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Conference report

**Japan: increasing its global role?**

**Monday 01 - Thursday 04 November 2010 | WP 1063**

In association with The Foreign and Commonwealth Office, The Japan Foundation and The Great Britain Sasakawa Foundation.



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#### **Executive Summary**

Japan is now at a crossroads in its global political and economic positioning. To discuss the future path of Japan, a group of senior Japanese, EU and US policy makers, opinion leaders and corporate sector representatives gathered at Wilton Park against the background of the global economic recession and increased security tensions in East Asia. A frank and robust exchange of views took place.

The key conclusions of the conference were:

- Japan will continue to contribute to shared challenges and global institutions though Japan's government and its people are increasingly looking inward. This is not likely to change under the Democratic Party of Japan (DPJ) government.
- Japan faces a critical challenge in overcoming a sense of uneasy introspection. There is no time for complacency or delay as Japan is called upon to assume a greater leadership role.
- Japan remains a key stakeholder in the international political sphere and remains concerned regarding the East Asian security environment facing Japan and the wider region.
- Japan is an active supporter of efforts to combat climate change, to counter proliferation of conventional and nuclear weapons, to support the UN (including being the second-largest contributor to its budget), and to provide Official Development Assistance (ODA) to the developing world.
- Despite Japan's consistent contribution to global good, it needs to internationalise and communicate better, developing a Japan national brand strategy to counter the often negative media attitude. It needs to develop and activate soft skills to market, brand and sell Japan actively.
- Japan can no longer attempt to be all things to all nations and needs to define its regional role. Japan is a liberal, values-based country, an ally of the US and a working partner of China, Republic of Korea (ROK) and ASEAN. Isolation is very dangerous for Japan as this would allow others to determine its regional relations at a time when Japan is threatened by the Democratic Peoples Republic of Korea (DPRK) and by China.
- Japan wants to engage, not contain China. Both countries are now economically interdependent yet China's political and military flexing pose serious threats to Japan's interests. It is critical for both countries to have a strong working relationship. To progress this, Japan, like Germany in Europe, needs closure on the war history issue.
- Western democracies and regional actors wish Japan to contribute more fully to the

burden of leadership in Asia, becoming a strong soft power alternative to China, a consultative facilitator working with peer democracies to promote universal values and embed China in the global governance architecture.

- Japanese public support for the alliance with the US and the status quo remains strong. The recent incident in the Senkaku Islands shows the importance of the US Japan Security Treaty and the urgency for Japan, with US support, to build its defensive military capacity and strategically expand links with allies.
- Japan needs to open its society to foreign investment and immigration in order to continue to compete in fiercely competitive global markets. There is a need to empower Japanese women / non Japanese in mainstream management to increase its talent pool.
- Core priorities for the future must include recreating a working relationship with China, convincing a sceptical public about the value of more and deeper Economic Partnership Agreements and getting US-Japan security relations back on track.
- Only Japan, trusted by both the EU and US, can bring global best practice to Asia. Japan could and should lead a virtual EU in fast growth Asia Pacific.
- The only way that Japan can move forward is to accept the burdens of a greater leadership role and take bold initiatives on core issues of security and democracy both bilaterally and multilaterally.

### **Japan's International Outlook in the New Political Era**

1. It is interesting to look at how Japan's international priorities are developing after a year under the DPJ and to see whether Japan is optimistic or pessimistic about its future and standing in the region and in the wider world. Different views emerged on Japan's current status and mindset regarding its future role and responsibilities in the international community, though there was a shared sense of Japan's key challenges ahead, with interesting insights into how best to overcome these.

2. One view is that Japan is a proactive, global player in both the economic and political spheres and that the stereotype view of a 'disappearing Japan' is an exaggeration. In the UK, there has been a widespread image of 'Japan's lost decade(s)', and how China's GDP is now surpassing that of Japan. Accordingly people ask if Japanese society is stagnating and whether the Japanese economy is in decline. Economic data suggests differently. The balance of Japan's financial assets owned by the household sector amounts to 17.5 trillion US dollars with net capital assets overseas at 3.3 trillion US dollars. In addition, over 40 percent of the fast growing Asian economy comes from Japan's GDP which per capita is still ten times bigger than that of China. Japan's unemployment rate, at 5.1 percent, is the lowest among the G7 countries. The crime level is below one-fifth of the US figure and Japanese people enjoy the highest life expectancy level in the world. Japan accounts for 20 percent of world Research & Development investment, and the number of Japan's internationally registered patents is more than 8.5 times that of the UK. According to World Bank statistics for 2008, the scale of both the Japanese and Chinese economies exceeds that of the UK, France and Germany combined. In a sense, Asia has become the 'engine of the world economy'. This is due, in large part, to the central role Japan has assumed in fostering economic cooperation and direct investment in Asian countries with its advanced technologies. Foreign Minister Maehara has clearly stated that Japan will attach importance to economic diplomacy and is calling on the EU to conclude an Economic Partnership Agreement (EPA).

3. Japan is also a proactive global player in the political sphere and remains concerned about the East Asian security environment facing Japan and the wider region. North Korean missiles continue to put almost all the Japanese archipelago at risk. The rapid military growth of China, its lack of transparency and maritime expansion in the South and East China Seas has increased the degree of uncertainty in the region, prompting many

countries including the US and ASEAN member states to express their concern. Furthermore, China's aggressive reaction to the crash incident off the coast of the Senkaku islands has increased this concern. Japan does not intend to confront China or seek to contain it but is urging China to abide by international rules and to act as a responsible member of the international community. The British Foreign Secretary William Hague, in July, described Japan as 'the UK's closest partner in Asia' and it plays a vital role in Asia-Pacific Economic Cooperation (APEC) aiming at further economic integration and an enhanced growth strategy for the region.

4. An alternative view suggests that Japan's government and its people are increasingly looking inward, and that this is not likely to change under the DPJ. This clearly has implications for the region. Primarily there is a battle of ideas in East Asia – and indeed globally - about what are the true challenges to our global future and how to address them. China has worked hard to present itself as following a new and successful model of development, rebounding from the global financial crisis with even higher economic growth than before, and purportedly speaking up for other developing countries regarding possible global controls on greenhouse gas emissions and other aspects of global governance. There is no consensus within Japan about its global role – which is why the political system is split, changes frequently, and it has been paralysed on strategic questions such as how to respond to China's ascent, how to adapt the US-Japan alliance to Japan's view of its security needs and determine what role Japan should play in regional and global institutions. Like China today, Japan was previously aggressive in ideas about the nature of global economic competition and institutions, including many calls for reform. This confidence was shattered with the collapse of the so-called bubble economy, and has never returned. Many Japanese voters hoped for the emergence of a new sense of purpose and leadership in the DPJ but are now disappointed. Japan has now had 8 prime ministers in the last 10 years. Many wonder if Prime Minister Kan will restore Japanese confidence, create a new sense of purpose for Japan in the world, and lead Japan once again to be a global leader, reforming its economy and addressing in a serious manner Japan's crippling fiscal challenges.

5. The DPJ has delivered an unclear agenda plagued by internal squabbles and weak political authority in a divided Diet where bureaucrats still wield much de facto power. The poor handling of the recent Senkaku crisis was illustrative: ironically, Prime Minister Kan's standing was rescued by China due to its over-reaction even after the release of Captain Zhan from custody in Okinawa after 16 days: (Holding four Japanese nationals accused of spying on a military installation when in fact they were preparing a bid to remove Japanese Imperial-era chemical weapons; escalating the rare earth metals export ban scare; fueling the flames of anti-Japanese demonstrations in interior China). This all served to distract the Japanese public from their dismay that Japan had more or less given in to China without an underlying strategy, exposing the problems of DPJ management concerning coordination and public relations.

6. Japanese people seem to show declining interest in the world outside Japan and therefore a reluctance to engage with it. Compared to South Korea and China, significantly fewer Japanese young people study abroad. Japan continues to struggle to develop a successful way to teach foreign languages with even the Japan Exchange and Teaching Programme (JET) - one of the few successes in Japan's efforts to internationalise Japan – facing an uncertain future under DPJ rule. Despite this, Japan's contribution is overwhelmingly positive for the international system, with Japan seen as a key stakeholder. Japan is an active supporter of efforts to combat climate change, to counter proliferation of conventional and nuclear weapons, to support the UN (including providing the second-largest share of its annual budget), and to provide ODA to the developing world.

7. In terms of Japan's key challenges ahead, Japan's inward focus is a major problem exemplified by many years of political instability and leadership change in party politics. Core priorities for the future must include recreating a working relationship with China, convincing a sceptical public about the value of more and deeper Economic Partnership Agreements and getting US-Japan security relations back on track. The current sub-

optimal prognosis is that Japan seeks to be a constructive player in the system but its inward focus and domestic political challenges almost certainly will keep it from playing more than a supporting role over the next several years.

8. The global system is going through transition in terms of the architecture of governance. Historically, this was brought about by war e.g. Japan was rehabilitated by entry into post war global institutions, following the legal and normative base of the international system. Japan's priority was to be accepted as a member of international society sharing universal values. Today's scenario takes place with the end of Cold War structures, though legacy issues continue in East Asia with remaining territorial disputes between nations as exemplified in recent conflict over the Senkaku Islands. DPJ rationale seems a change from the Liberal Democratic Party (LDP) foreign policy view (in 2004 the Koizumi Government simply repatriated seven Chinese activists who landed on Senkaku). The DPJ position focuses on the Japan China Fisheries Agreement 2000 which divides the territory around Senkaku into different zones. Strong support of the Japanese position by the USA has been taken as a boost for the DPJ with reconfirmation of the fact that the US Japan Security Treaty covers the Senkaku Islands. In the 1972 US resolution, Okinawa and the Senkaku Islands reverted to Japan. The USA is charged under Article 5 of the treaty to offer a security commitment to Japan. This has restored confidence towards the US in Japan after tension regarding the Futenma base issue. The DPJ response to the infringement of Japan's territorial integrity was to call on China to follow the rules and norms of the international system as Japan did in its own post war rise. However, China does not necessarily view these as universal and perhaps believes that it should shape new international values rather than accept the status quo. Clearly the DPJ policy of engaging rather than containing China has not produced a positive outcome in terms of the territorial problem. There has been no demonstration of Chinese commitment to universalism or adaptation of global standards e.g. the International Court of Justice. There is a growing concern over perceived double standards from China, which wishes to be seen as a big power but shirks the associated responsibilities by saying that it is still a developing nation.

### **Global Economic Prosperity: Japan's Role and Future Influence**

9. There has been much coverage of the "lost" two decades but it is sometimes forgotten that Japan did grow during that time. The impact of the "Lehman Shock" in Japan was considerable. Exports were reduced by 30% in 2009 and GDP was down 9.4% in FY 2008/9, the worst in the OECD. The position in late 2010 is problematical for Japan with a poor corporate outlook. Recent data (September 2010) shows that industrial production is down 2% with inventories up sharply. Unemployment remains relatively high for Japan at 5% with core consumer prices index (CPI) down 1.1% Private consumption remains flat with retail sales down 3.7% month on month.

10. The Japanese government seems focused on inflation targets and intervention rather than tackling the structural issues of uncompetitiveness in the Japanese economy. There is no coherent tax policy. The national debt is still very cheaply priced, with Japanese Government Bond (JGB) yields at 0.8%. 95% of debt is domestically serviced, but for how long can Japan continue to borrow from itself? Japan's traditional business model which focused on market share and size is now insufficient. Economic growth will require deregulation and foreign direct investment (FDI) promotion and a change in both culture and structure to bring highly capable Japanese women and immigrants into the workforce. In the interconnected global system, the drivers of the Japanese economy are now external. Japan's historical focus on protectionism and resistance to competition is directly opposite current trade policy priorities (Trans-Pacific Economic Partnership (TPP), EU/Japan, Economic Integration Agreement (EIA)) and imposes tough choices on the government of Japan. Deregulation and proportionate regulation are key issues. Japanese management of risk needs to be reevaluated e.g. setting fares for air travel services is no longer a credible option for a first world country, and the recent controversy over the Japan Airlines bankruptcy intervention raises concerns about Japan's ability to allow market forces

to function and have a 'level playing field'.

11. Weak domestic demand in Japan now necessitates increased external focus for economic growth in key potential global regions such as Africa. The deregulation of the labour market over the last decade, with the demise of the lifetime employment system, means that a third of the current Japanese workforce do not have regular employment. Dampened wage levels have added to lowered domestic demand. A rapidly ageing population puts further demands on the healthcare system with increasing insecurity among young Japanese people trying to find secure employment. This is imposing hard choices on Japan's political leaders as Japanese people are entering a period of introspection and potentially dangerous self marginalisation. The world business context is now rapidly changing with the liberalisation of trade and opening of markets. Japan cannot go it alone with no foreign, professional management talent. Japan has to evolve, as other successful countries have, from the belief that bringing in a foreigner is a sign of failure rather than success in capturing the best global talent. A Japan-centric model based on capital and technology only will no longer work domestically nor in the international connected system.

## **Outlook and Opportunities In Japan's Bilateral Relationships**

### **Japan-US**

12. The public support for the alliance with the US remains strong, regardless of the DPJ's priority of rebalancing relations with Asia. Though the US military bases have been unpopular for decades (particularly in Okinawa), Japan clearly prefers a US-led order to a China-led order and therefore seeks to keep the status quo. Japanese leaders seem to be not adequately aware that the Japan-US alliance positively impacts on other countries in the region. China is now testing the strength of the alliance, most recently on the issue of the Senkaku Islands. The seeming weakness of the Japan-US alliance is inviting China's more assertive behaviour, which worries other countries in the region as well. Some argue that the alliance is solid but what matters more is perception: South East Asian countries, in particular, are highly concerned about what is happening not only between Japan and China but also between Japan and the US. The state of the alliance matters to Europe as well. A couple of concrete examples: some defence experts say that given the series of problems in the alliance, it is understandable that Japanese officials would not want to upset their US friends further by considering the purchase of Eurofighter. If Japan participates in the TPP, it may influence the EU's position regarding the idea of a Japan-EU EPA. In this regard, it should be remembered that one of the main drivers of the EU's move to conclude a Free Trade Agreement with South Korea was that the country was going to conclude an FTA with the US. Speaking with a single voice vis-à-vis China needs to be one of the core functions of the Japan-US alliance and should involve other like-minded countries, including the EU. This is not a containment of but rather an encouragement of China to be a responsible player in the international society. It is natural that Japan, the US, Europe and other peer democracies need to coordinate their positions and speak in one voice to influence China. The lessons of the West's (particularly the EU's) failure in this regard vis-à-vis Russia need to be learned.

### **Japan-China**

13. China's economic growth is linked to communist party integrity. It is sometimes forgotten that the Chinese Communist Party is also a nationalist party. Japan was a historical enemy and can be positioned as a modern one when politically strategic domestically for China to do so. Though China may have, for genuine nationalist reasons, engaged strongly in the recent dispute over the Senkaku Islands, the diplomatic victory was delivered to Japan, primarily though China's 'own goal' in what internationally was seen as an overly aggressive approach prompting widespread support for Japan. This negative reaction to China underscores the political tightrope that what may play well domestically and be seen as patriotic and strong, can be detrimental externally and seen as 'bullying'. The result of the incident is enhanced security confirmation from the US to Japan and a reaching out from other Asian countries to the US, including potential for increased military cooperation, as a counterbalance to a perceived threat by China seen as wishing to

dominate the region. In essence, the US can now claim to have been 'invited' as an honest broker into the region. Other key countries such as India and Australia are wishing to talk with Japan about the future of China.

14. Yet Japan and China are now economically interdependent. China is Japan's largest trading partner with very significant Japanese FDI in China which represents the primary external market driving growth for Japan. Japan is actively involved in regional policy discussions with ASEAN, China, South Korea and Russia and is hoping to launch negotiations for a new Action Plan with the European Commission when the last one expires in 2011. It is clear that the best way to strengthen economic security in the region is to bring issues of contention to the World Trade Organisation. There needs to be closer liaison between the US and Japan to agree a strategy with other countries for a new set of rules for security cooperation, perhaps a regional structure to manage security. Evidently there are numerous fault lines requiring high level engagement on a new regional architecture, perhaps linked to an East Asian Economic Community, learning from the EU experience in that security in member states is now off the agenda. Perhaps like Germany in Europe, Japan needs to find closure on its war history and to stop being a convenient enemy for China to use when politically expedient to do so. A good first step would be to stop the denial of war crimes by some senior Japanese politicians.

## **Outlook and Opportunities in Japan's European Relationships**

### **Japan-UK**

15. When examining the relationship, it is useful to see where the common ground between Japan and the UK is and where is the potential for future partnership. Foreign Secretary William Hague has stated that UK's goal with Japan is 'to reaffirm our relationship and seek a closer partnership in commerce and foreign policy'. The UK wants to work with Japan to strengthen the global economy. Clearly, Japan matters to Britain as a major investor in the UK and is an important trading partner. The UK is the second largest Japanese FDI recipient in Europe and Japan is the UK's largest partner in R&D. Both countries are going through similar problems: low growth, large debt and an increasingly ageing population. The UK government has taken hard decisions to deal with the deficit. Foreign and security strategy is at the centre of government. In the 1970's, Japan's technology revolution changed the way globally that people accessed media and culture. Today, almost all households in Britain own Japanese products and Japanese companies now lead the world in electric or hybrid cars. Interestingly, the large Japanese companies are now seen as international and not necessarily Japanese. However, there is concern that there is a lack of clear vision for the future from a Japan uncertain of its place in the world and the UK is ready to work with Japan to restore confidence. One opportunity is to broker partnerships between British and Japanese universities to promote exchanges of researchers and students. Potentially, both countries could create joint university qualifications.

16. The UK is keen to work with Japan in driving a new commercial partnership with serious consideration being given to the Hitachi bid for high speed rail despite budgetary pressures. Reciprocally, Britain would like to see similar consideration from Japan for the Eurofighter Typhoon. Trade and investment needs to be both ways. The Foreign Secretary supports a UK/Japan Free Trade Agreement but to make this a reality, there needs to be a reduction in trade barriers. For instance, it makes no sense that only 50% of medical devices sold in the US and Europe are available in Japan. Equally, it takes 53.6 months to approve biopharmaceuticals in Japan whereas it takes only 7.5 months in the EU. This means that it takes longer for companies to get drugs into the Japanese markets and Japanese patients have to wait longer to benefit from innovative medicines. This needs to change to enable the European Commission to decide to launch negotiations.

## Japan- EU

17. Back in 2001, Tokyo and Brussels had ambitious plans regarding international economic, political and security co-operation when adopting the so-called 'EU-Japan Action Plan for Co-operation'. This action plan, which is running out shortly, had a lot of plans and declarations but fairly little concrete implementation. A list of more than 100 areas of bilateral co-operation led to a lack of focus with too many issues and areas. Currently, a core perceived problem is a lack of political will in the European Commission and Japan to do more. There is an absence of urgency in areas of international politics and security. Despite many protocols and declarations, there are few joint policies, apart from a recent exception on envisioned joint police training. With the EU focus on China over recent years, there has been no diversification of Japanese foreign and security policies. Much ongoing security dialogue has taken place on nuclear disarmament, ballistic missile proliferation, human rights including joint sponsorship of The International Criminal Court (ICC), counter-terrorism, Afghanistan and counter-piracy off Somalia. Equally, economic dialogue has focused on high level trade dialogue and issues like intellectual property rights and energy policy.

18. However, there has been no sense of urgency or new security or economic initiatives in a rapidly changing global environment. At the EU-Japan Summit in April 2010, the high level group were charged with the task of 'conducting a joint examination of the ways to comprehensively strengthen and integrate the Japan-EU economic relationship addressing all issues of interest to both sides including, for instance, all tariffs, non-tariff measures, services, investment in services and non-services sectors, intellectual property rights and government procurement'. The conclusion was 'at the summit meeting in 2011, summit leaders will decide on any appropriate next steps based on the outcome and the options for the further strengthening of Japan-EU political and economic relations identified by the joint 'High-Level Group''. Current EU- Japan stances on an FTA remain an obstacle to progress. Tokyo is keen to progress, particularly after the recent EU Korea FTA but Brussels is not yet prepared to commit to negotiations until Japan makes more progress on reducing non-tariff barriers to trade. Japan argues that the EU is protecting European automobile and electronics industry (the EU imposes 10 % tariff duties on imports of Japanese cars and 14 % on electronics).

19. Though the need for a meaningful action plan is clear, this will only happen if EU-Japan attempts to solve the issues on the bilateral trade and investment agenda are successful. Were a new action plan to succeed, it would need to focus on fewer areas and issues to be tackled together. The emphasis should be on soft power projection in security cooperation in Asia and beyond as well as development aid, climate change and environmental policies.

## Japan: Prospects for a Developing Regional Role

20. Given the relative decline of US supremacy and the rise of China, there are strong reasons for Japan to work as a lynchpin for the US's stabilising involvement in the region. Specifically Japan should do more with US support to build its own defensive capacity including submarines, navy and air power. It is time to review Japan's defence capacity and move away from outdated Cold War thinking. Given Japan's dominance in technology and manufacturing, it is no longer logical to have negligible arms exports and time to rethink the Three Principles on Arms Exports. Japan should sustain its US presence, deepening the alliance to further the 2005 joint strategic objectives regarding China, Korea, and Russia, whilst enhancing deterrence dialogue and contingency planning regarding North Korea.

21. Japan should take a lead role to create networks with like minded countries on shared interests at a regional level e.g. tsunami response. It should engage more fully with the increasing number of issues requiring a global approach such as nuclear disarmament. Specifically, such groups can have both the will and capability to act quickly and decisively. These groups could be trilateral e.g. Japan-US-Australia or Japan-US-South Korea or could decisively expand e.g. Japan-South Korea –Australia –NATO- India. Japan needs to support the next generation of regional stars in Asia including Indonesia, Vietnam and The



Philippines. New and effective channels of communication could open up e.g. Japan-US-China and Japan-US-Russia. Equally, in the face of common threats, Japan needs to strengthen its weakest links: relationships with South Korea and with Russia. Japan should take a consultative lead role in rule making. The rising powers do not necessarily respect the status-quo rules of international engagement making this a necessary and important focus. Evidently, Japan as a respected member of the global community needs to take a flexible view, engaging with the WTO, regional or global groups as required. The preferred method is for Japan to link with core like-minded countries to facilitate a group approach to critical issues like economic security, diversification and internet freedom, maintaining strategic lines of communication with the US, EU and India as well as G20 and G6+1. At a more regional level, a critical relationship is with the East Asia Summit as well as developing strategic links with key ASEAN countries such as Indonesia and Vietnam.

22. Japan can no longer attempt to be all things to all nations and needs to define its regional role. Japan is a liberal, values-based country, an ally of the US and a working partner of China, ROK and ASEAN. Isolation is dangerous for Japan as this would allow others to determine its regional relations at a time when Japan is threatened by the DPRK and by China. Other countries in the region have low expectations from Japan but high hopes. It is expected to continue to ally with the US on security matters and to provide ODA and technology expertise. Japan should present an alternative leadership model in Asia to China's rise. The power balance between Japan and its neighbours has already begun to shift. In the coming years, Japan needs to chart its own economic path. It must increase R&D spending. Last year, there were more Chinese research papers than US ones. Japan needs to reestablish its ability to lead on trade issues or will simply be left behind. Given China's significant military expansion and increased threat level to Japan and the region, Japan needs far more investment in its own defence capacity. Japan has already lost political momentum to China in the region. Similarly, in the Asia relationship with the US, the ROK has taken the initiative whilst the regional architecture is being shaped by ASEAN. The only way that Japan can move forward is to accept the burdens of a leadership role and take bold initiatives on core issues of security and democracy both bilaterally and multilaterally. It needs to make the significant investments required to work with networks of like-minded nations to protect the political, economic and maritime security of the region.

## **Japan's Role in Global Low Carbon Transformation**

23. Japan clearly has a strong future role in aiding global environmental progress and mitigating climate change. However, its political will to do so was declared too late with policy design already in progress. Low carbon investment is a key component of its economic growth strategy. Japanese technology is still competitive but is losing superiority because of delayed policy decisions and lack of systematic thinking. It sometimes feels that Japan is locked into past glory and underestimating the threat of being overtaken by emerging countries. Japan still has significant financial resources but these are not used to optimal effect. It maintains a geopolitical advantage in Asia but is being caught up by South Korea and China. At the time of the Kyoto agreement, Japan had visible leadership in creating a low carbon world but this has faded. At the Copenhagen summit, Japan was present but practically invisible, allowing the debate on climate change to be dominated by the US and China. Kyoto-fever is now fading out with Japan worryingly aiming at a more substantial and quiet contribution to the low carbon world. In negotiations, Japan strongly requests equal status for its role but its lack of visibility clearly damages its credentials. It would be far more productive for Japan to first publicise and carefully brand its contribution and then seek the respect and status due. The world is becoming low carbon and Japan, as in other areas, must decide to lead or be forced to follow. Japan has manifest strengths but needs to link domestic policy and international positions, balancing environmental aspirations with economic pragmatism.

## Japan and International Institutions: Developing Key Relationships

24. The past 50 years has seen Japan as a consistently top source of development assistance overseas. Japan is the second largest supplier of capital to the World Bank. In its June 2010 report on ODA Review, Japan's Ministry of Foreign Affairs presented a new way forward for Japan's ODA, identifying 3 Pillars of Development Cooperation: reducing poverty (contributing to the achievement of the Millennium Development Goals), investing in peace, and supporting sustainable growth (with emphasis on the MDGs and including assistance for climate change and other environmental issues). The new way forward is underpinned by the focus on: strategic and effective aid, taking a leadership role in the international community, human resource development, promotion of public understanding and support, reinforcing policy-making functions and implementation capacity.

25. The world needs nations like Japan to help achieve the MDGs. It has proven knowledge in helping the developing world. The World Bank welcomed the commitment made by Prime Minister Kan at the UN MDG Summit in September 2010, (\$8.5 billion over five years starting in 2011) to help improve the health of mothers and babies as well as education services in poor countries. The World Bank will continue to look to, and rely on, Japan's contribution and leadership in strengthening cooperation and promoting donor harmony.

26. Yet Japan does not have a clear strategy in its relationship with and membership of the UN, IMF, World Bank and WTO. Japan's position as the world's largest creditor and still arguably the second largest economy often appears to be insufficiently recognised by these key international institutions when they face fundamental challenges. The transition to a G20 will not necessarily make G8 irrelevant as both will continue to play their respective roles. G7 is more like a self appointed board of directors of the world economy, whereas G20 is more like a shareholders meeting representing different forces within the global economic community. The crisis which has made the creation of the G20 process necessary is also undermining well established international economic institutions such as the IMF and WTO. Multilateralism is weakening, with trade policy now focussing more on bilateral and regional free trade agreements. Japan is not immune and pursues FTAs and RTAs, hence the recent internal debate on whether to join the Trans Pacific Partnership agreement negotiations promoted by the US and some others around the Pacific Rim. Japan, being one of the greatest beneficiaries of the success of the Bretton Woods institutions and the WTO, should rather be taking the lead in calling on all governments to resist their political instincts for seeking immediate export gains which undermine the hard won fruits of multilateral cooperation.

27. APEC today comprises 21 so called "economies" in the Asia Pacific region. It was created at the end of the 1980s with the initiative of Japan and Australia as a regional economic cooperation forum and to keep the US engaged in the Asia Pacific region. Another motivation for APEC's creation was to give due attention to the newly industrialising economies, as well as to bring China, together with Taiwan, into a community of market oriented economies. They became members in 1991. This was possible due to APEC's adherence to the principle of separation of politics and economics, and thus APEC membership has been open to so-called "economies" and not limited to sovereign states. For China and Chinese Taipei, participation in APEC was the precursor to their accession to the WTO in 2001. The importance to China of its membership in the WTO cannot be overemphasized. APEC, unlike FTA negotiations, is not a negotiating body for binding commitments. It promotes trade and investment liberalisation through voluntary measures and peer pressure. It subscribes to the principle of so-called "open regionalism", and it reinforces multilateralism. Aspiring to play a more active role in international peace and security, Japan, with the backing of increased economic capabilities, undertook actively to contribute to the peacemaking efforts of the UN as well as to the process of UN reform. However, its pursuit of a permanent membership on the Security Council has not yet been fulfilled. A sea change is brewing in the global distribution of power from West to East. Japan is uniquely positioned to underpin the effectiveness of the UN as an international organisation devoted to peace and security.

## **Cooperation in Third Country Environments: Where Japan Can Add Value**

28. Japan plays a vital role in development cooperation in the South. The Japanese approach of “think together and work together”, which emphasizes self-help and ownership, contributes to expanding the capacity of people in developing countries to achieve and sustain the Millennium Development Goals and enhances opportunities for using their latent capabilities. In September, the UN summit on the MDGs concluded that the Goals are attainable by 2015 if the international community is united in its efforts. Japan committed to contribute \$8.5 billion for health and education for the next five years. This emphasis on local initiative reflects Japan’s own modernisation experience. In the latter half of the 19<sup>th</sup> century, Japan strived to catch up with Western countries by importing their technologies and institutions. Western experts, technicians and educators came to Japan to impart technology and knowledge, but the Japanese did not accept Western ideas and technologies without adapting them to local conditions. Their success, in fact, was due largely to the modification of external factors to fit local needs and conditions. Another feature of Japan’s international cooperation is its readiness to provide grant aid and concession loans to build physical infrastructure such as roads, water supply facilities, schools, hospitals and irrigation systems. In many cases, infrastructure projects are accompanied by capacity development cooperation for community people, local administrators and government officials so that the projects can be sustained and even scaled up by local initiative. Japan maintains 93 ODA field offices, with 400 officials as long-term residents, assisted on a contract basis by more than 5,000 Japanese experts with long experience of working in developing countries. Japan has discovered that enormous energy and abundant resources can be mobilised locally if the potential beneficiaries are actively involved in the process. Local ownership and empowerment are crucial for any project to be sustainable and scalable.

## **Outlook: Prospects and Strategies for Japan’s Global Role**

29. Japan faces a core challenge to overcome a sense of uneasy introspection. There is no time for complacency or delay as Japan is called upon to assume a leadership role. The global context now is a multipolar and interconnected world with shifting alliances amidst a scale of change that is vast and rapid. Japan, with its history of a homogeneous society, needs to define its own identity in this complex world order. A comparison with the UK may be useful. Japan finds strength in homogeneity whilst the UK is seeking strength in diversity and multiculturalism. Regarding the business environment, FDI only accounts for 2.5% in Japan as opposed to 48.5 % in UK. A third “opening” of Japan would require serious domestic reform including welcoming the vast pool of professional talent to be found in Japanese women, and genuinely embracing a work life balance for Japanese people including greater rights to family time and holidays. One useful comparison globally is how the UK punches above its weight by engaging with its overlapping circles in the North Atlantic, EU, Gulf, Africa and the Commonwealth. As Tony Blair said ‘ Britain is European but not only European’. How can a similar approach work for Japan? Despite cultural resistance to punching above its weight, and post war restrictions on hard power and the centrality of the US Alliance, Japan can be both Japanese and Asian.

30. Japan is confident but too often defensive rather than engaged. A central theme is to stay true to Japan’s traditions, values and contemporary strengths whilst maintaining the regional and global architecture for the liberal, free trading, multicultural global system. There is a need for security in a dangerous world and consequences to ignoring the international framework e.g. currency. One unexpected development from the current crisis is the real global threat from state capitalism and protectionism. There is increasing competition for natural resources e.g. rare earths. The best response for Japan is to react to the serious threat to Japan’s interests with its trading partners. Japan should not play China at its own game but instead project its own soft power and provide alternative and consultative leadership for Asia. Japan’s corporate competitiveness is under threat, not helped by the low number of Japanese students now studying abroad compared to those

from China and South Korea. Japan urgently needs to internationalise and communicate better, developing a Japan national brand strategy to counter the often negative media stories about Japan. Furthermore, there is a need to embrace non Japanese in mainstream management. Ignoring the global talent pool for a continued reliance on 1% of the world population (ie. Japanese males) limits potential. Japan needs to develop soft skills to actively market, brand and sell Japan.

31. Global competition will be based on knowledge and IPR not manufacturing (for example, 80% of Nokia profits are in Finland while 80% of parts are from Japan). Japan must win the battle for ideas underpinned by Japan's strengths and commitments : democracy, human rights, ODA, social cohesion, welfare, low crime, rules based within international system, education, corporate compliance, technology and commercial expertise. Japan needs to activate its circles of influence: its immediate neighbourhood of Korea and China, wider East Asia, ASEAN + 3 , APEC and NATO + 4. Accepting that the US Alliance is central at political, economic and military levels, Japan should also embrace a stronger relationship with the EU as two soft global powers with shared values and interests in a multilateral framework. The 27 EU member states would be a good place to start expanding Japan's sphere of influence, given Japan's historic role as an East/West bridge, while deeply embedded in Asian architecture. Japan could and should lead a virtual EU in fast growth Asia Pacific. Whether realised or not, there would be great value in the process of building an East Asia Economic Community. No other plateau has the scale and ability to embed China, India and others in the liberal global architecture. This could focus on interdependent, multilateral issues: rule making, climate change, capacity building, food/water security, WTO standards, development (ASEAN/Mekong), human rights, democracy. Only Japan, trusted by both the EU and US, can bring global best practice to Asia and can lead that process from within the region.

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