging signs both for those that support and those that oppose the TPP. People that would like Japan to join the TPP, what do they see in the Abe administration that they think encourages them to think that Japan will indeed join? Well, a number of things. As Okamoto-san was saying, the Cabinet appointments, the fact that you have in the Ministry of Agriculture a politician who is not considered to be a traditional agricultural policy-tied politician. So that's encouraging. People like Mr. Amari who thinks very deeply about free trade, competitiveness and issues of that nature.

There's also the fact that the Abe administration has launched these committees on economic revitalization and competitiveness and has established a partnership with key business leaders in Japan. Many of them make the case that, indeed, if you really want to restart the Japanese economy, you need to think about TPP membership. Many TPP watchers in Japan also report that Mr. Abe personally is in favor of TPP. We all know that one of his biggest priorities is to strengthen the U.S.-Japan relationship and, therefore, if TPP can be folded into that, he would be well-disposed to move forward.

Those that oppose the TPP also have a number of things to point at in trying to make the case that this is not happening. What would they look at? Well, they would look at a party that is heavily reliant on the fickle agricultural vote. They would also note that many LDP candidates in the past election came out saying that they oppose the TPP. They would also point out that the party is sharply divided, that you have within the party a group that opposes the TPP, and that close to half of LDP lawmakers belong to that group. They would also then note what we have been hearing all day that the central political priority of the Abe administration is to win the Upper House and, therefore, that no decision will be made until after that.

So the real question is, well, what happens after that election? I think that rather than venture a prediction and then be proven wrong, in seven months you'll still remember, let me tell you what I think it would take for that to happen. I think that it would actually hinge on the following questions, and that is can Prime Minister Abe reach consensus within the party? Can he bring on board all these LDP politicians that went out and campaigned on an anti-TPP platform? How is he going to deal with the existence of that anti-TPP grouping within the party? Going back to a question that Mr. Okamoto already mentioned and this is a perennial question I think, will Japan join in time? If it really is only after July, when will it happen in terms of Japan actually having any input on the agreement? I think that we have to be very clear that if Japan does not join in time, if Japan comes to the TPP via an accession negotiation and not as a founding member, it's going to face an uphill -- it's going to be harder because it will be more difficult to have input on what actually becomes this agreement. Thank you very much.

OPEN DISCUSSION

Rust Deming: Thank you. Those were tremendous presentations. We have about 30 minutes, so what I suggest, with John's permission, is that questions from the audience be addressed not just to this panel. We have the two keynote speakers, Gerry Curtis and Yukio Okamoto here; and we have at least one representative from the first panel, Glen Fukushima. So feel free to offer questions to anyone.

Chris Nelson: Thanks. I'm Chris Nelson of The Nelson Report. Wonderful discussions. How am I going to boil this down to a report? I have no idea, but fortunately I don't have to do it tonight. In the last few months, because of the difficulties with TPP, I've been hearing an increasing sense that RCEP might be more attractive because it has less practical and political impediments. Do you also have that sense? Are we perhaps putting too much of our hopes on TPP? Is RCEP something that might end up being more doable? So that's the question on that one.

On the defense side, especially for Okamoto-san, I thought his outline of the problem in Senkaku was brilliant and terrifying. And for what it's worth, in my conversations, unclassified ones with people across the river and others, I would say they would echo almost word-for-word his very morbid assessment of what the Chinese are really up to here. When I have conversations with people who have conversations with the White House, not that the White House talks to anybody else as far as I could see, their hope about the Xi Jinping people having better judgment is just that -- it's a hope. They also look at the pattern of Chinese actions. They especially see the Chinese in effect putting an embargo around the Scarborough Reef as what the Senkakus are in for.

So my question is do you think that Secretary Clinton's statement on Friday is that we do not want the Chinese to take active steps to mess around with the status quo. That's necessary obviously. Is it sufficient to persuade the Xi Jinping leadership that we have finally drawn some kind of line in the sand that is supporting our ally Japan? Or do we need to do more things to make it clear that stability absolutely has to be maintained there?

Mireya Solis: Thank you very much, Chris, for that question. Just very briefly. I think RCEP will be easier to negotiate in the sense that the selling points are its flexibility and its attention to the development gaps, especially thinking about the smaller ASEAN countries. You might have an easier agreement, but an agreement that does not deliver as much in terms of economic gains. Many things are sacrificed for the sake of patching something together. Now, there is that wide diversity in terms of what has been negotiated in each ASEAN plus 1 FTA. So it's not going to be just a piece of cake either because many countries will think that their approaches are the right one and they have to now come to reconcile this and you have an unwieldy group of 16 countries. So we think people talk about the TPP as a mini Doha and complain that with 11 countries it has become very burdensome. You cannot find a common agreement and so forth. Well, RCEP has 16 countries and some that have very different views as to what should be the rules negotiated. So it's easier, but it's not a piece of cake.

Rust Deming: Sheila, do you want to talk about Senkaku?

Sheila Smith: I'm happy to go first. I thought Secretary Clinton's statement on Friday was important for two reasons. One was the unilateral word, which is basically for China. I thought the other piece of it that was important for an American policy statement and our delivering it, to a certain degree, was the reference to the 1972 Reversion Agreement for Okinawa. I think one of the flaws in the formulation - that under international law, we don't recognize this. I mean, that we don't take a position on sovereignty. Well, we have in the past and we have administered Japan's residual sovereignty over the Senkaku Islands. It's a historical fact. And so acknowledging that historical fact is probably pretty important as signaling goes. So I thought there are two pieces of that statement that I thought were important.

Rust Deming: Yukio, do you want to talk this one at all?

Yukio Okamoto: Thank you, Chris, for the question. Well, first of all, Sheila was right when she said an alliance cannot be an alternative for Japan solving the issue with China. It is incumbent on Japan to really squarely face the historical issue. Koreans are easier to engage with because they have no deep indication of the problem as China has with Japan. So Gerry was very right when he said Japan should not look away from the Kono statement. We should do really something about the comfort women and so forth. But in order to really prevent the situation from further aggravating, the alliance with the United States is a *sine qua non* for Japan. Because as Chris pointed out about the Scarborough Reef, China has been historically showing that they would try to fill any power vacuum whenever they find it.

In 1974, they took Paracel from the Vietnamese when the U.S. was withdrawing from Vietnam. Later, Russia, who came to replace the United States, withdrew from Vietnam, and then China took Johnson Reef from Vietnam, killing 70 Vietnamese sailors. Then in -- when was it, '94 or '95, after the U.S. withdrew from Philippines, they came in to take Mischief Reef. So it is really important that Japan must solve the Futenma issue and guarantee the safe stationing of U.S. troops there. I'm not saying that the U.S. troops on those islands are the direct deterrence to Chinese advancement. But if Japan and the United States are seen to be having confrontations even at the local level so that Marines were seen to be pushed out of Okinawa, then in the eyes of China, they will do the same thing as they did in the South China Sea. So in that sense, I think the Japan-U.S. alliance is the right one for Japan.

Sheila Smith: Just a footnote because I think Chris said an important second part of that question. It was whether this is enough to persuade Xi Jinping, right? I mean, whether the Clinton statement would really get through. I guess I won't prejudge that particular nugget of U.S. policy articulation, but I do think it's going to be important that we are unambiguous about the deterrent. I have come full cycle. I'm about to write something and so I've gone one way and the other way, and one way and the other way on this debate. I don't say it from a hawkish point of view. I simply say I think we should be unambiguous that we will be not only willing to, but capable of acting in the case that China decides to test the proposition. Now, I don't think there's anybody in this room or anybody in Tokyo for that

matter who really wants to have a war with China over the Senkaku/Diaoyu dispute. Nobody does, right?

But I think it would be a mistake to be ambiguous, right? If our intention is to deter and defend, then I think we ought to be clear about it. And I think the government has been clear privately and publicly. But I think that the challenge here, and I think you read it in the Senate resolution, you read it slightly in the Friday statement, is how to deescalate the crisis. And therein lies the deep fundamental challenge for U.S. policy. I don't think we should minimize deterrence, but I don't think we should provoke escalation either. I think that's going to be – that's a very difficult message to signal. But I think our public messaging should be very clear and unambiguous.

Yukio Okamoto: One thing I'm a bit worried about Xi Jinping's regime is that there are - at least among the permanent politburo members - there seems to be no strong leader of security affairs. They all are economic experts. The politburo members are clearly designed to bring a smooth landing to Chinese economic problems. But who is going to lead, going to be the ideological pillar of diplomatic and security policy? I find none except Mr. Xi Jinping himself, which means that there will be increasing amount of influence from the PLA.

Gerald Curtis: It seems to me that the Chinese and Ishihara Shintaro have exactly the same common interest in testing the U.S. commitment to the alliance. If we don't, if we're not totally unambiguous in that commitment, the Chinese will sense weakness and try to take advantage of it, and the right wing in Japan will have a field day saying that after all we can't depend on any one else for our security, and that we have to do it for ourselves. This is playing exactly according to Ishihara Shintaro's playbook. So, yes, totally unambiguous. That's important and the public message should be totally unambiguous, but there has to be a private message given to Prime Minister Abe that we do not want them to do anything to further escalate this issue.

My argument, as I made this morning, is that Japan should recognize that there is a dispute and talk about it. We recognize that there is dispute over sovereignty. Japan should recognize there's a dispute over sovereignty. Some people will say, well, all that would do is convince the Chinese that this is a sign of Japanese weakness. Maybe. But they'd be making a very big mistake because once Japan is on the same page as we are on this issue about the dispute existing over sovereignty, I think it makes it much easier for the U.S. to be even more unambiguous in our support for Japan. So, yes, unambiguous, but also a strong message to the Japanese. They should do nothing to further provoke and escalate this crisis.

Chris Nelson: Does that include no warning shots in the event that the Chinese encroach? What if the Chinese will maybe not hear the radio warning or decide they'll let some hotshot pilot act like the pilot at Hainan. So what if they don't back off and if Japan shoots a warning shot?

Sheila Smith: Can I say something about the warning shots? I think there has been a communication about clarity of rules of engagement. I think, again, the kind of media speculation about Mr. Abe and what he's going to do, et cetera, I think that there is a very clear desire to avoid inhabiting those islands. When we talk about escalation, there's some pretty clear steps that I think we could probably talk out loud about, [steps] that would be an

escalation, [like] putting people on the island. Absolutely not a good idea. I will tell you though, I've had many, many conversations in Japan, that are not politically motivated and are not coming from the political side but from the uniform side - that their worst nightmare is if China actually puts people on the island and then they're stuck with a fait accompli. But for now, I think that's a very clear point of escalation. We don't want that to happen.

To be fair, I think the Japan coast guard and the surveillance agency of China have been very careful in their interactions. Despite all the incursions and that kind of thing, there has been a certain amount of professional interaction on the maritime side. But I think it's very nerve-racking and, I think, that's why the F-22s went into Okinawa, because the scrambles and the fighter jets in the air and the misreading of intentions is extraordinarily dangerous.

The advertisement of Rules of Engagement - just to be clear, that was not a new step. That happened in 1987 vis-à-vis a Soviet reconnaissance plane. Those were existing Rules of Engagement. They were just being telegraphed publicly so there was no miscalculation. But I think we are now in a situation where the United States ought to be very forward leaning and engage with both China and Japan on maritime confidence-building rules of the road kind of discussions. We've had those conversations with the Chinese ourselves. We ought to be having them in the East China Sea right now.

Rust Deming: Marc, you want to add anything, remove any ambiguity?

Marc Knapper: Actually though, just getting back to a point that Okamoto Sensei made about the importance of strengthening the bilateral alliances as a way of managing the regional issues, I cannot agree more. We say a lot that unless the U.S. gets its relationship with Japan right, it can't get its relationship with the rest of Asia right. I think the same is true for Japan and its engagement with Asia. Unless it gets its relationship with us right, then things with Asia will become more difficult. So I would say, yeah, let's get realignment on track. Let's move forward. We've done relocation and I think that will send a positive message to the region.

Ed Lebow: Ed Lebow of Haynes and Boone. A question about the U.S. discussion about authorizing the export of liquefied natural gas to Japan. Assume for a moment that this is really crucial to the Japanese economy to have relatively reasonable prices for energy going forward. Assume that the United States wants to see Japan doing well, and assume that is in the geostrategic interest of the United States. What can Japanese industry and government do to play a role in the U.S. discussion without being seen as interfering with internal political affairs in the United States?

Marc Knapper: Sure, I can take an initial crack. I mean, obviously it's a discussion that's full of political and other implications domestically. But at this point right now, it's in the hands of the Department of Energy. I think they're looking at all sorts of different factors in their ultimate decision. But this is something really, at this point, that's not government-to-government but rather between industry and the Department of Energy. I fully agree that there are certain choices that the Japanese industry will need to make, depending on how they want to proceed. But I think going forward, this is something that I assume will move beyond industry-to-industry decisions and move to government-to-government. But at this

point, really it's hard for me to say what kind of decisions the Japanese government should be making on what is right now a private sector choice.

Rust Deming: Mireya, do you want to add something?

Mireya Solis: Just a quick note. I think that even if all the stars align and people in the Senate would stop making the case that we should not export LNG and so forth, we have to realize that the realities of building the infrastructure for having a substantial export capability will take a long time. So it's not going to be a short-term solution for the immediate energy problem. Even though I agree that the procedure is very cumbersome, and that having an FTA is necessary to demonstrate that it is in the national interest, the public interest to export, we cannot assume that this could be a short-term solution.

Yukio Okamoto: We really want to import especially your shale gas. In Japan, one million BTU natural gas cost \$16; whereas, in the United States it's only \$3. Of course we have to build liquefaction facilities and pay transportation costs, but experts calculate it will be still \$10 to \$12 when it goes to Japan. So we are really dying to import. But your regulation is such that unless the country is in an FTA arrangement with the United States, you are not going to export. That will make it doubly important for Japan to come to TPP.

What can Japanese companies do without being seen as interfering? Osaka Gas and Chubu Electric have contracted with their American counterparts to build a liquefaction plant costing \$3.5 billion or close to U.S. \$4 billion near Houston. Tokyo Gas and Sumitomo Shoji jointly are going to build a similar premise in Maryland, an terminal for exports to Japan. We don't know if it will happen or not, but these are investments to be encouraged.

Evan Mangino: Good afternoon. My name is Evan Mangino. I'm with the U.S. Department of Agriculture. Clearly, you have a lot of interest in TPP and Japan's participation in TPP. I would like to ask our panelists that have spoken throughout the day whether they realistically in their heart of hearts think TPP is going to be concluded before July?

Mireya Solis: No. I mean, there are two moving targets, right? This is a perennial question. You have the question of when will the actual TPP countries hammer out the final agreement, and when will Japan find the domestic consensus to join in. The fact is that we've been asking that question for a long time, and it's becoming the time, in 2013, that it's very different. It's post-Obama reelection. Some of the constraints have been eliminated. There is a need to have a focal point to conclude those talks, and I think the time is running out for Japan to reach that decision. The later they come, as you all know, the less impact it's going to have in the actual agreement.

Rust Deming: Mireya, if I may ask a question just on the trade. The Japanese are now in the process of negotiating three agreements with one more possibly down the road -- TPP. What about the bureaucratic overload? How do they do this? Are there incompatibilities? How do they manage all these things? How do they get the right issue to a political level into some kind of a priority?

Mireya Solis: I think that's going to be an important question, I mean, because there are

real bureaucratic limits in terms of the resources, in terms of time allocation. These agreements may have different rules and, therefore, to keep sight of everything being negotiated at different tables is going to be a real challenge. So I don't know exactly how they'll do it, but in the past there had been shifts in terms of the bureaucracy. Some people had been less focused on WTO issues to come and help in the EPA agenda. I think that with these three big negotiations now moving forward, we can expect much more of that.

David Fischer: I'm David Fischer, retired Foreign Service. Perhaps for Sheila Smith, I was wondering if you could speculate a little bit about what the LDP might be able to do or be willing to do to move the decisions in Okinawa a little more favorably towards the Henoko side or even an up or down decision by the end of this year. There used to be a feeling during the DPJ period that the LDP had better ties to local constituencies in Okinawa. That may have passed. Is that your sense?

Sheila Smith: Well, two pieces of this, and that is the problem itself. What can be done to make this move faster, because it's been umpteen years now, and the political process is [always] waiting for the next local election or the next national election. The first thing to understand about the issue, of course, is Japan's national government doesn't have the constitutional authority to force a solution. It has to get the governor's approval. There's the possibility of a special measures law or some kind of legislative initiative that could change that. But I don't think, given what we've all been discussing about the Upper House election and the weakness of the ability to move forward, I don't think you have a balance in the legislature that would really like to take on Japan's governor's rights on coastal development issues, because it's not just an Okinawa problem. It's a nationwide problem of local authority, and the trend is in the opposite direction.

All that being said, the LDP in Okinawa, at least for the DPJ who are in government, was anti-base. Now, will the LDP in Tokyo shift the local chapter's receptivity to this issue? Conceivable. But the man who is expected to run against Governor Nakaima in the next gubernatorial election is Mr. Onaga, the current mayor of Naha who has been anti-Henoko from the start, and forcefully so. So I don't think you've got a --this is not going to be a flip-flop kind of constellation of politics inside Okinawa. For all the reasons of political capital, I'm not sure that Mr. Abe is going to take this on. I heard nothing that suggests that this is something he wants to dive into feet first. But getting the issue in front of the governor faster, it's a procedural issue, and it can be done. He can force that decision process. You know, tell the MOD to put it in front of the governor now and he will have to thumbs up or thumbs down. So that, I think, is what we should expect if we expect any change at all.

Rust Deming: Yukio, do you want to comment on Okinawa at all?

Yukio Okamoto: Well, last year and the year before that, two years in a row, I testified in the Japanese Diet that there is no possibility of the Henoko option and we have to think of an alternative way. I would have to spend one hour on what can be that alternative action. But as for Henoko, we must depart from the present agreement.