

# Trumponomics and Japan

A little more than three months have passed since the advent of the Trump administration. What will the new administration's "America First" focus bring? Will the US relinquish its previous role as the global leader? Even now, hope and anxiety remain mixed both within the US and globally. Hopes have been high that the administration would adopt growth-oriented economic policies, but at present the concrete policy direction remains unclear. How should we think about "Trumponomics"? And how should Japan respond? This issue of My Vision considers these questions.

## About this Issue

### What will "America First" bring?

– The realization of economic growth is not a certainty

**Yuri Okina**

NIRA Executive Vice President,  
Vice Chairman of the Japan Research Institute, Limited

## Expert Opinions

### Trumponomics and Japan

How will Trumponomics change US policy?

And what effect will these changes have on Japan?

We asked a group of experts for their opinions regarding President Trump's policies and their effects, and how Japan should respond.

Interview period: January – February, 2017

#### How Donald J. Trump could promote long-term economic growth

**Glenn Hubbard**

Dean and Russell L. Carson Professor of Finance and Economics at Columbia Business School

#### The details of economic dialogue must be made public

**Hiroshi Yoshikawa**

Professor, Faculty of Economics, Risho University

#### International trade policy in the Trump era

**Fukunari Kimura**

Professor, Faculty of Economics, Keio University

#### The effect of the advent of Trump on energy and environmental policy

**Takeo Kikkawa**

Professor, Graduate School of Innovation Studies, Tokyo University of Science

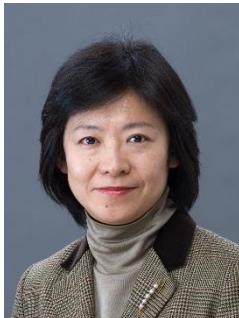
#### "America First" is an opportunity for Japan

**Yukio Okamoto**

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## What will “America First” bring?

### -The realization of economic growth is not a certainty



**Yuri Okina**

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**Expectations on Donald Trump’s economic policy are high, but the outcomes remain an unknown quantity**

A little over three months have passed since the advent of the Trump administration. Since President Trump’s inauguration, a variety of information has been published in quick succession, but no matter how one considers it, “America First” appears to be the distinctive policy characteristic that sets Mr. Trump apart from previous presidents. This stance has been expressed in the policies propounded by a sequence of Executive Orders issued rapidly following the inauguration, for example concerning the building of a wall on the Mexican border and restrictions on the entry of refugees and migrants to the US.

These policies place the priority on ensuring employment for US workers, but the stance of the Trump administration offers cause for concern over the fragmentation of a society previously known as a “melting pot.” At the same time, there is a strong expectation that Trump will adopt growth-oriented economic policies; consumer and business sentiment is improving, share values have increased, and the dollar, while subsequently weakening, became stronger for a period.

Viewed from the perspective of Japan, the meeting between the leaders of the two nations in February 2017 offered, for the present, a “soft landing” for Japan-US relations. However, it remains necessary to consider how Japan should respond to an America of which it cannot be certain, and what international role the nation should adopt.

In this issue of My Vision, we have therefore sought opinions from a group of experts, based on the perspectives of their fields of specialization, as to what effect the Trump administration’s economic policy, so-called “Trumponomics,” will have on the US and world economies, and how Japan should respond.

Professor Glenn Hubbard, who served as the Chairman of the U.S. Council of Economic Advisers under President George W. Bush, stresses tax reform and the easing of regulations in order to increase productivity, and the provision of support for employment, as policies that will have a positive effect on economic growth.

By effecting these policies, the Trump administration can be seen to have the intention of reinvigorating areas such as finance and energy-related industries, which were significantly affected by the strengthening of regulations during the Obama era, and, further, of conferring benefits on a manufacturing industry that has lost export competitiveness and on the middle class through tax reductions. The revision of Obamacare and large-scale (as much as one trillion dollars) infrastructure investment have also been raised as key policies. As Professor Hubbard points out, if, rather than instituting short-term policies, Mr. Trump is able to tackle long-term structural problems head-on, it will be possible to maintain expectations towards growth in the US.

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However, it is still unknown to what degree many of these policies will be realized following their debate by the Republican Congress. There is also a strong possibility that even if Trump's policies are passed by Congress, it will take time for their effects to become apparent. With regard also to the monetary policy of the Federal Reserve Board, which has a significant effect on Japan's long-term interest rates and exchange rate, it is likely that the FRB will decide the pace of interest rate increases while determining how the effects of the Trump administration's policies are manifesting themselves.

The policies of the Trump administration also attract numerous skeptical perspectives. Viewing the IT industry that is currently driving the US economy as the product of a unique American ecosystem generated by the fact that the nation has attracted large numbers of talented immigrants, Professor Hiroshi Yoshikawa raises fundamental doubts regarding the "America First" concept. Professor Yoshikawa also questions Donald Trump's awareness of the current status of the US economy. Offering an important perspective on the limitations of Trumponomics, he points out that the US economy was already recovering, that government expenditure should not be the centerpiece of economic policy, and that the effect of tax cuts in reinvigorating the economy is doubtful.

Changes in trade policy and reform of the tax system, for example the introduction of border adjustment measures, can be considered to be economic policies that epitomize the "America First" concept, but whether these measures are even feasible, and the fact that protectionist policies may produce unwanted side effects, is also a cause for concern.

In the area of trade policy, President Trump announced the withdrawal of the US from the Trans-Pacific Partnership (TPP) soon after his inauguration, and has also proposed a direction for the revision of the North American Free Trade Agreement (NAFTA). In addition, as Professor Fukunari Kimura points out, we must bear in mind the possibility that the movement towards the introduction to the company tax system of border adjustment measures that would benefit American export industries may violate the system of trade rules with the World Trade Organization (WTO) at its center, inviting retaliation from affected countries and producing a negative effect on the world economy.

The transformation of US energy and environmental policy also offers cause for concern in relation to the long-term growth of the world economy. It was predicted that the Donald Trump administration would adopt a passive stance in relation to global warming; the actual effect of the advent of the administration has been to diminish the impetus towards implementation of the Paris Agreement and create fears of a slowing of the pace of international efforts to address environmental problems. Professor Takeo Kikkawa points out that the US shale gas revolution has reduced the price of natural gas, and offers the persuasive opinion that as long as this situation continues, the damage to the Paris Agreement will be limited.

Overall, there are significant uncertainties surrounding President Trump's protectionist policies, and the potential for the realization of tax cuts and the possible effects of policies involving large-scale government spending are also unclear. It is highly possible that unless President Trump makes fully-fledged efforts to address essential long-term structural issues, economic growth under the administration will not match the initial expectations of the market. It will be essential to prudently monitor future policy developments.

#### Japan's role in protecting the international public good

How, then, should Japan respond to a changing America? Geopolitical risk has ratcheted up a notch, and uncertainty on the diplomatic front is increasing. Yukio Okamoto emphasizes that precisely such a juncture presents an opportunity for Japan to expand its frontiers and play a role in protecting the international public good.

It will be necessary for Japan to call for cooperation from other nations including the US, to carefully analyze the international situation, and to make a greater international contribution to regimes of free trade, the rule of law and environmental protection. The view that the international role that Japan should uphold is increasing is shared by most of the experts interviewed for this issue. The February meeting between the leaders of Japan and the US established a new economic dialogue. What will be required of the Japanese government will be to engage the US in close and strategic dialogue while never wavering in its commitment to the logic of free trade and investment.

## **How Donald J. Trump could promote long-term economic growth**



**Glenn Hubbard**

Dean and Russell L. Carson  
Professor of Finance and  
Economics at Columbia  
Business School

The sanguine response of equity markets to Donald Trump's election makes sense if his presidency heralds a pro-growth policy, but it also lays bare steps the new administration and its economic team need to take to justify that optimism.

One issue should take precedence over the others: The creation of building blocks for restarting economic growth. Resetting expectations for long-term growth requires policies that enhance productivity growth and support work. Two building blocks to raise productivity are tax reform and regulatory reform. Tax reform can raise investment and productivity by significantly reducing marginal tax rates on business income, while broadening the tax base. Regulatory reform is a second building block for growth by weakening impediments to investment in energy and utilities, while overhauling financial regulation to improve credit availability for small and midsize firms.

Work is vital for growth, incomes and social dignity. Tax reform is a core element here, too. These additional building blocks provide the broader support for work that is needed economically. First, market-based health care reforms can slow the rate of growth of health care costs. Second, we should strengthen substantially the earned-income tax credit for childless workers to encourage and support entry-level work and the earnings-building skills that work provides. Third, current spending on unwieldy federal job training programs can be directed toward personal re-employment accounts for income support and enhanced personalized training for individuals.

At the same time, a well-structured infrastructure program can augment aggregate demand as expectations for growth are reset, while bolstering productivity over time. But to do so, it needs certain elements. First, it should be a long-term commitment. Second, an infrastructure program should be a partnership, bankrolled by federal, state, local and also private funds, with the mix depending on the project.

While constructive in its early strong response to the financial crisis, the Federal Reserve has been depended upon too much by a government not willing to tackle bold reforms. An early emphasis on growth by the Trump administration will mean closing the door on failed efforts at stimulus and overreliance on monetary policy. An emphasis on short-term policy has allowed the neglect of long-term structural problems that have held back growth and aggravated economic anxiety for many households and business people.

Now, the right building blocks, action and communication can sustain optimism and generate higher incomes and greater opportunity. Trying to accomplish a much broader agenda than a focus on growth risks loss of policy focus and clarity of the economic message to the public.

Professor Hubbard is a prominent American economist. He received his Ph.D. in economics from Harvard University, and has taught at Columbia University since 1988. He also serves on the Economic Advisory Panel of the Federal Reserve Bank of New York. From 2001 until 2003, Professor Hubbard was Chairman of the U.S. Council of Economic Advisers under President George W. Bush, and was involved in the design of the Bush tax cut in 2003. A specialist in public finance, macroeconomics, and industrial organization, Professor Hubbard is the author of numerous books and papers, and has co-authored works including *BALANCE: Why do great powers lose it? How can America regain it?*

## **The details of economic dialogue must be made public**



**Hiroshi Yoshikawa**

Professor,  
Faculty of Economics,  
Rissho University

Fiscal stimulus is the centerpiece of current US economic policy. President Trump seems to believe that the US economy is struggling, but in fact the economy at hand is coming good. Housing prices are approaching their level prior to the subprime shock, prompting the economist Robert J. Shiller to speak of signs of a bubble. The FRB commenced raising interest rates at the end of 2016. The issue of aging infrastructure remains, as evidenced for example by the Minnesota bridge collapse, but the appropriate amount of expenditure on public works must be judged on the basis of the nation's macroeconomic status.

The effect of tax reductions in invigorating the economy is also doubtful. The international competitiveness of US manufacturing industry did not decline as a result of high corporate taxes, and reducing tax rates now is unlikely to reinvigorate manufacturing.

Google, Amazon, and the other IT companies that are driving the US economy are products of the nation's corporate ecosystem, not the result of government policy. In this sense, Trump's cry of "America First" is extremely ill-considered.

Against this background, in their first meeting as leaders, Prime Minister Abe and President Trump agreed to establish a new economic dialogue between the US and Japan. If the Trump administration continues to project a sense of instability, it is predicted that the effect on the economy will be negative. And if this is the case, it is likely that dialogues will see Japan being criticized for inducing a weak yen.

While the two nations have launched past joint measures such as the Japan-U.S. Structural Impediments Initiative, the international cooperation demanded by the US is not a boon for Japan. Negotiations between the two countries have often been based on misreadings of the facts, and have tended to lead to ill-judged policy. Looking back on the past, it is clear that protectionism has not been a solution to problems.

The particular concern, however, is that Trump will attempt to bargain in the areas of fiscal policy and economic problems using the security relationship as a bargaining chip. It may be that Japan's exchange rate phobia will be clearly noted, and the exchange rate used as a "hostage" in negotiations. The exchange rate should be determined by the market; it should not be an item on the agenda in negotiations. From the perspective of avoiding this outcome also, details of the discussions held during economic dialogues must be made public.

Believing that protectionism has an economic impact on all countries, Professor Yoshikawa maintains a focus on the policy transitions occurring in the United States, which has historically been a leading actor in the promotion of free trade. Professor Yoshikawa took his Ph.D degree from Yale University, and specializes in the study of macroeconomics. Following positions including an assistant professorship in the Department of Economics of the State University of New York, he became a professor in The University of Tokyo's Graduate School of Economics. Professor Yoshikawa retired in 2016 and took up his present position. He also holds a range of official positions, for example as a member of the Ministry of Health, Labour and Welfare's Social Security Council, and was the former Chairman of the Financial System Council of the Ministry of Finance.

## **International trade policy in the Trump era**



**Fukunari Kimura**

Professor,  
Faculty of Economics,  
Keio University

The advent of Donald Trump has exposed not only the US but also the entire world to great uncertainty.

In East Asia, the first issue is whether we will be able to reach a fixed and stable equilibrium on the security front. In connection with international trade policy also, dramatic changes in the security system are the greatest area of concern.

We must also take care that the system of international trade rules with the WTO at its center does not collapse. There is a strong possibility that the various schemes Mr. Trump has tweeted about, such as introducing high tariffs against countries recording a surplus in their trade with the US, introducing a border tax, and introducing high tariffs in order to build a wall on the border with Mexico, would violate the concession tariff rules and the principle of non-discrimination to which the US is committed under the WTO.

Countries falling victim to these policies would probably appeal to the WTO for dispute settlement, but a judgment would take some years. Failure by the US to withdraw its policies during this period would no doubt drive the affected country to take countermeasures. If the body of international trade rules which has been developed up to the present is simply set at nought, it will have a significant negative impact on the entire world economy.

What will become of regional economic integration? Negotiations may be commenced to revise the North American Free Trade Agreement (NAFTA), but what would their aims be? There is no possibility that the US will return to the Trans-Pacific Partnership (TPP) Agreement over the short term, but can the other 11 parties to the agreement commit to a TPP lacking the US? If so requested by the US, Japan would have no choice but to enter FTA negotiations with the US. What type of negotiations should these be? Will the FTA between the EU and Japan be concluded? Many questions have to be considered.

It is at precisely such a time that we must carry through the logic of free trade and investment. For example, as was demonstrated by the TPP negotiations, issues such as the scrapping of agricultural protections by Japan and unreasonable demands for the sale of American cars must not be negotiated as an entire package, with consideration only of the cost of political adjustments. Unless we persist in reasonable discussion, we will never be able to push back irrational demands.

We should also work to conclude the Regional Comprehensive Economic Partnership (RCEP) proposed by ASEAN, and thus announce to the world our intention to continue to advance free trade and investment within the region. While we will continue to negotiate those areas on which we cannot reach agreement immediately, it is now high time to move rapidly towards an early conclusion of the RCEP.

Professor Kimura studies international production and distribution networks from a variety of theoretical, empirical, and policy perspectives, and stresses the importance of mega-FTA. His areas of specialization are international trade and development economics. Professor Kimura took his Ph.D. in economics from the University of Wisconsin-Madison, and held positions as an assistant professor in the Department of Economics of the State University of New York and as an associate professor in Keio University's Faculty of Economics before taking up his present position in 2000. Since 2008, he has also served as the Chief Economist of the Economic Research Institute for ASEAN and East Asia (ERIA).

## **The effect of the advent of Trump on energy and environmental policy**



**Takeo Kikkawa**

Professor,  
Graduate School of  
Innovation Studies,  
Tokyo University of Science

What effect will the advent of President Trump have on energy and environmental policy? I would like to focus on two points.

The first of these is a negative effect on the Paris Agreement, an international framework for action on global warming, which was concluded in December 2015 and took effect in November 2016. The US and China are the world's major emitters of greenhouse gases, and the advent of an administration that is skeptical towards the idea of global warming itself will undoubtedly have a dampening effect on the implementation of the agreement.

However, what must also be considered here is the cold, hard fact that former President Obama's global warming-related measures, which appeared to tackle the problem actively, in fact simply reflected energy-related market forces in the US. The shale gas revolution that proceeded from the mid-2000s in the US reduced the price of natural gas, and an anomalous situation took effect in which the price of natural gas became lower than that of coal. This situation saw thermal power plants change their fuel from coal to natural gas, and as a result their emissions factors for greenhouse gases, in particular carbon dioxide, were reduced. Rather than an effect of his own policies, Obama's contribution to combating global warming can more correctly be seen as a benefit of this change in the market.

If we accept this, it is unlikely that Trump himself will be able to act independently of energy-related market forces. No matter how much he advocates the reinvigoration of the coal industry, to the extent that the shale gas revolution continues and the price of natural gas remains below that of coal, he will have a limited effect in doing so. Looked at coolly, then, the damage that the Trump presidency will do to the Paris agreement will itself be limited.

The second point is the significant effect that the change in US-Russia relations will have on Japan-Russia energy issues. President Putin's visit to Japan in December 2016 produced no discernible outcomes either in the area of territorial issues or of energy cooperation issues. The reason for this was the fact that the election of Donald Trump changed US-Russia relations dramatically for the better, and there was a strong possibility that sanctions on Russia would either be lifted or eased. This meant that Putin had no need to make concessions to Japan in either area. The advent of President Trump has also cast a shadow over the issue of Japan-Russia energy cooperation.

An economist, Professor Kikkawa studies Japan's energy industry from a business administration perspective. He completed coursework in the Graduate School of Economics of the University of Tokyo, and took his present position in 2015, after teaching as a professor in Hitotsubashi University's Graduate School of Commerce and Management, an assistant professor in Aoyama Gakuin University's College of Economics, and a professor in The University of Tokyo's Institute of Social Science. Professor Kikkawa specializes in Japanese business history and energy industry. He is a member of the Ministry of Economy, Trade and Industry's Advisory Committee for Natural Resources and Energy, and, as an individual strongly interested in the internationalization of research, he is also working as an official for the 2nd World Congress on Business History to be held in Tokyo in 2020.



## **“America First” is an opportunity for Japan**



**Yukio Okamoto**  
President,  
Okamoto Associates, Inc.

President Donald Trump’s inauguration address was a disappointment. Trump stressed his “America First” direction exclusively, with no mention of America’s principle of protecting freedom and democracy. He asserted “the right of all nations to put their own interests first,” and indicated that America would present a shining example of this pattern. No previous president has offered such a worrying inauguration address. If these principles are followed, our world will become one in which every nation turns its back on every other. Countries will no longer work to create regimes for the international public good – freedom, democracy, the rule of law, free trade, the strengthening of fiscal foundations, the provision of support to poor nations, the protection of the environment – and the world will simply drift.

However, Trump’s speech represents an opportunity for Japan. Japan criticizes “America First,” but if we consider the matter carefully, we will see that we have long put Japan first. While other nations accept many thousands or tens of thousands of refugees, Japan has been accepting only several tens. Last year the nation approved the entry of only 26 refugees. And yet discussion in the Diet sought to oppose Trump’s ban on the entry of refugees as unacceptable. This is truly self-serving. Since its peak in 1997, the overseas development assistance (ODA) provided by the Japanese government has been almost halved on an initial budget basis. Moreover, because much of the spending relies on repayments from developing nations, there is little actual fresh government spending involved. With regard to defense expenses, the ratio of Japan’s spending to GDP places it at number 102 in the world. Japan has made the armies of other nations responsible for the risk of defending its citizens and assets overseas.

Before Japan criticizes America, it is time for the nation to change this stance, and to involve itself in the world. A world in which Russian and Chinese expansionism is growing, and the role of the US and Europe is declining. Within this world, Japan’s living space will be limited. Precisely now is the time for Japan to open up its own path, take up the role of protecting the international public good, and expand its frontiers.

And Japan should call on America to undertake this role together with it. Happily, while America’s leader may be stubborn and petulant, there are many excellent people in the U.S. Cabinet. The abilities of the individuals involved in diplomacy and security are quite high. If Japan calls, America will not refuse. But if Japan fails to do so, then it may sink in a drifting world.

Mr. Okamoto is a diplomatic analyst with a reputation for offering understandable commentary covering a wide scope and based on an incisive perspective. Following his graduation from Hitotsubashi University’s Faculty of Economics, he entered the Ministry of Foreign Affairs. In 1991, he retired from the Ministry, and established Okamoto Associates, Inc. the same year. Mr. Okamoto served as a Special Advisor to the Prime Minister in both the Hashimoto and Koizumi Cabinets. He is extensively involved in giving lectures and offering commentary on television, and in newspapers and magazines. Mr. Okamoto is a Visiting Professor at Ritsumeikan University, a Specially Appointed Professor at Tohoku University, and a Senior Fellow of MIT’s Center for International Studies.