

Keynote Addresses

What Lies Ahead for US Economic Policy in the Trump Administration

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It is a difficult time to come from the US to be asked to speak about what is going to happen in Trump Administration. He has only been in the office for three weeks and like a lot of people in other countries, in our own country, there is a huge amount of uncertainty about what is likely to happen. The presidential election highlighted a deeply polarized America. The outcome is remarkable dramatic shift in US foreign policy and economic relationships with the rest of the world. The Republican party now controls all three branches of the government. The party itself is being redirected by the president towards much more nationalistic “America first” type of economic policy. It is a more protectionist role in global affairs.

Why the Trump win is a huge surprise to experts in the US about the election. He basically won one big racial group; white Americans for both male and female voters. He had very strong support among those who are most opposed to immigration, identify terrorism with Muslims, and fear the economic consequences of globalization. He also obtained a strong majority of white voters in rural and small urban areas with less than a college education. It is a major realignment of blue-collared workers in the US, which is for many years, people identify as Democratic party. Same groups had strong antipathy to Hillary Clinton urban views she was identified.

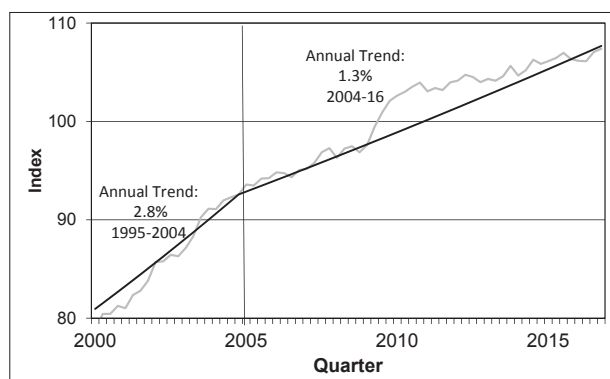
The best clue to what is going to be President Trump’s new economic order turns out to be in his inaugural address. He articulated a foreign policy perspective centered on putting American interests first. It is an extreme version of economic nationalism that makes virtues of protectionism and mercantilism. He has expressed opposition to multilateral negotiations and institutions in favor of bilateral negotiations that he believes will maximize US leverage. Some people observing this fear that this marks end of the dominant liberal order of the post world war II years.

What is the state of US economy as he takes over the American presidency? Economy is now approaching full employment in the US with an unemployment rate of 4.8%. We have slow supply-side growth, because of aging labor force participation and slow productivity growth. GDP growth in 2017 and 2018 probably will be a little bit above 2% annually. Inflation is gradually rising and should hit near 2% by the end of the year which has long been articulated as the American goal. This led a lot of forecast that Federal Reserve Board (FRB) interest rate increases about 0.75 percentage point by the end of the year. Along with the higher interest rates, most people expect to see the American dollar continue to appreciate.

The labor force decline dramatically in the very short period of

time since the year 2000. The major reason for this is the aging of the population. The baby boomers are now beginning to retire and those age groups change the percentage of the overall work force. Productivity growth rate in the US from 1995 to 2005 is a boom period for the American economy. Productivity growth was about 2.8% a year, but now it is falling for the last 15 years to less than half of that, which is little bit over 1% (Figure 1), that translates a potential GDP growth of only about 2% a year.

Figure 1 Output Per Person Hour



What is the Trump’s economic agenda? First macroeconomic policy, and tax cut for 2% of the GDP. He wants to reduce and simplify personal income tax system. Corporate tax rates will be cut dramatically from 35% today to down around 15 to 20%. He desires to have a large infrastructure program. He has not yet explained how that would be financed, but many people explain that he is going to advocate public partnership to transfer a lot of infrastructure operations into the private sector. That will represent a large fiscal stimulus of the GDP, but implies increases in the budget deficits.

Individual income tax will be reduced from 7 tax brackets at a present to only 3, and special rate even lower for business type income. Simplified tax structure eliminate state and gift tax in the US and revenue side of the program implies a loss about 1.5% of GDP. Controversial aspect of the program is corporate taxation. During his presidential campaign, the president proposed fairly traditional corporate tax reduction, just reducing the rates from 35 to 15% and no other major changes. But the Republican House of Representatives has a proposal for dramatic new form of corporate taxation, a cash flow tax. That will be much more controversial internationally, because of its particular facts.

They want to redefine taxable revenues and taxable expenditures to eliminate the taxation on exports, but

corporation is not allowed to deduct expenses that they had from imports. If the tax rate is 20%, this proposal means that there will be a tax on imports into the US and US exports will be free from corporate taxation. In other words, it looks in any aspects like a value-added tax. It would do a lot to eliminate incentives from American corporation to move economic activities in abroad, because they will get large tax advantages by staying in the US. What the impact would be on the US around the global economy depends critically in what would happen to the exchange rate. It is very controversial and uncertain. Most American economists believe that exchange rate will just rise to offset the effect of those changes. There is a lot of people who question that assumption and it remains very controversial in the US and will be very controversial in the global economy, because from the outside perspective, it looks like a tax of 20% on all imports to the US if exchange rate doesn't rise to offset it. It is not WTO compliant. There would be a big argument with the WTO about the meaning of the tax, but it's not clear that the Trump administration would care what the WTO says.

Major features of the macroeconomic program will be enacted by late 2017 and the biggest impact will be in 2018. There will be some conflicts between people on the congress over expenditure increases and budget deficit. Such a stimulus to policy will drive up interest rates, exchange rate and worsen the trade deficit even further. Administration objectives for faster growth and its focus on reduced trade deficit will be in conflict. What is going to happen on the American exchange rate?

Some concerned domestically the magnitude of increasing public debt in the US, rising the share of GDP. Without any changes by the Trump administration, the public debt will rise to about 87% of GDP by the mid 2020s. The Trump plan would raise that debt level even further by about 25%, putting the US over a 100% of GDP in its public debts which makes us uncomfortable, because it sounds a bit like Japan.

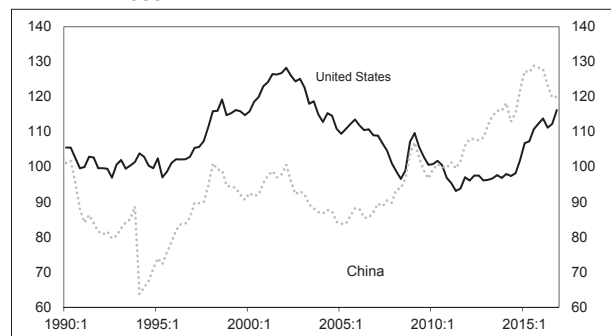
Trump will also raise defense and infrastructure spending and cut other nondefense programs. But precise dimensions of this economic program has not yet been proposed in detail and there still is no budget proposal to go along with it. FRB has questioned whether or not there is a lot of excess capacity in US economy. They think we are close to potential GDP. Implication is that interest rates and exchange rates would rise to offset much of the physical stimulus. Everyone seems to agree that supply-side benefits of these proposals will be small. Thus, there is a potential for a major conflict between the FRB and the Administration of economic policy. Yellen will be finished her term as chairman in February of 2018, and the President will have freedom to appoint several additional members to the FRB. There is likely to be a big battle over the future of monetary policy in the US and independents from the executive branch.

Stronger economic outlook and prospect for interest rate increases have already increased trade-weighted exchange rate dramatically by 15% over the last two years. Just to offset the proposed corporate tax, we will have to have another 25% increase if we went ahead with Republican plan for a value-added type of tax for corporate income. The impact on trade flows suggested that would be a gradual process. These dramatic

changes suggest to me that tax proposal of the congress will not be approved and something will be scaled back dramatically on the tax side.

This is the US exchange rate together with that of China (Figure 2). The last two years already had a lot of appreciation and if you had another 25% on top of that, there will be serious problem of the competitiveness on the American goods in the world markets. Euro of the same type of period had declining path. Japan, after falling sharply a few years ago, is now being appreciating its currency of last year.

Figure 2 Trade-Weighted Real Exchange Rates, Consumer Prices



The second feature of the Trump economic agenda is a trade policy. The US has already withdrawn from TPP and Trump is opposed almost all multilateral trade pacts. The administration will put major pressures on trade with countries that have large bilateral trade deficits from the US perspective. Their plans are to either cancel or dramatically renegotiate NAFTA, the agreement with Canada and Mexico, and to label China a currency manipulator. They will try to file unfair charges against China primarily over the issue of industrial subsidies. In the campaign, he threatened tariffs of 35% on Mexico and 45% on China, but those are not going to happen, because American consumers, who will pay the tariff, will be angry about increase in the price of the product purchase from these countries. There are going to be a lot of argument and battle over trade policy. He does seem to focus on trade balances at the bilateral level. It is very much interested in what people globally characterize as a protectionist point of view.

The US have a trade deficit with everybody in the world (Table). There is a handful countries with whom we have a surplus. Potentially, everybody is a target. Largest trade deficit is China. He mentioned repeatedly in the campaign for the size of that bilateral trade deficit. Germany is the largest surplus country within the EU and Mexico. It surprised me a little bit that when Prime Minister Abe visited Washington, it appears to have no discussion with the trade deficit with Japan. I don't know if that means the president shifts focus with his relationships with Japan more concerned about political, foreign policy issues than economics. We have to wait. Throughout Asia, there is a lot of the countries that had trade surpluses, from their point of view, with the US, which could be the arguments between Trump Administration and these countries. Related to NAFTA, it appears that the formal agreement will be scrapped or replaced

with bilateral agreements with Canada and Mexico. Agreement with Canada will be easy to negotiate, because there are not great differences between the two countries, but renegotiation with Mexico threatens very large disruptions. There is a big trade deficit and the US may have a large investment than Mexico, the value in which dramatically affected by some big dislocation of trade. How he actually plays out still remains to be seen. During the campaign, the president said Mexico would pay for the wall along the border, but Mexico said it would not.

Table: US Bilateral Trade Balances, Billions, 2016

Country	Exports	Imports	Trade Balance Goods	Balance Goods & Services
Global	1,460	2,210	-750	-501
EU	270	417	-165	-102
Germany	49	114	-64	-77
Canada	267	278	-11	6
Mexico	231	294	-63	-57
China	116	463	-347	-334
Japan	63	132	-69	-55
Korea	42	70	-28	-18
Other	471	556	-67	62

Trump's "America first" approach suggested he will be rather dismissive of major international institutions, such as the G-20, IMF and World Bank, given his preference for bilateral negotiation. But he may be attracted by public forum like G-20 meetings provide. US is anticipating at present he will attend the next G-20 meeting. What he will say and what he will do from there is uncertain, but he will not be supportive of expanded role of large emerging market economies, such as IMF and the World Bank.

Immigrations actions are also very close to his campaign themes. A ban on visitors from seven Muslim-majority countries and deportation of those at the airports has been temporarily blocked by the courts. Law forbids discrimination on immigration in the issuance of an immigrant visa because of the person's race, sex, nationality, place of birth or place of residence. When the president said it was based on people been over particular religion, that is illegal. He will now claim that it is an international security issue to avoid the focus on religion. He is already started and expanded deportation program for people who are resident in US illegally. Several hundred or thousands of people had been rounded up in these programs being subject for deportation. He still talks about trying to build the walls along the border with Mexico.

He vowed in the campaign the cancel of US participation in the Paris accord of 2015. While he can't withdraw immediately, he will reverse President Obama's regulation on the clean power plant and expansion of production of domestic oil and natural gas. He hasn't said much about the climate change proposals. It is not clear whether that is going to be a major objectives of the administration, but environmental regulation has already

attracted a lot of attraction. Focus on reducing the degrees of regulation of energy, he has approved pipelines, that was previously held by Obama Administration and remove some regulatory constraints on the production of coal. What is coal in the US? Coal is not economically feasible to use in competition with natural gas. I don't think we will see coal production will turn to anything like what it was in the past.

What is the implication of all this to Asia? It seems to me it remains uncertain, but it's certainly dramatic change. The US has withdrawn as a major advocate and participant in multilateral economic agreements in Asia. Asia will have to find other leader to take the place of the US. It also means conflict between the US and China over trade and investment policy. It's possible that previous participants in TPP could move ahead to have some form of regional agreement without US membership, but it's not clear how practical that is in other countries in Asia.

What is clear is that Trump has re-open the whole battle over protectionism at the international level. The movement force the gradual elimination of trade restraints and open free trading among countries looks like in a possible reversal. US would like to focus on a bilateral, pick one country at a time. Using the size of the US market is the major negotiating strategy to try to force countries to adopt changes in the trade relationship in favor of the US. Most effective responses here in Asia is to try to work together to continue to try to build on the Asian side a unified and fairly liberal economic association, which is the best way to encounter advocates the US approach. Japan has suggested its interest in bilateral free trade agreement with the US moving ahead. I recognized the TPP is not going to happen.

Question-and-Answer Session

Question from the audience

The US Bilateral Trade Balance table includes both products and service, including intellectual property, income and patent?

Barry Bosworth

It does not include income. US doesn't have a very big trade surplus in services with China at present time. Trump doesn't approve the income component, because he says that's a measure of the extent of which we lost jobs. American companies have moved abroad, they report large earnings in other countries, but it doesn't identify with as any increase in jobs in the US. For his constituency, the whole focuses on the issue of jobs. Hence, he tries to induce individual American companies to pledge to bring some of their production back to US.

Masahiro Kawai, Representative-Director, ERINA

First question is the impact of Trump economic policy on those voters who voted for Trump; pre-college, blue-collar, white workers in a rural area in the Rust Belt. What other chances for them to gain from economic policy of Trump?

Second, although Trump wants to see growth and the revival of the manufacturing sector in the US, what is really the chance of the manufacturing sector in the US who regain its importance

in the US?

Third, the table shows that the US has large deficit in the balance of goods and services trade about 500 billion dollars. It's a very large deficit, and many countries have surpluses against the US. Rather than blaming countries that have surpluses, perhaps the US should try to reduce deficit. In order to do so, savings have to improve. Trump wants to see a lot of investment in the US, but that approach does not seem to improve the US trade balance. How can the US increase savings relative to investment and improve trade balance?

Barry Bosworth

The first two questions go together. The issue of whether or not trump can deliver increasing job opportunities to trade for low skill workers in the US goes along with the issue about trying to revive the manufacture sector.

This is a common theme in the US that we like to blame foreigners for this decline and it's not going to turn around. This has been going on in the US for almost 70 years of continuously decline in the share of manufacturing employment in total employment. It's happening in most advanced economies. As incomes rise, turning towards services, and production less in manufacturing. Manufacturing tends to have a fairly fast growth productivity, so manufacturing sector doesn't need many workers as it used to. What Trump is doing seems to me as demonstration runs exactly the opposite direction. It is not because we are discriminated against every country in the world. He would be better off to try to find some way to improve the competitiveness of the American products in world markets.

You need to have the US exchange rate go down, not up. And it was going down from about 2003 up until a couple of years ago. In the last two years, the exchange rates going back up and we are seeing a fairly rapid increase in the trade deficit with the rest of the world. If he was going to do that rather than trying to get protectionism type measures against other countries, I think you are right to suggest how do you get a lower value-add exchange rate. You have to have a higher level of domestic saving in the US.

We have a trade deficit with the rest of the world mainly because we are a low saving country. We have pretty good investment opportunities and if others agree with that, a lot of the money flows in from the rest of the world to invest in the US to fill the gap of low savings. Savings are low in part because households have very low savings rate, but it's also low because of large government budget deficit. In a long run, we would want a strategy to try to find a way to increase national saving relative to investment. But it is a dilemma right now. We are still trying to recover from a disastrous financial recession just a few years ago. The US economy is maybe ahead of most countries in that recovery process, but it's not exactly what you call "strong economy" at a present time. Many economists are still advocating at least for the short run that we follow a most stimulus to policy.

It's been actually fairly high support for Trump's suggestions for tax cuts and increases in infrastructure spending. But the trade deficit is much more reflection of a long term structural

problem. It's been 30 years in the US at large magnitude and it does seem responsive to the exchange rate. I don't think right now the trade deficit a big crisis. The biggest problem is to get economy expanding in more rapid pace. But in the long run, US cannot go on borrowing from the rest of the world. In the longer period of the time, it's a macro economic problem to try to rise national savings relative to investment to close the gap, not a trade problem.

If you are a conservative republican, you have a deep belief in tax cuts. Trump picked on that and advocated large tax cuts. But while some republicans would advocate expenditure cuts to go along with tax cuts, Trump is advocating big increases in spending both financial defense and for infrastructure. He is going to have larger deficits that have to be financed by borrowing more from abroad, that is going to drive up US exchange rate, and it is going to defeat his efforts to try to improve competitiveness of American manufacturing. In a long run, this is not going to be a benefit to those workers who are looking for recovery of manufacturing solution to the problems.

It's a composition of those jobs that bothers people. I don't think we can bring back jobs in manufacturing. What we need is a more educated, well-trained workforce. Those people in the US who have a high degree of education make very high income and all employed. I think that policy works for them, but the core Trump support group of people are those who did not get a higher level of education, little late in their life, most of them are older in their 40s, 50s and even 60s who are a kind of late to talk about increasing job skills at that point of time. They feel the economic events for the last two decades hurt them a lot. I do not see how his policy is can actually help them. It's going to be a certain element of frustration in a next couple of years, because everything he is doing so far seems motivated by a desire to respond what he told that core group of constituent who are very unhappy with the current economic situation in the US. But I don't think he has a program that will actually make them better off. That is going to turn out to be very frustrating to the president over the next couple of years.

Zhang Yuyan

It is true that China is running huge amount of trade surplus with the US, but when my colleague calculated the trade surplus China with the US based on value-added, it was less than 100 billion dollars. It means that China's surplus is not the largest, but second to the EU. You mentioned that there would be a potential tariff towards China be 45%. How likely that can be trade war in the future between China and the US?

Barry Bosworth

This particular table shows trade imbalances by bilateral level over states the situation. I argued several times in the past, but a lot of economists now believe it's the waste of the time to calculate bilateral imbalances in a global economy where goods move around so dramatically. In this case, China serves as a final assembly point for lots of goods and services. The publication several years ago, who's actually producers of iPhone, was an excellent example of it. Since all the China was doing was

assembling the phone, and the value-added out of a 600 dollar purchase was about 10-15 dollars contributed to China. Taiwan, Japan and South Korea are making all the parts that fed in. Apple computer didn't want to report its profits in the US, because they would have to pay a high tax. Apple shows up is making most of the profit not in the US which will be subject to tax. It makes all this profit in the rest of the world. In US trade statistics which simply record where was the last port from which these goods. It is little bit more complex, but the measure is used can be misleading. The US does have a large trade deficit. You can argue over how its distributed across the individual countries. I would argue though probably in practice, there is a large trade deficit between the US and Asia. It's a production network system in Asia that is generating large value added in exporting those products in the US.

The other side of the problem that doesn't get discussed much is that most American companies are not interested in exporting. Not like European companies, American companies prefer to operate as a business in these other countries. Apple wants to operate in Asia. It wants to compete with Asian companies in the Asian market, and things it would do well. Most financial firms in the US, there is nothing to export in financial services to other countries. They want to be in financial markets in those countries to make profits from that. Most of the focus of American companies is operating in foreign countries, but not exporting to foreign countries. They want to go to a country, they want to produce there, and they want to sell largely in the country, sometimes to the third parties. US multinational corporations are right, because they are extremely successful. They make a huge profit, which account for about 25% of all corporate profits they could be reported by American base companies. Apple probably shows up in the tax statistics is having no profit in the US, but that is not accurate. Apple is one of the most profitable corporations in the world and it's just a profit overseas. I quite agree with you that these sort of statistics could be highly misleading in what they mean.

You can't think of that at this stage. The big loser from a global trade war is the American companies and the value of all those investments we have in other countries. It doesn't seem to me make any sense. I would agree with President Trump that there is room for the US to negotiate stronger on trade force. We have attended to abundant goods trade in favor of financial services and wall street interest, but these are marginal thing. It shouldn't fundamentally change everything. But I would look forward to an American government to more aggressively sort

out advantages of exporting by plants located in the US. I don't see anything wrong with that as long as you don't go war over it.

Lee Jong-Wha

About trade war issues, it is said that in April, the treasury sent a report to the US congress which country would be eligible for the currency manipulator. Several countries in this list could be pointed out as a possible candidate, because these countries have huge overall current account surplus and bilateral trade surplus with US. People may think some countries intervene in a foreign exchange market. Can we just trust your observation that trade war may not happen or still there is a possibility that US treasury will send a report and US congress will make political decision? How high the possibility is that Trump administration will do something for it?

All Asian countries, including China, Taiwan, Japan, North Korea and South Korea are subject to significant influence from the changing of US administration foreign policy. Could you say a little bit more on this point whether there will be significant uncertainties or risks which will come from the US administration's new foreign policy on Asia?

Barry Bosworth

There are certainly increased risk of trade war breaking out, because very extreme way in which Trump would state. People in the US side argue this is a favorite negotiating position of Trump that he has done before in business. He sticks out extreme positions and then compromises. I would agree with everybody who is much more worry than before about the risk of trade war. The tension on conflict over trade which I didn't think would been serious a year ago and I had though it really remarkable how the world economy had avoided in increase of trade restriction and very difficult time to speak about. I think it goes too far that we are going to have a trade war. I think that he is trying to frighten people.

I agree about uncertainty, but it's way too early to say after three weeks with the government doesn't even had secretariat state in treasury employ issue yet. He's done exactly what he said he was going to do in the campaign, which worry all of us. Usually, you think of the US government is as being a huge ship, very difficult to turn around not that subject to the whims of the individual leader. There are very few people yet worrying to stand up in oppose to a lot of those ideas in its own party. We just have to give more time.