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THE PRESIDENT'S JULY 8 MEETING WITH PRIME MINISTER KAIFU

SETTING

- o Kaifu sought this meeting with you to review key G-7 Summit issues, especially China, before discussing them with the Seven. It also presents an opportunity to acknowledge the Final Report of the Structural Impediments Initiative.
- o Building on your discussions last March in Palm Springs, this meeting will allow you to deepen your personal relationship and encourage Kaifu to continue to move on bilateral and international issues of interest to us.
- o This meeting could set the stage for another later in the year at which the two of you could lay out a broader vision of our relationship.

OBJECTIVES

- o Acknowledge that the Final Report of the Structural Impediments Initiative puts the relationship on a sound footing and thank Kaifu for his role.
- o Encourage effective follow-up and continued efforts to resolve economic friction which will permit us to move forward on our broad agenda.
- o We should also seek a commitment to conclude this year a multi-year commitment to host nation support.
- o While continuing to manage our economic relationship, we should now focus on enhancing our global partnership.
  - The G-7 Summit should foster the idea of triologue you articulated in Palm Springs. We should offer our support for Japan's own efforts to improve its political dialogue with Europe.
  - Western solidarity on China has produced results. We should urge the Japanese not to break ranks.
  - We should encourage continued Japanese assistance for emerging democracies in Central America and elsewhere.
  - We should reconfirm our desire to work together on transnational issues: the environment, counter-terrorism, narcotics control, and human rights.
  - Another promising area for cooperation is especially the superconducting super collider. Kaifu's endorsement is essential to Japan's participation.

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POINTS TO MAKE

ECONOMIC ISSUES (WITH ACCEPTABLE SII FINAL REPORT)

- Your leadership and vision were instrumental to our recent successes on economic issues. The Final Report of the Structural Impediments Initiative has helped put our economic relationship on a sound footing.
- This does mean that we can be complacent. We need to continue to address economic problems early on in the same cooperative, constructive way that we have since Palm Springs. The follow-on mechanism for SII will help.
- In Palm Springs, we discussed how we needed to achieve a "breakthrough" in our relations to fully realize the benefits of our global partnership.
- Now, following the SII final report and our recent trade agreements we should move forward on our bilateral and international agenda.

DEFENSE ISSUES

- I was happy to be able to receive Mr. Abe when he was in Washington to celebrate the thirtieth anniversary of the Security Agreement.
- While preserving the alliance which has been the bedrock of our relationship these past thirty years, we are making plans to ensure our bilateral arrangements keep pace with world events.
- An important element of this should be a comprehensive, substantial and multi-year package on defense cost-sharing.
- A substantial package would show the American public that Japan is carrying a greater and more equitable share of our common defense responsibilities and would mark the beginning of the fourth decade of our important security partnership in a fitting way.
- It should be wrapped up this year, so that we can put cost-sharing behind us and devote our energies to the global agenda.
- Another way to improve the public's perception of the value of our security relationship is to increase the two-way flow of defense technology.

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TRIALOGUE

- I applaud the wisdom of your efforts to deepen Japan's political dialogue with Europe, both through regional institutions like the EC and bilaterally.
- We should use the G-7 Summit to demonstrate to our European friends the value of a U.S.-Japan-European triologue.
- At the same time, through our triologue we should remind Europe that Asian issues remain important and deserve their attention.

CHINA

- China provides a good example of working together to achieve common goals in foreign policy. Western solidarity has sent a powerful message to the Chinese leadership and continues to have an important impact on China's internal policy debate, even if positive changes are slow in coming.
- We have indications that the more moderate elements in the Chinese Government may finally be gaining ground. We don't want to undercut them and strengthen the position of hard-liners who argue that China need not respond further to the West's human rights concerns but only wait for the West to reestablish relations on China's terms.
- Therefore, it will be important that we maintain a common approach toward China which demonstrates clearly that our commitment to political and economic reform is unwavering.
  - o We continue to believe that basic human needs is the appropriate standard for multilateral development bank loans to China and hope this basic common approach will be maintained by the Seven. World Bank lending should also remain well below previous levels.
- I know your government is also concerned about the need for flexibility on starting the Third Yen Loan Program in China, which is now on hold.
  - o We would hope that Japan would begin the aid program gradually and prudently, keeping in mind perceptions in China and the U.S. Congress. It would be helpful if your projects were similar to those funded by the World Bank -- limited to those addressing basic human needs and supporting reform and the non-state sector.

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#### AID FOR DEMOCRACIES

- As the world's two top aid donors, we have a special responsibility to ensure our assistance is used wisely to promote democracy and development.
- The G-24 project to help emerging democracies in Eastern Europe has been an effective example of coordinating donor community efforts. We value your participation and look forward to continued close cooperation in that forum.
- As you know, we also are working on a similar multilateral mechanism to assist the democracies in Central America. I hope Japan will play a leading role in that effort.
- We should look for other opportunities to help the less fortunate attain the peace, prosperity and freedom we enjoy.

#### URUGUAY ROUND

- Aid alone is not enough. The health and vitality of the world trading system plays a large role in the development of all countries.
- This is the last year for the Uruguay Round. Success is essential, but we face potential failure. Agriculture is a particular problem. Unless we all move, we risk the entire Round. Movement is also needed on services, intellectual property and other critical areas.

#### TRANSNATIONAL ISSUES

- Perhaps the greatest impact our cooperation could have on the world is on those issues which transcend boundaries.
- I understand you made a substantial commitment to President Salinas to help Mexico cope with its environmental problems. We will both be contributing to the fund to help developing countries find alternatives to CFC's.
  - o We should find other ways to help save the world's environment for our grandchildren and their children.
- Changes occurring in Eastern Europe have compelled terrorists to change the way they operate. However, we must remain vigilant against their activities.
  - o Japan's growing activity in aviation security assistance to Asian countries is a useful contribution.

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- Drugs continue to ruin lives in both producing and consuming countries. I understand the problem is growing even in Japan where enforcement measures had been effective in keeping the problem in check.
  - o Only by attacking this problem on an international scale can we hope to bring it under control. It will require decreasing demand by consuming countries and increasing both enforcement and development efforts by the producing countries.
- We have seen great victories for democracy and human rights in Eastern Europe, Central America, Mongolia, and elsewhere. However, we must remain vigilant in support of these values to ensure they take root and endure.
  - o By maintaining solidarity on China, speaking out on the abuse of power in Romania, and requiring transition to an elected, civilian government in Burma, we are helping the forces of democracy triumph over tyranny.

#### SUPERCONDUCTING SUPER COLLIDER

- I hope you will respond positively to my invitation to join the United States in building and operating the Superconducting Super Collider (SSC).

#### BROADER VISION

- I hope our momentum on economic issues can be maintained and we will begin to realize more of the benefits of our global partnership.
- If so, we might meet again later in the year to take stock of the achievements of our international cooperation and articulate publicly a positive vision of our relationship for the 1990s and beyond.

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o Economic Overview

- Real GNP growth in 1989 was roughly 4.9%, pulled by domestic demand growth of 5.9%. Most forecasts predict 4.0% growth in 1990. Inflation, while under control in 1989 (2.3%), has accelerated in 1990 to nearly a 3% annual rate. Unemployment has remained low at 2.3%.
- Money supply growth (M2) continued at a double-digit pace in January-April 1990, fueling current inflationary fears. The Bank of Japan has raised the official discount rate four times in 1990, the last time to 5.25% in March.
- The yen depreciated from a 1989 average rate of 138Y/\$1 to a current rate of around Y154/\$1. Japan's current account surplus has declined both in dollar and yen terms since 1987, from 3.6% to 2.0% of GNP (\$57 billion) in 1989. Fiscal policy remains tight; general government sector surplus (national/local) in 1989 about 3% of GNP.

o Political Overview

- Japan's Liberal Democratic Party (LDP) scored an impressive victory in February's key Lower House election. The Upper House remains in opposition hands.
- The current focus of political action is now in the Diet, where the controversial 3% consumption tax and electoral reform are key issues.
- The LDP's strong showing in the elections, together with the Prime Minister's effective management of the U.S. relationship, have made Kaifu's continuation in office through the end of his current term in the fall of 1991 more likely. Kaifu, however, has a small power base in the LDP and could still face challenges from within his party.

o Japan Views on Summit Issues

- In this his first G-7 summit, Kaifu will want to be seen as an effective world leader and summit partner.
- He will want to ensure that Japan is not singled out for any criticism on macroeconomic policy or trade issues.
- Kaifu will want the G-7 to adopt a more flexible position on China so that Japan can move forward with its \$5.1 billion (5 year) Third Yen Loan aid package this year.
- He will be eager to promote the concept of "trialogue" to ensure that Japan is included as a full partner in any major multilateral initiatives.