



CIGS Professor Jay K. Rosengard Seminar
“Dream or Delusion? The Promises and
Pitfalls of Trumponomics” (Q&A)
(Summary)

Date: 31 January, 2017

Venue: CIGS Meeting Room, Tokyo, Japan

Q1: Regarding corporate tax on repatriation of incomes, does it cover only periodical annual income or recover retained earnings? Also, what is the likelihood of Congress being friendly to Trump?

Jay K. Rosengard: My understanding on the corporate end is 10% tax on repatriated earnings would be retained. This \$1 trillion is accumulated over several years. However, we all know money is fungible, and most of it was paid out in dividend to shareholders. So, it was brought back in and the wealthy got wealthier. Businesses will invest where they think they can make money. They have an obligation to the shareholders, but they are for-profit institutions. We had almost the same proposal enacted under Bush, and it did not result in significant increased investment or job creation. This is an intervention, and it's not going to convince a corporation to make a low return investment.

For the second part, you've got two tendencies in Congress, and the real key is the Speaker of the House, Paul Ryan. He is very conservative and ambitious. He wants to do comprehensive tax reforms, but he is also a budget hawk. The question is you've got the tea party budget hawks and you have this desire to produce results. These pragmatic needs to produce results versus you are elected as a deficit hawk, fiscal austerity, prudent fiscal management, which will prevail? There might be some early victories where there is enough agreement on reducing corporate tax, but there is no detail on how do you do it. There have been proposals as we lower the rate to unilateral tariff to make up the revenue difference rather than take away corporate tax expenditures. We need some other way to raise the revenue and that's very contentious. But on many fundamental promises, it would be very difficult to remain united. They're not going to bring manufacturing jobs back or open coal mines. There are still going to have angry constituents 2 years later. The dilemma is if you do it, you will have problems with the opposition, and if you don't do it, you have accomplished nothing.

On the other hand, this could be a tremendous opportunity for the Democrats to figure out why they lost the election. They used to be the party of labor. Sometimes being in the opposition forces you to regenerate your party and figure out how you lost touch with your constituencies. For the Republicans, they control the Congress, full executive branch. It is a great opportunity for them to lead with things that would bring some Democrats along. So, maybe in the short-term, he will have some accomplishments.

Q2: What would be the positive developments of the US economy for the next 2-3 years that could have a positive impact on Asia? Also, what is your impression of the impact of what's going on in the US currently and after 6 months?

Rosengard: There's a competing trade proposal to TPP. It doesn't include trans-pacific partners but does include China, India, and Japan. Asian countries might be able to get more favorable bilateral advantages as Trump doesn't like regional or global agreements. Others have proposed that Asia should proceed with TPP, and eventually the US will join. Australia and New Zealand have proposed that they need to substitute China for the US. As long as there is no trade war and no putative tariffs or nontariff measures in areas of trades, Asia will be okay on trade. The risk is in some miscalculations which could trigger trade war on an integrated global economy.

The real risk is US' relationship with China. For China, I would be worried about the 10% tax on repatriated earnings because it could lead to outflow of capital. Chinese economy is slowing down and opportunities are becoming less lucrative. As China is trying to restructure its economy, this could be a significant change. I would be concerned about swings of portfolio capital leaving Asia because of appreciating dollar and rising interest rates. A positive change would be appreciating dollar, which would make Asian exports competitive versus US exports.

Q3: The economic cycle in the United States is booming for 6 years continuously and is now almost at the end of the boom period, but Trump would like to stimulate that. This may be like cracking an economy bubble leading to an economic crisis.

Rosengard: We have had longer than normal recovery in the economic cycle. Historically, the boom should be ending, and right now we are in an asset bubble in the stock market. In the short run, it looks good. However, fundamentals underlying that haven't changed. We do have the risk of both inflation and asset bubble.

There are several openings on the Federal Reserve coming up including the chairman and the deputy. It's unclear what types of changes will be coming at the Fed, which is politically independent, but members are nominated by the President and approved by the Congress. What's alarming is the economic illiteracy in the White House among chief advisors. The base of functioning of markets and how markets respond seem to be somewhat misunderstood. A lot of your concerns are to do with understanding the causes of The Great Recession.

Q4: Trump's policy doesn't offer any solution to improve inequality domestically. In the international market as well, his policies encourage or exacerbate inequality. This might cost US the trust of the current international structure.

Rosengard: On America-First Trade, both Mexico and US benefit significantly from the intertwining of the two economies. If you look at the US trade deficit, NAFTA, that is Mexico and Canada combined, it is only 10% of total deficit. The need is to understand our current condition. If you're going to anticipate and reduce vulnerabilities in the future, you have to understand your starting point. On climate change, Obama talked a lot about the new economy, and a lot of this was in the green economy. The threat to US manufacturing isn't trade or imports; it's automation. So, it's understanding where the growth potential is, where the new economy is with higher paid and higher value-added jobs. I agree it doesn't help workers losing their jobs and it doesn't help US competitiveness.

International leadership is a complicated question. He has only been there 2 weeks and maybe with growing variance. I have great faith in US institutions, in countervailing forces like the courts, like Congress, and in the long-run the sanity of the US voter. I also have some faith that this cabinet will explain to him how global economy works. Maybe some of the military people around him will restrain his worse impulses and explain to him the ramifications of starting conflicts with other nations. So, there is a greater likelihood of a gridlock happening in the US over above issues, but what worries Americans is undermining the credibility and legitimacy of the Office of the President. Under your question is that basic intangible about credibility and legitimacy of the Office of the President where words do matter and facts matter. There are some legitimate concerns, but maybe experience will help. If it doesn't help, then there are these restraining forces that can limit the damage both in the US domestically and internationally and the fates are intertwined.

Q5: To what extent can the court prevent Donald Trump's attempt to implement some controversial measures and presidential order?

Rosengard: The President has tremendous discretion in two areas, trade and defense. Eventually you have to go to Congress for both, but you can do a lot in the short-term. A lot of executive orders that have been issued are more symbolic, but very hard to implement. Let me give you an example on the courts. One is the recent executive order on halting all refugees for 120 days, halting all refugees from Syria indefinitely, all citizens from seven majority-Muslim countries for 90 days. There is a great likelihood when there is a full judicial review this will be reversed. In the interim, there is great harm being done and people are affected by this, so stop. It seems to violate both the first amendment 'freedom of religion' and the 14th amendment 'due process.' In the meantime, you see also the civil society response. As a result, there have been

clarifications, there have been backtracking a bit, but the courts have been very fast to intervene.

The other thing is the US has a federal system. I live in the Commonwealth of Massachusetts. A lot of things that people care about are state responsibilities such as health, education, first responders, primary and secondary education. On the other hand, foreign policy, defense, and trade are federal responsibilities. In a federal system, lots of things are not directly affected in the short to medium term.

The threatened 20% tax on Mexican imports to the US seems to be illegal under US and international laws. The US President can unilaterally impose up to 15% tariff for 6 months if it is a balance of payments problem. If it is more than 15%, you will have to withdraw from NAFTA also and that requires a 6-month notice. Then you go to WTO's Most Favored Nation protocol, and those rates are much lower than 20% in the US. Again, you would have not just the US legal system, but the international legal system like WTO intervening because it's against both domestic and international law. In terms of Congress, anything to do with taxing and spending laws have to go through Congress. The president or executive order cannot overturn a congressional law and cannot overturn a Supreme Court decision. So, there are limits to executive orders. You need money from Congress to implement most of the executive orders. These are two examples of I think countervailing forces: the judicial system, domestic and international, as well as the legislature.

Q6: Cutting away the noise of Mr. Trump or the two major political swings in the US in last 8 years and looking at change and disparities in the US society, where do you see this process going in terms of regulatory change?

Rosengard: Obama was elected on a platform of change. He was also a transformational leader, but he created unrealistic expectations and that's why he lost Congress after 2 years. In Obama's case, he got the new Democrat voters to turnout. In midterm elections, the Republicans got their base to turnout and that's how he lost the Congress. Trump among a different constituency has created unrealistic expectations. So, there'll be some disillusion within 2 years and the Democrats will do a much better job in getting their base out. Democrats basically assumed there was no chance for Trump to get elected and almost every analyst got it wrong. Hopefully what will happen is that the Democrats regenerate and they start listening to those in their party who are providing practical policy measures that would deal with the core underlying discontent of the marginalized and vulnerable, or you become irrelevant. If Republicans become

irrelevant, then you get a third party. But eventually you get a level of social and political discontent that you have some type of political revolution either within the existing party or third-party candidacy.

Again, we have seen these swings in US history. President Johnson's War on Poverty was one of those typical changes that greatly changed his dynamics. So, you reach a tipping point in politics where it's impossible to survive and ignore these underlying issues. When it is going to happen, you don't know. We have lessons from our own history. We have had great inequality before that has been addressed. We have had nativism, that is America first anti-immigrant. We have had first disengagement from global economy and global politics, the League of Nations we didn't support. If you try to look objectively, a lot of this is not new and it is part of a longer-term trend although it is not comforting at the moment.

Q7: You talked about two most likely scenarios at the given time, but listening to you, it seems that the two scenarios might take place sequentially?

Rosengard: Trump is not the first president to make a mess of it at the beginning. There have been many presidents who have bumbled and made mistakes. Trump doesn't have most of his cabinet. He has also asked all the senior people across the federal government and all the political appointee ambassadors to leave. So, he has no administrative capacity right now, but he doesn't seem to have any desire to consult with anybody at the moment. One school of thought is that when you see everything kind of falling apart, you basically grow into the office of the president. I'm not sure that the president has the emotional maturity to do that. It is less than 2 weeks in a 4-year term. Perhaps there will be some advisor that can guide Trump through this and then he evolves from campaigning to governing.

The problem with Trump is in the past up until now, when he doesn't get his way he doubles down. He doesn't try to find a middle way. He tries to publicly humiliate those who disagree with him including his own senators. If past behaviors are predictors of future behavior, the reaction has been to become more extreme and more personal rather than less. This is where I would love to be proved wrong. But the evidence to date doesn't seem to indicate that, which is why I am putting my faith in institutions and in countervailing forces to mitigate the worst impulses. People had never predicted he will get the nomination or that he would be elected. Now, they are convinced that this is just a phase he is going through. My view is that perhaps this is another state of denial. If I were a country not called America, I would just be making a lot of contingency funds.

You don't know which of these scenarios is going to happen and you have to kind of be prepared for the best.

Q8: How we should have prevented or lessened the level of inequality beforehand?

Rosengard: There are specific policy measures that can be taken to address the problem. Fiscal policies, part of it is the tax structure. Obama has increased marginal tax rate which affects the rich and that had an almost immediate effect on some of these numbers. The more you try to redistribute with high tax rates, the less efficient the economy becomes, but if you're making money by tracking rents and not creating value-added the real economy, then you want to discourage this behavior. There is no relationship between high tax rates and rate of economic growth, but there is a relationship between the distributional aspects on the expenditure side, specific expenditures, for example, in early education and preventive healthcare. There are specific tax measures and spending measures we can take.