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**Briefing Materials for the  
President's Meeting With  
Prime Minister Nakasone,  
2 January 1985** 

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Briefing Materials for the  
President's Meeting with Prime  
Minister Nakasone, 2 January 1985

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Nakasone's Meeting with the President [REDACTED]

Shortly after forming his new Cabinet in early November, Nakasone said that the period before President Reagan's inauguration was "more important than generally realized" because the President would be formulating his second administration's policies. We believe Nakasone wants to use his January visit to forestall basic changes in US policy toward Japan in order to buy time to deal with domestic issues. [REDACTED]

Nakasone and the Foreign Ministry do not expect Washington to raise the defense issue during his visit but anticipate that trade issues will be a major item on the US agenda. Nakasone has established a special committee to deal with international economic issues [REDACTED]

-- Other ministries see less urgency, however, believing trade will not be a problem until the second half of 1985 because the recovery has kept US unemployment down. [REDACTED]

Nakasone probably will point to the new committee and progress on bilateral issues during his first two years as indications of his sincerity in working to resolve trade differences.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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Limits to Japanese Flexibility [REDACTED]

A more assertive approach that reflects Japan's growing self-confidence as an independent world power will temper the Prime Minister's inclination to make concessions to the United States. Nakasone may be increasingly sensitive on this score. His ability to smooth relations through his personal ties with the President is admired [REDACTED]

With the bilateral current account surplus likely to be over \$30 billion this year and even higher next, trade friction will continue to trouble the relationship.

- Tokyo's effort to reduce its budget deficit will prevent expansionary government spending that could stimulate domestic demand--an essential ingredient for import growth.
- Revenue shortfalls will stall any wholesale tariff reduction and may mandate excise taxes that could put US products at a disadvantage. [REDACTED]

Tokyo's increasing unwillingness to respond to what it perceives as the unreasonable demands of US special interests will be the most serious limit to its flexibility in dealing with trade differences. Press reports and public opinions polls indicate the Japanese believe their markets should be more open, but there is a consensus that the trade imbalance with the United States is not Japan's fault. Rather, Tokyo sees it as the result

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of the strong dollar created by high US interest rates. In addition, Tokyo believes that the flow of funds and goods from Japan has helped fuel the US recovery. [REDACTED]

The government's agenda for economic restructuring could exacerbate trade friction. Competition between Japan and the United States in technology markets and Tokyo's practice of protecting some of its less competitive sectors already create tensions.

- MITI--seeking to promote the domestic software industry-- is still working on software protection legislation that would include provisions objectionable to the United States.



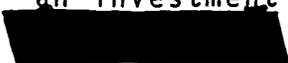
- The Japanese are committed to domestic satellite development to spur scientific research and for nationalistic reasons. US arguments against uneconomic indigenous production carry little weight with Tokyo, which will continue to protect government-related satellite programs.
- Policies that protect both depressed industries and the cumbersome distribution system are essentially social welfare programs designed to bolster employment. For political reasons, they probably cannot be eliminated.

We believe new or evolving areas, such as high technology, telecommunications, and finance, where interest groups in both Japan and the United States are still fluid, offer the best opportunities for relatively quick action to ease trade differences. [REDACTED]

Japan's dependence on trade for vital resources and for economic expansion could lead Tokyo to respond to pressures from other countries that run counter to US interests.

- The Japanese will increasingly join the EC and ASEAN to oppose US "protectionist" moves.
- Japan is under pressure to open markets to US competitors, such as Australia.
- Japan's need to diversify energy supplies will encourage continued trade with partners such as Iran and raise the prospect of new politically sensitive ventures, such as those that could result from the reported Japanese interest in oil in Vietnam.

- Tokyo may attempt to improve ties with the Soviet Union by encouraging trade as a leadin to better political relations. Japan will probably provide financing for the Sakhalin natural gas project if the Soviets can produce an investment plan and find Japanese buyers for the gas.

  
Nakasone has only limited flexibility on defense, although no likely successor is as well disposed toward US views on security matters. As with prime ministers before him, Nakasone places a premium on the Security Treaty with the United States, but in contrast he also believes Japan should improve its own defense capabilities. His personal ability or that of any prime minister--no matter how sympathetic--to make significant changes in defense policy, however, is questionable.

- Because defense remains a politically charged issue in Japan, the Prime Minister's rivals in the LDP can use it against him--which prevents him from moving too far ahead of the consensus within the party.
- Most Japanese believe the current effort on defense is adequate, making major changes in security policy unlikely, in our view, unless Tokyo faces an unequivocal foreign challenge--such as a dramatic change in the Soviet threat or fundamental uncertainty about its security relationship with Washington.
- Furthermore, budget cuts in various politically sensitive areas--agriculture, local government, construction, and transportation--will make Tokyo reluctant to increase defense spending beyond 1 percent of GNP. 



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How Japan Will Play the United States

The Prime Minister's major objective during his discussions with the President will be to contain disagreements over trade and defense and demonstrate to his countrymen his continued ability to manage the US-Japan relationship. The Nakasone administration will use several time-tested strategies. [REDACTED]

Sidetrack the United States by encouraging discussion of less sensitive issues. An agenda filled with issues that are not central to Japanese concerns is suited for this purpose--hence the alacrity with which both the Prime Minister and Foreign Minister have seized on the Pacific basin and African relief. Talks on nuclear disarmament and global economic recovery also serve this purpose. [REDACTED]

Try to ease US pressure on trade and defense by emphasizing action in other areas. Tokyo may assemble a list of "favors" Japan has done for the United States to accentuate the positive, turn attention from bilateral disagreements, and encourage US tolerance for a go-slow Japanese approach on pending US requests. The list could include:

- Increased economic assistance, particularly for LDCs designated "strategic" by the United States.
- Backing for the Caribbean Basin Initiative.
- Favorable votes in the United Nations and other world bodies on issues of concern to the United States. [REDACTED]

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On trade, emphasize progress to date or turn pressure back on Washington. If efforts to avoid discussion of differences over trade fail, Tokyo will point to promotion of Japanese direct foreign investment, export restraints, and trade packages that incorporate generalized promises and small tariff reductions.

- He probably will offer to extend auto export restraints-- at least informally--if Washington desires.
- Japan announced a new trade package in mid-December containing advanced implementation of Tokyo Round tariff reductions--largely directed at the LDCs.
- Nakasone will stress the importance of Japanese investment in the United States and might mention the unitary tax issue and barriers to investment posed by the Defense Department for national security reasons.
- He will cite recent progress on financial liberalization and standards and point to the potential for US sales created by the liberalization of the telecommunications market.

On defense, claim that significant departures in defense policy would arouse Japanese and Asian fears, assert that Japan cannot afford to do more, and keep US attention focused on the defense budget. In our view, domestic and Asian concerns do exist, but they are not as serious as the Japanese portray. A bigger problem is the conservatives' reluctance to pay for a stronger defense.

In portraying budget difficulties, rather than military requirements, as the key factor that shapes Japan's defense efforts, Tokyo is describing one of its objective political realities. But the Japanese also use this explanation to avoid unpleasant questions concerning Self-Defense Force military capabilities. The Japanese probably will point to:

- Steady increases in defense spending--but gradual and from a very low base.
- Dramatic personal intervention by the Prime Minister to secure additional appropriations--but in minute increments.
- Preparations for breaching the 1-percent barrier--without reference to the small sums involved.

Support for relatively low cost efforts to improve bilateral military cooperation has served a similar purpose in the past.

The Japanese try to use more effective joint military planning and exercises, agreement on defense technology transfers, purchases of US military equipment, strong host-nation support--all intrinsically beneficial to the United States--to dodge the larger issue of whether they need to make basic changes in defense policy. [REDACTED]

Maintain that trade and defense should be treated as separate issues. The Japanese underline both the importance of treating each problem on its own merits and the danger of permitting disagreements in one area to spill into the other. Nonetheless, the Japanese themselves regard the two as intimately connected. They see defense spending as a drag on the national economy and likely to undermine Japan's trade performance. Moreover, in playing the United States, Tokyo has tried to point to increases in the defense budget to deflect attention from economic differences. [REDACTED]

Cultivate the impression that pressure will probably be ineffective--and that public pressure will be counter-productive. Japanese negotiators often emphasize that the Prime Minister must be responsive to the opinions of other LDP leaders, the party's supporters in agriculture and business, and the public--which prevents him from being as forthcoming as he might wish to be.

-- This argument contains considerable truth, but the domestic political scene is more flexible than the Japanese usually suggest, and Tokyo's foreign policy is as much a product of what the external situation seems to demand as of what the Japanese deem desirable. [REDACTED]

As the political or financial price of concessions increases, however, so will the Prime Minister's need to demonstrate that changes are truly required in order to keep bilateral relations on track. Public statements by high-level US officials tend to be more effective than private messages in influencing key domestic constituencies whose agreement the Prime Minister must obtain to carry out painful policy adjustments. The Japanese argue, however, that such statements could trigger a nationalistic backlash and that, in the context of the subtle norms governing Japanese social interaction, quiet consultations within official channels are more effective.

-- We believe strong public US pressure will indeed carry a price, but it can be reduced if US requests are not total surprises, are explained in reasonable terms, and do not require abrupt departures from Japanese policy. [REDACTED]

Stimulate concern that Japanese concessions could threaten LDP dominance. Tokyo sometimes suggests that giving ground on trade or defense will alienate critical LDP supporters and

endanger the party's control of the Diet, thereby undermining its ability to secure passage of bills of interest to the United States. The possibility of an early election makes this a likely tactic.

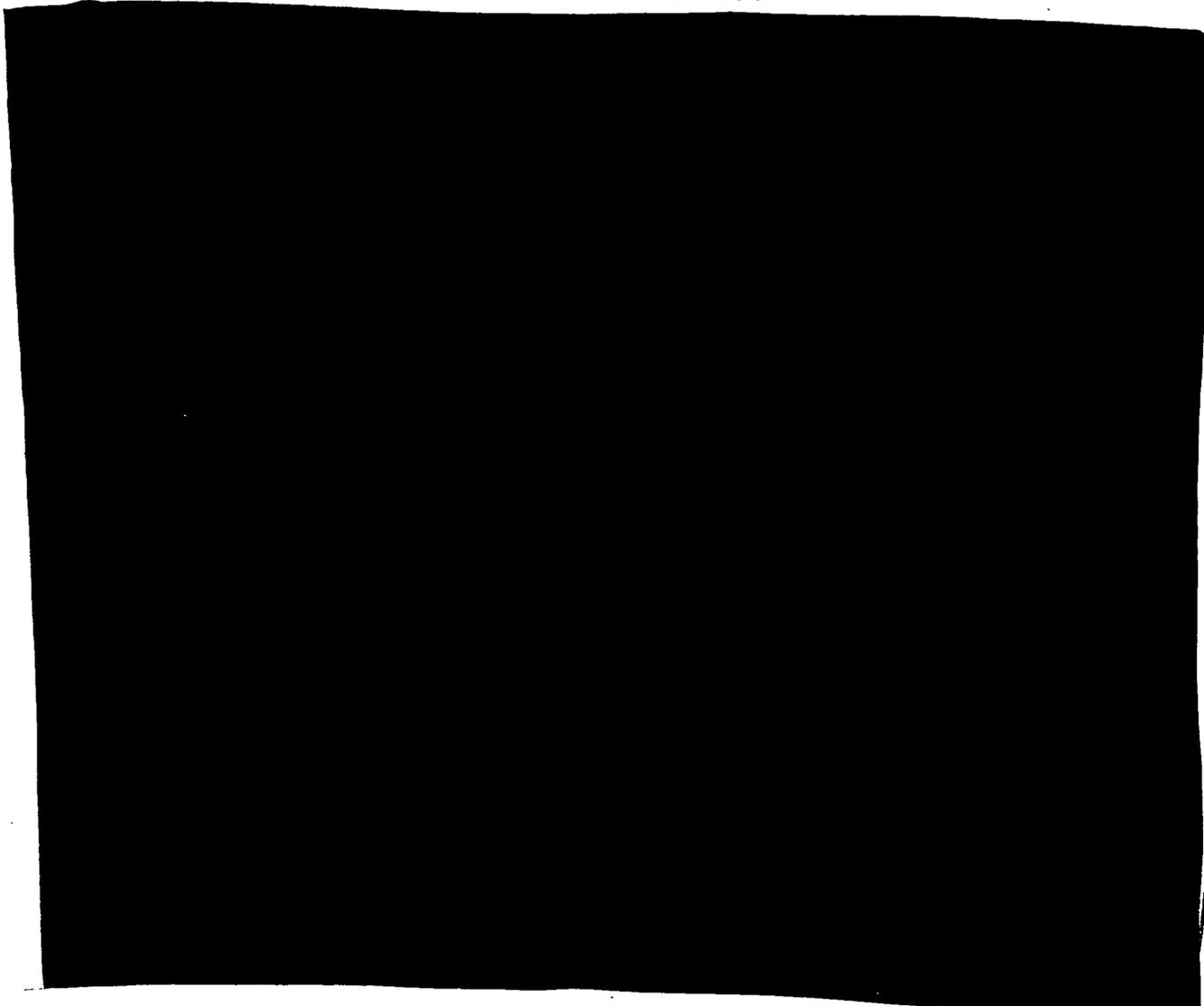
- LDP support is sufficiently tenuous that giving ground on an issue of importance to a key interest group could threaten the party's majority, although this is by no means a foregone conclusion.
- If the LDP lost its majority, management of bilateral relations would indeed become more complicated. Even so, the LDP could ally with one of the moderate opposition parties, which share its view of the importance of the US-Japan relationship. A leftwing government is virtually out of the question. [REDACTED]



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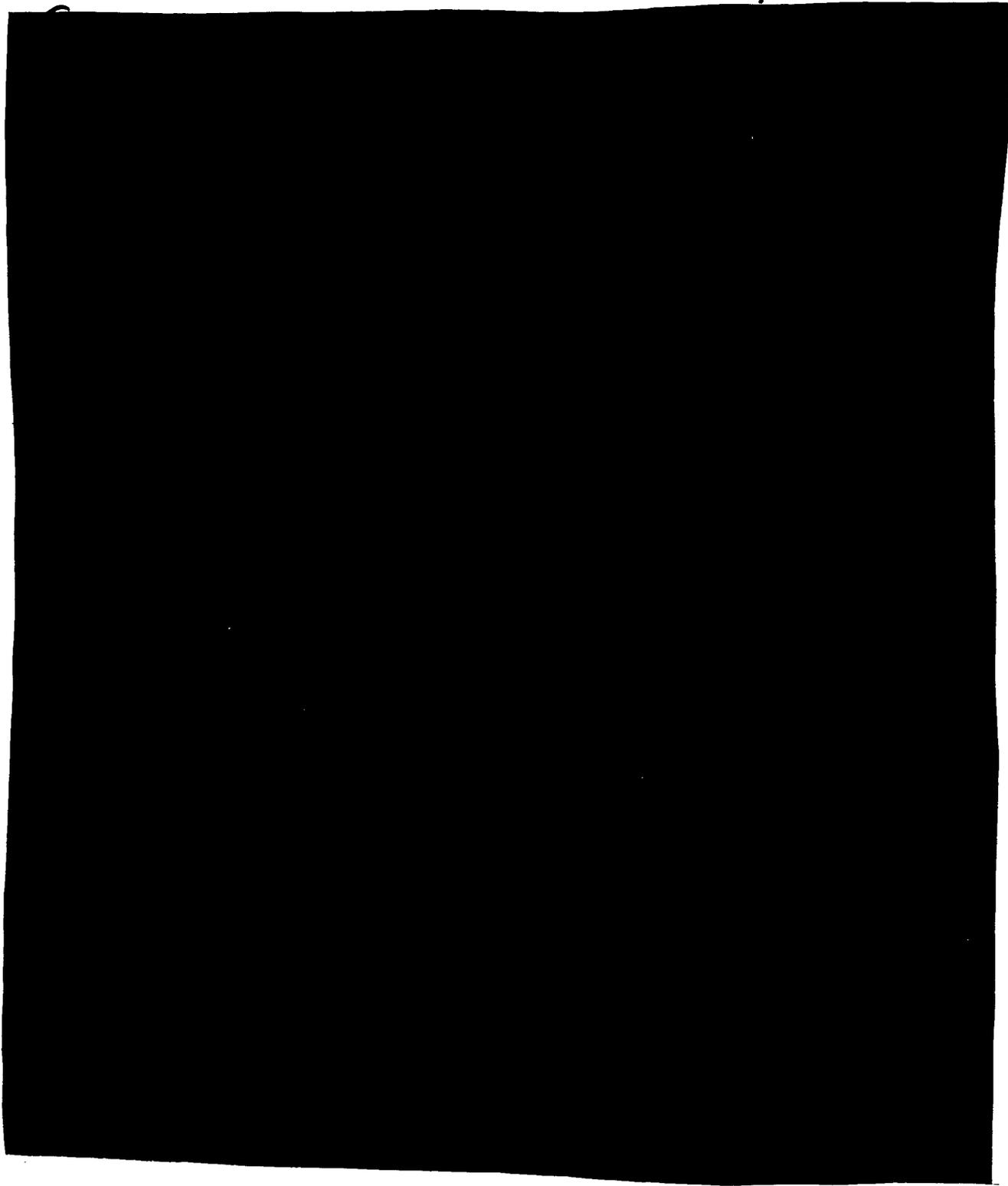


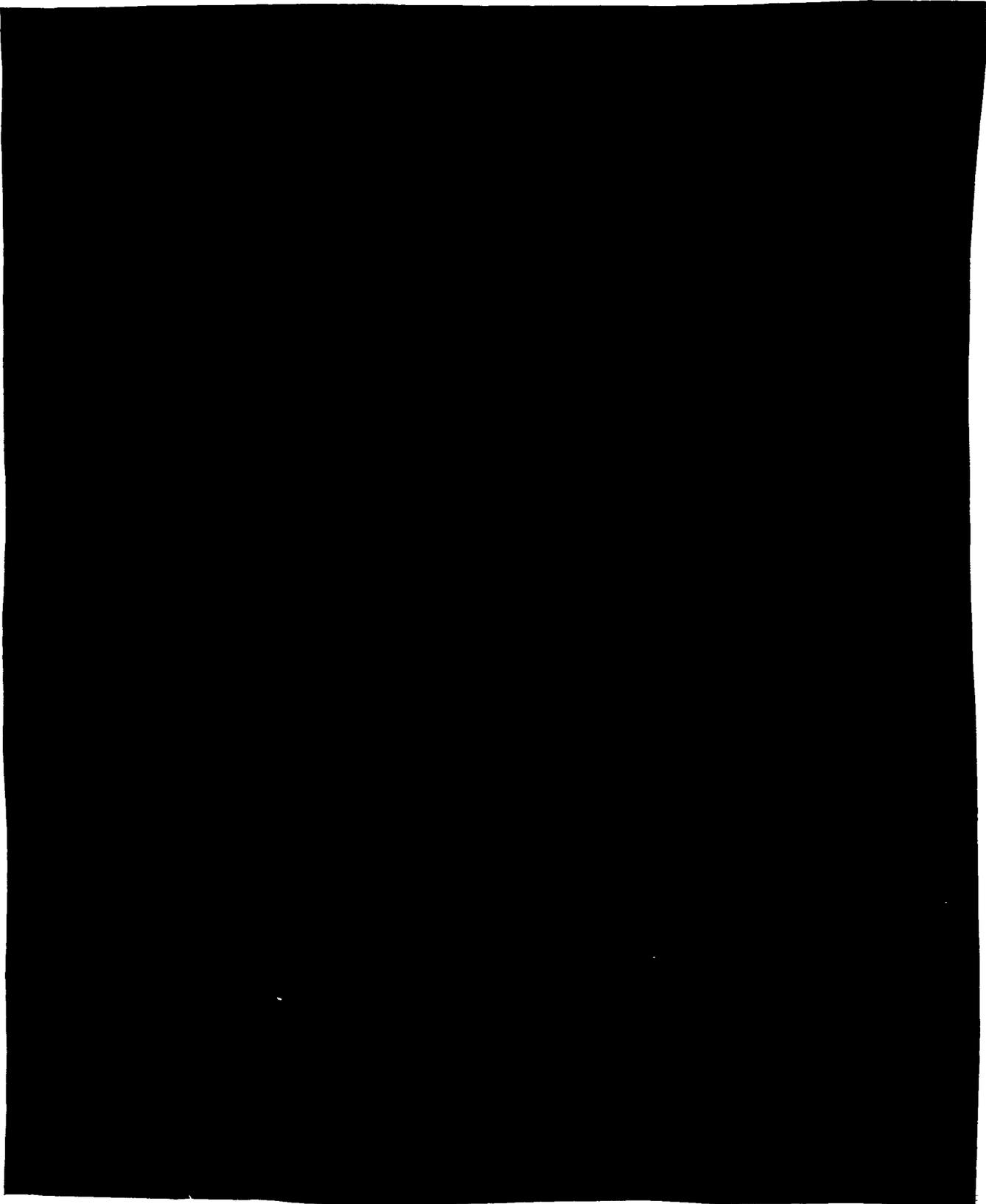
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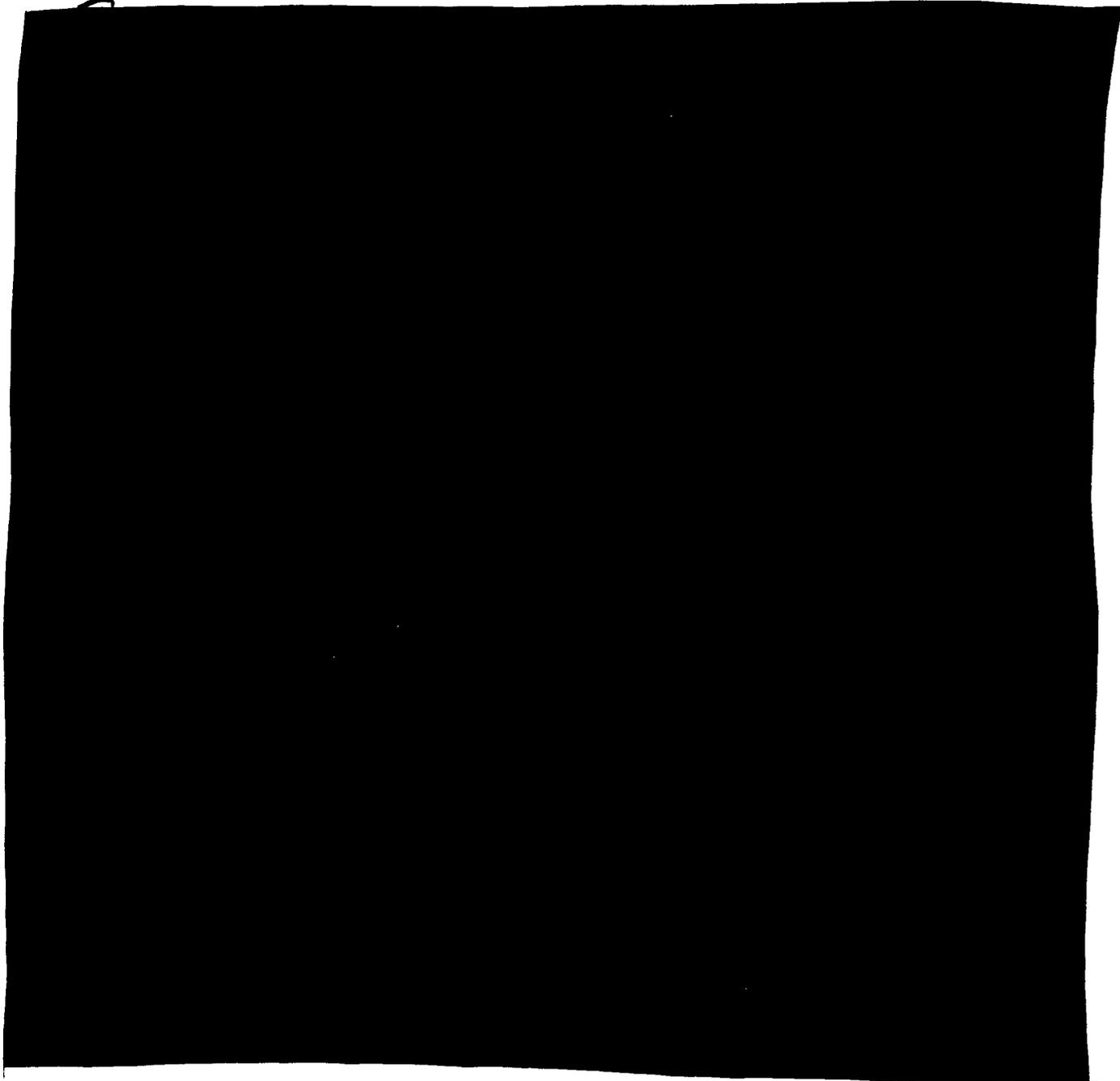
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Objectives of Nakasone's New Administration [REDACTED]

Domestic Goals

Nakasone's primary domestic target during his second administration will be to reduce the government deficit--projected to reach \$11.2 billion in Japan fiscal year 1985--without significantly raising taxes. This priority will govern his approach to other programs. In an effort to fulfill commitments made by previous administrations, his Cabinet will attempt to raise defense and foreign aid spending but will use administrative reform to continue to reduce other government expenditures. [REDACTED]

Pressure is building within the LDP for more expansionary policies--both from Nakasone's rivals who see a weakness they can exploit, and from Diet members who want to stop reductions in pork-barrel projects. For their part, the opposition parties will fight any increase in defense spending, especially if it threatens the 1-percent-of-GNP limit. Although a minority in the Diet, they can stall debate, thus preventing passage of important legislation. [REDACTED]

The bureaucracy, faced with a shrinking pool of funds, will vigorously lobby for key programs. The economic ministries, for example, have tried to sell budget increases by arguing for funding basic research that will aid restructuring toward high technology industries--a national goal. Big business nonetheless opposes budgetary expansion, fearing retreat from administrative

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reform policies could lead to tax increases. Business leaders in general also oppose increased defense spending beyond that necessary to satisfy the United States. [REDACTED]

Security and Foreign Policy Goals

Under the second Nakasone administration, Japan's policy will continue to be dominated by an approach that defines its security primarily in economic terms. Japanese political and government leaders are comfortable with the notion that national security depends on economic success based on trade--which in turn sustains domestic stability under an LDP government. One of Nakasone's primary goals, therefore, is to ensure that the international political and economic environment remains congenial to Japan's foreign trade. To do so he will:

- Seek to sustain world trade and monetary arrangements.
- Endorse projects of interest to the LDCs, such as ASEAN solidarity, the Contadora process, and freedom for Namibia.
- Promote political stability and economic growth in the LDCs through expanded foreign aid and cultivate Japan's image through cultural, sports, and educational exchanges. [REDACTED]

Japan's vulnerability to an interruption in the flow of imported food, fuel, and raw materials is at the top of Tokyo's list of national security concerns. Nakasone's government will, therefore, continue to pursue programs that:

- Maintain domestic production of rice and coal.
- Diversify import sources.
- Reduce import requirements through industrial restructuring and conservation.
- Build stockpiles and maintain foreign exchange reserves.

On the export side, Tokyo's priority objective is to maintain access to markets in North America and Western Europe for Japan's new, high-technology industries. To counter the protectionist threat, Nakasone's government will:

- Promote free trade and emphasize Japan's steps to open its own markets.
- Shift export industries to third countries or offer to build production facilities in markets that might otherwise be closed. [REDACTED]

Military Security Strategy: Most of the LDP and its backers take the Soviet threat seriously and put a high value on the US-Japan alliance, but they essentially believe the US nuclear deterrent solves Japan's security problem as long as the United States maintains military parity with the USSR and the Mutual Security Treaty is in effect. Although the Japanese military establishment has grown in size, sophistication, and public acceptance, it is still intended to perform only limited military functions. From one perspective, Tokyo has put a premium on the political purpose of the Self-Defense Force: that is, as a means to satisfy minimally US demands on defense burden sharing so that bilateral differences do not threaten the Security Treaty itself. [REDACTED]

Aspirations for World Leadership

Nakasone has long believed that Japan should conduct itself with greater independence and self-confidence. Although Japanese generally take pride in his success in elevating Japan's international status, they remain suspicious of schemes that might embroil the country in foreign conflicts and are concerned that Nakasone's known interest in strengthening Japanese defenses could lead to a pursuit of international stature based on military power. [REDACTED]

The Prime Minister's personal ambition to leave his mark on Japanese history and his need to use foreign policy achievements to buttress his somewhat shaky domestic political base coincides with his national pride. Given public sensitivity to his pro-military policy, his attempt to persuade the Japanese electorate that he can keep relations with the USSR on an even keel is particularly important. He has stressed support for US efforts to reopen arms control talks with the Soviets and backs an expanded Japanese dialogue with Moscow. [REDACTED]

[REDACTED] Nakasone hopes someday to persuade the Soviets to resume discussions on the Northern Territories--an unlikely development but a goal that combines his aspirations as a statesman and his nationalism. [REDACTED]

Nakasone also hopes to play the role of mediator in areas of international tension. He apparently believes, for instance, that he may be able to facilitate forward movement on the Korean Peninsula by brokering contacts between Seoul and Beijing and broadening nonofficial Japanese channels to North Korea. Japan will probably also continue to seek a role in mediating the Iran-Iraq conflict. [REDACTED]



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Japanese Interest in Disarmament [REDACTED]

Always a favorite Japanese theme, disarmament has recently received heightened rhetorical support from Prime Minister Nakasone and Foreign Minister Abe. Both recognize that Japan's influence is only marginal, but they see clear domestic political and foreign policy advantages in continuing to champion the issue. [REDACTED]

Most postwar Japanese politicians have identified themselves closely with peace-related issues in order to respond to a strong domestic sentiment that Japan must not be drawn into another war.

- Nakasone is particularly sensitive on this score, given his reputation as a hawk as well as press and opposition party accusations that he wants to "remilitarize" Japan and strengthen security ties with the West.
- Pressure on Nakasone is intensified because his foreign minister, who has accorded disarmament a central place in his "creative diplomacy," is a prime contender for leadership of the ruling party.
- Nakasone's position is not complicated by an active peace movement, however, and serious opposition to new US military deployments in Northeast Asia has not yet materialized. [REDACTED]

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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Nakasone has used support for disarmament to legitimize his efforts to strengthen Japan's security.

- Publicizing support for Washington's effort to reopen arms control talks with the Soviet Union helps him distract domestic critics opposed to expanded security cooperation with the United States.
- Nakasone asserted a strong interest in the aborted INF negotiations, pointing to the need for a global agreement that would prevent a Soviet shift of SS-20s eastward, where they could threaten Japan. We believe one objective was to broaden Japanese security horizons beyond the traditional focus on the US alliance to include Western Europe. [REDACTED]

Expressions of support for Western firmness and solidarity in arms control negotiations with the USSR are designed both to shore up relations with the West and to contribute to the overall Western deterrent, which Nakasone is convinced must remain strong throughout any disarmament process. We believe Nakasone hopes the US-Soviet arms control dialogue will show enough progress over the next year to permit a significant thaw in superpower relations. He believes a relaxation of US-Soviet tensions must precede significant improvement in Japan's relations with the USSR, a goal high on his agenda. [REDACTED]



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Japan's Relations with the Soviet Union [REDACTED]

Tokyo has taken an increasingly tough stance toward the USSR since the late 1970s, and despite Prime Minister Nakasone's interest in promoting dialogue, Japanese-Soviet relations will probably remain cool.

- Major improvement in political relations depends on Soviet willingness to reopen discussion of the longstanding Northern Territories problems. We believe Nakasone cannot afford to back down on this issue, and Moscow will continue to stonewall because of the islands' strategic significance and concern over the adverse impact territorial concessions might have on future border talks with China.
- The Soviets will probably continue their campaign to foment ill-will between Japan and both its Asian neighbors and the United States. The Japanese are aware of--and resent--Moscow's strategy.
- Moscow shows no sign of moderating its continuing military buildup in East Asia. Many Japanese suspect this is intended in part to intimidate them into conforming to Soviet wishes.
- Moscow's heavy-handed treatment of Japan, combined with the invasion of Afghanistan and the KAL shootdown, has increased popular antipathy toward the USSR, heightened Japanese awareness of the Soviet threat, and contributed to improved domestic political support for the Self-Defense Forces and the US-Japan alliance.

This memorandum was prepared by the Offices of East Asian Analysis and of Soviet Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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- Economic relations are on the decline, partly because political relations have deteriorated but also because large-scale Siberian resource development projects are no longer attractive to Japanese businessmen. [REDACTED]

Nakasone's desire to achieve a "breakthrough" in relations with the Soviet Union stems from an ambition to distinguish himself as the prime minister who persuaded Moscow to agree to discuss the territorial issue. Without such a Soviet reversal, however, his maneuvering room is limited. The Prime Minister and Foreign Minister have said they cannot officially visit the USSR until Gromyko visits Japan, and Gromyko thus far has been unwilling to come as long as Tokyo insists on bringing up the Northern Territories. [REDACTED]

The Soviets probably see in Nakasone's eagerness an opportunity to improve relations. They want to discourage growing US-Japanese collaboration on security issues in Northeast Asia and to forestall US-Japanese-ASEAN cooperation on economic and political matters. Moscow has responded to Nakasone's overtures with efforts to improve the political atmosphere, including the dispatch of high-level delegations, concessions to Japan during the recent fishery negotiations, and suggestions of a possible compromise on preconditions for a Gromyko visit. The Soviets' flexibility on this score will serve as a litmus test of the importance they attach to improved relations during the coming months. Even if Gromyko made the trip, however, we believe prospects for a dramatic breakthrough in political or economic relations would remain poor. Differences on substantive issues run too deep. [REDACTED]

Nakasone nonetheless will continue to encourage expanded private and governmental dialogue with the USSR.

- He wants to demonstrate at home that his commitment to enhancing Japanese security does not entail an unnecessarily provocative anti-Soviet policy.
- He has also stated repeatedly that Tokyo must keep channels of communication open to the Soviet Union precisely because it is Japan's most difficult and dangerous neighbor.
- He shares the prevalent Japanese view that Japan's relations with the Soviet Union are largely dependent on US-Soviet relations and Tokyo should not lag behind if Washington and Moscow improve their relationship. [REDACTED]



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Japan and China--Growing Strategic and Economic Ties [REDACTED]

Prime Minister Nakasone's visit to Beijing last March underscored the importance both countries attach to their relationship. Converging economic and strategic interests have encouraged closer ties. Tokyo sees China as a potentially lucrative export market, as well as a significant source of energy and other raw materials. China hopes to acquire increased Japanese investment, financial credit, and technology, as well as a larger Japanese market for Chinese goods.

- Trade is running at record levels this year. Japan has been China's largest trading partner since the mid-1960s, accounting for more than 20 percent of total trade.
- Japan is also China's largest creditor, and Japanese direct investment in China is picking up after a slow start. Japan's Export-Import Bank recently decided to supply \$2.4 billion in low-interest loans to finance Chinese oil and coal development projects.
- China has moved to the top spot among Japan's foreign aid recipients. Prime Minister Nakasone announced a \$2 billion aid package in March.
- Tokyo also has agreed to a one-time export of nuclear reactor equipment, subject to on-site "visits" by Japanese officials. The two countries are negotiating a bilateral nuclear cooperation agreement. [REDACTED]

The growth of Soviet military power in Asia has prompted Tokyo and Beijing to adopt broadly complementary policies toward the USSR and its allies.

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- During Nakasone's trip, both sides reaffirmed opposition to increased Soviet deployment of SS-20s in Asia and agreed to share information on the missiles.
- Both governments have opposed the Vietnamese occupation of Kampuchea and have provided strong diplomatic backing for ASEAN's efforts to bring about a Vietnamese withdrawal.
- Japan and China have condemned the Soviet invasion of Afghanistan, have refused to recognize the Kabul regime, and have sought to bolster Pakistan.
- Although Japan and China support different Korean regimes, both have tried to exercise a moderating influence on their respective partners. [REDACTED]

There is potential for discord in the Japan-China relationship as well as in the Sino-US-Japan triangle. Some in Tokyo are concerned that a radical leadership could reemerge in Beijing, while the Chinese remain wary of Japan's ties to Taiwan. The Chinese will also monitor Japanese response to US pressure to improve its defense capabilities, and both Beijing and Tokyo will compete for the attention of US policymakers. US-Japanese competition in the growing Chinese market for high-technology products could also cause friction in the Japan-China relationship. [REDACTED]

Japanese officials nonetheless are generally optimistic about future bilateral relations. They view support for China's modernization as a way to improve prospects for the survival of a moderate leadership in Beijing, help to reinforce China's "opening to the West," and reduce incentives for a Sino-Soviet rapprochement. The mutual strategic and economic benefits of the relationship probably will encourage continued close ties. [REDACTED]



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Japan and the Two Koreas [REDACTED]

Tokyo has always given priority to South Korea over the North, but until a few years ago its tilt was circumscribed by often strained relations with Seoul and a recurring interest in improving ties with P'yongyang. Under Prime Minister Nakasone, Tokyo has shifted decisively toward strong, open support for the South. [REDACTED]

Immediately after his election as prime minister, Nakasone broke the bureaucratic logjam that had blocked conclusion of an aid agreement and engineered a summit with President Chun in Seoul in January 1983. Chun reciprocated in September 1984, and the unprecedented exchange has helped ameliorate longstanding tensions and establish a political framework for progress on substantive issues. Even so, differences over the transfer of Japanese technology, South Korea's continuing trade deficit with Japan, and historic ethnic antagonisms typified by the treatment of Koreans living in Japan are certain to strain relations. [REDACTED]

Accompanying Nakasone's determination to strengthen relations with the South is willingness to support Seoul on critical issues related to the North.

- The Prime Minister expressed an unusual degree of personal sympathy after both the KAL shutdown and the assassination attempt in Rangoon.
- After Rangoon he also imposed sanctions on North Korea for more than one year, and he has supported Seoul's position on the inter-Korean dialogue.

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The domestic political liabilities in taking a firm line toward North Korea have declined in recent years. All opposition parties have distanced themselves from the North, and the non-Communist opposition has moved to improve relations with the South. The LDP, therefore, is under less pressure to appear interested in adopting a "balanced" Korea policy. [REDACTED]

Nonetheless, Tokyo still sees advantages in broadening nonofficial contacts with North Korea. Aside from the economic benefits of regularizing fishery arrangements, encouraging some progress on repayment of North Korean debts, and expanding trade, Japanese officials believe P'yongyang should be drawn out of its isolation and into closer contact with the West. In addition, we believe Nakasone wants to work toward legitimizing the division of the peninsula by encouraging contacts among the two Koreas and the major powers and sees Japanese dialogue with the North in this context. Although the Prime Minister probably harbors few illusions about P'yongyang's objectives, he seems to see an opening for some forward movement. He has:

- Joined the United States in urging China to increase contacts with South Korea and has offered Japan's good offices as an intermediary.
- Applauded the North's offer of flood relief and its willingness to resume talks with the South.
- Endorsed Seoul's request that both Koreas be admitted to the United Nations.

Nakasone hopes to be in a position to act quickly should these limited signs of movement develop into an inter-Korean thaw. He wants to take as much credit as possible for any progress achieved and is sensitive to the negative political fallout in the event others--especially the United States and China--negotiate an understanding without Japan's knowledge. [REDACTED]



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Pacific Basin Economic Cooperation [REDACTED]

Pacific Basin economic cooperation, a recurring theme in Japanese policy for over a decade, will be high on Nakasone's agenda in California. [REDACTED]

- In addition to shifting the spotlight from bilateral trade friction, the Pacific cooperation idea gives Nakasone a region-wide issue on which he can work with Washington as an equal and thereby enhance his leadership image at home.
- Nakasone probably sees sponsorship of Pacific cooperation as a way to win support among LDCs for his plans for a new multilateral trade round.
- He may also hope that even limited success of a cooperation plan would help Japan by smoothing relations with suppliers of important commodities. Economic expansion in the Pacific would also create new export opportunities for the United States--perhaps reducing the focus on the bilateral trade relationship. [REDACTED]

Nakasone probably will address Pacific Basin cooperation in broad terms, but may also suggest several relatively small cooperative projects. Tokyo wants to keep the US and Japanese presence in the plan low key to avoid putting off the smaller countries and reviving memories of Japan's wartime East Asia Co-Prosperty Sphere. By keeping the projects small, Tokyo can also keep the cost down. [REDACTED]

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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[REDACTED]

The projects will be practical and concrete to respond to LDC and NIC complaints that such plans are too often merely hot air.

- Nakasone probably will again raise the idea of a joint fund for Pacific Basin academic studies.
- Tokyo advocates splitting human resource development responsibilities, with Japan giving low technology training on Okinawa and the United States providing high-tech education in Hawaii.
- Nakasone believes the private sector should sponsor the initial stages of cooperation. [REDACTED]

Debates over which nations should be included and differences among Southeast Asians who would not benefit equally from the projects could easily derail the plan.

- The ASEAN nations will probably balk if China and South Korea are included. They fear Tokyo and Washington might ignore Southeast Asian interests in favor of catering to these more important powers. China's inclusion if Taiwan were excluded could also create difficulties. [REDACTED]



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Japan's New Initiatives in Africa [REDACTED]

After years of essentially ignoring Africa, Tokyo has begun to focus on the continent.

- In mid-November Foreign Minister Abe became the first senior Western minister to visit drought-stricken Ethiopia and Zambia. During the trip he announced that Tokyo would increase food aid to Africa by nearly \$50 million, bringing the total to \$163 million for JFY 1984.
- During the same period, a joint government-private sector mission--reportedly the largest Japanese delegation ever dispatched to the continent--visited eight African countries to investigate how Japan could best provide financial and material assistance. Stops included Ethiopia, Zambia, and Mozambique.
- As a result of Abe's briefings upon his return home, Tokyo plans to step up activity in Africa, urge other industrialized nations to provide greater support, and seek closer US-Japanese cooperation in the region. Japanese aid to Africa totaled some \$265 million in 1983.
- At the request of African leaders, Japan has agreed to act as UN coordinator on African issues.
- In an effort to stimulate the limited domestic interest in Africa, the Japanese Government is conducting a publicity campaign, which has included naming October "Africa month" and holding "starvation lunches." [REDACTED]

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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Although Tokyo's sudden interest in expanding its role in Africa is motivated in part by humanitarianism, both the Foreign Minister and the bureaucracy have seized on African issues for more important reasons.

- With international attention focused on drought and famine victims in the region, Tokyo views it as an arena in which to demonstrate to Washington and other Western nations that Japan is a cooperative ally ready to fulfill its international responsibilities.
- Abe's political ambitions almost certainly were a driving force behind his trip. Abe, who wants to succeed Prime Minister Nakasone, hopes to gain public recognition of his "creative diplomacy"--without sharing the credit. Abe's earlier solo venture in Middle East diplomacy, where his efforts to mediate the Iran-Iraq war have stalled, has not served that goal well.
- Japanese officials have also said they want to prevent growing economic problems in Africa from becoming a destabilizing force and a drain on the international community.
- These factors suggest Tokyo's interest in Africa could decline if the involvement of other industrialized nations falls off or if Abe identifies other areas that better serve his political interests. [REDACTED]

We believe the emergence of a more active Japanese role in Africa, especially if Japan shares the economic burden of assisting the poorest nations, will generally serve US interests. The Japanese may go further than the the United States wants, however, by giving more than humanitarian aid to such Marxist countries as Ethiopia. Tokyo wants to keep its political foot in the door and claims to be more optimistic than Washington about the prospects for Ethiopia's turning to the West. [REDACTED]

Japan also has a large stake in South Africa. Tokyo does not have full diplomatic relations with Pretoria and in international forums is careful to denounce consistently apartheid policies. But Japan maintains strong commercial ties to South Africa. Trade amounts to more than \$2 billion per year, accounting for about half of Japan's total trade with the African continent. We believe relations with Pretoria will continue under the current arrangements as long as business remains attractive. [REDACTED]

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<sup>1</sup> Japanese aid to Africa totaled some \$265 million in 1983. [REDACTED]



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Financial Liberalization [REDACTED]

Prime Minister Nakasone considers the yen/dollar accord reached by US and Japanese finance officials last May as one of the high marks of bilateral relations in 1984. He has been quick to echo Western praise of Japanese financial market liberalization, which the accord promotes. Nakasone has been almost as sensitive to US Treasury criticism of the way Tokyo is implementing some of the agreed-upon measures.

-- [REDACTED] the Prime Minister shares US concerns about the limited liberalization the Finance Ministry is advocating in certain areas.

-- In particular, Nakasone has questioned Ministry decisions to exclude securities firms from the soon-to-be created yen bankers acceptance market and to require banks to notify the Ministry before issuing Euroyen certificates of deposit. [REDACTED]

We believe prospects for resolving bilateral differences over implementation are generally good. In response to Nakasone's criticisms, Finance Ministry officials have [REDACTED] said they will phase out most of the restrictions that upset their US counterparts. The officials have not disclosed when the restrictions will be lifted, but continued prodding by Nakasone should ensure genuine liberalization in these areas. [REDACTED]

On the other hand, bilateral differences over trust banking activity by foreigners will probably fester. Tokyo plans to carry through on its yen/dollar accord pledge to allow foreign

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banks to undertake trust banking in Japan beginning in 1985, but the Ministry of Finance intends to license only eight foreign institutions--the number of Japanese banks engaged in such activity.



We believe financial liberalization outside the confines of the yen/dollar accord will accelerate through the remainder of the decade despite bureaucratic obstacles. Continuing the pattern of the past ten years, the maturing of the Japanese economy will provide the primary impetus for deregulation.

- The economy's post-1973 transition from a high-growth to a medium-growth path destroyed much of the rationale for a tightly regulated financial system. The Finance Ministry responded with narrowly focused and piecemeal reforms, but once begun, liberalization fed upon itself. Losers from past deregulation demanded--and continue to demand--compensation in the form of liberalization in an area of their choice. Furthermore, the expanded freedom given Japanese banks in international dealings is generating pressure for similar leeway at home.
  - In an effort to ease the nation's transition to slower economic growth, Tokyo floated massive amounts of government debt starting in 1975. Issued with ten-year maturities, this debt begins maturing in the coming Japanese fiscal year (April 1985-March 1986). To refinance these bonds smoothly, the government must introduce new flexibility into funding methods and terms of new issues. Such reform will have ripple effects throughout the financial system, as regulators tend to link key interest rates to government bond yields.
  - In the mid-1970s when growth prospects dimmed, Japanese manufacturers took a keener interest in international markets. This contributed to the mushrooming of the current account surplus, which approached \$35 billion in 1984. As the surplus increased, so did fears about regulations inhibiting the efficient recycling of funds overseas. In response, Tokyo has improved foreign access to yen markets for sovereign borrowers. As long as savings remain above domestic needs, we believe the Japanese Government will feel compelled to liberalize further the country's international financial dealings.
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Status of Software Protection Legislation [REDACTED]

Legislation proposed by the Ministry of International Trade and Industry (MITI) to remove software from copyright protection could limit exports to Japan by US firms in the service, computer and software fields. The Ministry wants to promote the domestic software industry--an essential ingredient in economic restructuring--and to aid mainframe computer manufacturers by improving their access to US systems software, long the industry standard. MITI's plan would reduce the period of protection from 50 to 15 years and include provisions that could mandate release of software to competitors. If this occurs:

- US companies would be reluctant to sell software-based services or products in Japan, fearing the release of the software, which is frequently the most valuable component.
- Other nations, especially the NICs and LDCs, might follow the Japanese example, cutting further into US high-technology trade. [REDACTED]

The Trade Ministry would like to see the law pass this spring, although US pressure and a turf battle between MITI and the Education Ministry, which controls copyrights, have put it on the shelf for now.

- The Education Ministry is engaged in disputes with MITI on several other fronts and is not likely to give in on copyrights.
- The Foreign Ministry also opposes the MITI position.

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[REDACTED]

We believe continued pressure from the United States and Europe, combined with the bureaucratic deadlock, could push the issue to a political level in the ruling party for final arbitration. Because MITI's plan is so unambiguously protectionist, the leaders of the ruling party could well respond positively to pressure from Washington on software. [REDACTED]



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Liberalization of Japan's Telecommunications Market [REDACTED]

US access to Japan's multibillion dollar telecommunications market will depend on the evolution of the market after Nippon Telegraph and Telephone (NTT) returns to the private sector in April. Several barriers to a completely open market are possible, the most serious stemming from the Telecommunications Ministry's (MPT) attempts to retain control of its traditional turf.

- MPT is drafting ordinances governing the approval of technical standards for telecommunications equipment that are apparently more restrictive than the current regulations.
- The Ministry has formed an association of Japan's largest equipment manufacturers to determine standards; foreigners will not be allowed to attend meetings of this body.
- The notification system for the establishment of telecommunications service companies could be used to restrict foreign firms. [REDACTED]

NTT's efforts to expand its markets also could limit US entry.

- [REDACTED] NTT may continue to release technology to suppliers on a preferred basis.

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EA M 84-10238 [REDACTED]

[REDACTED]

Nonetheless, forces within Japan could encourage a more open market. With budget growth virtually frozen except for defense and foreign aid, the economic ministries are attempting to move into new areas in order to compete for a share of the shrinking pie.

- MITI, the Construction Ministry, and the Transportation Ministry, which all are trying to expand their influence into telecommunications, will oppose MPT's attempt to dominate the sector, as will NTT. [REDACTED]

The prospect of liberalization also has energized foreign and domestic firms that wish to enter the market. Forced to survive in a competitive environment, NTT will have to base its procurement and technology sales more on profit/loss considerations than on concern for maintaining traditional relationships. Although it is likely to dominate the overall market, it probably will have to purchase equipment, software and databases abroad, improving prospects for US firms, which have a competitive edge in telecommunications services. [REDACTED]

US pressure has helped to accelerate the liberalization process and probably can continue to influence the development of a truly open market.

- Because telecommunications is a relatively new issue, interest groups are not firmly established and do not have the political clout of traditional lobbys such as agriculture.
- MPT is not experienced in the international arena and probably is susceptible to high-level pressure.
- Japanese businesses wishing to break into the telecommunications market share the US desire for an open market.
- The impasse created by bureaucratic rivalries could kick decisions up to the Liberal Democratic Party, which may be more inclined to make political choices that reflect Washington's interests. [REDACTED]



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The Defense Spending Limit [REDACTED]

Over the past several months politicians, bureaucrats, special study groups, and the press have begun to focus on the question of whether Japan's defense spending will--and should--break the self-imposed limit of 1 percent of GNP set in 1976. Spending on defense is expected to total .998 percent of GNP when the fiscal year ends on 31 March.

- Last spring Prime Minister Nakasone appointed a Liberal Democratic Party (LDP) study group to consider revising the ceiling.
- During the summer some politicians and members of the press predicted that a proposed pay hike for government employees or the Japan Defense Agency's request for a 7-percent increase in its JFY 1985 budget could push spending over the limit.
- Defense advocates in the LDP recommended this fall that the ceiling be revised, pointing to US pressure for Japan to do more in its own defense.
- The Peace Research Council--a private think tank commissioned by the Prime Minister to study defense issues--recommended in mid-December that the ceiling be abolished.
- In mid-December the defense caucus of the LDP is expected to recommend revising the ceiling.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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[REDACTED]

- Although the Democratic Socialist Party also supports breaking the limit, the other opposition parties-- including the LDP's small coalition partner--are opposed, arguing it would violate Japan's postwar peace orientation. [REDACTED]

Proposals for a new limit have included changing the cap from "below 1 percent" to "about 1 percent," leaving the limit at 1 percent of GNP but removing defense personnel costs, raising the ceiling to between 1.3 and 2 percent, or eliminating it altogether. [REDACTED]

[REDACTED] that Nakasone might announce a change in the ceiling in December when the budget is approved by the Cabinet, but at present the timing does not appear right for such a move.

- Japan's rate of economic growth will allow Tokyo to sustain the present rate of defense spending growth without breaking the limit.
- Embassy reporting suggests Nakasone does not now have broad support within the LDP for announcing a revision of the ceiling.
- Breaching the limit in December could work to Nakasone's advantage in talks with the President, but could also open the way for domestic criticism that he did so to follow Washington's dictates. [REDACTED]

Japan will probably break the barrier sometime in 1985, especially if growth is lower than anticipated or a supplemental budget is passed. Many in the LDP would prefer the break to occur during the summer when the Diet is not in session. That timing would also allow for extensive groundwork as a result of debate on the issue in the spring budget hearings and the recommendations by authoritative defense study groups. [REDACTED]



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Japanese Defense Procurement [REDACTED]

This spring Tokyo was forced to acknowledge it would not reach the procurement objectives of the National Defense Program Outline (NDPO), Japan's basic military planning document, by the end of the current Midterm Operations Estimate (MTOE) in 1987.

- Funding problems caused by the 1 percent of GNP cap on defense spending forced repeated delays in orders of weapons systems included in the plan.
  - Postponing achievement of the NDPO has pushed back any possibility of completing the already outdated Outline--drafted in 1976--until the mid-1990s at the earliest.
- [REDACTED]

The first objective of the next MTOE, covering Japan fiscal years 1986-90, therefore, will be to make up the procurement shortfalls in the previous plan. That will only be possible if the Japan Defense Agency's (JDA) budget is significantly and consistently increased through 1990--and the Japanese record to date makes that unlikely. [REDACTED]

Planning now under way on the new MTOE reflects more balanced procurement, incorporating improvements in the logistics base with weapons purchases. The Estimate emphasizes improving sealane and air defense capabilities.

- The Maritime Self-Defense Force will seek to increase the number of P-3C antisubmarine reconnaissance aircraft, outfit destroyers with close-in air defense systems against missiles, and equip submarines with surface-to-surface missiles.

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- Air Self-Defense Forces improvements will concentrate on developing the next generation of fighters, improving the air defense warning and control system, introducing the US Patriot surface-to-air missile system to replace the aging Nike-J, and possibly developing an aerial refueling capability for its fighters.
- The Ground Self-Defense Force will seek to introduce new tanks and improved infantry combat vehicles to be fielded primarily in Hokkaido. [REDACTED]

Some high-level officials in the Defense Agency and the Liberal Democratic Party (LDP) have called for a revision of the goals under the NDPO. They point out that the original Outline was written during a period of detente between the United States and the Soviet Union. They cite the build-up of Soviet SS-20s in Asia, the KAL incident, and changes in force levels in Korea as reasons why Japan should not restrict itself to the original framework of the NDPO. The LDP, in fact, is considering revising both the 1-percent defense spending cap and the NDPO. The party's success with the spending limit will indicate the likelihood of real changes in the NDPO. [REDACTED]



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Defense Technology Transfer [REDACTED]

Despite exchanges of messages and some bilateral discussions, defense technology transfer generally remains stymied, with little evident progress since the November 1983 agreement with Washington. A specific US case has not yet been proposed to test the accord, and the Ministry of Foreign Affairs, the Japan Defense Agency (JDA), and the Ministry of International Trade and Industry (MITI) still do not agree on how to handle a test when it occurs. [REDACTED]

Even so, some groundwork has been laid:

- In August, Washington formally identified five general technologies for possible exchange with the Japanese.
- In November, the Joint Military Technology Commission, established under the agreement to expedite technology exchanges, met for the first time. [REDACTED]

Japanese business continues to have reservations about the exchange agreement.

- The private sector is skeptical of US motives and worried that officials negotiating for access to Japanese technologies could compromise proprietary information and make it available to potential US competitors.
- Business also believes Washington uses US national security concerns as an excuse for deliberately limiting Japanese access to US commercial technologies and, therefore, sees little reason to be forthcoming.

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Even so, there is little evidence that the Japanese bureaucracy itself wants to move ahead in implementing the accord. So far, no ministry has taken the initiative to push for implementation and none appears likely to do so until firm US proposals for technology exchange force Tokyo's hand. 



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Controlling Technology Loss [REDACTED]

In an effort to keep step with the Western crackdown on technology losses to the Soviet Union and its allies, Japan has strengthened and redesigned its export control program. The most striking development over the past two years has been an increase in the level of coordination among the ministries charged with formulating, implementing, and enforcing export controls. The new program has spurred both cooperative and complementary efforts, including:

- Formation of an interagency committee with representatives from the Trade and Foreign Affairs Ministries, the National Police, Customs, and the Japan Defense Agency to improve Japanese export controls.
- More careful review of entry visas for East Bloc trade and scientific delegations, as well as stricter interpretation of export control regulations.
- Initiation of end-user certificates and some controls on reexports.
- Awareness programs designed to enlist public support and business compliance with the stricter controls. [REDACTED]

Most of Tokyo's measures informally extend existing authorities that limit Soviet access to advanced technologies and discourage unwanted transfers before they occur. Consequently, the results are not as visible as the seizure of proscribed cargoes and prosecution of violators carried out in other COCOM countries. Nonetheless, by avoiding formal legislation Tokyo has

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[REDACTED]

maintained flexibility to discourage or delay technology sales while exercising its near autonomous control over export licenses. [REDACTED]

Most major trading and manufacturing firms--believing they have little to lose because of the poor political and business relations between Japan and the USSR--have accepted Tokyo's stricter controls.

- Many have denied Soviet requests for restricted technologies.
- Others with histories of illegal sales now insist that proper export licensing procedures be followed. [REDACTED]

Largely as a result of continuing US and international pressures, as well as its own experiences with Soviet espionage activities, Japan has become sensitive to the strategic implications of unregulated technology transfer and more aware of Japanese vulnerability to Soviet S&T collection. With the exception of antiespionage legislation, however; proposals for new laws restricting trade or the activities of foreigners in Japan are unlikely. Nonetheless, improvements made thus far probably will become permanent, with further refinements coming at a measured pace, as long as the Western consensus on controlling technology leakage holds. [REDACTED]



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Economic Growth and Budget Issues [REDACTED]

Prime Minister Nakasone will face some difficulties next year in his effort to manage the growth-oriented Japanese economy:

- The recent 5-percent growth rate is a big improvement over the previous four years' lackluster performance, but it has been driven partly by strong export performance. With the foreign sector weakening, GNP growth in 1985 will probably slow. Our most recent figures show weakened foreign demand cutting overall growth in the third quarter of 1984 to an annual rate of 3 percent.
- Growth of the domestic economy has picked up this year, but some in Tokyo are concerned that investment will drop next year as the foreign sector's stimulus declines.
- Meanwhile, Nakasone's rivals within the Liberal Democratic Party (LDP) have used proposals for boosting economic growth to question his management of the economy. Kiichi Miyazawa, heir apparent of the Suzuki faction, and former Economic Planning Agency Director General Komoto have both called for fiscal stimulus-- either through increased public spending or tax cuts. [REDACTED]

The government's commitment to holding the line on spending in an effort to reduce the government's persistent budget deficit will constrain steps to strengthen domestic demand. The LDP's supporters in the business and financial world also favor controls on spending and a smaller government sector, as does the

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powerful Ministry of Finance. The Finance Ministry has proposed a tight budget for JFY 1985 that will cut most agencies' spending by 10 percent.

- Defense and foreign aid are major exceptions. These items, along with rising debt service costs, will drive overall spending up by 4 percent. [REDACTED]

JAPAN: THE NAKASONE ADMINISTRATION'S HANDLING OF  
 ECONOMIC ISSUES OF CONCERN TO THE UNITED STATES 

<u>Issue</u>	<u>Status</u>	<u>Comments</u>
1. Financial liberalization		Much progress made in implementing 1984 yen/dollar accord, which promotes deregulation. Differences over trust banking and Euroyen markets remain.
2. Agricultural quotas and tariffs		Agreement reached in spring 1984 calls for expansion of beef and citrus imports over next three years. Government refuses, however, to consider complete liberalization of agricultural imports.
3. Standards and certification procedures		Recently have begun to accept foreign test data but implementation in several key areas still slow.
4. Telecommunications legislation		Foreigners will be allowed to sell value-added networks after Nippon Telegraph and Telephone (NTT) privatized in April 1985. New equipment standards being drafted appears they may be more restrictive than before.
5. NTT procurement of foreign equipment		After bilateral agreement took effect in 1984 foreign sales to NTT increased initially, but US sales have declined recently. Outlook uncertain after return of NTT to private sector.
6. Restraint on steel shipments to the United States		Have expressed willingness to accept export restraints although have yet to agree on limits for various types of steel.

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- Indicates issue basically resolved during Nakasone's tenure.
  - Indicates progress has been made but problem areas remain.
  - Indicates no real movement has occurred since Nakasone took office in 1982.

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ISSUE	STATUS	COMMENTS
7. Voluntary restraint on export of cars to the United States	●	Decided to extend initial agreement signed 1980 for a fourth year. Bureaucrats have hinted extension in 1985 also possible.
8. Purchase of foreign satellites	●	Tokyo will allow private firms to purchase foreign satellites, but government policy of domestic development of satellites remains firm.
9. Permission for foreign lawyers to practice in Japan	●	No movement so far and none likely before 1987.
10. Whaling moratorium	●	Tokyo signed agreement in November 1984 to sperm whaling as of 1988, but disagreements with Washington over interpretation have subsequently arisen.
11. Software legislation	●	Proposed protectionist legislation stalled by bureaucratic wrangling but not yet dead.
12. Sales of foreign cigarettes	●	Japan Salt and Tobacco Company monopoly on sales ended, but concerns about distribution and pricing system persist.
13. Energy purchases from United States	●	Participating in feasibility study of Alaska LNG project but dragging feet on boosting coal purchases.
14. Removal of semiconductor tariffs	●	Elimination of tariffs approved by Tokyo and will be enacted when parallel legislation passed by US Congress.
15. Foreign direct investment in Japan	●	In May 1984 Diet revoked regulations limiting foreign investment in 12 Japanese companies. Improvements also made in approval process for direct investments.
16. Depressed industry policy	●	Still limits foreigners' sales opportunities by aiding noncompetitive industries. Continues to restrict foreign access to industrial trade councils.
17. Excise taxes	●	Expanding number of items subject to excise taxes, which hit import sales

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