

Panel: “Keys to Coordination and Prosperity in the World”

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The United States and Japan are the two largest economies in the world by a wide margin. Both countries have undergone a remarkable economic transformation over the last century. At the end of the 19th century, Japan and the United States each produced less output than India or China. The Japanese economy was less than half the size of France. Few observers predicted the future success of Japan and the United States. For example, in 1881 the Japan Herald wrote:

“Wealthy we do not all think [Japan] will ever become: the advantages conferred by nature...and the love of indolence and pleasure of the people themselves, forbid it. The Japanese are a happy race, and being content with little, are not likely to achieve much.”¹

One key to the impressive development of both Japan and the United States has been their interaction with the global economy, especially through trade. Even the U.S.-Japan Treaty of Peace and Amity signed in 1854 foreshadowed this importance of trade. One of the key components of the treaty was the opening of two Japanese ports to American ships. My comments will therefore focus on the importance of continuing to foster strong trade relations between the United States and Japan, as well as the rest of the world.

The U.S.-Japan trade relationship has substantially evolved since the signing of the Treaty of Peace and Amity. The initial treaty discussed the exchange of wood and coal, and even the provision of water to supply U.S. ships. Trade between the United States and Japan has since flourished; total trade between the United States and Japan was about \$170 billion in 2003. These trade flows have supported growth in both nations and substantially contributed to their current prosperity and success.

Over the last decade, economies such as China and India have emerged as more important participants in the global trading system. Their emergence increases the potential benefits from trade, but at times can also increase the related tensions. For example, the rapid growth in exports from countries such as China and India has increased competition in some sectors in the United States and Japan—especially in low-skill and labor-intensive sectors. Since many of these exports are everyday items that are highly visible—such as dolls and sporting goods—this has heightened concerns about job losses due to increased trade with low-wage economies.

Although trade can negatively affect some companies, concerns about trade are often overstated. For example, a large share of U.S. imports from China is actually imports that used to come from other countries—instead of being produced in the United States. In fact, the share of U.S. imports from the Pacific Rim as a whole—including China—has actually fallen since the mid-1990s. Therefore, the increase in U.S. imports from China is more than made up for by decreased imports from other countries in the region.

¹ David S. Landes, *The Wealth and Poverty of Nations*, 1998, pg 350.

It is also important to remember that increased imports from low-cost producers raise standards of living by providing cheaper goods for consumers. A recent article provides several compelling examples²: lifting restrictions on imports of baby clothing saved U.S. parents roughly \$400 million in 2003, and the price of toys in the United States at Christmas was 24 percent lower in 2003 than in 1997 due to the elimination of tariffs. These types of gains to consumers from trade were even evident in Japan after the signing of the Treaty of Peace and Amity. Within two decades after the treaty was signed, foreign interaction contributed to Japan's first bakery, photoshop, telephone, beer brewery, and cinema.

The benefit of trading with emerging countries comes not only through imports, but also increased exports to these rapidly growing markets. Increased growth in emerging Asia offers a tremendous opportunity. China and India currently have a combined population of 2.3 billion. This is roughly 35 percent of the world's population. These are vast, untapped markets. Higher standards of living in these countries will substantially benefit the global economy. In fact, we have already seen evidence of this potential benefit through exports. Between 2000 and 2003, Japanese goods exports to China increased by about 70 percent, and U.S. exports to China by about 75 percent. In contrast, Japanese and U.S. exports to the world excluding China basically stagnated over the same period.

As the global economy continues to evolve, it will be critically important to remember these substantial benefits from trade. Maintaining support for free trade, and especially support for breaking down remaining trade barriers, however, can be difficult. Adjusting to changes in trade patterns can cause painful transitions and job losses. Some countries respond by adopting protectionist policies. Although these sorts of policies may appear to help isolate a sector from competition in the short-run, over time they inevitably harm consumers and producers, reduce competitiveness, and slow growth.

There are several steps that governments can take to ensure that we continue to receive the substantial benefits from free trade:

First, strongly encourage progress in global trade discussions through the Doha Development Round. The greatest gains from increased trade flows will occur if all countries around the world reduce their barriers to trade. Granted, some of the largest remaining barriers to free trade in countries such as Japan and the United States are in politically-sensitive areas. This is why it is important for Japan and the United States to show leadership in the global trade talks by tackling these challenges, and setting an example for other countries.

Second, respect the global trading system and work together to enforce these rules. For example, one issue of concern in the United States and Japan is the lack of respect for intellectual property rights in some trading partners, such as China. It will be important for developed economies to ensure that property rights are respected. Countries will be most successful by working together on these issues.

² David Wessel, "Imports Help Consumers—If Not Politics," *Wall Street Journal*, March 25, 2004.

Third, take steps to improve growth and thereby job creation. Raising and sustaining economic growth is the single-most effective way to strengthen labor markets and reduce the concerns about job security that drive concerns about trade. It is much easier to garner support for trade when workers are less worried about their ability to find a new job. The recent strong recovery in the United States, and the start of a recovery in Japan, suggests that both countries have made important progress in this area.

Fourth, adopt policies to ensure a flexible economy, such as through deregulation. Increased economic flexibility allows countries to better adapt as the global economy evolves, and more easily shift resources to where they can most benefit from trade. President Bush and Prime Minister Koizumi have taken an important step in this direction through the Regulatory Reform Initiative, a part of the U.S.-Japan Partnership for Growth. It will be important to continue to make progress in deregulation.

Finally, ensure that workers have adequate skills in order to adopt new technologies and succeed in new job opportunities. It is especially important that workers can receive training so that they can adapt to structural shifts in the economy resulting from trade. For example, the U.S. government recently expanded Trade Adjustment Assistance (TAA) which provides funding for training, moving expenses, and health care costs after a job loss due to international trade. Although no policy can fully remove the difficulty and suffering for workers and their families when they become unemployed, there is a role for government to help ease the transition.

To conclude, the relationship between Japan and the United States has gone through many ups and downs since Commodore Perry pointed his guns at Edo Bay, but the trade and broader economic relationship has recently flourished to the benefit of both nations. It will be important to make further progress, breaking down remaining barriers to trade around the world. The recent evolution of trade patterns resulting from the rapid growth of China and India only hint at the additional, substantial benefits to Japan, the United States, and the rest of the world from further increases in trade in the future.