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United States Department of State

Washington, D. C. 20520

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Under Secretary has seen.

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INFORMATION MEMORANDUM
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TO: P - Ambassador Armacost
FROM: INR - C. Thomas Thorne, Jr., Acting
SUBJECT: Growing Entanglement of US-Japan Trade and Defense Issues

While Japanese leaders eschew any direct link between trade and defense issues in their contacts with the US, growing GOJ frustration over the negative US reaction to what it regards as extensive trade liberalization efforts could impede the formation of a consensus in favor of defense decisions favorable to the US. US-Japan trade relations are fast approaching a watershed with the impending announcement next week of Japan's "action program" under the shadow of threatened Congressional retaliation. At the same time, Japan's long-debated decision whether to do away with its one-percent-of-GNP defense spending limit is coming to a critical juncture, and Japan's consideration of SDI and military technology exchange with the US is also under close review.

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There is growing alarm in Japan, reflected in the private statements of officials and recent press reports, over the increasing prospects of Congressional trade retaliation. Many of the reports express serious concern that the US will begin soon to step up defense pressure in concert with trade demands. There have been increasingly broader hints from pro-defense elements in Japan that the GOJ will soon replace the one-percent limit with a new limit based on a defense buildup plan, permitting much greater flexibility in the future allocation of funds for national security. None of the statements on the issue have been definitive, however, and there is reportedly strong resistance to the proposal from opposition parties and, more importantly, from within the LDP.

A July 25 Tokyo Shimbun article, quoting a Japanese government source, cited US administration pressure on Nakasone to replace the one-percent ceiling to give the executive branch a "weapon" to convince Congress and the American public of Japanese good faith. The report, though inaccurate, is a good

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example of the growing tendency in Japan to see the defense issue in that light.

Through accounting adjustments and other manipulations, Japan probably could put off a decision on the one-percent issue for some time. Nakasone had hoped to be rid of the barrier this summer, but he may not want to risk a domestic reaction to the perception that he has once again caved in to US pressure--particularly if his strenuous trade efforts are rejected out of hand and there continues to be a lack of LDP consensus on the issue. If, on the other hand, US reaction to his action program and other trade measures is more muted, Nakasone might elect to go ahead with replacement of the GNP-related barrier as a further indication of good faith to the US, counting on his current popularity among the public to help him weather any domestic political flak. Although Japan's policy of gradual defense buildup is not in jeopardy, its consideration of other critical defense issues, such as SDI, technology transfers, and procurement of specific weaponry may also be influenced by events in the coming weeks.

The increasing confluence of trade and defense issues in US-Japan relations highlights the inevitable broad impact of chronic trade friction between the world's two largest economies. The US-Japan trade problem, if unchecked, will continue to place severe strains on overall bilateral relations and has potential serious consequences for Western security.

Drafted: INR/EAP:DMorris
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