

The Evolving US-Japan Relationship

J. Thomas Schieffer

United States Ambassador to Japan

United States Ambassador to Australia, 2001-2005

In the first years of the 21st century a profound change has occurred in the US-Japan relationship. We have moved beyond the security and economic paradigm of the Cold War to understand the global opportunities presented by our strategic partnership. The US-Japan alliance has long been the cornerstone of American foreign policy in the Pacific and remains so today. Both the United States and Japan recognize that the positioning of US forces on Japanese soil reassures the region and deters potential aggressors so that peace and security can be maintained. More and more, the United States and Japan also recognize that their strong and active partnership can meet other global challenges as well.

Over the past decade we have seen unprecedented cooperation between our two countries. Japan has made concrete contributions in the struggle against international terrorism through its support for coalition operations in both Afghanistan and Iraq. Its deep involvement in fostering stronger regional approaches to challenges like nuclear proliferation of the Korean peninsula has been very helpful to building a more stable, peaceful North East Asia. Japan also has joined the United States in humanitarian and reconstruction efforts like the 2004 Indian Ocean Tsunami. Together we are supplying almost \$1.5 billion in aid and are providing expertise to help victims rebuild their lives. We also are working with Japan in areas of global concern that range from the prevention of pandemic avian influenza to promoting sustainable economic development in Africa and Asia. Japan's experience, technological prowess, and proven advances in energy efficiency and greenhouse gas reductions will be an advantage to both of us as we try to develop a new international consensus on climate change. The United States and other countries will be depending on Japan to exercise further global leadership this summer when it hosts the G-8 Summit in July and, in two years, the Leaders Meeting of the Asia-Pacific Economic Cooperation (APEC) forum.

The evolutionary trend toward a stronger bilateral relationship is evidenced in many places. Our security alliance with Japan, for example, is undergoing a major transformation. The planned realignment of US bases will create a more streamlined, sustainable "footprint" that can ensure an enduring US presence. Beyond just the stationing of US forces, however, this transformation will change our basic operational concepts, adopt the most modern technologies, and integrate the systems and networks of US and Japanese forces to bolster our joint capacity to meet this century's diverse security challenges.

The economic relationship of the past, which at times could be rancorous, also has changed into a new, more collaborative structure. In 2001, President Bush and then-Prime Minister Koizumi established the Economic Partnership for Growth (EPG) as the general

framework for US-Japan economic relations. The aim of this initiative was to facilitate trade and investment that would generate employment and wealth for Japanese and Americans alike. Running to over 75 pages, 2007's annual Report to Leaders from the US-Japan Regulatory Reform and Competition Policy Initiative, the leading component of the EPG, documents how American and Japanese officials are actively looking for ways to advance Japan's plans to reform and reenergize its economy, to remove trade and investment barriers on both sides of the Pacific, and to further common prosperity.

At the heart of US support for this exercise is our hope for the continued health and vigorous development of the Japanese economy. At the time of the EPG's launch in 2001, Japan had already suffered a decade of economic stagnation. Gross domestic product growth between 1992 and 2002 averaged less than one percent per year, the lowest among the major developed countries. Fears remained that Japan's banking system, still burdened with the bad debts of the so-called "bubble economy" of the late-1980s, would collapse, with global repercussions. Efforts by earlier Japanese governments to spend their way out of a recession led to a range of redundant public works and a burgeoning government debt well in excess of Japan's total GDP. Finally, the ascendancy of China and others in Asia caused some to wonder if Japan's post-war role as an Asian economic leader would soon be eclipsed or marginalized.

Fortunately, those fears have so far been unfounded. Since 2002, Japan has enjoyed its longest period of sustained postwar economic growth, albeit at a fairly moderate rate of about two percent per year. Two factors have underpinned Japan's recovery. First, a vigorous program of economic reform pursued by former Prime Minister Koizumi helped restore business confidence. Aided by interests rates held near zero percent by the Bank of Japan, Japan's financial institutions largely worked through their bad loans of past years and began to lend again. Japanese companies, too, put their balance sheets in order and started to invest. Koizumi also restored discipline to the fiscal system and slowed the expansion of unneeded public works. Finally, in what will perhaps be the most far-reaching legacy of the Koizumi era, he pushed through measures privatizing a number of inefficient government-owned corporations, the most noteworthy being Japan Post, the country's postal system whose financial entities hold assets roughly equivalent to China's current GDP.

The second factor which has contributed to Japan's recovery has been the tremendous growth of trade among the developing economies of East Asia. The International Monetary Fund (IMF) recently reported that trade between East Asian countries and the rest of the world grew by 500 percent from 1990 to 2006. Even more startling is the fact that trade among East Asian countries expanded by 850 percent over the same period. The IMF also found that the newly emerging economies of East Asia, of which China is the most prominent example, are more dependent than ever on exports. Intermediate inputs—parts, pieces, and components that go into making finished consumer products—have made up 60-65 percent of intraregional trade in Asia. Japan has been one of the major suppliers of those parts, pieces, and components—with affiliates of Japanese firms in Southeast Asia or China frequently being the main customer. As a result, net

exports contributed on average to about one-third of Japan's GDP growth between 2002 and 2007.

This is not to say that Asia has replaced the United States as a major market for Japanese goods. If anything, the United States has become even more important to the Japanese than it was in the past. Japan's trade surplus with the United States in 2007 ranked only slightly behind the surplus Japan maintained with all of Asia. As Japan's exports to Asia largely consist of components in other goods, we can safely assume that a substantial fraction of Japan's trade with Asia is actually consumed in the United States.

Consequently, Japan's recovery has depended to a great extent on its economic ties to the rest of the world and the United States in particular. In fact, the average annual contribution of private consumption to Japan's GDP growth actually declined somewhat over the 2002-2007 period according to the Organization for Economic Cooperation and Development (OECD), and the consumer price index continues to hover near zero. The main reason for this phenomenon is the fact that wages in Japan have largely stagnated despite the steady increases in GDP. Although Japan's leading companies are doing well, especially in international markets, many Japanese consumers have yet to realize any tangible benefit from the success of those enterprises.

All of these observations bring us back to the emphasis on reform and deregulation in the US-Japan economic partnership. Without further reform—liberalizing the labor market, eliminating obstacles to competition and foreign investment, enhancing regulatory transparency in the financial and other sectors, and overhauling the inefficient, protected agricultural sector—there are question marks as to whether Japan's current recovery is sustainable. Japan is not alone in needing to accept changes that will secure the way of life its citizens want. A number of European countries are engaged in reform programs to invigorate labor markets, to cut taxes, and to upgrade their economic systems. The United States, too, faces the prospect of possibly painful restructuring in our own economy. Should Japan slip back into the economic doldrums it endured in the 1990s, its capacity to address the challenges of the new century will diminish. Moreover, without additional measures to stimulate growth and productivity, Japan, with a shrinking population already among the oldest in the world, will risk being marginalized if major economic powers elsewhere reform their economies first.

Ensuring that Japan and the United States work together as regional and global partners will continue to be a central goal of American foreign policy. Through various diplomatic initiatives, we will stress the opportunities that present themselves when we view the world from a common perspective. No two countries in the Asia-Pacific region have more to gain from closer collaboration than the United States and Japan. A common desire for common values of democracy, tolerance and human rights, transformed a relationship of suspicion, hatred and war into a friendship of trust, hope and peace. Now, it is time for that friendship and that relationship to make an even greater contribution to the peace and stability of the entire international order.