UNITED STATES-JAPAN ECONOMIC RELATIONS
(1945-1997):
A HEGEMONIC QUEST?

A thesis presented by Elif Hakan

To

The Institute of Economics and Social Sciences

In Partial Fulfillment of the

Requirements

For the Degree of Master of

International Relations

Bilkent University

August, 1997

BILKENT UNIVERSITY
Institute of Economics and Social Sciences

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August 1997
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I certify that I have read this thesis and in my opinion it is fully adequate, in scope and in quality, as a thesis for the degree of Master of International Relations.

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ABSTRACT

In this thesis, the purpose is to analyze the dynamism in the US- Japanese economic relations between 1945- 1997; with regard to the hegemonic stability theory. After stating the basic assumptions of the theory; the economic decline of the US and the rise of Japan are explained and illustrated. Future prospects for the bilateral relations of the two and the future of the world economic leadership are given; following an overall look to the relations. As a response to the question which country the hegemon is today; the thesis concludes that after the Pax Americana era, there is no hegemon in the face of the US losing its strength in the economic arena and Japan not qualified to assume the role, due to its inadequacy in the military sphere. According to the hegemonic stability theory, the two politically powerful countries with their strengths emanating from different sources, do not offer a hegemonic solution but their bilateral relations and cooperation with other advanced countries (G - 7) are vital for an orderly functioning liberal world economy.

ÖZET

Bu tezin amacı; 1945- 1997 yılları arasında Amerikan- Japon ekonomik ilişkilerindeki değişimin, hegemonik istikrar kuramı temel alınarak incelenmesidir. Kuramın temel prensipleri belirtildikten sonra; Amerika'nın ekonomik açıdan gerilemesi ve Japonya'nın yükselişi tablo ve grafiklerle açıklanmıştır. İkili ilişkiler ve dünya ekonomisinin geleceği konusundaki düşünceler, ekonomik ilişkilerin yer aldığı bölümden sonra gelmektedir. Pax Amerikan döneminden sonra Amerika'nın ekonomik alanda gerilemesi ve Japonya'nın da askeri açıdan yeterli güce sahip olmaması sonucu, bir hegemonun olmaması, bu çalışmanın ortaya çıkardığı bir sonuçtur. Hegemonya dengesi kuramına göre, politik güçleri değişik alanlardan kaynaklanan Amerika ve Japonya'nın hegemonyaları söz konusu değildir. Ancak ikili ilişkileri ve diğer gelişmiş ülkelerle işbirlikleri (G- 7), liberal dünya ekonomisinin düzeni açısından son derece önemlidir.

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I. INTRODUCTION:

The purpose of this thesis is to study the impact of American- Japanese relations on the global economy by using the hegemonic stability theory. The 1990s have witnessed tremendous changes in the international system, owing to the end of the Cold War, brought by the collapse of the Soviet Union. The victory of liberalism versus communism in both economic and political spheres has led to debates over a new world order. The bipolar stability and predictability gave way to a " unimultipolar" world as Samuel P. Huntington calls it[1]. This is because we are living in a world of multi-power centres militarily dominated by the US after the demise of the Soviet Union.

The liberal world that experienced the prosperity and security of the international regimes under the US guarantee during the Cold War, is at a turning point as the US is exhausted economically at a time when the economic sphere has surpassed the military in the priority chart[2]. The end of the Soviet threat legitimizes the debate that there no longer is a need for large defense budgets, but for economic welfare programmes. So, the US allies that prospered under the US security umbrella seem to be more advantageous today given their economic powers and potential for influence in the international affairs. Through realist glasses, a world of international economic competition and thus protectionism makes more sense than a borderless, cooperative world economy when it is realized that the priority of national interest has not changed but concentrated on economics rather than security affairs.

Another systemic change - change in the structure of the international political economics- brought by the end of the Cold War is the increasing regionalization of the world economy mainly into three trading blocs: the Americas, the European Community and the Asia- Pacific region under the leadership of Japan[3]. Despite the optimism that the world is moving towards a more global, liberal open economy and free trade, the persistence of protectionist measures, managed trade (through bilateral arrangements) and inefficiency of international economic institutions, lead to realpolitik calculations and complicate the management of the system without the US capacity to sustain the regimes[4].

The hegemonic stability theory of neorealists, formulated in the early 1970s, focuses on this nature of the international system and argues that a hegemon is the guarantee for the operation and continuation of regimes. The distribution of power in the international system and the changing economic and military balances determine the hegemon[5]. In the words of Robert W. Cox, to be a hegemon:

> " a state would have to found and protect a world order that was universal in conception, i.e., not an order directly expressing the interest of one state but an order that most states could find compatible with their interests given their different levels of power and lesser abilities to change that order. The less powerful states could live with the order even if they could not change it" [6]

So the hegemon should have the most efficient economy capable to meet hegemonic costs (draining its economy as Gilpin states) and the military means needed to protect the system[7]. The US, the leader of Americas, Japan, the leader of

Asia-Pacific respectively seem to be the candidates for the future global leadership. The former's military and the latter's economic supremacy put them into that position. In a way, these two states have shared the two hegemonic dimensions: economic power and politico-military power[8].

The Cold War, which changed Japan from an ex - enemy to a US ally contributed to its strength and later its demise, quickly reintegrating this country into the world political system. This important geopolitical development has increased the importance of Japan since the Japanese economy has become the center of international politics as security dependence of Japan on the US has become less vital with the removal of the Soviet threat[9]. At the same time, other than being an important member of Group 7 (G-7) -club of the world's leading industrial countries - Japan has created a kind of Asian co-prosperity, strengthening its position in the Pacific. But Japan is moving with very cautious steps despite the international especially American pressure on it, to be more assertive politically. Meanwhile, the United States is trying to continue playing its global role with simultaneous attempts to manage its chronic budget and trade deficits[10]. The advocates of benefiting a larger " peace dividend" insist for a different budgetary allocation, with less emphasis on the military and urge Japan for more burden sharing. In fact, according to the understanding that politics and economics are inseparable; Japan, due to its extensive economic activities in the world, will have to develop a foreign policy in which she will have greatly expanded roles[11]. Otherwise only as an economic power, it is not possible for Japan to be a truly global power. Japan is expected to end its postwar pacifist sentiment and participate in concerted action for coping with regional conflicts, nuclear proliferation, management of the world economy and environmental issues[12]. The United States can no longer afford to deal with all global issues, as it did in the post- war era. Japan can not remain a " free rider " concerning the international public goods[13].

It is the structural characteristics of the international system that determine the weakening or strengthening of a state as a hegemon. Today, first of all the possession of nuclear weapons makes states less willing to solve disputes through armed conflict. Also, the increasing economic interdependence and interests of states in international commerce create a common interest of sustaining stability in the world economy. What is more is the economic challenge of Japan that became apparent with the export-led economic growth strategy of the 1970s and its role beginning in the 1980s, as the world's foremost creditor nation[14]. Japan has become the economic power, supporting US foreign policy goals and budgeting the deficits of the ex-hegemon[15]. In the face of the US economic decline, the US-Japanese relation turns out to reflect a division of labor, with Japan as the financial leader and US as the political/military leader[16].But the crucial point is that the US and Japan are two separate states with their own interests, the reconciliation of which will be difficult in the absence of the Cold War criteria.

The hegemonic responsibilities require a continuing economic surplus to be used for "consumption, production and protection ". But the US economic surplus has disappeared since the 1980s, facing the country with the problem of financing its commitments[17]. The historic reversal of the financial positions of the US and

Japan has taken place during the Reagan administration in the US. The export-led growth strategy of Japan and its closure to imports other than raw materials had created a surplus in Japan's trade and payments balances[18]. The Japanese need for a market to get rid of its financial surpluses coincided with the US need to stimulate domestic consumption in America and go on with the military expenditures, despite the large budget deficit[19]. This type of a " symbiotic " relationship increased the Japanese investments in the US and changed the latter into a debtor nation though it seemed to be a short-term solution to finance the deficit[20].The result was the "Nichibei " economy which meant the increasingly integrated Japanese and American economies and became the key economic relationship in the world[21].

The main economic problems of the US are the budget deficit, low savings rate inadequate for investments, inefficient education and training of the American work force and inadequate spending on R&D[22]. In the face of these problems the US sees Japanese economic power as a strategic threat; there are even people calling this rivalry an economic war with Japan[23]. Also, the serious imbalances in trade between the US and Japan are a " fact ". This friction that has grown in the second half of the Cold War became acute especially in the early 1990s. Japan has been criticized for the adverse effects of its protectionism during the world recession of 1991 and 1992. Rather than advantages that Japanese trade and investment have brought to the US, the monopolistic Japanese trade practices and non-tariff market barriers have been debated in trade negotiations[24]. Especially the unsuccessful GATT summits have been good examples to show the lack of US leadership in the economic sphere and the circumstances of the post hegemonic era[25]. In Frank Langdon's words; " perhaps it will take a global environmental crisis as serious as a cold war to supply the stimulus and leadership needed"[26]. It is obvious that today there is no hegemon.

For the current global economic problems, which are uncertainties in the liberal multilateral trading system, the increasing gap between the developed and developing countries, the difficulties of making reforms in the economies of former socialist countries and the world-wide shortage of capital; there is need for cooperation especially in three respects. These are, creation of a non discriminatory, multilateral trading system; maintenance of successful transformation of former command economies into a global liberal economy and economic assistance to the developing countries[27]. For achieving the stated aims, there is need for Japanese collaboration and working institutional arrangements. This may either mean strengthening the existing institutions, adapting them or creating new ones, for handling the emerging issues[28]. A possible threat to the institutional fabric is that the increasing heterogeneity in the membership of international organizations may cause instabilities. But the fact that the world economy is regionalized may help, since the leaders of different regions (Japan, Europe and US) would check its own backyard· This is in case the post hegemonic era remains fragmented economically. In fact a scenario could be coequal, shared global leadership by the US and Japan, if their political interests coincide.

With these in mind, in this thesis the changing balances in the economic and political relations between the US and Japan since the 1970s will be dwelled on.

The main emphasis will be to analyze the nature of the alliance especially in the post - hegemonic era and dynamics of change will be studied. Through the theoretical framework of realism, more specifically the hegemonic stability theory; the global political economics will be evaluated with regard to power capabilities of the US and Japan. In Chapter 2, the hegemonic stability theory is elaborated. Chapter 3 concentrates on the economic decline of the US and the rise of Japan. The US-Japan economic relations are the topic of Chapter 4. At the conclusion, Chapter 5 offers some future prospects for the global leadership and the US-Japan bilateral relations.

II. THE THEORY OF HEGEMONIC STABILITY

A. Anarchy versus Cooperation in the International System

The anarchic nature that realism argues the international system has, is due to the absence of an authoritative government to enact and enforce rules of behavior among states which are the major actors of international affairs. Self help which is accepted as the rule, implies that nation - states rely on their own means and arrangements for achieving their self interests, bringing wars, conflicts and discord as the result. [1] The basic assumptions of the realist school that are also shared by neorealist scholars (Kenneth Waltz, Robert Keohane, Stephen Krasner, Robert W. Tucker, George Modelski, Charles Kindleberger and Robert Gilpin) are: the conflictual, anarchical nature of international affairs, accepting order, justice and morality as exceptions; the nation-state as the essence of social reality and nationalism as the basic loyalty; belief in primacy of power and security in political life as the basic human motivation [2]. Different from classical realism, neorealists have rediscovered the economic component of international affairs, as a result of the surfacing of economic factors in the 1970s. R. Gilpin states that this was not due to a crisis in realist thought but was due to a crisis in world capitalism. According to neorealism, the international political system determines the framework for economic activities. Therefore the international economic arena is not autonomous as liberals argue and is not the driving force behind politics as Marxists claim. It is assumed that economic factors have effect on the distribution of wealth and power, but do operate in the context of political struggle among states. Hence changes take place first in the political then in the economic sphere, as a result of the former[3]. The theory of hegemonic stability, developed by neorealists, tries to examine the dynamics of international political economy through this perspective and puts forth the conditions under which cooperation among nations is possible, despite anarchy prevailing in the system.

B. The Theory of Hegemonic Stability

The theory first put forth by Charles Kindleberger, in the form of a theory of "leadership" or "responsibility", argues that an open and liberal world economy requires the existence of a hegemonic or dominant power. As Robert Keohane states, hegemony by a single country makes it possible to develop strong international regimes, the rules of which are precise and well-obeyed. The hegemon is able and willing to establish and maintain the norms and rules of a liberal economic order and with its decline, the liberal economic order is greatly weakened [4]. Hegemony, in the economic sense, is preponderance of material resources. Immanuel Wallerstein defines hegemony as "a situation in which the ongoing rivalry between the so-called 'great powers' is so unbalanced that one power is truly primus inter pares; that is , one power can largely impose its rules and its wishes (at the very least by effective veto power) in the economic, political, military, diplomatic and even cultural arenas" [5]. So it is the liberal hegemonic power that provides the favorable political environment for the successful operation of the market[6]. But for the development of the liberal international economy, the hegemon itself must be committed to values of liberalism, otherwise the system can easily be turned into imperialism through imposition of political and economic restrictions on lesser powers. The powerful states other than the hegemon should also have interest in the growth of market relations, since the hegemon cannot compel them to follow the rules. This brings us to three prerequisites of Gilpin for the emergence and continuation of the liberal system:

1. Hegemony
2. Liberal ideology
3. Common interests.

For the other states to accept the rule by the hegemon, there must be a general belief in the need for and legitimacy of this rule. The necessary support requires a considerable degree of ideological consensus[7]. It is the prestige and status of the hegemon in the international political system that makes other states accept the rule. The moment when they regard the actions of the hegemon as self-serving and contrary to their own political and economic interests, the system begins to be weakened. Or if the citizenry of the hegemon believes that the other states are cheating or if the costs exceed the perceived benefits, then again the system deteriorates[8].

According to David Lake, the theory of hegemonic stability is in fact a research program consisting of two distinct theories[9]. The former one, "leadership theory" is built upon the public goods model and aims to explain the production of the international economic infrastructure which is international stability. The leadership may be both " benevolent" or " coercive" depending on the circumstances. On the other hand, the latter one, the hegemony theory, focuses on different trade policy preferences of states and seeks to explain international economic openness[10]. The term international economic openness is defined as the sum of free trade and protectionist elements in the foreign economic policies of at least the largest states within the system. Lake argues that these two theories are not incompatible; even some variants state that countries can be leaders and hegemons at the same time. But one point to be emphasized is that hegemony should be coercive, as a difference from prerequisites of leadership[11]. Charles Kindleberger, who exemplifies leadership theory according to Lake, explains that a single leader is necessary for the provision of the public good of international stability. Lake prefers to call this term as international economic infrastructure. Political scientists Norman Frohlich and Joe A. Oppenheimer have first put forth the idea that public goods would be underproduced in absence of a leader to bear the disproportionate share of costs[12]. (Seeing the concept " hegemon" as equal to " threat, pressure, force", Kindleberger has preferred to use the term " leadership", in explaining how to sustain international stability.)

Concerning the second component of the hegemonic stability research program, which is the hegemony theory; the openness of international economy becomes the dependent variable and is the result of strategic interaction and bargaining of self-interested states. Since free trade or economic openness are desired by the hegemon, it is coercive, exercising power in order to change the policies of other states to satisfy its own goals. The coercion may take place either in the form of negative sanctions (threats) or positive ones (rewards). So the hegemony theory is not based on a public goods model and free-riding is not the main political problem. On the contrary, what is problematic is the incompatible trade policies of competing states[13]. A new version of the leadership theory adds that a group of states may replace the single leader[14]. Lake agrees with Krasner's argument that openness can be achieved under either hegemony or a system of many small, highly developed states, as long as it is in their interest to sustain openness.

C. Basic Assumptions of the Theory of Hegemonic Stability

The study of hegemony has interested many scholars since concentration of power in the hands of one state is important on the course of interstate political relations. Despite many versions of the theory, there are two basic assumptions:

1. The dominant actor declines or disappears.

2. As a result, all others undergo (or the world undergoes) a period of crisis and instability[15]. Charles Kindleberger argues that there has to be a stabilizer - one stabilizer, for the world.

> "Four secondary theorems, found in works of R. Gilpin and C. Kindleberger are as follows:
>
> 1. Theorem a (the benevolence argument) : The hegemon is benevolent and predatory behavior is considered as defensive, taking place only in the face of exploitation by smaller countries.
> 2. Theorem b (the leadership argument) : Harmony and cooperation are extremely difficult or impossible without a hegemon. (Regime theorists, e.g. Keohane do not agree with this.)
> 3. Theorem c (the "state of grace" argument) : A harmony of interests can emerge due to the leader and a positive-sum-game world is possible, hence the transactions are benign in times of hegemony[16].
> 4. Theorem d (the hegemon's dilemma argument) : The hegemonic responsibility is altruistic in the sense that the hegemon upholds the system to its detriment, though it weakens in time. This has been stated in different forms in the literature:

(a) The Triffin dilemma of hegemonic currency: The hegemon when providing the system with liquidity and a common currency for international transactions, undermines the confidence of markets and central banks in its own currency, so weakening its own position.
(b) The investment dilemma: The hegemon's overseas investments may undermine its competitiveness by developing potential challengers.
(c) The technology spread dilemma: The hegemon forgoes its advanced technologies, through international aid and investment.
(d) The open market dilemma: It is a responsibility of the hegemon to police a regime of free trade. It should open its own market even if the free riders do not reciprocate, hence the hegemon may be threatened with a balance of payments deficit and be worse by a loss of competitiveness, as a result of technological spread.
(e) The" small exploit the rich" dilemma: The hegemon pays more than its fair share for public goods, in this way is exploited by small, free riding nations[17]. "

In the hegemonic stability theory, a powerful actant guarantees the existence and effective functioning of the system. The hegemon provides and protects the system by bearing a disproportionate share of costs. Hegemony is especially seen as a solution to the problem of provision of " public goods"[18]. Gilpin takes the open market economy as a collective or public good. A collective good is one, the consumption of which by an individual, household or firm does not reduce the amount available for other potential consumers[19]. This condition is called the "jointness" of public goods[20]. Also, public goods are " nonexcludable" which means that the actors can not be excluded from consumption, whether they contribute to the costs of provision or not[21]. So, what is problematic is that the recipients may prefer "free-riding", causing suboptimal production of the goods[22]. Under hegemony, which is a partial solution; the largest participant of the economic system may have sufficient incentive to produce public goods even without guarantee that others will contribute their shares, because it will also be the largest beneficiary of the utilization of public goods[23]. The ability of the hegemon to provide public goods and solve collective action problems, makes hegemonic governance desirable. C. Kindleberger's well-known example showing the value of hegemony is about world monetary stability during the inter-war period. During this era, Great Britain had lost its hegemonic status but its position was not filled by the United States yet. The result was the Great Depression and many states had to raise tariff barriers and devalue their currencies to protect their national interests. No strong nation was willing to assert financial leadership and stabilize the situation, hence the results were catastrophic. [24]

According to Gilpin, another important function that makes the hegemon crucial is the fact that the hegemonic power becomes a model showing the benefits of a market system and works as an engine of growth for other economies, through its imports, investments, transfer of technology and diffusion of knowledge[25]. The economic component of power is more important than the military for the hegemon to exert influence in the international system. As Robert Keohane states "the hegemon must have control over raw materials, sources of capital, markets and have competitive advantages in the production of highly valued goods." The control of financial capital, particular technologies and natural resources are important means of leadership. Hirschman argues that even threat of trade, finance or technology cut off can be an important means of leverage of hegemon over other states[26]. The theory puts forth that the hegemon or dominant power assumes leadership in dealing with a particular issue. So the theory has been applied to a wide range of issue areas such as; exchange of money, trade, finance, health, environment, communications, air transportation, fishing, navigation on high seas.... In this way, the hegemon influences the other states to cohere and establish rules of conduct, in different fields of international relations.

The theory of hegemonic stability is one of the approaches explaining the creation of "international regimes" to govern different issue areas. The proponents of the theory who apply it to the question of regime development assume that the structure of the international system (distribution of capabilities and power) determines the possibilities of cooperation[27]. Brilmayer, who finds regime theory akin to the theory of hegemonic stability states that regimes can also facilitate the provision of public goods but the degree of their effectiveness without a hegemon is disputable[28]. Also there are authors (e.g. Keohane, Snidal) that are optimistic about the possibility of collective action in the absence of hegemony, arguing that cooperation can persist through inertia[29]. John Ruggie argues that after the establishment of some international institutions such as International Monetary Fund, World Bank and international money and trade regimes; there is a " non state" internationalization of authority which facilitates continuation of the system as one of " embedded liberalism", as a fusion of power, interests and legitimate social purpose in the major capitalist states[30]. The hegemon that plays an important role in the operation of world economy by creating international regimes that are "principles, norms, rules and decision making procedures around which actor expectations converge in a given issue area". It has responsibility to prevent cheating, free riding and enforce rules of a liberal economy, encouraging others to share the costs of maintaining the system. According to the theory, if there were no hegemonic power to create and manage international regimes, the international economy would be unstable since liberalism and free trade would give way to economic nationalism[31].

For Keohane, hegemony and international regimes may be complementary, or even- to some extent- substitutes for each other since they both serve to make agreements possible and to facilitate compliance with rules[32]. He believes that cooperation does not necessarily require the existence of a hegemon, after the establishment of international regimes. Keohane insists on possibility of non hegemonic cooperation and that this can be facilitated through international regimes. One reason why governments value regimes is that it is easier to maintain regimes than change them[33]. International regimes do not imply a new international order beyond nation states; they are arrangements motivated by self- interest, where sovereignty remains a constitutive principle. The exploration of the evolution of the norms and rules of a regime is a means of studying continuity and change in world political economy[34]. Keohane, who finds realism weak in accounting for change, especially when the sources of change lie in the world political economy or in the domestic structures of states shows Gilpin's cycles of hegemony as an achievement[35]. Gilpin, in explaining " change" emphasizes hegemonic wars as the basic mechanism of systemic change[36]. After a hegemonic war, power is redistributed, a new hierarchy of prestige is established and this determines which new states will govern the international system. Gilpin's solution to static realism that can not explain change is that institutions and rules may in time become inconsistent with power realities; bringing the result of decline of hegemonic states. He explains hegemonic decline with " the law of uneven growth"

> " According to realism, the fundamental cause of wars among states and changes in international systems is the uneven growth of power among states. Realist writers from Thucydides and Mac Kinder to present- day scholars have attributed the dynamics of international relations to the fact that the distribution of power in an international system shifts over a period of time; this shift results in profound changes in the relationships among the states and eventually changes in the nature of the international system itself."

Here, there are three main assumptions of Gilpin:

1. According to the law of diminishing returns, the growth of every society describes an S shaped curve.

2. Hegemonic states tend increasingly to consume more and invest less.

3. Hegemonic states decline due to a process of diffusion of technology to others, in a way, helping to create challenging powers[37].

There are two alternatives for a declining great power: to increase resources or to decrease costs. Most frequently, the dominant state is not able to find additional resources or reduce its costs. The result is an acute disequilibrium and the rise of another power trying to transform the system in ways advancing its interests while the declining hegemon tries to maintain its position. Consequently, the international system experiences tensions and crises. According to Gilpin, throughout history, the primary means of resolving such a disequilibrium between the structure of the international system and the redistribution of power has been "hegemonic war"[38]. Every international system has been a result of the territorial, economic and diplomatic realignments following hegemonic struggles that determine who will govern the system. The defining characteristics of a hegemonic war are the following:

1. It involves a direct contest between the dominant powers (rising challengers).

2. The main issue at stake is the nature and governance of the system[39].

3. It is characterized by the unlimited means employed and by the general scope of the warfare[40].

The conclusion of one hegemonic war is the beginning of another cycle of growth, expansion and eventual decline. The redistribution of power goes on according to the law of uneven growth and equilibriums that continue for some time are reached through wars since mankind is not successful at the use of an effective mechanism of peaceful change[41]. In this way, Gilpin explains the dynamics of international political economy.

D. Two Cases of Hegemonic Stability : Pax Britannica and Pax Americana

" Since the Industrial Revolution, two successive hegemonic powers in the global system; Great Britain and the United States have sought to organize political, territorial and especially economic relations, in terms of their respective security and economic interests"[42]. Their partial successes have been due to the imposition of their will on lesser states and also because other states have benefited from their leadership and provision of public goods (security, protection of property rights) in exchange for revenue. In studying hegemonic stability, two spheres have to be distinguished: economy and security. In the economic field, both Pax Britannica and Pax Americana enforced liberal economic rules, fostering free trade and freedom of capital movements, supplying the key currency and managing the international monetary system. For these two great powers, it was profitable to assume these responsibilities since the outcome was a secure status quo, free trade, foreign investment and a well- functioning international monetary system; all surpassing the costs of sustaining them. Meanwhile lesser states benefited from the international political and economic status quo as well[43].

The era of Pax Britannica began with the end of the Napoleonic Wars and continued till the outbreak of the First World War. The success of the British liberal economy owing to the political triumph of a middle class committed to liberalism, general acceptance of liberal ideas in the international system and recognized benefits of free trade led states to negotiation of tariff reductions and opening of their borders to the world market.

The second hegemonic era, that of the United States began following the Second World War[44]. As the victor of the war, the US expanded economically and dominated the world economy, and supported the global monetary system through the Bretton Woods agreement[45]. The General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) have been established, and trade barriers have been reduced. Under American leadership, the basic means of liberalizing global trade was bilateral agreements with unconditional most-favored-nation clauses. GATT itself was a package of 123 bilateral trade agreements intending to expand international trade. Since each agreement contained a MFNC (Most Favored Nation Clause), each signer was given the same concessions that the other nation had conceded to all the other countries at the conference with which it had concluded agreements[46]. The United States, after understanding that the post - war world-wide recovery depended on the reconstruction of intra - European trade, insisted that European states reduce discrimination against one another, but be able to discriminate as a group against non European states. So tariff barriers and quotas against the United States were justified on the ground of increasing and liberalizing trade[47].

As the economic hegemon, the United States had the responsibility of making an asymmetric bargain; opening its own borders for easing protectionism by others. In this way, the United States was able to knit together a political coalition of liberal, democratic, capitalist countries; hence the system created was subsystemic, excluding the fascist states in the 1930s and the Soviet bloc, beginning in the 1940s[48]. For the sake of its long term interests, the United States has carried the burden of short- term and additional costs. These costs rise due to free rider problems and the hegemon has to pay more than its share[49]. The other states benefit from the large size of the hegemon's market, the opening of which may cause the latter to lose. All through the post war era, the United States has sustained an international economy, disproportionately advantageous to other countries[50]. But the central role of the US currency has been a means of power[51]. " The right of seigniorage", profit that comes to the seigneur (sovereign power) from the issuance of money has been used to its own advantage. The United States has made a successful use of its financial power to reward friends and punish enemies. An important role of the hegemon is "crisis management" for the survival of a liberal world economy that the United States has sustained as a result of its strength with regard to three of the most commonly used dimensions of national power base : GNP, military expenditures and manufacturing production.

B. Russett argues that American preponderance though not adequate to set all the rules for the entire world system, permitted it to establish the basic principles for a new economic order in 80 percent of the world economy, controlled by capitalist states. This 80 percent constituted a collective security system under political and economic control by the United States[52]. Giovanni Arrighi distinguishes between two types of achievements of the United States: in security and economy. The former achivement concentrates upon the pacification of relations among capitalist states hence bringing a peace based on deterrence, through maintenance of stable boundaries between the capitalist and communist worlds. A second gain according to Arrighi in the post war era has been the decolonization process supported by the United States; in this way opening these previously closed markets, sources of raw material, to the world economy[53]. Thus the Third World was opened to capitalism.

Concerning the hegemonic decline of the United States that began in early 1970s, A. Stein states it was due to the " hegemonic dilemma" which is a situation in which the hegemon can not choose between either committing itself to openness to maximize its returns (regardless of what others do) or activating a policy of continued closure in order to maximize its " relative" position in the system[54]. The United States has tried to use its position to protect its status especially in the 1980s, cooperating with major capitalist states for financing its hegemonic responsibilities[55]. Paul Kennedy explains the decline of the United States with his thesis of " imperial overstretch" which implies that extension of ambitions of great powers beyond the limits of their resources leads to their decline[56]. Today there is disagreement over whether Pax Americana is at an end or not. Contrary to those that believe the era ended and a post hegemonic one began; there are proponents of the understanding that despite the decline of the United States " relative" to its former position, it is still the first power at least in the economic sphere[57]. What has changed is the use of its economic power for the United States; priority is no longer given to the establishment of a world capitalist order but to the pursuit of national interests, such as increasing domestic economic growth[58]. This line of reasoning insists on the vitality of the US position today, concerning global politics and economics and the continuation of the structure it has created in the liberal system.

E. Critiques of Hegemonic Stability Theory

The theory of hegemonic stability is criticized for its certain assumptions. One aspect challenged is the existence of international collective goods. Some argue that there are no real international collective goods since goods like trade and monetary regimes are used by a very small number of states. They explain that the international collective goods do not meet the two requirements for this status; namely indivisibility and nonappropriability. The former means that the consumption of the good by one does not preclude consumption by another; the latter implies that no one can be denied access to the good. In the light of these; the critics say that requirements can easily be violated and consumption of one good can preclude that of another. Some actors can be denied access to the good. International actors may provide goods through bargaining, mutual cooperation and punishment of cheaters. So critics explain that the appropriate model for international economy is that of a prisoner's dilemma or collective action problem[59]. Snidal says that, because benefits of hegemonic regimes are not shared in common but are redistributed from one state to another, we can not say all members of the international system simultaneously benefit from the collective good. Hence the criterion of jointness is not met[60]. Also, because the hegemon most probably would have means enabling it to exclude states it wants from enjoyment of public goods, the second criterion is far from being met either[61]. Another critique asserts that free trade is not a public good since it is excludable and rival[62]. But at the same time, the enforcement of trade rules is a public good anyway since the dependent variable according to the theory is international stability, not free trade or international economic openness.

Another point that scholars diverge on is the matter of motivations of the hegemon. One trend exemplified by the work of Kindleberger emphasizes the "cosmopolitan economic goals" and the "benevolence" of hegemon. Another view, that of Gilpin stresses the enlightened self interest and security objectives. For example, the United States has accepted the responsibility of becoming a hegemon and supporting the international system, in order to realize its own economic, political and ideological interests[63]. Keohane states that there is no automatic link between power and leadership, the “willingness” of the hegemon to govern inter-state relations is important[64].

The effect of decline of hegemony on the liberal world economy is also a matter of controversy. While scholars like Gilpin argue that the hegemon's decline weakens the prospect for the survival of the liberal trading system, there are scholars e.g. Keohane and Ruggie who emphasize the importance and endurance of international regimes of different issue areas, even after the hegemon. Contrary to the realist assumption that cooperation and stability are just due to dominance by the hegemon, the institutionalists state that " interdependence" creates interest in cooperation[65]. It is shared economic interests that help creation of international institutions and rules, so that these are "recognized patterns of practice around which actors' expectations converge" and do not necessitate the presence of a hegemon to foster cooperative behavior among states[66]. So, concentration of power in the hands of a hegemon is not the only source of order.

Keohane argues that the decline of US hegemony only partly explains the decline of post war international regimes. After 1970s, advanced countries have continued to coordinate their policies even if imperfectly. Stein insists that only one state, a hegemon can not alone create a liberal system, since without agreements and coordination of policies, a global regime is not possible. Even if the hegemon "imposes" a regime on weak countries, this does not create a global regime[67]. Also, the decline of the hegemon does not mean closure of the system and the former hegemon remains to be important in coordination of relations despite the lack of will to continue bearing costs[68]. When testing the applicability of hegemonic stability theory, D. Snidal has used two criteria. One is the public goods assumption, the critique of which is given above and the other is the assumption that collective action is impossible without hegemony on the ground that if cooperation was possible then states could also provide the necessary public goods even in absence of hegemony[69]. This second assumption is challenged by stating that it is in the interests of states to cooperate especially under conditions of increasing interdependence and anarchy need not preclude international collective action. Kindleberger is criticized for his pessimism that cooperation is not possible without hegemony.

Keohane criticizes Gilpin's systemic theory of change since it lacks an understanding of internal processes to explain observed effects. He believes that the theory contributes to our understanding, but does not explain change or why certain contenders emerge rather than others. For Keohane, the emphasis on power, interests and rationality is inadequate to explain change; the institutional context that states are found in should be studied[70]. Because hegemonic leadership is unlikely to be revived in this century, as no hegemon could survive after a nuclear war; the basic dilemma becomes how to organize cooperation without hegemony. This is a question that can not be neglected by just relating it to the presence of hegemony.

A common critique of hegemonic stability theory is its moral (normative) base; whether it is morally sound for one nation - state to dominate others or not[71]. The theory deals with the problem of how world politics is changed by a highly asymmetric distribution of world power, in which one state dominates the rest. Regime theory which is an offshoot, examines the role of the hegemon in maintaining international institutions and takes the asymmetric distribution of power as given, not questioning whether this is morally acceptable or not. The liberal critique of hegemonic stability is that hegemony is autocratic, not democratic since hegemons are not elected and they can not be recalled. Also, they are not constrained by written constitutions[72]. The realist explanation for the exclusion of a normative evaluation of international hegemony is that international affairs are different from domestic ones and questions of right and wrong do not make sense. A quotation from Kenneth Waltz exemplifies this understanding: "States in anarchy can not afford to be moral... The preconditions for morality are absent in international politics. Every state, as a consequence, has to be prepared to do that which is necessary for its interests as it defines them. Anarchy is the realm where all can, and many do, play 'dirty pool ' " [73].

The primacy of security relations and emphasis on discrepancy between principles and actions in the international arena leads realists to this line of reasoning. But liberals who base their arguments on domestic analogy (seeing similarities between states interacting internationally and individuals interacting domestically), emphasize the importance of political morality which addresses the problem of justified hierarchy in the global system. So political morality is a means of differentiating legitimate international hegemony from illegitimate one[74]. What is important for liberals is the justification of hegemony that can be sustained through the " consent " given by other states to the hegemon since the principle of sovereign equality of states is to be preserved. [75] Another point criticized and that has normative implications is whether hegemony helps poor countries or not. According to Baumgartner and Burns, asymmetrical control relationships between states work heavily to the advantage of dominant countries and to the disadvantage of weaker countries, hence explaining that the regimes are not mutually beneficial as suggested by the theory of hegemonic stability[76]. Krasner's words; "The hegemon is equally likely to use its power simply to further its interests at the expense of other states," reflects the understanding criticized by liberals[77]. A further challenge to the theory is that it is in fact used to rationalize American imperialism and domination of other countries[78]. The proponents of the theory themselves are also aware that the hegemon can exploit its position in the name of nationalist ends. But Kindleberger opposes this view and adds a normative side to his arguments by underlining the altruistic motive of the hegemon in fulfilling its responsibilities. He prefers to use the term "benevolent despot" in place of hegemon. Kindleberger explains benevolence in terms of three phenomena:

1. Power begets greatness: The dominant powers are aware of their responsibility and behave in a farsighted way.
2. Power begets greatness in selected countries: Hegemony means coercion, motivated by narrow interests but leadership necessitates benevolence and the United States is a true leader.
3. Rewards gained by the hegemon are immaterial: They are prestige, glory and anticipated immortality. These compensate for the economic costs[79].

Here, there is an explicit ethnocentric bias, favoring the United States and its dominance. This approach of the theory has been challenged, especially by less developed countries (LDCs) and post communist states, reflecting the North & South debate and problems of underdevelopment. On the other hand, Marxists and neo Marxists attack hegemony when exercised by capitalist countries, though they had for long accepted the SU as their own system's hegemon.[80]

The number of examples of hegemonic eras given by neorealist scholars is found to be threatening the validity of the theory. This number which is only two, even stated by some theorists to be only one (the US era), is very limited[81]. Also, the theory is thought to overemphasize the role of the state and of political factors in the operation of the international market economy; undermining ideologies, domestic factors, social forces, technological developments and the market itself[82]. Still, the fact that the theory sees the rise and decline of a hegemon as an important determinant of "structural change " is a contribution to the understanding of the "dynamics" of international political economy. Russett puts forth a dimension of power, often neglected: the pervasive cultural influence of the United States[83]. This effect, what Gramscians would call cultural hegemony, has helped in creating common perceptions, preferences with the United States for other states in both economic and political spheres. The near - global acceptance of some aspects of American culture, like consumption, democracy and language has eased the rationalization of hegemony.

A methodological critique of neorealists comes from Mansfield. He believes that the study of distribution of power which is important for dynamics of political economy, when measured by counting the number of poles in the system, without taking power inequalities among major powers and neglecting the number of both polar, nonpolar major powers into consideration, leads to an incomplete analysis[84]. In order to overcome such limitation, "concentration" should be focused on, as well as the number of poles in the system. One limitation of measuring the distribution of power by counting the number of preponderantly powerful states, is the difficulty of determining which states are to be counted. The criteria for distinguishing polar powers from others are relative. Gilpin distinguishes three types of structure: hegemony, duopoly (bipolarity) and balance of power (multipolarity)[85]. In hegemony, there is a wide power disparity between the largest state in the system and the others; bipolarity means the approximate equality of the two largest states and a wide power disparity between the smallest pole and any remaining state. Finally multipolarity is the approximate equality of more than two powerful states and a wide disparity between the smallest pole and any other state in the system. Mansfield states that polarity defined in this way leaves no room for information of the level of inequality between polar or nonpolar powers and that the relative size of nonpolar major powers may have strong influence on a variety of international outcomes[86].

Under the light of these there is reason to believe that groups of states can provide international public goods as well and it is wrong to ignore nonpolar major powers in the study of political economy. Grunberg also criticizes Gilpin for downplaying especially the balance of power, not recognizing that it played a large role in history. Bipolarity should be made compatible with hegemony at least when studying the post - war international political economy[87]. The US hegemony can not be regarded truly global given the existence of the Soviet Union and its bloc at the same time with the capitalist order. Therefore the hegemonic stability theory can be evaluated as inadequate in a complete analysis of the world economy.

The theory of hegemonic stability, by linking the economic structure and its evolution with the international distribution of power, combines political factors and economic outcomes, satisfying the need for international political economics. After the analysis of the theory in this chapter, Chapter 3 will focus on the dynamics of the decline of the post - war hegemon, the United States; and the rise of Japan as a challenger to it, between the years 1970 - 1989, on the basis of the theory of hegemonic stability.

III. DECLINE OF THE US AND THE RISE OF JAPAN (1970- 1989)

A. Decline of the Post- war Hegemon: The United States

1. Early Post- war Era

After the end of the Second World War (WWII), the United States (US) as the only preponderant power in political, military and economic terms relative to its war- time allies and enemies, was a candidate for leadership of regimes regulating relations between states. Its large market, great productive capability, financial facilities, strong currency and the possession of an atomic weapon were adequate to make the US the right candidate[1]. The US capabilities and willingness to assume this role coincided with the readiness of war- torn countries for cooperation with the US in order to ensure their economic rehabilitation and military and political security in the face of the communist threat emanating from the Soviet bloc countries. The challenge of this Eastern bloc acted as catalyst for the development of institutions for political integration and military preparation, like the North Atlantic Treaty Organization (NATO), and prepared ground for close economic relations[2].

The ability of the US to exert control over outcomes has taken place in positive and negative ways. Positive control of outcomes implies the acceptance the US has gained for values, institutions and policies carrying an American world-view, like liberal democracy, open trade and investment[3]. On the other hand, negative control of outcomes is related with the ability of the US to prevent other countries from implementing policies opposed to the American definition of national interest, like spread of communism - before the collapse of the Soviet Union- or a threat to American technological leadership. The former, positive control of outcomes can best be exemplified with the Bretton Woods system that sustained economic order and stability from 1944 to 1976. This liberal economic order led by the US was possible, owing to concentration of power in a small number of states giving consent to US leadership and sharing common interests with it. The system of the Western alliance was composed of a set of rules, institutions and procedures to regulate important aspects of international economic interaction; excluding communist states that had centrally planned economies and interacted in a separate international economic system under the leadership of the Soviet Union. The less developed countries sharing liberal values had no voice in the management of the system, just like Japan that remained subordinate till its economic recovery, supported by the American assistance[4].

Created by the Bretton Woods agreement, the system relied on a limited conception of international economic management composed of the removal of barriers to trade and capital flows and the creation of a stable monetary system. The US hegemony led to a period of unparalleled economic growth till the 1970s, when a decline became apparent due to both internal and external reasons, which will be dwelled on in this chapter. Charles Kindleberger calls this period as the inner decay of the hegemon, through which it ages and slows down, exhausted of sustaining the public good of global stability[5]. The economic problems that the US has faced will be elaborated below, in terms of three pillars of an economic order: money, trade and finance[6].

2. Economic Hegemony of the US

The hegemony of the United States in the economic arena, as distinguished from the political and military ones can be analyzed in three subfields; money, trade and finance; the last one being composed of international production and foreign aid issues. The changing status of the US with regard to each is explained under the light of domestic economic developments, having repercussions on the functioning of international regimes.

a. Money:

Concerning the first field, international monetary management, the determinant was the bilateral negotiations of the US and the United Kingdom (UK) as the world's leading economic and political powers of the WWII era: these led to the creation of the Bretton Woods system in July 1944[7]. The Bretton Woods agreement provided for the establishment of the International Monetary Fund (IMF), and the International Bank for Reconstruction and Development (IBRD, known as the World Bank) [8]. The former was intended to serve three functions: overseeing the system of pegged exchange rates (fulfilled till 1971, when the fixed exchange rate system was abolished), providing financial assistance to countries with balance of payments problems out of a fund composed of contributions of member countries and trying to ease transactions in foreign exchange in order to foster international trade. The US has been an important contributor to the IMF, especially in the early post- war era and has determined the budget hence the leverage of the organization. The latter, World Bank, as an investment bank has financed specific projects such as roads, dams, agriculture, education... but in time its activities have expanded to broader programs of structural reform, causing its responsibilities to be closer to those of the IMF[9].

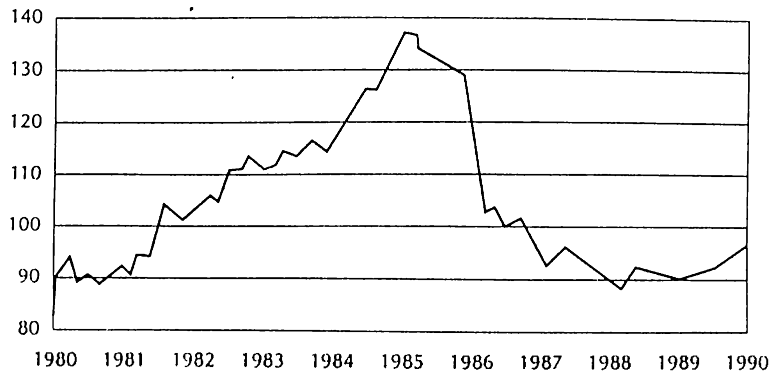
IMF was created as the center of the fixed exchange rate for which countries would establish the parity of their currencies in terms of gold and maintain exchange rates within 1 percent plus or minus of parity; since the approval of the organization was needed for any change in exchange rates. In this way, currencies could be convertible making circumstances ripe for free trade. But still the emphasis was on national and market solutions to monetary problems and the IMF and IBRD were inadequate to cope with the economic problems of the war-torn US allies [10]. Therefore, the US started off by 1947 to unilaterally manage the monetary system which necessitated a fixed relationship of the dollar to gold at 35 dollars an ounce. Since gold production was inadequate to provide liquidity and determine international values of currencies (through their fixed relationships to gold), the dollar assumed this role but the outflow of the currency for international use created a balance- of- payments problem for the American economy in time. Other than providing liquidity, the US became the facilitator of adjustments, managing the imbalances in the system by e.g. tolerating European and Japanese trade protectionism and discrimination for them to overcome their deficits[11].

In 1960, the foreign dollar holdings began to exceed US gold reserves and led to a great balance- of- payments deficit; the US unable to alter its exchange rate, experienced an overvaluation of the dollar and this exacerbated the trade deficit of the country. Meanwhile, other countries could alter their exchange rates to account for inflation. The relative economic recovery of Japan and Western European countries and decreasing need for American security umbrella, in the face of de'tente between the US and the SU undermined the system by the end of the1960s[12]. After the announcement of President Nixon in 1971 that the dollar would no longer be convertible into gold and the US would impose a 10 percent surcharge on dutiable imports; in December 1971, the financial ministers of Western countries met and agreed (Smithsonian agreement) that the world was on a dollar system without a link to gold and there would be no restraint on exchange rate fluctuations. The world economy was still dependent on the US economy for stability. As long as dollars were constant in demand and value, there would be no problem and it could function as a medium of international exchange, but the value did not remain constant.[13] It was in March 1973 that all major currencies were floating, leaving the monetary management to the market.

A major blow, exacerbating the economic decline of the US was the oil crisis of 1973, as the Arab oil producers increased oil prices, causing oil consumer countries to borrow in order to meet their energy needs. IMF, IBRD and private banks played an important role in recycling the oil revenues of the producers to the consumers in the form of loans. The US also, unable to reduce its demand for oil was pushed into the worst inflation, recession and balance- of- payments problems. The inflationary effect of this development was that high oil prices increased the costs of consumers and manufacturers leading to higher wages and prices in the economy[14]. Another problem was that the Third World countries that had borrowed from the American banks were experiencing deficits as well and were not able to pay the loans back, let alone the interests[15].

The money borrowed was the OPEC surplus (petrodollars) and the careless recycling of it by the Western banking system led to the Third World debt problem[16]. Since OPEC countries wanted the payments to be done in dollars, the demand for the currency increased worldwide, bringing an overvaluation with it and the trade balance deteriorated as the dollar reached its peak in 1985.[17] Under these burdens, the US was trying to cope with inflation through reduction of taxes to restore growth, under the Ford administration, so that it could recreate confidence in the dollar and contribute to more stable exchange rates. Since the government competed with the private sector for savings to finance the fiscal deficit, pressure on credit markets increased the interest rates (discouraging domestic investment), inducing an inflow of foreign capital. This meant increasing demand for dollars and pushed its price up. The currency kept on rising because the force driving the dollar was the movement of capital entering the country rather than the trade balance. Only after 1985, the currency started to fall.[18]

Figure1. Index of the Dollar's Value Against Fifteen Industrial Country Currencies



Source: *Economic Report of the President, 1989* (Washington, D.C.: Government Printing Office, 1989).

Index: 1980–1982 = 100.

Source: Pool and Stamos, International Economics (US, 1990), p. 201.

A recovery in the American economy and strengthening the dollar thus maintaining its international role successfully was not possible during the administration of President Carter, since the US could not overcome stagflation. This meant that the economy was in a trap of both stagnation and inflation and the solution considered by this administration was supply- side economics, later on also applied by the Reagan administration[19]. In this theory, the role of relative prices in providing incentives for individuals to work, save and invest is emphasized. As one of its pioneers, Paul Craig Roberts states: " Reducing the marginal tax rate lets the income earner keep a larger percentage of any additions to income and therein lies the incentive to generate additional income or GNP." Thus the supply- side theorists believed that other tax reductions would lead to incentives for greater business investments[20]. The second oil crisis, the shift of employment from manufacturing to service industries thus decreasing productivity in this sector and increasing military expenditures in the face of the Soviet invasion in Afghanistan - revival of the Cold War- all contributed to the frustration concerning the economy.

During the Reagan administration, reduction in the money supply to squeeze inflation and tax cuts to eliminate recession were utilized as remedy to problems[21]. But the inflation fighters were the low income groups and they paid heavily for sustaining price stability: unemployment brought social problems with it[22]. Also, tax cuts that were seen as a solution, could not stimulate the economy since decreasing money supply increased the interest rates, making investments less likely. Continuing government spending in the military sphere and the limitation of R& D (Research and Development) only to the military sector not extended to others, were far from saving the economy from recession and inflation. The repercussions of these on the international monetary system was the choice of collective leadership for management of values of major currencies[23]. But this was possible only to a limited extent since West Germany and Japan would not accept a new framework as demanding as the fixed exchange rate system, closely tying their economies to that of the US which they believed was inflationary. Therefore the policy coordination was limited to bringing down interest rates and the value of the dollar in order to stimulate the American economy and help it get rid of the budget and trade deficits[24].

At the Plaza meeting of September 1985, the Group of Five finance ministers stated that direct governmental intervention was required for stability in the monetary system[25]. According to the Plaza accord, signed by the US and Japan and announced to G- 5 countries, the orderly appreciation of the main non- dollar currencies vis- a- vis the dollar was agreed on. The currency fell till the American authorities intervened to stop it[26]. The accord did not work due to three reasons; first of all, the devaluation of the dollar did not change the fact that the US was a safe haven for foreign direct investment, second, the dollar fell against the yen and the mark, not the other currencies such as those of Canada, Mexico, and the last reason was that strong import demand in the US continued, believing that higher quality was coming from abroad hence the trade deficit did not improve. Further depreciation of the dollar could even cause foreign direct investment pull- out, dragging the economy into recession concerning investments.[27]

The Tokyo Summit of the G- 7, in May 1986 (US, Britain, Canada, France, Germany, Italy and Japan) where the main issues were the US trade deficit and the huge Third World debt and then the Baker- Miyazawa accord on the dollar- yen rate in October 1986 were the platforms for further negotiations. During the Louvre Summit of February 1987, it was stated that the currencies should be stabilized within fairly narrow ranges around the rates that existed at the time of speaking; but the necessary policy changes did not come. Also, Japanese and German efforts to eliminate US deficits through overvaluation of their currencies and stimulating their domestic demand, could not be successful since their growth rates were inadequate and they found the effort inflationary[28]. The Venice Summit of June 1987 was a continuation of band- aid trial- and - error muddle- along efforts[29]. The Bank of Japan and Bundesbank bought dollars to prevent the dollar from collapsing. With the end of this triple intervention to the market to stabilize the dollar, the currency fell in October 1987 and there really was a mess when President George Bush came to power. In 1988, imports were at an alarming rate- nearly 460 billion dollars in 1988 alone; an increase in exports to 322 billion dollars helped narrow the trade gap but the side effect of devaluation which is inflation had become a serious concern. Therefore the understanding that there was need for protectionist measures became widespread.[30] Large deficits continued and were exacerbated by the Gulf War. The economic boom to revive the American economy did not come. Thus, there was only limited cooperation in the framework of the floating exchange rates and given the problems that the dollar faced and the unwillingness of other countries such as Germany or Japan to take burden of managing the monetary system, there was no candidate to assume the role of the US, by the end of the 1980s.

b.Trade

As the dominant military and economic power in the post- war era, the US fostered an open trading system in order to sustain global economic growth and cooperation, knowing that political stability required economic prosperity. Free trade, as part of a liberal economic order would necessitate a multilateral approach in order to ensure support and participation. This aim was realized through the extension of the bilateral tariff reduction negotiations of the US with third parties to the international forum. In this way, tariff reductions would be applied not only to negotiating parties but to other trading partners as well, on a most- favored- nation basis. Under the US leadership, an international conference was convened in 1947, in Geneva and general trading guidelines were drawn in the form of the General Agreement on Tariffs and Trade (GATT)[31]. The basic principle, the principle of non- discrimination was clearly reflected to the most-favored- nation principle, according to which:

> " any advantage, favor, privilege or immunity granted by any contracting party, to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." [32]

Another important rule of the regime has been the prohibition of the use of quantitative restrictions like quotas, except for balance- of- payments reasons. But GATT also had escape clauses such as preferential systems, customs unions and free trade associations that were detrimental to a totally open economic order. GATT in time became institutionalized and turned into an international organization with a secretariat and an institutional forum within which trade negotiations would take place, headed by the US. American leadership has been important for the promotion of trade liberalization since the US encouraged Europe and Japan for free trade through its aid programmes and permitted discrimination even against itself, keeping its market open for European and Japanese goods despite their protectionist policies[33]. Under these circumstances, trade expanded rapidly as long as the US could carry the burden. Meanwhile, the Western European countries were getting together under common policies in the European Economic Community (EEC) and Japan was recovering economically.

The customs union of the EEC meant discrimination and the Common Agricultural Policy of the community especially was opposed to the American interests.

Japan which was carrying out a policy of protective economic nationalism, by maintaining an undervalued yen, was encouraging exports and restraining imports in order to reach a balance- of- trade surplus[34]. Between 1960 and 1970, world trade growth accelerated, the physical volume of manufactured- goods trade expanded 2.7 times. But the increasing competitiveness of the allies and the overvaluation of the dollar under the fixed exchange rate began to be detrimental to the US economy, causing its exports to be expensive in the world markets, creating in time a trade deficit since the US was open to the exports of the allies though it had difficulty in selling abroad. The last year the US trade balance recorded a surplus was in 1970[35]. In 1971, the Nixon administration brought new measures to increase productivity and control imports by a 10 percent surcharge on dutiable ones and the dollar was twice officially devalued, as a remedy for the trade deficit[36].

The end of the Bretton Woods system, as the currencies began to float freely in 1973 was problematic for the future of free trade, decreasing chances of predictability and stability. The US administrations, trying to cope with inflation and recession during the 1970s, drew close to protective measures and during the GATT negotiations in Tokyo in 1973, retreat from liberalism and rise of new protectionism were apparent[37]. Since tariffs were dealt with and bound by GATT, more hidden forms of protection were utilized. For example, governments began to use voluntary export restraints, orderly market arrangements... in a way organizing trade which ought to be free, through bilateral means[38]. In the US, tariffs have declined steadily from 1914 to 1986. They decreased from 59 percent in 1932 to 7 percent after implementation of the Kennedy Round tariff cuts by the early 1970s[39]. But in the face of the global economic problems of the 1970s, continuing through the 80s, non- tariff restrictions have been utilized in international trade. These barriers have existed before as well, but their significance increased with the decrease or total elimination of tariff barriers through successful GATT negotiations.

Used in higher- technology sectors and difficult to be identified; non- tariff barriers carried an increasing percentage of world trade outside the GATT, which left countries free to use NTBs according to their domestic political economic interests[40]. According to an OECD report, "within the protected sectors, the scope of protection has both deepened and widened, with the absolute number of non-tariff barriers quadrupling between 1968 and 1983" [41]. Trade increasingly became a network of bilateral and regional relationships as outcome of nationalistic approaches owing to the two oil crises causing dramatic rise in the price of oil and pushing the world economy into recession, monetary instability (floating exchange rates) and increasing interdependence. Protectionism became a means of improving payments imbalances for countries[42]. Meanwhile; placing the blame for the decline in US competitiveness, on unfair foreign actions and protectionism has led the US managers and workers to underemphasize that the reason could be lack of efficiency on their part. Also government officials have stated that the US was still supporting rules of the liberal international regime and this has become the justification for greater use of trade- distorting measures by the US[43].

The US was hardly the driving force behind trade management as faced with domestic economic dilemmas. The problem was that the means to strengthen the economy were mutually exclusive. The appreciation of the dollar in the first half of the1980s while easing inflation, further exacerbated the trade deficit problem, also causing recession with regard to increasing interest rates. By 1984, the deficit had exceeded 100 billion dollars for the first time in American history; as the volume of exports remained unchanged despite the increasing volume of imports.

Table1. US Merchandise Exports by End-Use Category, 1965-1988

(billions of $ U.S.)

	Total	*Agricultural Products*	*Industrial Products*	*Capital Goods*	*Automotive Exports*	*Other Exports*
1965	26.5	6.3	7.6	8.1	1.9	2.6
1970	42.5	7.4	12.3	14.7	3.9	4.3
1975	107.1	22.2	26.7	36.6	10.8	10.7
1980	224.3	42.2	64.9	74.2	17.5	25.4
1985	214.3	38.9	53.6	75.6	24.8	37.1
1986	227.2	36.5	57.3	75.8	21.7	35.9
1987	254.1	42.0	66.7	86.2	24.6	34.6
1988	322.4	55.4	85.1	109.2	29.3	43.4

Source: *Economic Indicators*, Aug. 1989; Council of Economic Advisors, U.S. Government Printing Office, Washington, D.C., 1989.

Note: Military shipments are excluded.

Source: Pool and Stamos, p. 53.

Table 2. US Merchandise Imports by End-Use Category, 1965-1988.

(billions of $ U.S.)

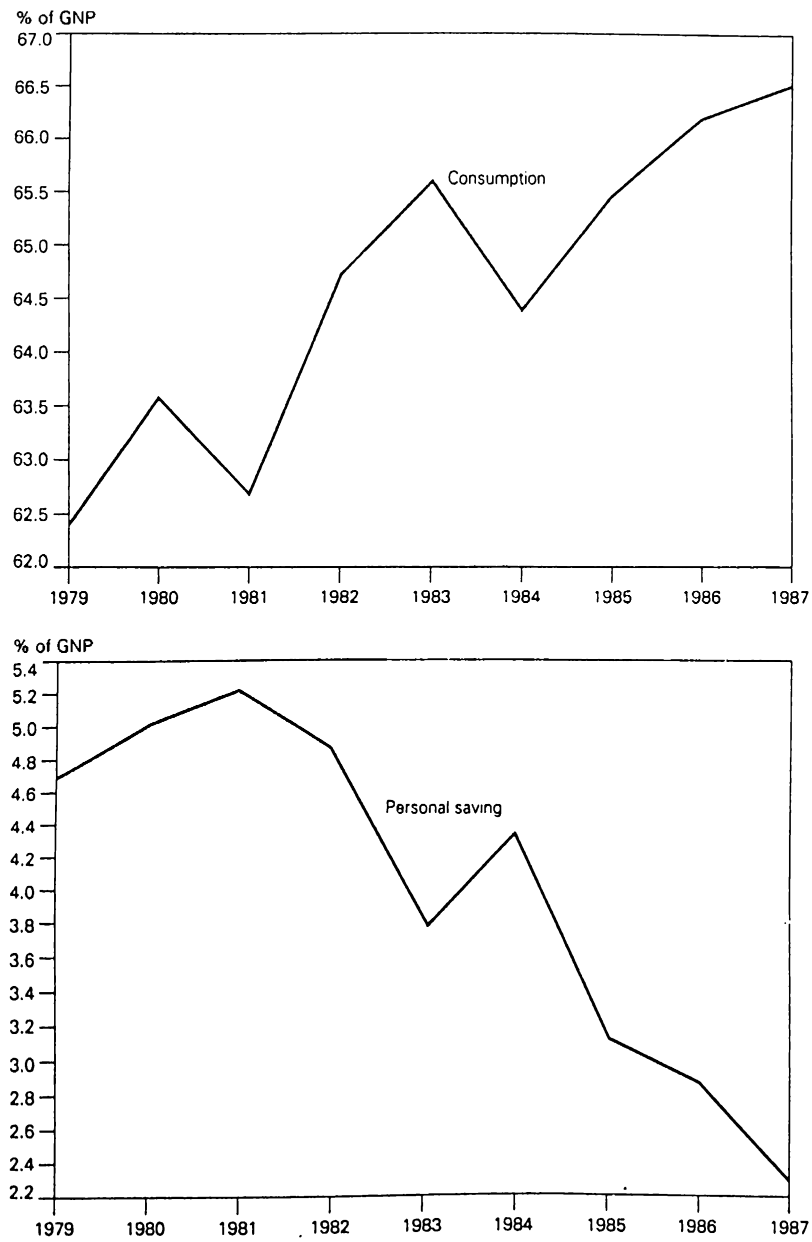
	Total	*Petroleum Products*	*Industrial Products*	*Capital Goods*	*Automotive Imports*	*Other Imports*
1965	21.5	2.0	9.1	1.5	0.9	8.0
1970	39.9	2.9	12.3	4.0	5.7	15.0
1975	98.2	27.0	23.6	10.2	12.1	25.3
1980	244.8	79.3	54.0	31.2	27.9	57.4
1985	328.7	48.8	62.7	61.4	62.2	93.4
1986	368.5	34.4	69.9	72.1	78.1	114.0
1987	406.2	42.9	71.2	84.8	85.2	125.8
1988	441.0	40.0	81.0	101.4	87.7	130.9

Source: *Economic Indicators*, Aug. 1989; Council of Economic Advisors, U.S. Government Printing Office, Washington, D.C., 1989.

Source:. Pool and Stamos, p. 53.

Tax cuts of the Reagan era tempted the Americans to consume more and spend their incomes on imports rather than saving, which was the real aim of the administration.

Figure 2. US Private Consumption, Private Saving and Government Dissaving, 1979-1987.



Source:. W. R. Cline, <u>US External Adjustment and the World Economy</u> (Washington, 1989), p. 55.

In the end, the currency markets would have to acknowledge the situation and dump the dollar[44]. This was possible only through cooperation with Japan and Western Germany, concluding the Plaza and Louvre accords in order to first depreciate the dollar and then save it from collapse. Experiencing twin deficits, the US was also dealing with a budget deficit, increasing due to continuing government (military) expenditures and began borrowing from abroad, especially from Japan which in time increased the Japanese assets in the US. What is more is that, when in 1987 Germans and the Japanese did not tolerate a rise in the American interest rates and responded by raising interest rates, the stock market crashed (October 19, 1987)[45].

The trade deficit has shown itself in two ways: the first one was related with the products in which the US has lost competitiveness (cameras, television sets... almost all produced in other countries) hence imported from abroad and the second one was comprised of intermediate products produced abroad by US firms and then imported to the US, exacerbating the trade deficit crisis. This second trend has been called outsourcing or export platforming and has become a major part of American manufacture[46]. A very pessimistic picture may be drawn but all these show that the American economy was not able to assume its post- war role of liberalizing world trade through unilateral gestures and had to solve its domestic problems in cooperation with industrialized countries. This paved the way for trade to take place outside the GATT framework, regulated by ad hoc bilateral agreements[47].

C.Finance

Concerning international finance, the US hegemony has shown itself in the form of lending and making investments abroad, acting as the primary source of capital for developing countries and the lender of last resort, in the form of lending money and providing an open market for goods produced in other countries till 1985[48]. Also it was the pioneer of foreign direct investment in different countries later on followed by the European and Japanese corporations[49]. In this section the American use of aid and foreign direct investment in the post- war era and the reasons leading to less effective use of these means by the US will be stated.

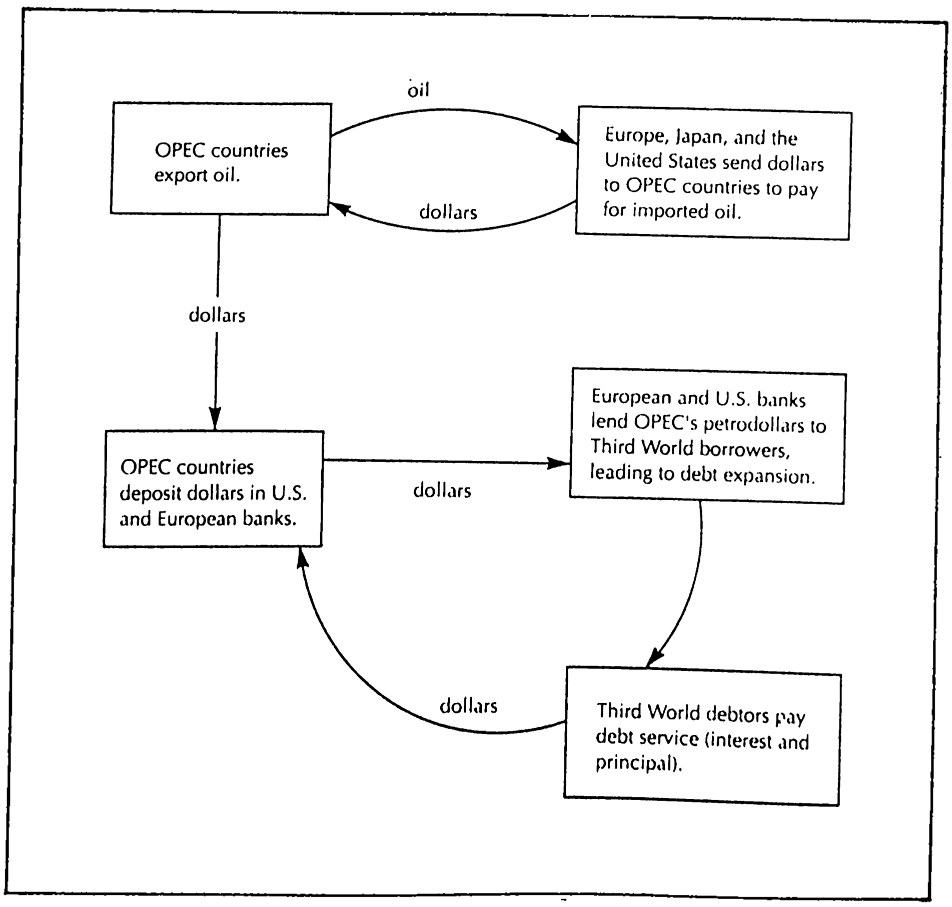
I. Foreign aid

During the era of American - led finance (1947- 1985), official foreign aid has become an important form of capital flow, beginning with the Marshall Plan with the aim of strengthening liberal economies vis- a'- vis the Soviet threat. The objectives of the aid programmes have been the restoration and reconstruction of war ravaged countries, helping underdeveloped areas to prosper and strengthening the defenses of the free (liberal) world[50]. In addition, international organizations (such as the World Bank, regional development banks and the IMF) have been established under American leadership, in order to channel capital to developed and less developed countries[51]. The US has been the largest contributor to these agencies but its share has declined in time, in the face of its domestic economic problems. In the early post- war era, American aid policy was influenced by the Cold War, making it a priority to support allies and gain new friends in the Third

World . The US also urged Europe and Japan for contribution and supported the creation of a Development Assistance Committee within the OECD, to deal with aid policies[52]. During the1950s and the 1960s, the US supported different initiatives in international organizations to increase the flow of aid to South but this did not prevent the widening gap or meet the Northern expectations of democracy or political stability[53]; since Third World saw aid as a tool, creating dependence. After the Vietnam war, many in the US began to see economic aid as a means involving the country in the internal affairs of recipients; also influenced by increasing domestic economic problems such as inflation, recession; opposition to aid programmes became apparent[54]. US foreign aid decreased from 3.5 billion dollars in 1967 to 3.0 billion dollars in 1973, meanwhile aids became tied in the sense that recipients had to purchase goods from donors[55]. Concerning foreign aid in terms of goods and services; some industries producing items for foreign aid have utilized products and services in other industries to make their finished goods, making extra expenditures. On the other hand, foreign aid has helped to increase the flow of necessary commodities and raw materials to the US and increase demand for American goods abroad[56].

In the 1970s and the 1980s, channels like trade relations, foreign direct investment and private bank loans rather than official foreign aid gained importance in the relations between North and South[57]. At the time of the first oil crisis (1973-4), as the dollar was the strongest currency, the dollar rich OPEC nations wanted to cycle their oil revenues into American and European banks. The banks faced a dilemma, they had billions of dollar deposits but in the face of the recession (that was due to high oil prices) they could not put them to work and had to lend with high interest rates to be able to pay interest to OPEC nations[58]. The capital poor Third World states borrowing money, had to pay high interests and the seeds of the Third World debt crisis were planted.The problem was exacerbated by the end of the 1970s, the second oil crisis hit the southern economies more than any. Increasing oil prices decreased the demand for the exports of these countries and increased their importation expenditures; between 1979- 1981 the money owed to the banks was more than 200 million dollars[59].

Figure 3. OPEC Petrodollar Recycling

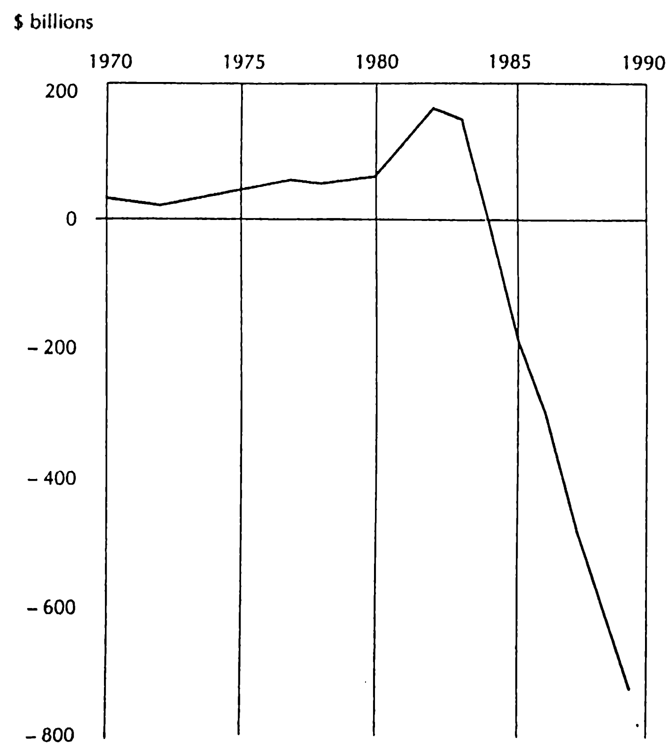


Source: Pool and Stamos, p. 143.

In the first half of the 80s, the official US government policy (Baker Plan) was that both private bank and governmental loans should be continued if debtor countries could restructure their economies, under IMF- approved austerity plans; this decreased the amount of loan flowing to South[60]. Another development concerning the crisis was the plan of the Treasury Secretary Brady in 1989 that called on US commercial banks to reduce lending and on international financial institutions (IMF, WB) to support the process by changes in their lending policies[61]. This plan also stressed a case- by- case basis in handling the debt problem and called for reforms under IMF and WB, but diverged from the Baker plan with its emphasis on debt reduction[62]. Meanwhile there were "domestic" problems to be dealt with and American banks began to give domestic loans[63]. Consumers and the government borrowed in order to consume more; also companies borrowed not to buy capital equipment to increase their competitiveness but to buy one another. This did not develop productivity but increased borrowing in the domestic realm.[64]

Concerning official foreign aid, under Reagan administration through the 1980s, cuts in nondefense components of the US budget led to shift of emphasis from development assistance to military one[65]. The Cold War was once again providing the main rationale for US foreign assistance. Other than the frustration with foreign policy results of economic aid, the US and other Western countries have lost confidence in their capacity to determine development paths of poor states. Multilateral aid has grown more rapidly than bilateral aid programmes, comprising one fourth of all Western economic assistance[66]. Other than domestic economic problems of the US preventing large amounts of official aid, the experience of the Third World debt crisis prepared ground for more multilateral aid. After being analyzed here as a lender, the "debtor" characteristic of the US should be emphasized as well. The US did not become a debtor because it went to Japan and Western Europe and asked for money; but the fact is that by 1983, the capital flow into the US began to exceed the flow of US capital investments to the rest of the world[67]. In five years' time, the world's largest creditor nation became the world's largest debtor nation. By 1986, Japan became the world's largest creditor nation[68].

Figure 4. US Net External Assets, 1970-1989.



Source: U.S. Department of Commerce, *Survey of Current Business*, Vol. 68, No. 6, June 1988.

Source: Pool and Stamos, p. 176.

The necessity to finance the US budget and trade deficits with foreign capital (selling domestic assets abroad) and the acquisition of billions of dollars by foreign central banks to support the dollar have created a US dependence on other governments[69]. The foreign investment financing the deficits, in 1985 changed from portfolio investment to direct investment in US property and businesses (especially by Japan and European countries: Germany, Switzerland, France and Italy)[70]. This made it difficult for the US to catch up in the face of its trading structure based on importation. Japanese economy while funding American government deficit became so tied with the US economy that this integration was called as the Nichibei economy and was evaluated to mask the American decline[71]. The external debt of the US, mostly privately held made the country a "safe haven" for foreign investments. Increased interest rates to cut inflation, US need for external savings to finance American domestic national debt and Japanese German surpluses, led to increasing foreign direct investments in the US. [72]

International production through MNCs composes the second branch of international finance and has become by the end of the 80s , a vulnerability for the US economy according to many scholars. But there are also ones believing that foreign owned companies have made the US economy more competitive[73].

ii. International Production (MNCs)

" MNCs are those economic enterprises- manufacturing, extractive, service and financial - that are headquartered in one country and that pursue business activities in one or more foreign countries"[74]. In the early post- war era, especially the 60s American corporations dominated the scene and profited from operations abroad in Europe, Japan and Latin America[75]. After the mid- 70s, European and Japanese corporations, even those of newly industrializing countries such as Brazil, India and South Korea have surpassed the US. At the basis of the operation of MNCs, there is product cycle theory according to which, a corporation of an advanced economy first of all experiences monopoly in its own country due to technology, then as a result of growing foreign demand, diffusion of technology and rising trade barriers, it becomes profitable to produce the commodity in another advanced country[76]. In the end, production is also shifted to less developed countries where comparative advantage becomes lower wage rates there. The intra- firm trade has become an important part of global trade. Till European and Japanese multinationals narrowed the technology gap with the US, American corporations placed important proportion of their assets abroad and gained large amounts[77]. The total book value of all direct foreign investment has increased from 158 billion dollars in 1971 to 546 billion dollars in 1981. In 1976, 47.6 percent of all foreign direct investment belonged to the US, 35.9 percent to Europeans and 6.7 percent to Japanese, but the predominance of the US declined with increase in the corporations of the latter ones[78].

Table 3. Trends in the Direct Investment Abroad of Selected Countries, Selected Years, 1971-1981.

PARENT COUNTRY	1971	1976	1981
United States	52.3%	47.6%	41.4%
United Kingdom	15.0	11.2	11.9
Germany	4.6	6.9	8.3
Japan	2.8	6.7	6.7
Canada	4.1	3.9	4.7

Source: United Nations, Economic and Social Council, Commission on Transnational Corporations, *Transnational Corporations in World Development: A Re-examination*, E/C. 10/38 (New York: United Nations, March 1978), p. 236, and U.S. Department of Commerce, International Trade Administration, *International Direct Investment*, (Washington, August 1984), p. 7.

Source:. D. H. Blake and R. S. Walters, The Politics of Global Economic Relations, (New Jersey, 1987), p. 92.

In the 1980s, the US became world's largest host for MNCs as well as being a source of foreign direct investment[79]. This led to anxieties that foreigners especially the Japanese were buying up America[80]. Gaining market shares abroad became synonymous with being competitive globally, maximizing long run returns and sustaining protection against protectionism. This trend was fostered with Reaganomics which caused interest rates to rise through increasing military expenditures and cuts in taxes and encouraged foreign investors to first, buying securities, especially government debt, than to purchase of American assets that became very cheap for foreigners after the devaluation of the dollar, in the second half of the 80s[81]. Other than the nationalistic thinking that this was "fire sale" of America and autonomy began to be lost[82], a more optimistic view suggested that there were certain benefits of foreign direct investment for America[83]. This was regarded as a sign of the increasing internationalization of the economy, strengthening the US firms and making them more competitive since investments meant new jobs, innovation and productivity. Through sustaining US investment in the face of low US national saving rate, foreign direct investment contributed to economic growth. In addition the trend was not unique to the US; worldwide joint ventures, technology and production sharing arrangements and other alliances were proof of this[84]. Still caution was widespread vis- a'- vis foreign direct investment, especially towards Japanese investments, thinking that this exacerbated American deindustrialization.

The laissez faire approach of the US caused it to make joint ventures with Japan, transporting research findings, manufacturing experience there, but facing limited local control and no technology transfer on the side of Japanese corporations[85]. Also people were thinking that US investment abroad exported jobs, decreased exportation and fostered "deindustrialization". The fear was that American economy would become just an assembler of components manufactured abroad by US multinationals[86]. Therefore, international production has become a sensitive political issue, on the American agenda. Meanwhile the role of MNCs in the development of the Third World has become a hotly debated issue, there are two opposite views; the former seeing corporations as engines of growth and the latter as agents of imperialism (dependency school)[87]. The US also continues foreign direct investment as a host country, but beginning with the 80s, control of home country has become limited and difficult in the face of a great variety of negotiated arrangements, different from the times of early multinationalism. US share of GDP (Gross Domestic Produce) has fallen from 27 percent in 1950 to 18 percent in 1984[88]. A relative decline in the ability of the US to lead international finance is apparent in both foreign aid and international production components of the field, especially in the light of the rise of other powers. The US has turned inward economically to deal with its domestic economic problems and is less active when compared with the economic hegemon of the early post- war era.

3. Hegemonic Decline

Paul Kennedy's argument in his book " The Rise and Fall of the Great Powers" that the US like its predecessors has overextended on all fronts and gradually slipped into second- rate status, having to share power with emerging power blocs in Europe and the Pacific, has been a popular one[89]. When analyzed with regard to different subfields, the relative economic decline and problems faced are easily seen. The economic rise of the hegemon in the 1950s and the 60s and development of world economy under American leadership has been stagnated in the 70s and further in the 80s, with the changing internal and external circumstances. Among the former; increasing consumption though through borrowing, importing exceeding exports and decreasing productivity can be counted[90]. Twin deficits, those of fiscal and trade, are among reasons of hegemonic decline which Kindleberger calls as " inner decay " due to heavy burdens of sustaining leadership and the free rider problem[91]. The loss of technological leadership and increasing interdependence[92] with the rest of the world, have weakened American economy and the US began importing innovative technologies from Germany and Japan in order to remain competitive in high- volume products through utilization of used off- shore production. R&D expenditures have been made in the military sphere especially during the 80s[93]. According to Gilpin, the relative loss of US shares in exports of manufactures and high tech products has been an evidence of decline in its hegemonic character.

With regard to changing external circumstances, the increasing competitiveness of Western Europe and Japan can be stated; increasing their prosperity under the US leadership, later on cooperating with the declining hegemon to mask its fall. The global economic recession of the 1970s, oil crises and the Third World debt problem have affected American economy, perhaps more than any other economy, given its pivotal role and centrality of its currency in the financial relations. According to the declinists, the evidences of the American decline are the following:

> " - mounting US trade and fiscal deficits
> - continuing and even accelerating declines in US shares of global economic power and in US rates of growth in key areas of economic performance

Table 4. Average Annual Growth Rates of Real GNP

	United States	*Japan*	*European Community*
1961–1965	4.6	12.4	4.9
1966–1970	3.0	11.0	4.6
1971–1975	2.2	4.3	2.9
1976–1980	3.4	5.0	3.0
1981–1985	2.6	4.0	1.5
1986–1987	2.9	3.1	2.5
1983–1987	3.8	3.8	2.3

SOURCE: Annual Report of the Council of Economic Advisers, in *Economic Report of the President*, Washington: U.S. Government Printing Office, 1988. Based on Table B-111, p. 374.

Source: S. P. Huntington. " US Decline or Renewal?" Foreign Affairs, vol. 67, no. 2 (Winter 1988-9) p. 83.

> sustained systemic weaknesses like R&D, education, savings, investment patterns, production of scientists (domestic mismanagement[94]) " [95].

Declinists believe that external expansion rather than internal stagnation is the main reason for decline[96]. Different scholars diverge on the priority of internal and external reasons for the decline of the American economy, which is a subjective and relative concept changing up to the beholder. Anti- declinists are optimistic about the US leadership and public willingness to reverse downward trends in the domestic economy[97]. This thesis accepts that by the end of the 80s, a relative decline was apparent.

B. Rise of Japan

1. Postwar Reconstruction and Roots of Economic Growth (1945- 1969)

Defeated and devastated in the WW2, Japan experienced a period of reconstruction, rehabilitation aided by the US, preparing the ground for the country's economic development. War brought Japan to the verge of starvation and challenged its political and economic existence. Japan was regarded as an underdeveloped country and only under the American protection, it was possible for it to establish economic, political, social and educational systems[98]. Japan, identifying itself with the West, had the national slogan of " catching up with the West" since economic prosperity was a means to be accepted by the Western community[99].

During the years of occupation (1945- 52), under the authority of Supreme Commander for the Allied Powers (SCAP), General MacArthur; efforts were in the direction of turning Japan into a peaceful democracy. Article 9 of the new constitution stated that the Japanese people would forever renounce war as a sovereign right of the nation, forbidding them to have any armed forces[100]. As in 1949 the Liberals came to power, a big reform began in order to revitalize the prewar companies, with the aim of ensuring economic recovery. Though the American occupation was formally ended in 1952, US troops remained in Japan, in the framework of the Security Treaty signed. In this era, trade agreements and provision of equipment by the US have been important for a boost to the economy. The fact that the US needed an ally in the North Pacific vis- a- vis the communist threat was effective and especially during the Korean war, America spent huge sums of money for Japan[101].

In 1949, Japan adopted a unitary exchange rate of 360 yen per dollar, preparing the basis for its admission to the IMF in 1952 and to the GATT in 1955[102]. During the 1950s, leaders of Japanese enterprises did not pay for R&D, but imported new techniques to be used in production as a mean to industrial recovery[103]. Together with strong government support and protection to growing industries[104], and gaining more than any other country from the pattern of free trade in the framework of GATT and IMF; Japan embarked on an era of economic growth fuelled with the famous National Income Doubling Plan of 1960 and in 1964 it brought down the share of its industries under import protection to 7 percent, meeting a basic criterion for participation in the world economic system. In 1964, Japan became an IMF section eight country which showed its new status as an economic power among world's free market nations[105]. In the 1960s, whole world experienced prosperity but especially in Japan income was tripled[106]. With an eye to these early developments, in the second part of Chapter 3, the rise of the

Japanese economy is dwelled on, with regard to two pillars of its economy: trade and finance, the latter involving investment and aid relations of the country. The reasons underlying the Japanese success and peculiarities of Japanese trade and finance are analyzed.

2. Trade

When Japan became a party to GATT in 1955; the international institutional framework governing trade and investment relations of the non-communist bloc in the postwar era, it began to benefit from the public good of more open access to foreign markets, without making the contribution of opening its own market. This attitude of Japan was tolerated by the US in the 1950s, but since the 60s, Japan has been under pressure of its trading partners to reduce its trade barriers [107]. Therefore Japan has not been part of two- way flows of manufactured goods, seen in the trade of most other industrial nations; as a late comer determined to catch up, it has had little interest in promotion of free trade, on the contrary has been motivated to justify protectionism. With this rationale, Japan has at the beginning put a reservation to Article 12 of GATT, allowing it to continue its extensive system of quota controls on imports, but at the same time continuing government supported export and investment promotion programs, leading to a surplus by the end of the 1960s[108].

Japan began liberalizing its trade barriers in the early 1960s but not because of a belief that liberalization would bring benefits to the Japanese economy, just due to foreign pressure and fear of utilization of retaliatory protectionist policies by other countries. Also the maturation of Japanese industrial structure and financial markets has been effective[109]. The main understanding in the Japanese business circles has been that the country should export manufactured goods in order to pay for raw material imports, given the fact that Japan has experienced serious raw material scarcity problem and has had to import these from abroad. In this way, a new term was born "processing nation", characterizing Japan which does not have raw materials itself but prospers by importing raw materials, adding value to them and then exporting the manufactured products in order to pay for the original raw materials[110].

Import- substitution policies are an important part of industrialization efforts, but the general Japanese bias toward imports, in nearly all sectors of society (academic, government, business) has been a too long, wrong and one-sided application of the comparative advantage theory to manufacturing, overemphasizing the disadvantage in natural resources[111]. Therefore, there is also no ground for intra- industry trade which means imports and exports of similar products, creating a highly criticized aspect of the Japanese trade since intra-industry trade among developed nations has increased especially in the 1980s[112]

Table 5. Intraindustry Trade in Major Countries.

	Intraindustry Trade Index (1989)		*Estimation by Lincoln (1985)*	
	All Products	*Manufactured Products*	*All Products*	*Manufactured Products*
U.S.	0.55	0.64	0.54	0.61
Japan	0.28	0.49	0.23	0.26
EC	0.85	0.91	—	—
non-EC	0.64	0.76	—	—
Germany	0.78	0.65	0.63	0.67
France	0.73	0.81	0.74	0.82

Source: MITI, Annual Survey on Trade in 1990, Lincoln (1990).
Note: *Trade imbalance effect is adjusted with respect to manufactured products.

Source. Y. Funabashi, Japan's International Agenda, (New York, 1994), p. 115.

Intra- industry trade increases product variety, creating a wider consumer choice also reduces adjustment costs of opening an economy to foreign trade since industries can remain intact, while specializing in narrower product - ranges. Japanese exports have been concentrated in industries with low intra- industry trade levels, reflecting a different trade pattern from that of other industrialized nations though Japan has also become an advanced industry, since the mid 1970s. According to Lincoln, a reason for this, other than the bias towards importation can be that an important proportion of Japanese trade has taken place with developing Asian nations that are not at a level adequate to carry out intraindustry trade with Japan. But this is the Japanese pattern when trading with the US and European countries as well[113]. As a result of this policy, Japan reached a huge trade surplus (that rose from about 35 billion dollars in 1983 to over 53 billion dollars in 1985) making the country a financial power[114], leading it to making investments abroad especially in the US, and increasing its budget for Official Development Assistance (ODA) mainly to Asian countries.

Table 6. Manufactured Imports as Percentages of GDP.

Country	1970	1980	Percentage Increase
Japan	2.41	2.87	19
U.K.	10.16	16.03	57
Italy	7.96	12.70	59
France	9.23	13.09	42
Germany	10.41	15.03	44
U.S.	3.48	5.73	64
Canada	16.40	20.20	23

Source: Derived from figures in World Bank, *World Tables*, 3d ed., Comparative Economic Data, Table 6 and country pages, Economic Data Sheet I, using current prices.

Source: A. Iriye and W. I. Cohen, The United States and Japan, (Kentucky, 1989), p. 131.

Japan's trade policy has been a reaction against restrictive measures of its trading partners and their pressures to liberalize access to its market and has become a proponent of " managed trade". Tyson and Zysman (1989) have named the Japanese trade policy as " moving band of protectionism " implying the liberalization of trade only after overinvestment in a protected domestic market, together with concentrated exports abroad. Thus liberalization has taken place slowly, gradually after catching up with the level of Western technology[115]. According to the theory of hegemonic stability, Japan has pursued a policy of myopic self- interest in trade[116], benefiting from the public good of free trade as a "free rider ", and pursuing protectionist policies. Theorists of this school believe that Japan pursued this policy in the early postwar era because it was small enough to act as a free rider and will continue to do so because it has not become large enough to stabilize the system alone, in the face of declining American hegemony[117].

3. Finance

After the WW2, during the occupation years American authorities started the moves for the liberalization of the Japanese finance and the efforts were continued by the Japanese government through the 1950s. It was in the 1960s, when Japanese banks were allowed to operate abroad and the international use of the yen and sale of Japanese equities began. In 1964, Japan accepted the IMF obligation to maintain convertibility on current account transactions and in the late 60s, emerged as a creditor for the first time which meant that the assets held abroad by Japanese nationals and corporations far exceeded the assets held in Japan by foreign nationals and corporations[118]. During the first half of the 1970s, Japanese authorities imposed controls on the capital outflows and liberalized inflows in order to deal with the government deficit but in the latter half, outflow was encouraged in the face of increasing surplus. By the 1980s, internationalization has accelerated and Tokyo became the third leg of a globally integrated financial system, after New York and London. The internationalization of Japanese financial institutions has brought further push for liberalization and outward looking policies[119].

a. Foreign Direct Investment (FDI)

Direct investment is any investment in a foreign corporation in which the fixed ratio of 10 percent or more of its stock is acquired. The Japanese foreign direct investment began in the early 1950s, but was quite small in amount (around 200 million dollars or 300 million dollars) till the 1970s and the areas and types of industries invested in were limited; mainly in developing countries and related to resource acquisition[120].

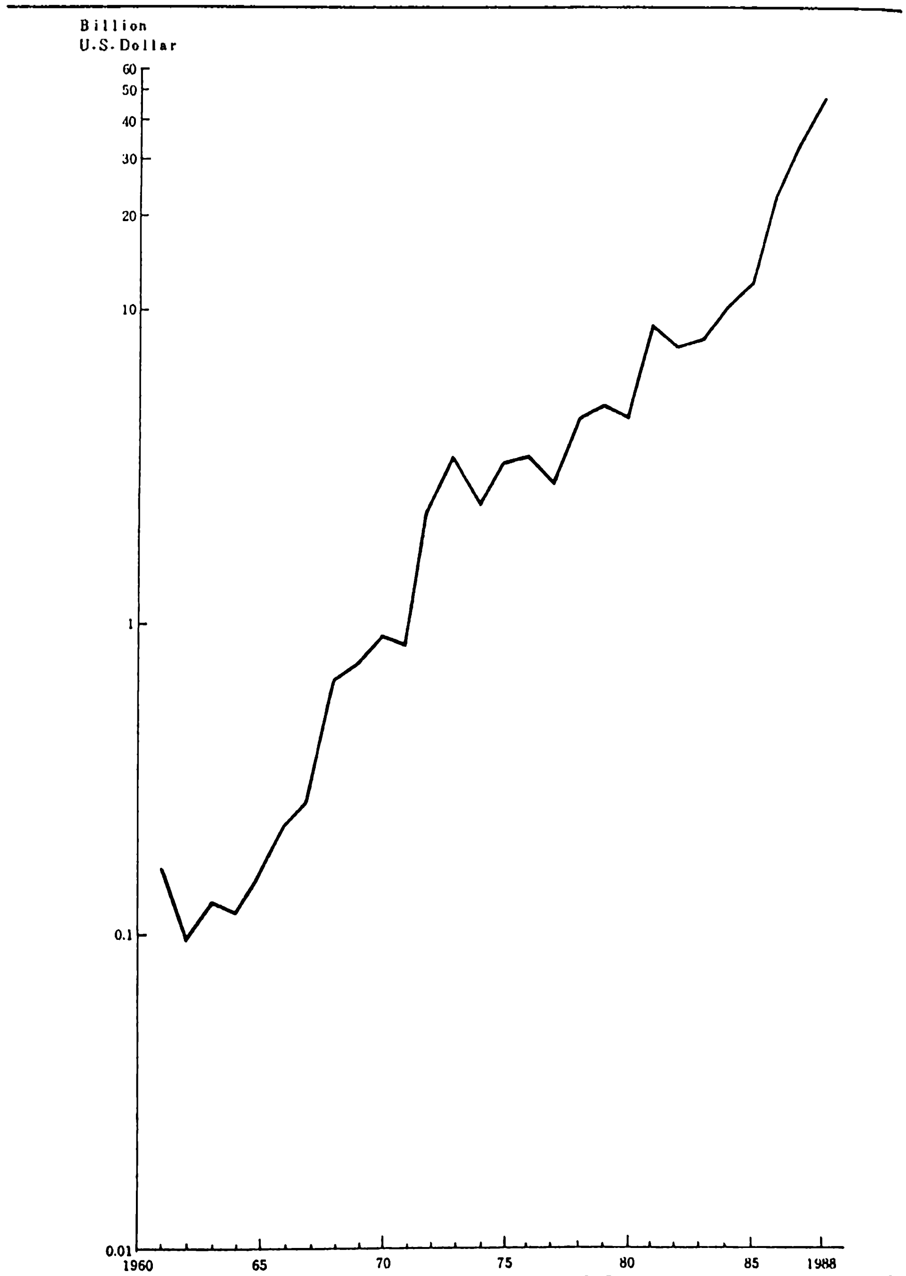
Table 7. Japan's Foreign Direct Investment by Region, 1951-1988.

	North America	(United States)	Asia	(Asian Newly Industrializing Economies)	(Association of Southeast Asian Nations)	Europe	Middle East	Oceania	Other Areas
1951-60	31.1	(30.7)	17.3	(4.6)	(9.2)	1.1	19.8	0.7	30.0
1961-70	25.0	(18.6)	21.3	(5.0)	(13.1)	19.3	8.4	7.6	17.4
1971-75	24.3	(22.0)	28.1	(10.2)	(17.6)	15.2	5.2	5.3	21.9
1976-80	28.6	(26.6)	27.3	(10.2)	(16.8)	9.5	6.2	7.8	20.6
1981-85	36.4	(34.8)	20.4	(8.7)	(10.8)	13.9	1.5	3.6	24.2
(1951-85)	32.2	(30.2)	23.3	(9.1)	(13.4)	13.2	3.6	5.1	22.7
1986-88	46.9	(45.3)	12.4	(7.2)	(3.5)	18.7	0.4	4.9	16.7

SOURCE: Ministry of Finance, *Taigai chyokusetsu-toshi no kyoka todokede zisseki.*

Source: R. Komiya and R. Wakasugi. " Japan's Foreign Direct Investment," Annals, no. 513 (Jan. 1991), p. 52.

Figure 5. Japan's Foreign Direct Investment, 1960-1988.



SOURCE: Japan, Ministry of Finance, *Taigai chyokusetsu-toshi no kyoka todokede zissei* [Statistics of approval/notification of overseas direct investment], various years.

Source:. Komiya and Wakasugi, p. 50.

The first phase of the Japanese foreign direct investment of the 1960s and the1970s was export oriented, aiming development of natural resources in developing countries, manufacturing low- tech products in LDCs - less developed countries- (Asia and Latin America) and investing in developed states (the US and Europe) in areas of commerce, banking and services[121]. The main aim of the Japanese direct investment of the era was exploiting natural resources, low wages in Asian countries and preparing ground for Japanese exports to these regions[122]. Also, Japan was transfering low technology to LDCs in the face of growth of internal capacity of its firms. After the rapid economic growth of the 1960s and the 70s, since Japan reached a huge trade surplus, Japanese foreign direct investment accelerated and the Japanese economy began to change from a trade oriented economy into a foreign investment oriented one.

At the beginning of the 70s, affected by the global recession and inflation exacerbated by the oil crisis, the Japanese growth rate fell and the surplus was absorbed by growing government deficits. But as soon as the deficits were eliminated in the late 70s by increasing taxes and decreasing government spending, Japanese investors began to look abroad for good investment opportunities[123]. Therefore the Japanese foreign direct investment that accelerated in the early 70s (exceeding 2 billion dollars in 1972 which was called as the very first year of direct investment) though stagnated between the two oil crises; remained at an annual rate of 3- 4 billion dollars and continued with a changing nature in the 1980s[124].

This qualitative and quantitative change was that Japan began to make investments in developed countries in North America and Western Europe, and in technology based industries, though concentrated before in developing nations. In this way the Japanese foreign direct investment converged toward the Western style. Especially the US which needed inflow of capital from abroad due to the fact that imports were exceeding exports, became a market, where Japan got rid of its surplus[125]. This was also how the US became a debtor nation. Meanwhile, the structural power of Japan in the financial system grew due to size and importance of Japanese financial institutions and Japan's authority over them. By 1987, Japanese banks dominated 35 percent of international banking business and the share of the US was only 17.6 percent[126]. Japan has utilized foreign direct investment as a vital means of eliminating trade barriers to its exports and has profited more from this field after the appreciation of the yen in the second half of the 1980s[127]. The appreciation was the result of monetary accords agreed upon by G- 5 countries and the falling import prices due to the falling oil prices and decreasing dollar demand in connection with this[128].

Table 8. Japanese Foreign Direct Investment: Percentage of GNP and Amount.

	1965	*1970*	*1975*	*1980*	*1985*	*1988*
Percentage	0.5	0.7	1.7	1.8	3.4	4.0
Amount[b] (billions of U.S. dollars)	0.4	1.5	8.2	19.5	45.0	113.1

[a] Two kinds of statistics are available for calculating Japanese FDI: one from the Ministry of Finance is based on the notification/approval, and the other is based on statistics for balance of payments. In this table, the accumulated FDI from Japan was calculated from Bank of Japan, *Kokusai Shūshi Tōkei Geppō*, June 1969, p. 47; August 1976, p. 47; September 1986, p. 53; December 1987, p. 61; and January 1989, p. 63. Calculation of GNP in dollars is based on International Monetary Fund, *International Financial Statistics*, July 1972, pp. 210–13; January 1978, pp. 204–7; August 1982, pp. 240–43; June 1986, pp. 286–89; and July 1989, pp. 314–16. Except for 1965, application of the exchange rate is based on the average annual par rate/market rate.

[b] Accumulated amounts based on balance of payments.

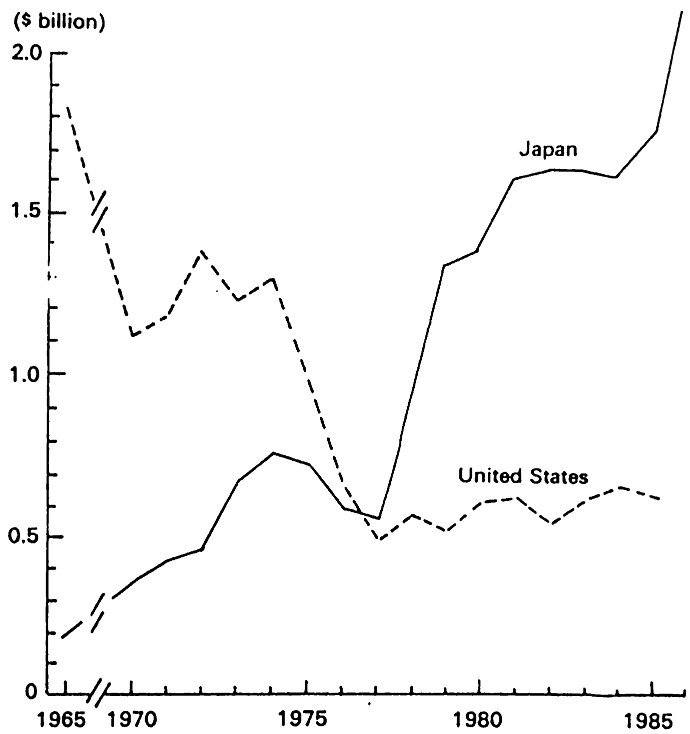
Source: Y- K. Yoon. " Japanese FDIs in the 1980s," World Politics vol. 43, no. 1 (Oct. 1990), p. 5.

Another advantage of foreign direct investment for Japan has been the utilization of labour in the home country (since labour market in Japan has been at a decline due to falling birth rate); in order not to stagnate manufacturing fuelled by technological superiority of the country. The critics of the Japanese foreign direct investment emphasize that the activity may cause unemployment at home or inadequacy of production experience and export of new techniques found as result of R&D efforts in Japan.

b. Foreign Aid Policy

Another field where the relative rise of Japanese economy has become apparent is the use of foreign aid by Japan as a means to increase its structural power, that is the Japanese ability to indirectly influence the environment in which other states operate[129]. During the 1950s and the 60s, the aid program of Japan has been affected by the country's narrow economic interests, since aid giving started with war reparations and economic assistance to Asian countries, especially with the aim of expanding Japanese exports and raw material imports from Asia[130]. After joining the Development Assistance Committee of the OECD in 1961, Japan has increased its aid efforts[131]. Following the first oil shock of 1973, Japan's efforts to secure supplies of energy and other resources affected its trade- oriented aid policy. But as the Japanese economy grew; in 1977, under pressure from other countries, the government announced a three year plan to double Japan's Official Development Assistance (ODA), extending it to Africa[132]. Concerning assistance to Asian countries, Japan surpassed the US in 1977[133].

Figure 6. ODA to Asian Countries from Japan and the US, 1965-1985.



Source: OECD Development Assistance Committee statistics (calendar years)
Note: Figures represent the total of net disbursements to East, Southeast and South Asia.

Source: J. Inada. " Japan's Aid Diplomacy," The International Relations of Japan , ed. K. Newland (London 1990), p. 101.

Since the late 1970s, Japanese administrations have emphasized a more active role in multilateral international efforts and chose foreign aid (ODA) as a major means of achieving this aim[134]. There are certain peculiarities of the Japanese ODA, stated below:

1. Emphasis has been on Asian countries

2. Yen credits, requiring repayment of principal and interest have been prefered and extended especially for infrastructure projects (as remedy for public goods deficiency in developing countries)

3. Aim has been encouraging efforts of development[135]

Beginning in the 1980s, a changing nature of ODA was that Japan has become more generous in direct aid to developing countries and has become more liberal with long- term development loans[136].

Table 9. Japanese Official Developmental Assistance, 1970-1989.

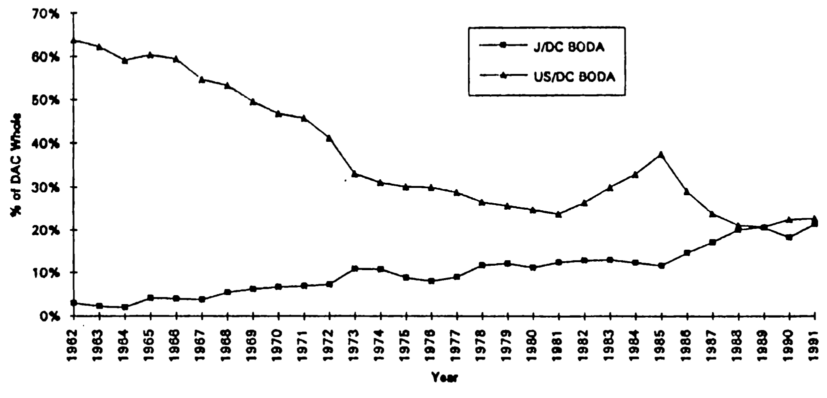
Country	1970	1975	1980	1985	1986	1987	1988	1989
				Total Net Flows (US$ billions)				
Japan	0.458	1.148	3.353	3.797	5.634	7.342	9.134	8.949
(% OECD total)	6.57	8.28	12.28	12.90	15.36	17.65	18.98	19.16
United States	3.153	4.161	7.138	9.403	9.564	9.115	10.141	7.676
France	0.971	2.093	4.162	3.995	5.105	6.525	6.865	7.450
Germany	0.599	1.689	3.567	2.942	3.832	4.391	4.731	4.949
Italy	0.147	0.182	0.683	1.098	2.404	2.615	3.193	3.613
United Kingdom	0.500	0.904	1.854	1.530	1.737	1.871	2.645	2.587
Canada	0.337	0.880	1.075	1.631	1.695	1.885	2.347	2.320
Netherlands	0.196	0.608	1.630	1.136	1.740	2.094	2.231	2.094
Sweden	0.117	0.566	0.962	0.840	1.090	1.375	1.534	1.799
Total OECD	6.968	13.855	27.296	29.429	36.663	41.595	48.114	46.697
				As Percentage of Donor GNP				
Sweden	0.38	0.82	0.78	0.86	0.85	0.88	0.86	0.97
Netherlands	0.61	0.75	0.97	0.91	1.01	0.98	0.98	0.94
France	0.66	0.62	0.63	0.78	0.70	0.74	0.72	0.78
Canada	0.41	0.54	0.43	0.49	0.48	0.47	0.50	0.44
Italy	0.16	0.11	0.15	0.26	0.40	0.35	0.39	0.42
Germany	0.32	0.40	0.44	0.47	0.43	0.39	0.39	0.41
Japan	0.23	0.23	0.32	0.29	0.29	0.31	0.32	0.32
United Kingdom	0.41	0.39	0.35	0.33	0.31	0.28	0.32	0.31
United States	0.32	0.27	0.27	0.24	0.23	0.20	0.21	0.15

Source: IMF, *World Development Report*, 1990.

Source: P. J. Meeks. " Japan and Global Economic Hegemony," Japan in the Post- Hegemonic World , eds. Akaha and Langdon (Colorado, 1993), p. 64.

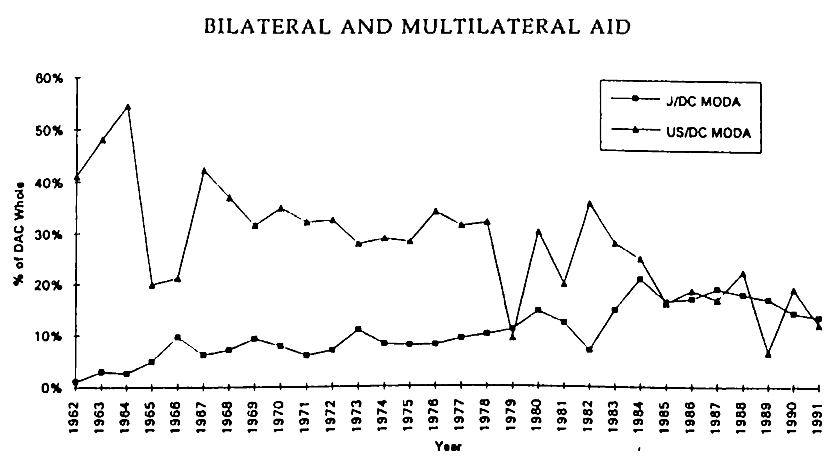
Japan began using ODA for supporting development of democracy and reduced the level of its tied aid[137]. Another characteristic of Japanese ODA has been the cooperation of government and private business firms in providing assistance. The Japan Overseas Development Corporation (JODC) exemplifies this trend and has been funded by both Japanese government and private sources[138]. The function of this institution has been to send Japanese technicians abroad to train local workers and finance small sized Japanese firms investing abroad and import goods produced by Japanese joint ventures. In the 1980s, most of the projects financed have been in East Asia and especially in ASEAN (Association of Southeast Asian Nations) countries and the Japanese have been teaching a great deal to these countries about industrial policy. A strong sentiment in these recipients has been fear of domination by Japan but still they prefer their economies to be tied to that of Japan's. In fact this has been a general problem of Japan, since Japan's money is welcome but its voice is not[139]. Even in international organizations where Japan has made greater contributions, this has happened so. [140] In the dollar terms, bilateral aid in 1980 was more than 500 percent of that in 1970 and multilateral aid was 1.500 percent[141]. By the mid 80s Japan became a major funder of World Bank Group and specialized agencies of UN[142].

Figure 7. Japan and the US Shares of DAC Bilateral ODA



Source:. D. B. Bobrow and M. A. Boyer. " Bilateral and Multilateral Foreign Aid," <u>Review of International Political Economy</u>, vol. 3, no. 1 (Spring 1996), p. 108.

Figure 8. Japan and the US Shares of DAC Multilateral ODA



Source:. Bobrow and Boyer, p. 109.

In 1987, 72 percent of Japan's loans were general untied loans, the same year the government announced that it would provide 500 million dollars in untied grants to African countries, which was the first case of untied grant aid[143]. In 1988, Japanese ODA totaled 9.13 billion dollars from 458 million dollars in 1970 and 3.35 billion dollars in 1980, putting Japan neck and neck with the US, for the title of largest aid- donor country[144]. In 1989, Japan passed the US in provision of development assistance[145]. Foreign aid has been an important strategic means for Japan and it is up to Japan to further the utilization of this economic means or not, through sustaining a current account surplus sufficient to fulfill what is expected from it[146].

4. The Japanese Challenge

The structural power of Japan in the international economic system has grown in line with positive developments in trade and finance pillars of its economy, since the 1950s and has become one of the advanced industrial countries. Japan has certain peculiarities of its own, concerning its trade, investment and aid relations. These have constituted a successful and growing economy and at the end of the 1980s, Japan has come to a point of challenging the US economically, which has been at a decline since the beginning of the 70s. The new economic status of Japan has increased the expectations of the other countries that it could participate more in international cooperative efforts, thus not only benefiting from profits of interdependence and internationalization in the economic sphere. The public opinion in Japan has also been changing in this direction[147]. Japanese officials also seek to increase Japan's status and role within international organizations such as the IMF, WB, UN and also among the G- 7 countries[148]. Meanwhile, the internationalization of Japanese economy has led to openness and liberalization, though limited and one- sided.

Since the 1970s, international political economy has witnessed dramatic changes; the one emphasized in this thesis is the economic decline of the ex-hegemon: the US and the economic challenge to it from Japan. Under the light of this analysis covering the period between 1970- 1989; the US- Japan economic relations that have a pivotal role in world economics, is elaborated in Chapter 4; with an eye to the post- Cold War developments and their repercussions on this relationship.

IV. THE US- JAPANESE ECONOMIC RELATIONS (1945- 1997)

A. Nature of the Relations

In the US- Japanese economic relations, there is a growing interdependence that has its roots in the post- World War 2 circumstances, when the US played the role of protector and rehabilitator for the war- torn Japan; making it a dependence era: that of Japan on America[1]. Under the American security umbrella and liberal economy, the burdens of which were carried by the US; Japan prospered, and, by the early 1970s, became an important economic power. Meanwhile, the US was experiencing serious economic problems (such as stagnation and unemployment) and began to lose the status of " hegemon of the post- war era". There has always been an "asymmetry" concerning the Japanese and American economies and in the 1980s this has shown itself as the dependence of the US on the Japanese credits and investments, as a debtor nation[2].

Economic interdependence has become inevitable in today's global economy whichever branch we analyze; in money, trade and finance, transactions have become borderless and integration with the world economy has become key to revival of domestic economies[3]. At this juncture, a continuing debate concerning the American and Japanese economies is whether the latter's rise has been detrimental to the survival of the former. American cynics blame the Japanese for their protectionist economic policies, believing these have fostered stagnation in the US. On the other hand there are scholars who believe that Japan has become a scapegoat and the unsuccessful economic performance of the US is the only reason for its own economic problems. The economic frictions between the two countries, especially the trade issue has become a politically sensitive one, used by politicians with election concerns and necessitates careful management.

Today there is no power to match the qualities required of a hegemon, as stated in Chapter Two of this thesis. When the US and Japan are evaluated with the criteria for being a hegemon, such as the economic, political and military leverages enjoyed simultaneously, the former lacks the economic strength and the latter does not have the military power needed. Both of these countries are powerful and effective in world politics; their strengths emanating from different sources of power[4]. The US is still militarily very strong after the end of the Cold War and has been facing domestic economic problems hence an economic decline since the early 1970s. On the other hand, Japan which makes very little defense expenditure has become an economic giant, as a result of its rise since the late 60s but especially the 80s. Under the post- Cold War global circumstances, where the economic relations have gained new prominence with the disappearance of the Soviet threat; the dialogue and cooperation between the US and Japan have become important determinants in the global economy. In the late 90s, the provision of the international economic public goods is up to the relations among wealthy nations (G- 7) where the American- Japanese dimension deserves special attention. In this chapter, this relationship (1945- 97) will be analyzed with respect to three spheres: trade and investment, technology, and macropolicy coordination; with an eye to successes and failures.

B. Trade and Investment

1. Trade Relations

The trade issue has become the most debated problem, concerning the American- Japanese economic relations. According to Abdul M. Turay, trade frictions have emerged due to loss of US competitiveness that has made it difficult to improve the trade imbalance even through the devaluation of the dollar (making American products cheaper in foreign markets) and the saving- investment imbalance between the two countries which denotes a high saving rate in Japan, causing a low level of consumption of products also including the American exports. On the other hand in the US the consumption level and especially that of imports has always been high[5]. Meanwhile protectionist methods have also been an obstacle to improvement; ironically the US tariff rates have been higher than those in Japan but the utilization of non- tariff barriers (NTBs) by the latter worsens the imbalance[6]. Such as Foreign Trade Zones (FTZ) where imports are stored, inspected, repackaged or combined with components made in Japan[7].

After the first half of the Cold War, by the end of the 1970s; an economic cold war between the US and Japan began and was exacerbated by the penetration of the Japanese investors to the American economy, in the 1980s [8]. The devaluation of the dollar could not solve the problem of the large American trade deficit with Japan. During the reconstruction period of the 1950s, when the US supported Japan in rebuilding its industry, it tolerated the " keiretsu " structure of Japanese companies which meant that they cooperated informally; fixing prices, dividing markets among themselves. The US was also ready to open its market to Japanese exports though Japan was reluctant to do the same to America. The first trade deficit emerged under these circumstances, in 1968[9]. Till early 1970s, security cooperation had the priority and this burdensome economic cooperation continued. After the 1970s, though the security issue remained important; trade frictions rose since Japanese firms expanded in export markets and their growing trade surplus with the US began to threaten the already declining US economy. Vaguely worded trade negotiations hardly helped ease the situation[10].

Even during the reconstruction period, the US had urged Japan to lower its trade barriers in accordance with GATT and pressured Japan to curb its textiles exports to the US, by 1957. Finally in 1971, the US took the measure of adopting a discriminatory 10 per cent duty on Japanese imports[11]. The trade frictions that began in low tech sectors such as textiles in the late 60s were carried to high tech industries such as semiconductors in the 1980s[12]. In 1985, the American trade deficit reached 117.7 billion dollars while Japan had a trade surplus worth 50 billion dollars with the US. A year later the US was taking certain measures, for example it wanted an agreement from Japan to guarantee American semiconductor producers, share of the Japanese market[13]. During the same period, Japan began to restructure its economy, reducing the role of exports and increasing domestic demand in order to expand imports. The ratio of manufactured imports to Japan's total imports increased from 31 percent in 1985 to 50 percent in 1988- 9. An improvement was seen in the bilateral trade imbalance since the trade deficit dropped to 55.4 billion dollars in 1988, from 59.8 billion dollars in 1987[14]. But these were not adequate to satisfy American demands; economic problems in the US caused the trade deficit issue to become a politically sensitive one[15].

In the face of the Japanese perception that importation is equal to vulnerability; bilateral negotiations have proved to be fruitless. For example, concerning the Japanese rice market, American penetration has been very difficult since the Japanese see rice as a very important part of their culture and have been sensitive not to import rice[16]. It was in 1993 that Japan ended the ban on importation of rice. The Japanese believe that it is the American economic short-comings not the Japanese NTBs that cause the trade deficit [17] . A common belief in Japan has been that the country should trade and export to live and the Americans failed due to ignoring exportation and insisted on being a consumer society, interested in short- term profits rather than long- term investments, such as R&D activities in order to increase their competitiveness[18]. The 1990 Structural Impediments Initiative (SII) talks and the June 1990 US- Japanese Trade Agreement have stated what the two should do to put their houses in order first, enabling them to better their relations. According to SII, the US should put its fiscal house in order, improve its elementary and secondary educational system, increase savings, take a longer term view in its business planning and improve its international marketing skills and ability to commercialize innovation. Meanwhile Japan would open its markets, modernize its distribution system, improve housing and public infrastructure, change its land policies, agricultural subsidies, institute a social welfare system appropriate to a modern industrial society and provide consumers with larger fraction of fruits of Japanese economy. But verbal commitments have not been realized[19].

Table 10. US- Japanese Trade Agreement, June 1990.

United States	*Japan*
1. Cut the federal budget deficit and reduce government debt	Increase spending on public works to $2.77 trillion in the 1991-2000 decade
2. Stimulate private savings and investment by creating family savings accounts, enhancing existing individual retirement accounts and cutting capital gains tax	Reduce from three days to one the time it takes for imports to clear customs
3. Revise laws to allow for new joint ventures, limit product liability awards and stimulate investment in new plant equipment and research and development	Crackdown on bid-rigging, price-setting, oligopolistic behavior and coercive business practices that limit competition
4. Improve education and job training programs	Revise land policy to tame skyrocketing real estate prices
	Amend regulations to liberalize trucking, retailing and pharmaceuticals industries
	Improve patent protection for foreign companies.

Source: A *Los Angeles Times* Report; *Tampa Tribune*, Friday, June 29, 1990, p. 2-A.

Source: US- Japanese Trade Agreement, June, 1990. Conteh- Morgan, p. 127.

With the end of the Cold War thus that of the military and ideological threat Americans were faced with, they turned their attention to issues of economic well- being at home and economic competition abroad[20]. In 1992, the trade white paper issued by MITI stated that Japan should increase domestic demand for making trade more reciprocal[21]. Again the same year, President Bush during his visit to Tokyo asked for assistance to the troubled US automobile industry[22]. But the closure of Japan's market and the vulnerability the US experienced due to its interdependence with Japan continued. The July 1993 "framework" agreement between the two countries committed the US to deficit reduction, pledging continued openness of American markets and committed Japan to reduce its global current account surplus and to new policies to increase imports. But the two parties could not agree on the time span and extent of these reduction and expansions[23]. Unable to meet the deadlines, talks were suspended by 1994. A little improvement in the merchandise trade deficit took place the same year due to increase in the volume of US exports [24].

In 1995 the US had a surplus with Japan in services trade - more than 17 billion dollars-. But in general Japanese limitations on importation continue. Also bilateral and sectoral trade negotiations as a means to solve problems has come to its limits. What is interesting is that today the US can not do anything about Japanese protectionism because Japan imports substantial amounts of products and services, and adheres to most of the international rules, disciplines of World Trade Organization and the OECD[25]. Therefore the US does not have a convincing argument to remove Japanese barriers to trade. Structural adjustments in both countries rather than sectoral trade confrontations to open certain markets can ease the situation. International consensus and pressure through G-7, WTO and OECD may help more, by discussing issues at multilateral forums. This would also be in the interests of other states since US- Japanese managed trade would be detrimental to them, replacing free trade with regionalization. This trend can be stopped by cooperation, which necessitates the existence of similar perceptions and this is the point the difficulty stems from[26]. But this may even be a competitive type of cooperation because of the mutual economic vulnerability caused by increasing interdependence. Some scholars e.g. Conteh- Morgan evaluate the negotiation attempts of the two countries as the process of developing a separate trade regime to regulate the US- Japanese economic relations[27] . But these have not reached either American development or Japanese openness in trade, to the extent aimed for.

2. Investment

The American overseas investments that have accelerated in the post-WW2 era have been surpassed by those of other leading economic powers, one of them being Japan. Especially in the 1980s, Japanese foreign direct investment in the US has increased dramatically, adding one more area of friction to the economic relations of the two countries. Though economists stress the advantages of liberal trade and investment policies and show the weaknesses of the American economy, American politicians running for re- election have turned the issue into a politically sensitive one, in the form of worries about " the selling of America to foreign investors"[28]. In today's interdependent world economy, what the US needs is improvement in its competitiveness, rather than limiting Japanese investments and labeling this country as a scapegoat[29]. The dollar devaluations of the 80s were aimed at increasing American exports but at the same time they decreased the costs of Japanese investments in the US assets and helped finance the huge US budget deficit and military spending, without taking the long- term effects into consideration, as Japan in time increased its market shares in America[30].

By the end of 1987, Japan had direct investments worth 33 billion dollars in the US, meanwhile US direct holdings were worth only 14.3 billion dollars but this number made the US Japan's largest foreign investor[31]. The high rate of savings and investments in Japan has made the country home of world's leading enterprises investing abroad[32] and the US with its high consumption level and twin deficits of trade and budget, has been receptive to these multinationals[33]. In the 1990s, a growing trend for Japan has been manufacturing more overseas than exporting from home. This change in the Japanese economy has taken place with divergence of corporate, public and private interests the harmony of which once made the country an export leviathan[34]. Breaking their keiretsu relationships, the Japanese MNCs are competing even at home, reflecting "a truly multinational set of norms for corporate behavior"[35]. Rather than American or Japanese business styles as in the 1980s, best practices of each are merged and applied. Under the light of these developments; the US has to survive in a more challenging and competitive environment and the increasing economic interdependence worldwide, increases the vulnerability of the US and Japan vis- a- vis each other.

C. Technological Developments

Among the most debated issues in the American- Japanese economic relations, "competitiveness" in technology also has an important place, since know- how is the basis of production. The US is at the verge of losing technological leadership[36]. Other than inadequacy of economic resources to be devoted to R&D in the face of domestic economic problems and huge military expenditures[37]; the US seems to experience a disadvantage in access to Japanese know- how though the latter is more advantageous. This asymmetry also has its roots in the post- WW2 era when the US permitted transfer of its technology to Japan, for the technology is the basis of economic recovery.

In the occupation era, American management training exports, industrial statisticians and other specialists went to Japan in order to advise on selling abroad for surviving economically[38]. Japanese students began to study at American universities[39]. In this way, the US licensed technology to Japan. But even after Japan prospered and became able to afford scientific and technological studies; the structural difference between the ways Japan and the US conducted research, made it difficult for the US to reach the findings of Japanese studies. This is because the US develops technology at universities (basic research) which is open to academic consortia but Japan uses industrial laboratories (process and production technology), restricting the use of findings[40]. Also, few US scientists do research in Japanese but the Japanese are more willing to learn English and study in America. Thus there are certain structural and economic obstacles for the US. Americans should save more in order to spend on improving their technological capability and production system[41].

A more optimistic view by Conteh- Morgan is that Japan and the US cooperate even in military technology and the triumph of this was apparent during the Gulf War, concerning the weapons used. Japanese machine tools have become vital for the American military. Still there are suspicions and conflicts which can be evaluated as seeds of technonationalism. A common belief in the US is that Japan cooperates with the US in R&D for access to advanced technology and is good at exploiting US know- how. On the other hand, the Japanese state that the US engages Japan to its projects when it cannot afford them[42]. For example in 1983 the US government funded 29.3 percent of all business R&D expenditures while the Japanese spent just 1.8 percent. In the same year, the US has started using retaliatory measures for Japanese protection of patents[43]. In the face of continuing American demands for reciprocal flows of technology from Japan; technonationalism is an important threat and obstacle to attempts for increasing competitiveness[44]. Therefore science and technology are among areas necessitating conscious coordination and cooperation.

D. Macropolicy Coordination

Macropolicy coordination proves to be a difficult arena for cooperation, due to different priorities, structures of different economies; though it is extremely important in the face of lack of a hegemon dominating the world economy[45]. The US and Japan; the former ex- hegemon and world's largest debtor and the latter as the new financial leader and world's largest creditor have an important place in the coordination efforts. According to Takatoshi Ito, policy coordination is advantageous for two reasons; the first is spillover effects of welfare improvements and the development of the world economy rather than effects of contrasting national efforts. The second is that through coordination; governments are prevented from taking short- sighted policies especially when they face political difficulties[46]. On the other hand, though theories support coordination, in the real world, it is very difficult for countries to have the same "true" model of the world economy, cooperate on it and enjoy benefits[47].

An analysis of the second half of the 1980s when coordination efforts were frequent, shows the difficulties and weaknesses of multilateral management; concerning the international monetary system, free trade and institutional harmonization. The Plaza (1985) and Louvre (1987) Accords that are analyzed in Chapter Three have proved to be fruitless in the long- run due to weakness of the American economy and the unwillingness of major developed countries to bear the burdens of other economies. The positive short- term effect of the Plaza Agreement (September 22, 1985) on the US - depreciation of the dollar- should not be taken as a realistic model for future coordination[48]. This has not caused improvements with regard to trade and capital account imbalances. Still the accord is a unique example of a deal where the G- 7 have agreed on more than just a willingness to cooperate, which may for the future prove to be the difficulty of collective leadership up to the hegemonic stability theory.

E. Global Impact of the US- Japanese Economic Relations

An overall view on the US- Japanese relations in spheres of trade, investment, technology and macropolicy coordination gives a pessimistic picture if evaluated with high expectations for cooperation. Especially when considering the decline in the economic capabilities of the ex- hegemon, the US and the economic challenge rising from Japan; cooperation between the two countries becomes even more important. Of course they are not the only ones to carry out the responsibility of sustaining harmony in global economic relations, the cooperation of all countries is needed. But as the US and Japan together account for 40 percent of world GNP, the vitality of their contribution is obvious[49] After the end of the Cold War; the perceptions, interests of the two seem to differ more but given the increasing interdependence of the world economy and the priority of the economic issues, cooperation is inevitable. But the success of the attempts necessitate structural changes in the economies of the US and Japan and greater harmonization. After an analysis of the relations, Chapter Five dwells on the future prospects for the coordination of international economic relations with regard to American and Japanese contributions to it. It evaluates possible scenarios, according to the hegemonic stability theory.

V. CONCLUSION

Up to this point, this thesis has shown the complex nature of the US-Japanese relations, the basis of which has been the "1960 Treaty of Mutual Cooperation and Security" creating a Japanese dependence on the US for its defense and foreseeing economic development for the country. But the 1970s, during which the US has declined economically, lost its hegemonic abilities and at the same time been challenged by Japan; have brought a new characteristic to the relationship: mutual vulnerability and increasing need for collaboration. An important difficulty stems from the fact that the two countries have different perceptions. For example for the Americans, security and economic issues have always been closely related and the US has accepted making economic concessions for the sake of security interests. On the other hand for the Japanese these two spheres have been treated as totally different ones, giving priority to the economic sphere [1].

After the end of the Cold War; with the evaporation of the communist threat combined with the extermination of the hegemonic capabilities of the US (in the economic arena not the military) since the 1970s; economic frictions between the US and Japan have come to the fore. There are strong sentiments in both countries vis- a- vis each other. The opinion poll conducted by Louis Harris and Associates in July 1989 in the US showed that 68 percent of American respondents saw the economic threat from Japan as a bigger threat to the future of their country than the Soviet military threat. Meanwhile, the Yomiuri Shimbun poll of July 1991 in Japan showed 24 percent rating the US as a security threat versus 22 percent for the SU and another poll stated that only 48 percent of respondents believed that their country benefited from its security relationship with the US[2]. Long standing biases and economic rivalry may be more effective in the face of lack of a common enemy which used to be the SU and a hegemon (that used to be the US) to regulate international economic regimes (money, trade and finance relations). The American market still is the largest, the dollar is a major currency in the monetary system and the US has unmatched nuclear capabilities[3], but these are not adequate to make the ex- hegemon reassume its role. Under these circumstances multilateral cooperation not only with Japan but with other advanced countries becomes vital for a liberal economic world order to function.

According to E. Ahmad, the American accusations on Japan that the latter uses harsh, unfair capitalist practices, are similar to those argued by the developing nations regarding their relations with the Western countries. Therefore the US should catch up with Japan; since there is no more a paternalistic relationship between the two countries, this is the most the US can do[4]. Many political economy scholars and the Japanese themselves believe that Japan is not ready for a global leadership role. To assume such a responsibility, even if Japan had all the capability, the political will should exist as well[5]. Still, Japan has begun questioning its dependence on the US and its new generation wants to take more steps alone. The Pacific Basin has become a region of competition for Japan and the US since the latter is cautious about prospects of Japanese leadership in the region because

Japan seems eager and capable of playing such a role. Though the Asian nations are hesitant about relying on Japan which once had imperialist aims on them, the US does not want to risk the large market there[6]. Hence this is one of the conflict-ridden issues but there is a reasonable consensus that the leadership prospects for Japan is limited to the Far East and this is possible as long as the Pacific nations are ready to see Japan as a model, rather than a rival.

According to the hegemonic stability theory, there are four possible scenarios for the future, debated by political scientists [7]:

1. A second phase for the Pax Americana,
2. Bigemony shared by the US and Japan,
3. Pax Consortis among major advanced states,
4. Pax Nipponica with the rise of Japan as the new hegemon.

The first scenario foresees a continuation of the US leadership in the framework of the same division of labor for the US and Japan which means that Japan continues financing US foreign policy goals which it conceives to be the same as its own perceptions, despite the end of the Cold War. Therefore Japan supports the endurance of the American hegemony and continues with the Yoshida Doctrine of conservative pacifism[8]. The second option, bigemony denotes a co-equal leadership of the US and Japan as a result of the integration of the economies of the two countries. According to this model, the economic strength of Japan also turns into military power and the US and Japan cooperate in this field too, sharing equal status. Pax Consortis reflects a truly idealist balance of power system with no hegemon, where many consortia among major actors in the form of different coalitions and agreements regulate the inter- state relations[9]. Here, the civilian role of Japan shows itself in fostering a world free from military solutions, as the economic issues have become prior to military ones in the aftermath of the Cold War. It is an active economic policy making the country politically powerful and effective. But the most active role for Japan is put forth by the fourth scenario: Pax Nipponica which is Japan's rise to hegemony becoming number one and governing international regimes.

Japan has really economically challenged the US but for becoming a hegemon - according to the neorealist theory- supremacy in the military sphere is a prerequisite too. Therefore for this model, a neutralisation of nuclear powers is needed for Japan to lead the security arena[10]. Elimination of military solutions is a nice hope for the future but is not realistic. The continuing post Cold War regional rivalries and the armed solutions to these prove that the trend is not in the direction of nonmilitarization. The Gulf and Bosnian wars are perhaps the most impressive examples. The national interests of states continue to rival with those of each other and economic frictions, ethnic conflicts, territorial claims... replace the ideology based problems of the Cold War. To sum up, Japanese hegemony or a joint leadership of the US- Japanese (neglecting the economic frictions the two countries have)are less probable than the endurance of status quo, a second phase of Pax Americana supported by Japan and other advanced countries, including an enlarged European Community which in the longer term may take the form of Pax Consortis. But the likelihood of this prospect is limited since it would necessitate the circumstances required for a smoothly functioning United Nations; so that the developed countries (G-7) could act as banker, gendarme and environmentalist[11]

This thesis has analyzed dynamism in the "economic" relations between the US and Japan, underlining the weaknesses in the American economy and the developments in the latter's economy. Hence Japan has come to a position to challenge the ex- hegemon economically. Taking the "hegemony" concept as a whole "not dividing it to different fields" (such as military hegemony, economic hegemony), the study concludes that today there is no hegemon and the most probable picture is one of multilateral cooperation to sustain the American origined international regimes, necessitating the advanced countries to see this in their interest. On the other hand; an overall economic analysis of the US- Japan relations proves a challenge from Japan, enough to create a real interdependence which at the same time acts as a catalyst for cooperation, though it can be of an adversarial type, in the face of mutual vulnerability.

The existence of economic conflicts such as the trade and investment imbalances, difficulty of macropolicy coordination and asymmetry in technology transfers do not necessitate an "economic war" or a "second cold war". Still a cooperation limited to the US- Japan axis would not be adequate to regulate an orderly, liberal world economy; a total neglect of the other advanced countries especially the European Community would be a wrong understanding. As F. Bergsten states, there are today, three important economic poles: the US, Japan and the EC[12]. Therefore they are to share power and responsibility and their currencies will be the world's reserve currencies, determining the magnitude of the transactions. Maximum harmony in the economic relations of Japan and the US would be the locomotive for coördination and cooperation efforts at the global scale.

CHAPTER 1

[1]Samuel Huntington, " US' Changing Strategic Interests, " Survival , vol. 33, no. 1 (Jan, Feb 1991), p.6.

[2]Regimes are sets of implicit or explicit principles, norms, rules, or decision-making procedures around which actors' expectations converge in a given area of international relations. Principles are beliefs of fact, causation, and rectitude. Norms are standards of behavior defined in terms of rights and obligations. Rules are specific prescriptions or proscriptions for action. Decision-making procedures are prevailing practices for making and implementing collective choice.

[3]D. Unger and P. Blackburn,ed. Japan's Emerging Global Role, (Colorado, 1993), p. 26.

[4]Earl Conteh-Morgan, Japan and the US: Global Dimensions of Economic Power (New York, 1992), p. 121.

[5]Ibid., p.6.

[6]Robert W. Cox, "Production and Hegemony: Toward a Political Economy of World Order," as quoted by Earl Conteh-Morgan in Japan and the US: The Global Dimensions of Economic Power (Beverly Hills, Sage: New York, 1992), p. 116.

[7]Conteh- Morgan, p.117.

[8]Ibid., p.7.

[9]Glenn D. Hook and Michael A. Weiner, ed.The Internationalization of Japan (London, 1992), p. 36.

[10]Ibid., p. 48.

[11]Unger and Blackburn, p. 199.

[12]Ibid., p.57.

[13]Greg Schmergel, ed. US Foreign Policy in 1990s (New York, 1991), p. 247.

[14]Kathleen Newland, ed. The International Relations of Japan (London, 1990), p. 6.

[15]Harrison M. Holland, Japan Challenges America (Colorado, 1992), p. 164.

[16]Newland, p. 9.

[17]Ibid., p. 148.

[18]R. Gilpin, The Political Economy of International Economic Relations (New York, 1990), p. 329.

[19]The tax cut without reduction in expenditures had led to this deficit.

[20]Gilpin, p. 332.

[21]Ibid. , p. 337.

[22]Huntington, p. 11.

[23]Ibid., p. 10.

[24]T. Akaha and F. Langdon, ed. Japan in the Post-Hegemonic World (Colorado, 1993), p. 80.

[25]Ibid., p. 84.

[26]Ibid., p. 88.

[27]Unger and Blackburn, pp. 60-61.

[28]Ibid., p. 63.

CHAPTER 2

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[3]Keohane2. , p. 310.

[4]Robert Gilpin, The Political Economy of International Relations (New Jersey, 1987), p. 72 -- Hereafter cited as Gilpin 1.

[5]Lea Brilmayer, American Hegemony: Political Morality in a One-Super Power World (New York, 1994), p. 14.

[6]Gilpin 1, p.86.

[7]This is what the " Gramscian" Marxists call " ideological hegemony".

[8]Ibid., p. 73.

[9]David Lake, " Leadership, Hegemony, and the International Economy: Naked Emperor or Tattered Monarch with Potential?," International Studies Quarterly, vol. 37, (1993) , p. 459.

[10]Ibid., p. 460.

[11]Ibid., p. 461.

[12]Charles P. Kindleberger, " Hierarchy versus Inertial Cooperation," International Organization, vol. 40, no. 4 (Autumn 1986), p. 841.

[13]Lake, p. 469.

[14]Ibid., p. 478.

[15]Isabelle Grunberg, " Exploring the Myth of Hegemonic Stability," International Organization , vol. 44, no. 4 (Autumn 1990) , p. 451.

[16]Ibid. , p. 452.

[17]Ibid., p. 453.

[18]Brilmayer, p. 18.

[19]Gilpin 1. , p. 74.

[20]Duncan Snidal, " The Limits of Hegemonic Stability Theory," International Organization , vol. 39, no. 4 (Autumn 1985) , p. 590.

[21]Grunberg, p. 442.

[22]Free-rider problem means that some benefit from collective goods but refuse to pay their share in providing the good.

[23]Brilmayer, p. 18.

[24]Ibid. , p. 118.

[25]Gilpin 1. , p. 75.

[26]Ibid. , p. 76.

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[28]Brilmayer, p. 18.

[29]Ibid. , p. 118.

[30]S.Gill and D. Law, The Global Political Economy (NY, 1988), p. 79.

[31]Gilpin 1. , p. 75.

[32]Keohane 1. , p. 15.

[33]Ibid. , p. 50.

[34]Ibid. , p. 64.

[35]Robert O. Keohane, " Theory of World Politics: Structural Realism and Beyond," Neorealism and its Critics , ed. Robert O. Keohane (New York, 1986), p. 177.

[36]Robert Gilpin, War and Change in World Politics (New York, 1989), p. 209-- Hereafter cited as Gilpin 2.

[37]Keohane 2. , p. 178.

[38]Gilpin 2 , p. 197.

[39]Ibid. , p. 199.

[40]Ibid. , p. 200.

[41]Ibid. , p. 210.

[42]Gilpin 2. , p. 144.

[43]Ibid. , p. 145.

[44]Gilpin 1. , p. 73.

[45]Brilmayer, p. 15.

[46]Arthur A. Stein. " The Hegemon's Dilemma: Great Britain, the United States and the International Economic Order," International Organization , vol. 38, no.2 (Spring 1984) , p. 378.

[47]Ibid. , p. 379.

[48]Ibid. , p. 380.

[49]Brilmayer, p. 89.

[50]Ibid. , p. 90.

[51]Gilpin 1. , p. 77.

[52]B.Russett. "The Mysterious Case of Vanishing Hegemony; or, Is Mark Twain Really Dead?" International Organization 39:2 (Spring, 1985), p. 213.

[53]Ibid. , p. 217.

[54]Stein, p. 384.

[55]Brilmayer, p. 90.

[56]Ibid. , 3.

[57]Russett, 209.

[58]Ibid. , p. 221.

[59]Gilpin 1. ,. p. 87.

[60]Snidal, p. 591.

[61]Ibid. , p. 593.

[62]Lake, p. 463.

[63]Gilpin 1. , p. 88.

[64]Keohane 1. , p. 35.

[65]Ibid. , p. 8.

[66]Ibid. , p. 9.

[67]Stein, p. 358.

[68]Ibid. , p. 386.

[69]Snidal, p. 593.

[70]Keohane 1. , p. 14.

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[72]Ibid. , p. 7.

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[75]Ibid. ,p. 64.

[76]Snidal, p. 586.

[77]Ibid. ,p. 136.

[78]Gilpin 1. ,p. 88.

[79]Grunberg, p. 445.

[80]Brilmayer, p. 80.

[81]Russett, p. 214.

[82]Brilmayer, p. 92.

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[14]Richard Holt, The Reluctant Superpower: A History of America's Global Economic Reach (New York, 1995), p. 193.

[15]Ibid., p. 199.

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[38]Gilpin, p. 204.

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[41]Gilpin, p. 206- 7.

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[44]Holt, p. 212.

[45]Ibid., p. 241.

[46]Pool and Stamos, p. 52.

[47]Gilpin, p. 225.

[48]Eichengreen, pp. 247- 8.

[49]Gilpin, p. 306.

[50]Vatter and Walker, p. 461.

[51]Ibid., p. 311.

[52]Spero, p. 156.

[53]Ibid., p. 157.

[54]David H. Blake and Robert S. Walters, The Politics of Global Economic Relations (New Jersey, 1987), p. 141- 142.

[55]Spero, p. 162.

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[80]Omestad, p. 191.

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[95]S. P. Huntington. " US- Decline or Renewal? " Foreign Affairs , vol. 67, no. 2 (Winter 1988-9), p.78.

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CHAPTER 5

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